Consultation Paper

30 August 2019

London Stock Exchange plc Sustainable Finance Debt Capital Markets

Proposed Developments to LSE plc's Sustainable Bond Markets

Executive Summary

Sustainable investment continues to develop and grow as an asset class. More than $30 trillion in assets under management globally are now linked to sustainable strategies[1]. Investors with $86 trillion of assets have signed up to the UN Principles of Responsible Investments[2].

It is now increasingly important for companies and investors to manage physical and transition risks associated with a lower carbon economy, and to articulate how their strategies create impact in the wider economy. It is also the responsibility of systemically important Financial Market Infrastructures (FMIs), such as London Stock Exchange Group ("LSEG"), to offer appropriate services that support companies to raise capital to implement their sustainability strategies, and allow investors to channel savings through such instruments.

LSEG offers a choice of listing venues for green, social and sustainable bonds through London Stock Exchange ("LSE plc") and Borsa Italiana. LSE plc currently offers dedicated services for sustainable financing across asset classes, covering fixed income instruments[3] (LSE plc was the first global exchange to launch dedicated green bond segments in 2015), companies[4], investment funds, ETFs and other instruments. Borsa Italiana offers a developed market for fixed income, with a strong bond investment culture and retail participation. LSEG also offers trading platforms with a range of execution mechanisms to promote liquidity in green bonds – for example, MTS for European Corporate & Sovereign green bonds. Through FTSE Russell's industry-leading data and ratings for ESG, Carbon Emissions and Green Revenues, LSEG can provide investors confidence in the underlying credentials of issuers. LCH, one of the largest global CCPs, supports green bonds through eligibility for use as collateral. Given the breadth of its product offering, LSEG is well placed to drive the development of sustainable financing globally.

The market for green bonds has developed rapidly since launch with a range of "use of proceeds" instruments now available, for example social and sustainable bonds, issued under global principles such as the ICMA's Green & Social Bond Principles. New regional principles have also taken shape. Investors have also indicated an appetite LSE plc to take a more active role in ensuring that issuers report use of proceeds under their frameworks on a regular basis. At the same time, the market is now recognising those issuers whose businesses are anchored to sustainable activities as a whole, and those issuers operating in sectors that not considered "green", but who seek to manage their

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[1] The Global Sustainable Investment Review 2018, http://www.gsi-alliance.org/trends-report-2018/

[2] ESG Investing: Setting a Course for a Sustainable Future, https://www.bnymellon.com/_global-assets/pdf/our-thinking/esg-investing-setting-a-course-for-a-sustainable-future.pdf

[3] Currently, LSE plc is home to 119 green, social and sustainability bonds which have raised over £25 bn as at 16 August 2019.

[4] There are 108 "green economy" companies on LSE plc (companies with >20% of revenue derived from green activities as defined by FTSE Russell Green Revenue methodologies), with a market capitalisation of more than £275 bn, and 22 green funds with a capitalisation of over £10 bn.

climate footprint and impact for the longer-term. In these instances it may not be appropriate for them to issue "green bonds".

We are therefore consulting on developments to our sustainable finance offering in Debt Capital Markets. In particular we invite feedback on:

1. **Creation of a Sustainable Bond Market:** we propose bringing together LSE plc's current Green Bond segment, with new segments for "use of proceeds" and "Certified issuer" instruments as below, into one comprehensive Sustainable Bond market.

   1.1. **Creating dedicated new segments for Social and Sustainable bonds:** LSE plc proposes introducing dedicated segments for Social and Sustainable bonds, in addition to its current Green Bond Segment. This would enable investors to distinguish such bonds based on their framework and use of proceeds.

   1.2. **Introducing a new segment for instruments issued by "Certified issuers":** LSE plc proposes that those issuers who have obtained an independent certification or rating regarding the nature of their activities to be able to admit bonds to an "Certified issuer" segment.

   1.3. **Introducing mandatory requirements for issuers regarding reporting post issuance**: LSE plc proposes that issuers admitted to the Sustainable Bond Market commit to annual post-issuance reporting, which will then be published through our website.

