



1. Sustainable finance

As sustainability keeps being the subject of increased regulatory initiatives, so will it increasingly become a focal point in the agenda of public and private actors throughout sectors in the economic arena. Across the board, a lot of private and legislative initiatives already touch upon topics of sustainability.

Such initiatives have often dealt with sustainability in a rather fragmented and pluriform manner for a variety of reasons (such as focus on a specific social and economic sector, focus on a specific region or country, or the lack of uniform concepts of "sustainability"). Recently however, as part of the European Green Deal general (pan-European) regulations have been adopted and proposed to create a common reference framework for the classification of sustainable activities (the EU Taxonomy Regulation¹) and furthering European sustainability goals (proposal for a EU Climate Law²), with industry specific regulations and standards to follow.

Financing markets have been looking for ways in which their products can contribute to the worldwide sustainability agenda, giving rise to the concept of sustainable or "green" finance. Examples include the Green Loan Principles and the Sustainability Linked Loan Principles authored by the APMLA, LMA and LSTA and the various certification schemes by the Climate Bond Initiative. This current contribution will explore some aspects of sustainable finance in shipping.

2. Sustainability in shipping

The maritime industry has traditionally been targeted by a variety of environmental regulations. Generally speaking such regulations cover the areas of (i) air pollution, (ii) sustainability aspects of a vessel's build and lifecycle and (iii) water pollution and (aquatic eco-system) protection.

1 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

2 Brussels, 4.3.2020 COM(2020) 80 final 2020/0036 (COD), Proposal for a Regulation of the European Parliament and of the Council establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law).

With the shipping industry sector accounting for approximately 2.2% of global GHG emissions³, questions on the ways in which sustainable finance initiatives can contribute to achieving long term sustainability goals seem relevant. One of the first general questions which arises would pry into the character traits of "sustainable ship finance" to distinguish a "green ship finance market".

As there are no established rules on the characteristics of "sustainable ship finance", previously there seemed to be a lot of leeway for financing initiatives in the shipping sector to be labelled as sustainable. However, to avoid any claims of "greenwashing", adherence to the classification system in the EU Taxonomy Regulation now seems to be a minimum standard to be met. The EU Taxonomy Regulation creates an EU wide classification system establishing the requirements an economic activity needs to meet in order to be labelled as "sustainable". The European Commission ("EC") has clearly communicated that 'it will step up its regulatory and non-regulatory efforts to tackle false green claims'. In addition, for similar reasons an important role is attributed to 'reliable, comparable and verifiable information'⁴.

Against the above backdrop, various ways in which finance can contribute to sustainability in shipping can be considered.

3. Sustainable ship finance

3.1. Access to finance

Though sometimes it is voiced that mere compliance with regulatory requirements seems quite poor as a standard to be labelled as "sustainable activity", access to funding to finance such compliance in the maritime sector is not necessarily without challenges. General complications may exist in disproportionate cost to benefit of retrofitting for specific vessel types (considering vessel value and expected return on investment). Legal considerations may make it challenging to come up with appropriate security structures in retro fit financings.

Any initiative creating access to finance to achieve compliance with regulatory deadlines may therefore very well be deserving of the label of a sustainable activity. Funding provided pursuant to the EIB's Green Shipping Guarantee ("**GSG**") programme could be mentioned as an initiative with the potential of unlocking funding resources otherwise not accessible. The GSG programme is intended to finance shipbuilding projects including new vessels, conversion and retrofitting of vessels that promote sustainable transport and environmental protection.⁵ The EIB has already signed framework agreements with various European lenders⁶ under which various projects have already been financed.⁷ However, as financing

3 See e.g. CBI Shipping Criteria – Background Paper, The Shipping Criteria for the Climate Bonds Standard & Certification Scheme – September 2020, pp. 6-7;

