Linklaters

Unlocking New Opportunities: Hong Kong Expands Green and Sustainable Finance Incentives and Launches Taxonomy for Sustainable Finance

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Introduction

On 3 May 2024, the Hong Kong Monetary Authority ("**HKMA**") published its updated guideline on the Green and Sustainable Finance Grant Scheme (the "**2024 GSF Grant Scheme**"). The Green and Sustainable Finance Grant Scheme was first introduced by the HKMA in May 2021 and has since provided subsidies to eligible bond issuers and loan borrowers for the issuance of more than 340 green and sustainable debt instruments in Hong Kong totalling approximately US$100 billion. In addition, the HKMA published the Hong Kong Taxonomy for Sustainable Finance (the "**Taxonomy for Sustainable Finance**") on 3 May 2024, the aim of which is to provide a standardised framework for classifying and labelling financial products and investments based on their environmental sustainability.

The original Green and Sustainable Finance Grant Scheme was launched in May 2021 (the "**2021 GSF Grant Scheme**") and expired on 9 May 2024. Accordingly, the 2024 GSF Grant Scheme will take effect from 10 May 2024 and will be valid for another three years until May 2027. A bond or loan must be issued on or after 10 May 2024 in order to qualify for the 2024 GSF Grant Scheme. Bonds or loans issued before 10 May 2024 should continue to follow the 2021 GSF Grant Scheme, save for certain areas (as explained below) where the 2024 GSF Grant Scheme should be followed. In line with the 2021 GSF Grant Scheme, the 2024 GSF Grant Scheme provides subsidies to cover the costs of eligible green and sustainable bonds and loans in Hong Kong, with an expansion in scope this time round to cover transition bonds and loans. For the purposes of our debt capital market ("**DCM**") clients, this alert focuses on the bond aspects.

As was the case under the 2021 GSF Grant Scheme, the 2024 GSF Grant Scheme consists of the following two tracks:

- **General Bond Issuance Costs (Track I)**: covering bond issuance expenses (e.g. arrangement, legal, audit, listing fees, etc.) for eligible first-time green, social, sustainability, sustainability-linked and transition bond issuers; and
- **External Review Costs (Track II)**: covering transaction-related external review fees (e.g. including pre-issuance and post-issuance external review) for eligible green, social, sustainability, sustainability-linked and transition bond issuers and loan borrowers, including first-time and repeated issuers and borrowers.

> According to Eddie Yue, Chief Executive of the HKMA, "The extension of the scheme, with an expanded scope to cover transition finance instruments, reaffirms Hong Kong's commitment to supporting the region's increasing efforts to tackle climate challenge through transition activities and financing." – *Source*

Issuers can benefit from both tracks for one bond issuance (if they are an eligible first-time green, social, sustainability, sustainability-linked or transition bond issuer).

Below are the key details of the 2024 GSF Grant Scheme, including certain differences compared to the 2021 GSF Grant Scheme, and a discussion of the Taxonomy for Sustainable Finance. The HKMA intends to keep in view market developments and industry feedback and may update or adjust certain details of the 2024 GSF Grant Scheme as needed. The HKMA has also made clear that the Taxonomy for Sustainable Finance is a "living document" and going forward, it intends to expand the coverage of the taxonomy to include additional sectors and activities, including transition activities.

The Green and Sustainable Finance Grant Scheme

<table>
<tr><th colspan="3">The eligibility criteria for the 2024 GSF Grant Scheme are as follows:</th></tr>
<tr><th></th><th>Track I – General Bond Issuance Costs</th><th>Track II – External Review Costs</th></tr>
<tr><td>Eligible instrument types</td><td>Green, social, sustainability, sustainability-linked and transition bonds[1]</td><td>Green, social, sustainability, sustainability-linked and transition bonds and loans[1]</td></tr>
<tr><td></td><td colspan="2">1. Compared to the 2021 GSF Grant Scheme which referenced "green and sustainable bonds", the 2024 GSF Grant Scheme explicitly refers to the following types of bonds and loans:

> green bonds and loans;
> social bonds and loans;
> sustainable bonds and loans;
> sustainability-linked bonds and loans; and
> transition bonds and loans.

In particular, transition bonds and loans represent a new area covered by the 2024 GSF Grant Scheme, and only transition bonds and loans issued on or after 10 May 2024 are eligible under the 2024 GSF Grant Scheme.</td></tr>
<tr><td>Eligible issuers[1] / borrowers (excluding government issuers and government borrowers)</td><td>First-time bond issuers that have not issued green, social, sustainability, sustainability-linked or transition bonds in Hong Kong[2] in the rolling five-year period prior to the bond's pricing date.

