COVID-19 RESPONSE BONDS
WHAT ARE THE ISSUES?

In February, Agricultural Development Bank of China issued bonds to combat the coronavirus outbreak. Since then, we have continued to work on many bond issues to raise additional funds specifically to meet the challenges of the coronavirus pandemic. These include sovereign issues for the Republic of Indonesia, Republic of Guatemala and across Europe, and for a number of SSAs, supra-nationals and development banks.

Many issuers have made use of existing frameworks for Social Bond issues. The Council of Europe Development Bank (CEB) recently used its Social Inclusion Bond Framework to raise EUR 1bn to finance projects in its member countries in response to the Covid-19 pandemic, and Cassa Depositi e Prestiti S.p.A. has issued EUR 1bn dual-tranche Social Bonds under its CDP Green, Social and Sustainability Bond Framework as part of its ‘commitment to support enterprises and public authorities harshly hit by the Coronavirus emergency’.

The Nordic Investment Bank has established a bespoke Response Bond Framework specifically to raise funds to alleviate the economic consequences of the coronavirus pandemic. We have also seen the African Development Bank, CAF, European Investment Bank, IDB Invest, Inter-American Development Bank, International Finance Corporation and World Bank all issue bonds in response to the coronavirus pandemic in various currencies.

A number of questions have been raised on Covid Response Bonds, and we set out below our thoughts on some of the main questions:

WHAT ARE THE KEY ASPECTS TO CONSIDER?

As with all use of proceeds bonds, the focus is on transparency to enable investors to make an informed decision. It is important to communicate the intended use of proceeds; whether that is a description of projects that have already been identified, or the parameters within which future use of proceeds will be selected.

In line with other use of proceeds bonds, the usual types of questions are as follows: How will this be monitored? Does the issuer have a framework or process for tracking the funds? How will the impact be measured? How will this be reported? Will there be any external review?

Given the need to raise funds quickly, there may not be time to put in place the more formal processes. The most important aspect is to be transparent.
DO COVID RESPONSE BONDS QUALIFY AS ‘SOCIAL BONDS’?

Social Bonds are use of proceeds bonds that raise funds for projects with positive social outcomes. That certainly fits with Covid Response Bonds. However, to avoid any misunderstanding, the term Social Bond should only be used if the ICMA Social Bond Principles (SBP) are also being applied.

The SBP looks for four core aspects: proceeds used for projects with clear social benefits; a process for project evaluation and selection; management of the proceeds; and reporting of the use of proceeds and expected impact. Transparency is of particular importance and a documented framework is expected. An external review is also recommended to confirm the alignment of the bonds with the four components of the SBP above.

The ICMA Q&A for Social Bonds related to Covid-19 confirms that only bonds that follow the four core requirements of the SBP should use the Social Bond label.

For the Social Bond for the Republic of Guatemala, which was the first Social Bond in Central America and the Caribbean, we worked with the Bank of America ESG team to ensure: (i) that the projects to be funded with proceeds from the social bond tranche met the criteria for eligible social projects (including those relating to the government's Covid-19 containment and relief efforts); and (ii) alignment with the Social Bond Principles.

Some issuers have found that their existing Social Bond frameworks do not cater for a sufficiently wide eligibility criteria to meet the needs of their response to the coronavirus pandemic. It is important for issuers to look at the eligibility criteria and the potential eligible projects included in any existing framework and decide whether they need to amend their existing framework before they can use the Social Bond label. Other issuers do not have existing Social Bond frameworks and have had to evaluate the advantages of implementing one against potential delays. Some issuers have gone on to issue coronavirus related bonds without labelling them Social Bonds in order to access markets more rapidly.

WHAT COULD THE PROCEEDS BE USED FOR?

There is no prescribed list, the approach is based on transparency to enable investor choice.

The IFC has published guidance illustrating the types of use of proceeds that may be appropriate for coronavirus focused Social Bonds. The guidelines suggest three main areas: research and development for tests, vaccines and medications; loans to small businesses negatively impacted by the related economic slowdown; and production of health and safety equipment and hygiene supplies. The guidance also confirms that: "Fundamentally, social bonds related to COVID-19 must abide by the four core components of the SBP. It is essential that proceeds of the bonds go exclusively towards addressing or mitigating social issues wholly or partially emanating from the coronavirus outbreak".

Similarly the ICMA Q&A refers to: increasing capacity and efficiency in providing healthcare services and equipment; medical research; SME loans that support employment generation in affected small businesses; and projects specifically designed to prevent and/or alleviate unemployment.
stemming from the pandemic. Furthermore, ICMA indicates that, given the
global impact of the pandemic, Social Bonds, while seeking to achieve positive
social outcomes for target populations, may also serve to address the needs
of the general population.