2. **Considering the treatment of "transition bonds"**: LSE plc supports the creation of a market standard set of criteria for the classification and labelling of "transition bonds", most recently raised at ICMA's Annual Green & Social Bonds General Meeting. With the aim to identify principles for a potential "Transition Bond segment", we request for input on the following:

   2.1. Any Transition Bond segment must be separate from other Sustainable Finance segments, to provide differentiation and transparency for investors

   2.2. Transition bond requires require an issuer to provide investors:

      2.2.1. A description of the company's **transition strategy**;

      2.2.2. The **transition framework** and **use of proceeds** of the bond, in the context of executing the strategy, with independent third party certification that verifies the link to global standards such as the Task Force for Climate Related Financial Disclosure (TCFD), Transition Pathway Initiative (TPI) or Science-Based Targets; and

      2.2.3. The **ex-post impact of the deployment of the proceeds** on the transition pathway, with on-going reporting.

   2.3. It would be desirable if some or all of these elements were supported by an independent evaluation against a framework that could be consistently applied.

Please submit any responses electronically by emailing bonds@lseg.com. Responses are required no later than 30 September 2019.

1. Creating LSE plc's Sustainable Bond Market

Current Green Bond Segment Structure

Currently, LSE plc has a Green Bond Segment that encompasses all sustainable finance debt securities[5].

Eligibility to the green bond segment is based on the provision of an independent external review that the security meets an acceptable international standard in relation to its use of proceeds. The external review could take the form of a Second Opinion, Verification, Third Party certification or a Green Bond Rating[6].

Green Segment

Green, Sustainability & Social

112 Green bonds

3 Sustainable Bonds

4 Social Bonds

MIT Parameter Configuration

Current green bond segment structure comprises of 11 segment/sector combinations that allow for the admission of green bonds on any market and across trading services such as OFIS and Trade Reporting only

Criteria

*The external review could take the form of the following:

I. **Consultant's Review / Second Opinion**

II. **Verification**

III. **Third Party certification**

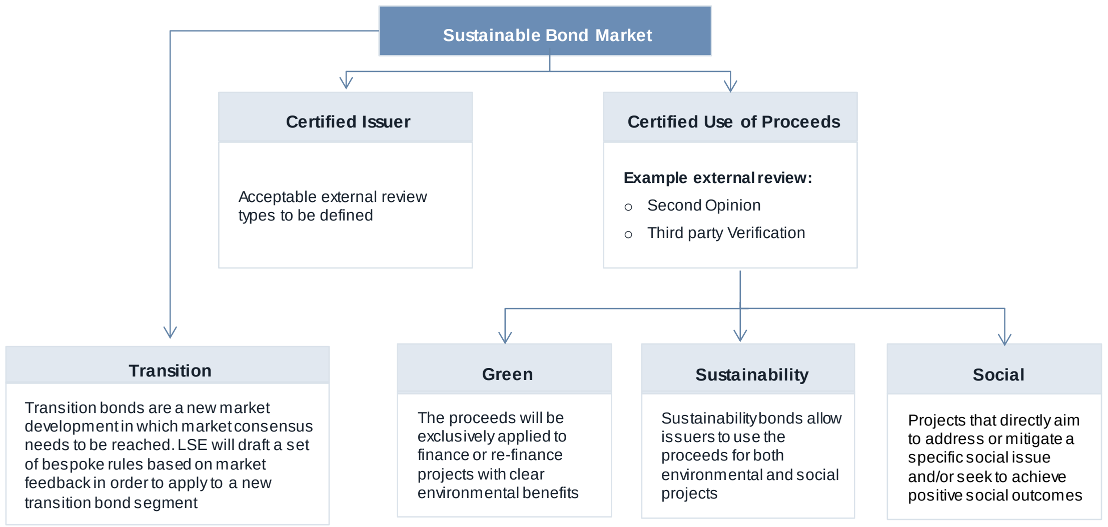
IV. **Green Bond Rating (separate from an issuer's overall ESG rating)**

Proposed Sustainable Bond Market Structure

Below we outline the proposed framework and key changes of the planned Sustainable Bond Market. These proposals have been suggested based on feedback from market participants and in light of developments in the green bond space.

[5] As of 16 August 2019, LSE plc has 119 active bonds admitted to its Green Bond Segment. Of these, four could be classified as sustainable and three as social bonds

[6] LSE plc requires that the independent verification is from a provider of sufficient reputability and expertise in providing independent opinions.