Consistent with its aim to promote Hong Kong as the leading green finance centre in Asia, the incentives under Track I of the 2024 GSF</td><td>Bond issuers and loan borrowers, including first-time and repeated issuers and borrowers (each entity can apply for a subsidy for two eligible loans[3] at most).</td></tr>
</table>

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<tr><th colspan="3">The eligibility criteria for the 2024 GSF Grant Scheme are as follows:</th></tr>
<tr><th></th><th>Track I – General Bond Issuance Costs</th><th>Track II – External Review Costs</th></tr>
<tr><td rowspan="3"></td><td>Grant Scheme will not be available where a financial institution acts as both the issuer and as an arranger in its bond issuance.</td><td></td></tr>
<tr><td colspan="2">1. The term “issuer” means the entity issuing a bond and the entity’s associates. The term “associate” refers to a person or corporation (i) over which the issuer has control; (ii) which has control over the issuer; or (iii) that is under the control of the same person or corporation as the issuer.

Based on feedback from the HKMA under the 2021 GSF Grant Scheme, PRC state-owned enterprises were not necessarily “associates” merely due to their ownership by the State-owned Assets Supervision and Administration Commission (SASAC) or other PRC government entities. However, they could be treated as “associates” if they were held under intermediate corporate common ownership. We expect this previous position (based on the 2021 GSF Grant Scheme) would equally apply in the case of the 2024 GSF Grant Scheme but issuers and lead arrangers are encouraged to consult with the HKMA on a pre-application basis.

2. The following issuers will be eligible under Track I – General Bond Issuance Costs:

> issuers who have issued bonds in Hong Kong during the five-year period but such bonds are not green, social, sustainability, sustainability-linked or transition bonds; and
> issuers that are issuing transition bonds in Hong Kong for the first time, including those issuers that have previously issued green, social, sustainability or sustainability-linked bonds in Hong Kong.

3. The limit of two eligible loans includes all eligible loans (issued before, on or after 10 May 2024) where the entity acts as borrower or guarantor. This limit is not expected to apply to bond issuances.</td></tr>
<tr><td>Eligible issues[1]</td><td>Eligible bond issues must:

> be issued in Hong Kong[2];
> have an issue size of at least HK$1.5 billion (or</td><td>Eligible bond issues and loans must:

> be issued in Hong Kong[2];</td></tr>
</table>

The eligibility criteria for the 2024 GSF Grant Scheme are as follows:		
	Track I – General Bond Issuance Costs	**Track II – External Review Costs**
	equivalent in foreign currency); > be (i) lodged with, and cleared by, the HKMA's Central Moneymarkets Unit ("**CMU**") in their entirety; or (ii) listed on The Stock Exchange of Hong Kong Limited ("**SEHK**"); and > be, at issuance, issued to (i) 10 or more persons; or (ii) less than 10 persons none of whom is an associate of the issuer. In the case of green, social, sustainability and sustainability-linked bonds, a pre-issuance external review related to the issuance demonstrating alignment with internationally-recognised principles, standards or guidance, as provided by a recognised external reviewer[3] must be procured. In the case of transition bonds, the following must be procured: > a developed and appropriately disclosed transition plan (or equivalent disclosures on climate transition strategy) at the entity-level[4]; > pre-issuance external review demonstrating the adoption of internationally-recognised transition finance principles, standards or guidance (including the transition	> have an issue size of at least HK$100 million (or equivalent in foreign currency) (this represents a relaxation of the criteria under the 2021 GSF Grant Scheme where the minimum issue size was HK$200 million (or equivalent in foreign currency)); > in the case of bonds only, be (i) lodged with, and cleared by, the CMU in their entirety; or (ii) listed on the SEHK; and > in the case of bonds only, be, at issuance, issued to (i) 10 or more persons; or (ii) less than 10 persons none of whom is an associate of the issuer. In the case of green, social, sustainability and sustainability-linked bonds and loans, a pre-issuance external review related to the issuance demonstrating alignment with internationally-recognised principles, standards or guidance, as provided by a recognised external reviewer[3] must be procured. In the case of transition bonds and loans, the following must be procured: > a developed and appropriately disclosed transition plan (or equivalent disclosures on climate transition