We have also seen second opinion providers, such as Sustainalytics, look to
facilitate social bond issuance in response to coronavirus by expanding its
internal taxonomy to explicitly identify potential uses of bond proceeds related
to the virus, such as healthcare expenditure and socio-economic impact
mitigation.

DO ALL OF THE PROCEEDS NEED TO BE USED IN
RESPONSE TO CORONAVIRUS ISSUES?

Again this comes down to being clear and transparent with investors. The
ICMA Q&A does contemplate issues where not all of the proceeds are
directed at coronavirus projects, with the remaining proceeds being used for
other eligible social projects. In such instances, transparency is needed to
show the percentage of allocation of proceeds, and details of the various
projects to be funded.

ARE THERE ANY LISTING ADVANTAGES?

If it is a Social Bond then a Covid Response Bond can take advantage of
reduced fees on the Luxembourg and Nasdaq exchanges.

Nasdaq announced on 3 April that, listing fees would be waived for Covid-19
bonds on the Nasdaq bond markets in Copenhagen, Helsinki and Stockholm
during 2020. The waiver applies to new bonds issued to explicitly and solely
finance projects or assets that alleviate the negative economic or health
consequences of the COVID-19 pandemic. The issuer must publicly announce
that the purpose of the bond in question is in line with the waiver
requirements.

The Luxembourg Stock Exchange announced on 15 April that, until 30
September 2020, it will waive the listing fee for social and sustainable debt
instruments that are issued to address the consequences of the current
coronavirus pandemic. In order to qualify, the bonds must clearly indicate the
Covid related use of proceeds, and they should also follow the SBP.
Qualifying bonds will be eligible for display on the Luxembourg Green
Exchange (LGX).

WHAT IF AN ISSUER DOES NOT FOLLOW THE SOCIAL
BOND PRINCIPLES?

An Issuer may wish to raise funds without following the SBP, or obtaining an
external review, particularly given the need to mobilise quickly to tackle the
unexpected adverse impacts that may result from the pandemic. An Issuer is
of course free to do so, provided that there is transparency for investors. If the
SBP are not followed, then an issuer should consider expressly stating this,
and should not use the label Social Bond. For example, the Nordic
Investment Bank has established a bespoke Response Bond Framework, and
took care to state that: “The framework has not obtained a Second Party
Opinion. Despite playing an important role in societies’ response to the crisis,
the framework should not be considered compliant with the Social Bond
Principles.”
WHAT ARE THE RISK FACTOR CONSIDERATIONS?

As with other use of proceeds bonds, it should be clear that investors must make their own assessment of whether the intended use of proceeds meets their specific investment criteria. The response to the pandemic will require funding to meet an incredibly broad set of challenges that will change over time and it is likely that capital will need to be directed to many different projects.

We have been advising on Covid Response Bonds across our international network. If you would like to discuss any aspect of this briefing with us, please do not hesitate to contact any of your usual Clifford Chance contacts.

Example of Use of Proceeds: Nordic Investment Bank Covid Response Bonds

"Eligible projects will contribute to the UN Sustainable Development Goals: 3 - Good health and well-being; 8 - Decent work and economic growth; 9 - Infrastructure; and 10 - Reduced inequalities.

1. Lending to public sector
   a. Financing of temporary and permanent measures to increase capacity in healthcare services.
   b. Financing of temporary increase in social security expenditures, including, but not limited to, unemployment, sickness, child- and elderly care benefits.
   c. Financing of government or government-related institutions’ expenditures aimed at supporting member country companies in temporary need of subsidisation due to supply or demand side disruptions in their operations in order to protect viable companies.

2. Lending to financial sector
   a. Financing of financial institutions’ extraordinary measures to provide funding for small and medium-sizes enterprises and mid-cap corporates that are negatively affected by the pandemic.

3. Lending to real economy sector
   a. Financing of large companies in the medical equipment and healthcare sector facing an increasing demand for equipment or services related to the pandemic.
   b. Financing of companies in the infrastructure sector that are in need of funding due to supply or demand side disruptions in their operations.

In addition to the eligible categories listed above, the following general criteria for loan identification and selection apply:

- That the proceeds are used to finance projects in NIB’s member countries.
- That the loan is not used for activities on NIB’s Exclusion List.
- That NIB has access to reliable data for reporting on allocation of proceeds and impact to the extent possible."
This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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