4 Brussels, 11.12.2019, COM(2019)640, p. 8

5 <https://www.eib.org/en/projects/pipelines/all/20150334>

6 Including ING (<https://www.eib.org/en/press/all/2018-036-ing-and-eib-provide-eur-300m-to-finance-green-shipping>), ABN AMRO (<https://www.eib.org/en/press/all/2017-137-abn-amro-and-eib-sign-eur-250m-for-smes>), BNP Paribas (<https://www.eib.org/en/press/all/2018-036-ing-and-eib-provide-eur-300m-to-finance-green-shipping>) and Société Générale (EIB, [Societe Generale Support Green Maritime Transport Plan - Offshore Energy \(offshore-energy.biz\)](https://www.eib.org/en/press/all/2018-036-ing-and-eib-provide-eur-300m-to-finance-green-shipping)).

7 Such as financings for Brittany Ferries (<https://gasnam.es/blog/2017/12/14/brittany-ferries-ing-powered-newbuild-receives-eib-support-under-green-shipping-initiative/>), Eureka Shipping (<https://vpoglobal.com/2019/01/16/eureka-shipping-secures-eur-10-1m-for-new-carriers/>) and the retrofitting of 42 Spliethoff vessels (<https://freightcomms.net/ing-and-eib-provide-e110m-for-spliethoffs-green-shipping-investments/>).

pursuant to the GSG involves engagement of commercial lending as well, for some parts of the shipping market (considering some of the possible commercial complications mentioned earlier on) initiatives of the sort may still need to be developed.

3.2. Transparency - macro incentives

As the EC acknowledges, reliable, comparable and verifiable information is of importance for the purpose of measuring movement towards sustainability goals. Transparency in respect of the relevant data therefore seems of obvious relevance for the development of a green ship finance market.

Although in the maritime sector data collection and reporting requirements already exist for CO₂ emissions and fuel oil consumption under EU MRV⁸ and IMO DCS⁹, various private initiatives further contribute to transparency on such data. Under the Poseidon Principles signatory commercial lenders commit themselves to monitor and report on the carbon footprint of their shipping portfolios against the benchmark of the IMO's absolute emission reduction targets for 2050¹⁰, whilst under the Sea Cargo Charter a similar framework for carbon footprint monitoring and reporting is created for chartering activities of cargo-owners and shipowners.

The Poseidon Principles, which only launched as recently as June 2019, attract a quickly increasing number of signatories. Currently, the number of signatories represent approximately 50% of debt extended to shipping¹¹ and includes conventional shipping banks as well as a maritime leasing company.¹²

Apart from contributing to transparency on relevant data, global initiatives like these and initiatives such as the Climate Bonds Initiative's development of Shipping Criteria for the Climate Bonds Standard & Certification Scheme (first published September 2020) and the certification scheme of the Green Award Foundation¹³ also contribute to the development of uniform measuring and reporting methodology.

Finally, one of the more direct aims of the above initiatives on monitoring and reporting would of course be triggering business decisions towards activities which allow the relevant emission reduction goals to be achieved.

3.3. Micro incentives: sustainability in shipping loans

3.3.1. Performance beyond compliance

In those instances in which (financing the) mere compliance with applicable environmental laws does seem to be too poor of a standard to deserve a 'green label' (i.e. situations in which there is no specific 'financing bottleneck' for such compliance) there are various ways in which a ship finance loan could require or

8 Regulation (EU) 2015/757 of the European Parliament and of the Council of 29 April 2015 on the monitoring, reporting and verification of carbon dioxide emissions from maritime transport, and amending Directive 2009/16/EC.

9 IMO Marine Environment Protection Committee Resolution MEPC.278(70) (adopted on 28 October 2016) adopting mandatory MARPOL Annex V requirements for ships to record and report their fuel oil consumption.