1.1. Broadening Use of Proceeds to Social and Sustainable segments

Under the new Sustainable Bond Market, bonds classified as social, sustainability or green in accordance with the relevant principles will be able to be admitted to distinct segments rather than categorised together under a single banner. This would allow investors to distinguish securities based on their different use of proceeds or broader KPIs and allow the applicable principles to be more clearly and accurately defined and visible to investors. Within these categorisations, issuers can admit securities with more thematic use of proceeds such as resilience bonds, blue bonds and SDG related bonds, for example.

QUESTION [1]: Do you agree that different categories of Sustainable bonds should be admitted onto different sectors in this way?

Currently all bonds admitted to LSE plc's Green bond segment utilise ICMA's Green Bond principles as the relevant international standard. Recently, regional standards for bonds have also been developed, utilising the ICMA Green Bond Principles as a guideline e.g. the EU Green Bond Standard, the PBoC's Green Bond guidelines and NDRC Guidelines in China, the ASEAN Green Bond Standards and the Indonesian Green Bond Regulations.

QUESTION [2]: Would investors benefit if LSE plc specifies which global or regional principles and/or standards are acceptable for eligiblity to its Sustainable Bond Market? If yes, which ones should be included?

1.2. Instruments Certified at an Issuer Level

As part of LSE plc's new Sustainable Bond Market, we would propose allowing instruments to be admitted based on:

I. Certified Use of Proceeds (e.g. independent second opinions / green bond ratings); or

II. Certified at an Issuer Level (e.g. based on an issuer rating or framework)

Bonds using these different approaches will be clearly differentated and tagged in order for investors to know the level of certification provided.

As more issuers choose to make sustainability central to their operations, we have seen an increase of companies deciding to issue all funding products within a single green or sustainable format. This option requires them to obtain an issuer level certification as opposed to certifying each individual bond as they are issued.

One recent example of an issuer taking this approach is **Asian Infrastructure Investment Bank (AIIB)** who were assigned an ESG rating, and as such has stated that it will not seek additional security-level certification for its issuances[7]. For the purposes of an issuer level certification, we propose that eligibility to LSE plc's Sustainable Bond Market should be based on an independent assessment by a third party provider. LSE plc also proposes that it may admit certain issuers based on its discretion to this segment.

The option of having certification at an issuer level would allow for the most flexibility in relation to eligibility to the green segment and should be considered in order to ensure the sustainable bond market can adequately meet the needs of various issuers who wish to make sustainability central to their entire operating model

QUESTION [3]: Do you agree that there should be choice in relation to the level of verification and that this should be sign-posted in this way?

QUESTION [4]: What level of certification should be accepted at the issuer level for eligibility to the Sustainable Bond Market? What certifications should LSE plc not accept?

1.3. Post-Issuance Disclosure Requirements

All bonds currently admitted to LSE plc's Green Bond segment are issued in accordance with ICMA's green bond principles, under which post issuance reporting on allocation of proceeds is required. To the extent that in the future alternative global sustainable bond standards are admissable, this may not be a mandatory requirement covered in the principles themselves but could be enforced via Exchange requirements instead.

Investor feedback has suggested to LSE plc that it would be helpful if we can confirm if such reporting has taken place regardless of the principles or standards used, and if it has, make a copy of the report available on its website (in whatever form provided) to alleviate any fears around impact and "greenwashing".

Under the new proposed requirements for LSE plc's Sustainable Bond Market, issuers will need to commit to provide LSE plc with a copy of any post-issuance report (this can take many forms, including dedicated reports, annual sustainability report and quarterly investor newsletters, amongst others) which will then be made available on our website. Issuers can also on an optional basis choose to provide ongoing impact reports, and in this instance these reports can also be made available on the website of LSE plc.

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[7] "AIIB Reaches New Milestone by Pricing Debut Global Bond to Unlock Financing for Infrastructure - News." AIIB, 9 May 2019, www.aiib.org/en/news-events/news/2019/20190509_001.html.

Issuers failing to comply with the requirement to submit a form of post-issuance reporting could have their securities moved to a separate segment of the Sustainable Bond Market whereby they are clearly marked as "pending reporting" in order to ensure investors are aware of the level of disclosure provided in relation to the securities.