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<tr><td rowspan="2"></td><td>plan related elements under such principles, standards or guidance), as provided by a recognised external reviewer[3]; and
> for use-of-proceeds instruments, pre-issuance external review demonstrating alignment with an applicable internationally-recognised taxonomy[5], as provided by a recognised external reviewer[3].</td><td>strategy) at the entity-level[4];
> pre-issuance external review demonstrating the adoption of internationally-recognised transition finance principles, standards or guidance (including the transition plan related elements under such principles, standards or guidance), as provided by a recognised external reviewer[3]; and
> for use-of-proceeds instruments, pre-issuance external review demonstrating alignment with an applicable internationally-recognised taxonomy[5], as provided by a recognised external reviewer[3].</td></tr>
<tr><td colspan="2">1. Based on feedback from the HKMA under the previous 2018 Pilot Bond Grant Scheme (which was consolidated into the 2021 GSF Grant Scheme and has since been superseded), a bond issue would include the setting up of a programme as well as the initial drawdown thereunder. In addition, printer, trustee and agent costs would not be included as eligible issuance expenses. Issuers and lead arrangers are therefore encouraged to consult with the HKMA to see if this previous position (based on the 2018 Pilot Bond Grant Scheme) would equally apply in the case of the 2024 GSF Grant Scheme.

2. A bond is considered “issued in Hong Kong” if half or more of the involved lead arranger(s) are recognised arrangers. Bond arranging activities comprise originating and structuring, legal and transaction documentation preparation and sale and distribution.</td></tr>
</table>

The eligibility criteria for the 2024 GSF Grant Scheme are as follows:		
	Track I – General Bond Issuance Costs	**Track II – External Review Costs**
	When assessing whether an arranger is a "recognised arranger", the HKMA will, based on the information provided in the Arranger Information Form, consider to what extent the arranger has substantial Hong Kong DCM operations, taking into account the size of an arranger's DCM operations, its use of Hong Kong service providers, its plans for developing its DCM operations in Hong Kong and other relevant factors. *A loan is considered "issued in Hong Kong" if at least half of the loan amount is borrowed from Hong Kong-based lenders.* 3. *When assessing whether an external reviewer is a "recognised external reviewer", the HKMA will, based on the information provided in the External Reviewer Information Form, consider whether it has considerable presence in Hong Kong, satisfactory observance of internationally-recognised standards and proven track records in providing external review services to green, social, sustainability, sustainability-linked and transition bonds and loans, especially international issuances.* *In considering an external reviewer's "considerable presence in Hong Kong", the HKMA will consider the current size and functions of its Hong Kong team, its plan for maintaining or expanding its presence in Hong Kong and other relevant factors.* 4. *A transition plan (or equivalent disclosures on climate transition strategy) developed at the group-level shall be generally considered acceptable to the extent that it encompasses the relevant climate transition disclosures for the issuing entity of the concerned issuance.* 5. *In the case of a national-based or internally-developed (for example, by financial institutions, external reviewers, etc.) taxonomy, the HKMA may, for the purpose of the 2024 GSF Grant Scheme, request confirmation, and additional information to support, that such taxonomy can reasonably be considered as internationally-recognised, or comparable to an internationally-recognised taxonomy, in the context of the concerned transition bond/loan issuance. The HKMA will consider such confirmation and additional information on a case-by-case basis, taking into account factors such as (i) in the case of a transition bond, the extent to which it is an international issuance (i.e. issued in a market outside the*	

The eligibility criteria for the 2024 GSF Grant Scheme are as follows:		
	Track I – General Bond Issuance Costs	**Track II – External Review Costs**
	issuer's home jurisdiction); (ii) in the case of a transition loan, the number and location(s) of the involved lender(s); (iii) the extent to which the taxonomy concerned is comparable to an internationally-recognised taxonomy in respect of, for example, the activities concerned; and (iv) whether it would result in a substantially different alignment assessment had the external review been performed in reference to an internationally-recognised taxonomy.	
Eligible grant amount	The grant amount for each bond issue is equivalent to half of the eligible expenses, up to the following limits: > HK$2.5 million where the bond, its issuer or its guarantor(s) possess a credit rating from one or more of Fitch Ratings, Moody's Investors Service, Rating and Investment Information, Inc, and S&P Global Ratings; or > HK$1.25 million where none of the bond, its issuer or its guarantor(s) possess a credit rating from one of the rating agencies above.	The grant amount for each bond issue/loan is the full cost of eligible expenses, capped at HK$800,000 in total for all pre-issuance external review and post-issuance external review services. In addition, the 2024 GSF Grant Scheme has introduced the following new "sub-caps" within the overall HK$800,000 cap: > HK$250,000 for all pre-issuance external review services; and > HK$200,000 per year for all post-issuance external review services for the first three years from the date of the eligible issuance or up until the maturity of the issuance, whichever is shorter. In particular, this HK$200,000 sub-cap applies to post-issuance external review services for eligible bonds and loans issued before, on or after 10 May 2024 (including those eligible bonds and loans subject