10 These targets are propelled by and track the goals set by the United Nation's 2015 Paris Agreement on climate change.

11 <https://www.tradewindnews.com/finance/poseidon-principles-signatories-soon-to-reach-50-of-all-debt-to-shipping/2-1-956020>

12 <https://www.offshore-energy.biz/sumitomo-mitsui-banking-corporation-joins-the-poseidon-principles/>

13 <https://www.greenaward.org/>

incentivize 'green performance scores' beyond applicable regulatory compliance goals.

Performance can for instance be measured in the areas of reduction levels for emission of GHG's such as CO₂, SO_x or NO_x, with specific contractual benefits being attached to each reduction level reached beyond what is legally required. Likewise, performance and quality levels beyond what is required under for instance the Regulations pursuant to the Ballast Water Treatment Convention can be incentivised.

It will be interesting to see to what extent contractual incentives like the above will be able to take the form of basic contractual requirements (i.e. simply obliging a borrower to go beyond what is required) rather than a voluntary option incentivised by certain contractual benefits. As an example, it seems that currently some borrowers are only willing or able to accept Poseidon Principles covenants under the condition that they will not be required to deliver more data or different data formats compared to monitoring and reporting requirements under EU MRV or IMO DCS.

3.3.2. Voluntary commitment - compliance beyond applicability

In instances in which a regulatory framework lacks altogether, contractual incentives can of course also contribute to sustainable behaviour. Ship finance loans can choose to reward compliance with regulatory regimes which formally are not applicable to a specific borrower or vessel. Similarly, where the possibility exists to reduce adverse environmental effects any such reduction can be rewarded, even though a binding regulatory instrument is absent altogether.

As sustainability aspects of a vessel's lifecycle are concerned, shipowners could be required to contractually opt for compliance with (parts of) the EU Ship Recycling Regulation¹⁴ ("EU SRR") where the EU SRR formally does not apply, whether due to flag requirements or vessel size (appreciating that in instances where the EU SRR does not apply, relevant applicable provisions from the EU Waste Shipment Regulation¹⁵ and/or the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes¹⁶ may still be useful). Similarly, compliance with the Hong Kong Convention¹⁷ (which is still awaiting entry into force) and related guidelines can be contracted in¹⁸. Although a group of financial institutions have already adopted and adhere to a set of voluntary 'best efforts' principles and guidelines on this topic¹⁹, the challenge of a meaningful set of contractual standards contributing to sustainable ship recycling seems to lie in the creation of a sufficient enforcement mechanism, especially where regulatory instruments such as the EU SRR seem to fail bringing about such mechanism themselves (as practices entailing end of life re-flagging and end of life sale may keep being problematic).

14 Regulation (EU) No 1257/2013 of the European Parliament and of the Council of 20 November 2013 on ship recycling and amending Regulation (EC) No 1013/2006 and Directive 2009/16/EC.

15 Regulation (EC) No 1013/2006 of the European Parliament and of the Council of 14 June 2006 on shipments of waste.

16 The Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal of 22 March 1989.

17 The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships (IMO) as adopted in 2009.

18 Leaving aside the discussion on whether or not the provisions of the Hong Kong Convention are less strict than those of the EU SRR.

19 See the Responsible Ship Recycling Standards (RSRS).

Further to the comments on monitoring and reporting in respect of emission data in paragraph 3.2 (*Transparency - macro incentives*) above, the terms and conditions of individual loan agreements may further contribute to transparency by stimulating borrowers to adhere to the principles of the Sea Cargo Charter in respect of their chartering activities. It should be noted that this may be more appropriate or feasible for some borrowers than others. Depending on the size of a borrower's business, the administrative burden of monitoring and reporting may be too heavy. In addition, the type of chartering activities may also be relevant to a borrower's ability to comply with these principles: where most of the data needed for reporting would be available to most time charterers, it might be very difficult for a particular voyage charterer somewhere down the chain to obtain such data.

In addition to the above, similar contractual mechanisms can be contemplated to incentivize 'green behaviour' in the absence of any specific regulatory framework whatsoever (e.g. in respect of exhaust systems reducing residual methane slip by LNG-fuelled vessels).