QUESTION [5]: Do you agree that it should be mandatory for issuers to produce some form of post issuance disclosure in relation to the impact and activities related to their sustainable issuance? Do you agree that LSE plc should enforce this as a requirement for eligibility to the Sustainable Bond Market? Is there a preferred format for this report to take?

QUESTION [6]: Do you agree that issuers failing to report on an ongoing basis should have their bonds removed from the relevant segment in the Sustainable Bond Market to a sign-posted "pending reporting" segment?

2. Establishment of a Transition Bond Segment – guiding principles

As the sustainable finance space continues to mature, we have seen emergence of the concept of "transition bonds".

Broadly, these are financial instruments that would allow firms to raise capital to help finance their transition from a high carbon emitting business model to a low carbon business model over a clearly defined period. Typically, this will be in line with the science of climate change and the Paris Agreement's goals.

Most recently, this concept was raised at the 2019 ICMA Green Bond Principles and Social Bond Principles Annual General Meeting. Investors, such as AXA, also advocate the need to recognise these securities as distinct from general green bond issuance in order to further promote green and sustainable capital raising[8].

Transition bonds may have the potential to play a significant role in efforts to achieving a 2°C or lower target for climate change. Therefore, although there is not yet a universal definition for what a transition bond is, LSE plc supports the creation of a market standard set of criteria for the classification and labelling of such bonds and is seeking to convene market participants to help define these.

LSE plc also recognises that from the perspective of an investor a transition bond is different to other sustainable finance instruments that have developed, such as Green, Social and Sustainable bonds. Thus, we believe that any bonds admitted to LSE plc as "transition bonds" should be clearly marked as such, and admitted to a different segment to those segments described in section 1.

QUESTION [7]: Do you agree that transition bonds should be treated as a separate asset class to traditional green bonds and a segment for transition bonds should have a bespoke set of criteria behind them?

[8] AXA Guidelines on Transition bonds - https://realassets.axa-im.com/content/-/asset_publisher/x7LvZDsY05WX/content/financing-brown-to-green-guidelines-for-transition-bonds/23818

The aim of transition bonds is to become a new class of bonds that allow 'high carbon sectors/carbon intensive' firms to finance their transition to a low or zero-carbon business model.

Under current frameworks, this may or may not fit the criteria for a traditional green bond. However, by facilitating transparency in relation to the issuer's **transition strategy** and supporting its execution, this instrument could attract investment by those investors who wish to support the transition to a low carbon economy, including the vital decarbonisation of heavier emitting industrial sectors, with greater confidence in the impact of that investment and significantly reduced risk related to perceptions of greenwashing concerns.

LSE plc believes that a transition bond would require clarity from the issuer on three guiding principles:

(i) their **transition strategy**; (ii) the **use of proceeds in the context of executing the strategy**; and (iii) the **impact, ex-post,** of the deployment of the proceeds on the transition pathway.

It would be desirable if some or all these elements were supported by an independent evaluation against a framework that could be consistently applied, such as TCFD or Science-based targets.

QUESTION [8]: Do you agree with this definition of a transition bond? Are there any other considerations when defining transition bonds?

QUESTION [9]: Should there be any excluded sectors when thinking about transition bonds?

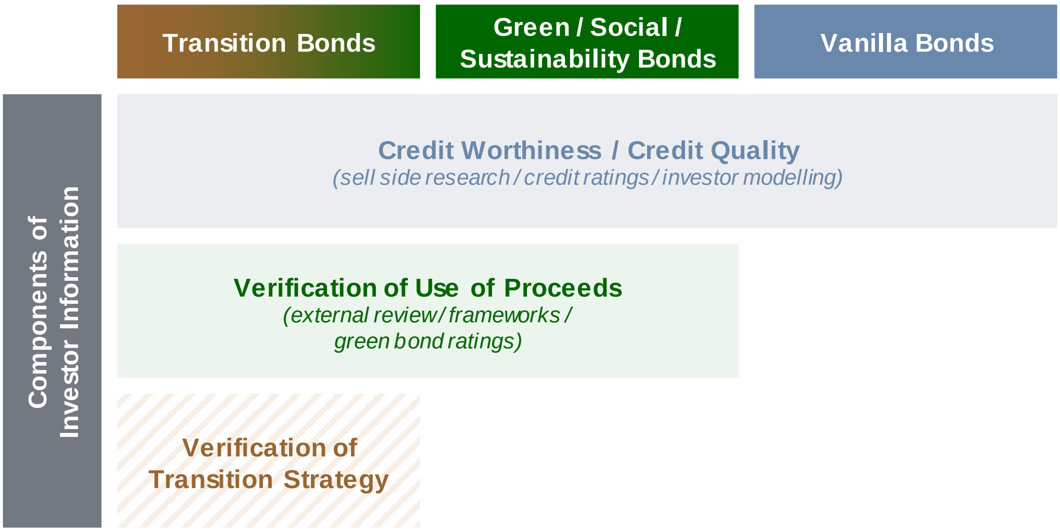
When considering how to design a transition bond segment, it is important to first establish what information an investor might require to credibly be able to invest in such an asset class. Based on initial feedback, we suggest this is:

1. Analysis of the credit worthiness of the issuer;

2. Verification of the transition framework, and verification on the of use of proceeds in support of that strategy;

3. Effectiveness of the use of proceeds on the issuer's transition (ex-post)

Analysis of Verification Tiers of Transition Bonds versus Existing Asset Classes



We propose that existing methods are sufficient for analysing credit worthiness of an issuer (issuer ratings) and verification of use of proceeds (independent second party opinions), so long as this is linked to the transition strategy of an issuer.

Thus, the "missing information" from a transition bond are: an **externally verified or certified transition framework** based on an issuer's transition strategy, and a feedback mechanism as part of **ongoing reporting** against the bond's proceeds and ex-post impact.

A. Transition Framework

In order for an issuer's Transition Framework to be credible, it should be based on standards and concepts accepted widely in the market and deemed to be robust.

Use of standards and methodologies put forward by bodies such as The Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD), a market-driven initiative set up to develop a set of recommendations for voluntary and consistent climate-related financial risk disclosures in mainstream filings, and the Transition Pathway Initiative (TPI) could form the basis of any such design.

TCFD have put forward a report outlining recommendations related to climate disclosure that are adoptable by all organisations, included in financial filings. They are designed to solicit decision-useful, forward looking information on financial impacts with a strong focus on risks and opportunities related to a transition to a lower carbon economy. The core elements put forward are centred around governance, strategy, risk management and appropriate metrics and targets.

TPI puts forward a methodology[9] rating a company based on the quality of their management of greenhouse gas emissions and risks and opportunities related to the low-carbon transition, as well as on how the company's carbon performance now and in the future might compare to the international targets and national pledges made as part of the Paris Agreement.

For the purposes of this segment we would propose that a credible framework would **adhere to the recommendations set out by TCFD** and should include a TPI Management Quality **Level 4**, and a **Paris Pledges** Carbon Performance scenario to ensure appropriate levels of ambitiousness of a company's transition plan. See Appendix B and C for more information.

QUESTION [10]: What are the most important considerations when putting together a credible transition strategy?

QUESTION [11]: Do you agree with suggested market standards as forming a base of a credible Transition Framework? Are there any others you would suggest?

QUESTION [12]: What form should an independently reviewed transition strategy take? Should this form part of an issuer's overall green framework or be prepared as a standalone document?

B. Verification of Transition Framework

External verification companies and rating agencies will be important in helping to provide independent opinions of issuers' Transition Frameworks, similarly to the current situation for normal green bonds. Such a process allows issuers to validate that their thinking has been independently reviewed and certified to ensure robustness. This would also increase investor's level of confidence in the securities being issued. We would propose that the analysis of an Transition Framework should be undertaken by external review agencies.

QUESTION [13]: Are external review agencies / rating agencies best placed to undertake analysis of issuers' Transition Frameworks?

Reporting of Transition Bonds and Linking Back to Framework

One additional consideration as to the robustness of a transition bond segment is the requirement for issuers to report on an ongoing basis versus the strategy put forward in their Transition Framework.

Similarly to bonds on other segments in the Sustainable Bond Market, we propose that issuers of transition bonds should be required to commit to annual reporting on progress of their transition.

It is also important to think about the best way this reporting can be linked back to scientific and quantitative measures so as to appropriately measure a company's performance compared to their targets.

[9] See Appendix B for further detail on TPI's methodology

QUESTION [14]: Are there any other scientific and quantifiable ways of measuring a company's progress versus their targets in relation to transition?