The eligibility criteria for the 2024 GSF Grant Scheme are as follows:		
	Track I – General Bond Issuance Costs	**Track II – External Review Costs**
		to the 2021 GSF Grant Scheme).
Eligible expenses[1]	Eligible expenses include: fees to Hong Kong based (i) arrangers; (ii) legal advisers; (iii) auditors and accountants; (iv) rating agencies; SEHK listing fees and CMU lodging and clearing fees. Expenses relating to external review services are covered under Track II – External Review Costs.	Eligible expenses include all transaction-related fees paid to recognised external reviewers for: (i) pre-issuance external review (for example, certification, second-party opinion, verification, ESG scoring/rating, assurance, etc) including external review based on applicable internationally-recognised principles, standards or guidance[2]; and (ii) post-issuance external review.
	1. Expenses covered by another grant scheme(s) in Hong Kong or outside Hong Kong are ineligible. *2. This includes the Taxonomy for Sustainable Finance.*	

The application process for the 2024 GSF Grant Scheme is as follows:	
Application for the grant	Prior to or after the issuance of the bond or loan, lead arranger(s)/lender(s), on behalf of the issuer/borrower, are encouraged to consult the HKMA via gsfgs@hkma.gov.hk on a pre-application basis before submitting the formal application. The HKMA will give a no-objection to the pre-application if it is satisfied that the eligibility requirements for the 2024 GSF Grant Scheme are met. A formal application may be made by the lead arranger(s)/lender(s) within three months after the issue date of the bonds/loan, or within three months of the invoice date in the case of post-issuance external reviewer costs (applications for post-issuance external reviewer costs of bonds/loans may also be submitted by the issuer/borrower directly). The HKMA will process applications in monthly batches.
Application for recognition as	As with the 2021 GSF Grant Scheme, arrangers and external reviewers may apply to be recognised

The application process for the 2024 GSF Grant Scheme is as follows:	
recognised arranger and recognised external reviewer	arrangers and recognised external reviewers respectively for the purposes of the 2024 GSF Grant Scheme, which status will be valid for a period of one year, after which the recognised arranger or recognised external reviewer will need to update its information with the HKMA. The application process can be made in one of two ways: > a submission can be made by the lead arranger(s) / lender(s) as part of a bond/loan application under the 2024 GSF Grant Scheme so that the arranger or external reviewer will be assessed simultaneously with other parts of the application; or > an arranger / external reviewer may choose to apply on it own and seek a recognised arranger / external reviewer status before being engaged for a particular bond / loan. *In addition, the HKMA has specifically noted that the recognised arranger status of any existing recognised arrangers and the recognised external reviewer status of any existing recognised external reviewers under the 2021 GSF Grant Scheme will remain valid under the 2024 GSF Grant Scheme.*

The Hong Kong Taxonomy for Sustainable Finance

The Hong Kong Taxonomy for Sustainable Finance
In addition to the 2024 GSF Grant Scheme, the HKMA has also published the Taxonomy for Sustainable Finance which is intended to be an important tool in providing a standardised framework for classifying and labelling financial products and investments based on their environmental sustainability. Importantly, the Taxonomy for Sustainable Finance is aligned with the Common Ground Taxonomy, China's Green Bond Endorsed Projects Catalogue and the European Union's Taxonomy for Sustainable Activities, but calibrated to reflect local conditions in Hong Kong. The Taxonomy for Sustainable Finance has a dual purpose – on the one hand, the classification system is intended to aid and promote a common understanding between issuers and investors to facilitate sustainable finance activities and minimise green-washing risks; and on the other hand, it is also envisaged that the classification system will assist companies to better formulate their own climate strategies and goals and increase transparency and accountability. The Taxonomy for Sustainable Finance will be particularly relevant for Hong Kong companies in sectors such as power generation, transportation,

> According to Eddie Yue, Chief Executive of the HKMA, "The release of the Hong Kong Taxonomy for Sustainable Finance marks a key milestone for Hong Kong's sustainable finance landscape. By providing a common language and framework for sustainable finance, we are equipping market participants with an important tool to make informed decisions, drive impactful cross-border investments, and contribute to global efforts in combating climate change."

The Hong Kong Taxonomy for Sustainable Finance
construction and water and waste management. Hong Kong companies in these industries may wish to consider the Taxonomy for Sustainable Finance when structuring products such as sustainability-linked bonds and loans (particularly in designing certain aspects of such bonds and loans such as the key performance indicators) or when considering the nature and scope of eligible projects in relation to the use of proceeds of green, social, sustainability and transition bonds and loans. Such companies may also wish to have regard to the Taxonomy for Sustainable Finance when formulating their own climate strategies and goals to ensure general alignment and cohesiveness between the two.

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