3.3.3. Sustainability linked loans

As follows from the above, lenders have various opportunities to incentivise sustainability in shipping on the micro level of individual ship finance loans. An appropriate way to do so for lenders can be by means of terms and conditions along the lines of the LMA's Sustainability Linked Loan Principles.

Within the 'four corners of the document' there seems to be a great number of ways in which ship finance loans can address a borrower's performance in the sustainability area. Sustainability areas in which performance can be measured in shipping are abundant. Emission levels of CO₂, SO_x, and NO_x, ship recycling and ballast water management performance are only some of a variety of items in any possible shipping 'sustainability matrix'. As an example, reference is made to the various levels of certification within a range (from Class 1 up to Class 5) which can be obtained through the Clean Shipping Index.²⁰ With all available items an elaborate system of 'sustainability credits' for borrowers or vessels can be engineered from all available standards and contractual covenants available within the applicable sustainability matrix.

Contractual terms and conditions can be tailored to specific scores within specific sustainability focus areas, with positive scores being met by more favourable terms and conditions or other benefits and less positive scores by downgrading to more restrictive or onerous terms and conditions or loss of benefits (whether this be by means of more or less restrictive financial covenants, interest variations in a sustainability performance related margin grid or otherwise).

Although the market is of course still developing, currently it seems that lenders are increasingly using margin-based mechanisms to incentivize sustainable behaviour. Examples include a USD 390,000,000 senior secured credit facilities agreement for International Seaways²¹, a USD 1,300,000,000 refinancing for

²⁰ <https://cleanshippingindex.com/methodology/>.

²¹ <https://www.maritimeprofessional.com/news/international-seaways-signs-refi-deal-355173>

MSC²², a USD 713,000,000 sustainability linked loan package for Euronav²³ and a USD 200,000,000 sustainability-linked loan for Seaspn.²⁴ All of these financings include a sustainability-linked pricing mechanism linked to the carbon efficiency of the borrower's fleet (or a part thereof), with key performance indicators being calculated in a manner consistent with the de-carbonization trajectory outlined in the Poseidon Principles.

It remains to be seen whether a green ship finance market can be achieved solely by means of financial incentives for borrowers provided for by margin-based mechanisms. Without a doubt, making low sustainability performance more costly than sustainable activities in general will contribute to moving towards climate change goals, yet especially against the regulatory backdrop of instruments such as the EU Taxonomy Regulation one might ask the question whether - from a macro perspective - at some moment the system would also need to provide for checks and balances to counter any perverse stimuli. More specifically: how fragile is a system in which the lowest scores on sustainability performance generate the highest returns for financiers, and how liable are financiers to ask for a pricing level artificially set higher at the front end in a margin grid to secure reasonable income levels for situations in which their borrower performs well on the relevant sustainability scorecard? A possible way in which to address this first question and increase the "green value" of sustainable ship finance might be to apply any interest proceeds obtained as higher returns triggered by a borrower's polluting behaviour towards environmental funds to combat such pollution.

Finally, with the above comments on claims of greenwashing in mind, it is important that lenders and borrowers keep in mind that any sustainability assessment and certification procedures used to arrive at awarding sustainability credits must make use of reliable, comparable and verifiable information and objective assessment methodology. For similar reasons (apart from efficiency reasons) it may be preferable to engage a specialised and independent third party for reasons of assessment and certification where possible. Any mechanism applied to produce sustainability performance scores should apply the classification system of the EU Taxonomy Regulation as a minimum threshold.

22 <https://www.abnamro.nl/en/commercialbanking/corporates-institutionals/accelerating-the-sustainability-shift/abn-amro-acts-as-sustainability-coordinator-in-msc-s-usd-1-3bn-refinancing.html>

23 <https://www.euronav.com/media/66178/20201105-earnings-release-q3.pdf>

24 <https://www.offshore-energy.biz/seaspn-inks-200-million-sustainability-linked-loan/>

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