QUESTION [15]: Do you think these levels are appropriate to judge the level of transition an organisation is in?

QUESTION [16]: Do you have any further comments that may be relevant to LSE plc's proposed Sustainable Bond markets?

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APPENDIX A

List of questions in this Consultation Paper

QUESTION [1]: Do you agree that different categories of Sustainable bonds should be admitted onto different sectors in this way?

QUESTION [2]: Would investors benefit if LSE plc specifies which global or regional principles and/or standards are acceptable for eligiblity to its Sustainable Bond Market? If yes, which ones should be included?

QUESTION [3]: Do you agree that there should be choice in relation to the level of verification and that this should be sign posted in this way?

QUESTION [4]: What level of issuer level certification should be accepted for eligibility to the Sustainable Bond Market? What certifications should LSE plc not accept?

QUESTION [5]: Do you agree that it should be mandatory for issuers to produce some form of post issuance disclosure in relation to the impact and activities related to their sustainable issuance? Do you agree that LSE plc should enforce this as a requirement for eligibility to the Sustainable Bond Segment? Is there a preferred format for this report to take?

QUESTION [6]: Do you agree that issuers failing to report on an ongoing basis should have their bonds removed from the relevant segment in the Sustainable Bond Market to a sign-posted "pending reporting" segment?

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APPENDIX B

Transition Pathway Initiative Methodology[10]

The initiative assesses companies on two dimensions based on publicly available information:

1) Management Quality

2) Carbon Performance

TPI's Management Quality framework uses 17 indicators (Yes/No questions) to test the progress that companies have made regarding carbon management practice. These indicators then allow for the mapping of these companies on to five levels. Companies must be assessed as 'Yes' on all questions pertaining to a level before progressing to the next. (Companies that have been assessed as 'Yes' on all Level 4 questions are describes as '4* companies).

TPI Levels of Management Quality:

Level 0	**Unaware of (or not acknowledging) climate change as a business issue**
Level 1	**Acknowledging climate change as a business issue:** Company acknowledges their responsibility to manage its greenhouse gas emissions and adapts a climate change policy
Level 2	**Building capacity:** Company's basic capacity, management systems, and processes are developed, and company begins reporting on practice and performance
Level 3	**Integrating into operational decision-making:** Improvement in operational practices; company assigns senior management or board responsibility for climate change, and provides disclosures on its carbon practices and performances
Level 4	**Strategic assessment:** Company develops a more strategic understanding of risks and opportunities related to the low-carbon transition and integrates this into its business strategy decisions

Carbon Performance

TPI's Carbon Performance assessment translates emissions targets made at the international level under the 2015 UN Paris Agreement into benchmarks against which the performance of individual

[10] Transition Pathway Initiative – Click here for more information

companies can be compared. A sector by sector approach is taken, in recognition of the fact that different sectors of the economy face different challenges arising from the low-carbon transition, including where emissions are concentrated in the value chain and how costly it is to reduce emissions

(1) a 2 degrees scenario, which is consistent with the overall aim of the Paris Agreement to hold "the increase in the global average temperature to well below 2 °C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 °C above pre-industrial levels", and

(2) a Paris Pledges scenario, derived by aggregating the emissions reductions pledged by individual countries as part of their Nationally Determined Contributions to the Paris Agreement.

APPENDIX C

Task Force on Climate Related Financial Disclosure[11]

Objective

1) promote more informed investment, credit, and insurance underwriting decisions

2) Enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks

The Task Force developed four widely-adoptable recommendations on climate related financial disclosures that are applicable to organizations across sectors and jurisdictions.

		Recommended Disclosures
Governance	The organization's governance around climate-related risks and opportunities	Describe the board's oversight of climate-related risks and opportunities. Describe management's role in assessing and managing climate related risks and opportunities
Strategy	The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning	Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term
Risk management	The processes used by the organization to identify, assess, and manage climate-related risks	Describe the organization's processes for identifying and assessing climate-related risks
Metrics and Targets	The metrics and targets used to assess and manage relevant climate-related risks and opportunities	Disclose the metrics used by the organization to assess climate related risks and opportunities in line with its strategy and risk management process.

[11] Task Force on Climate Related Financial Disclosure. Click here for more information

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