CEE Finance and Capital Markets 2021-22

Sustainable transformation in CEE

Freshfields Bruckhaus Deringer

Introduction

Welcome to the latest update on market trends and legal developments in the CEE banking, finance and capital markets sectors presented by Freshfields Bruckhaus Deringer and some of the central and eastern Europe (CEE) region's leading local law firms forming part of our Stronger*Together* network. This year, we focus on sustainability, in particular sustainable finance in CEE and financing the region's transition to a sustainable economy

Sustainable finance has rapidly evolved into a mainstream boardroom topic globally. With an emerging appreciation of environmental, social and governance (ESG) matters, the market for green and sustainability-linked bonds and loans as well as all types of financial and finance products to fund projects linked to sustainability or the transformation to more sustainable economies is also growing in CEE.

We expect this trend to continue and rapidly gain even more momentum. A primary aim of the COP26 UN Climate Change Conference in November 2021 is to help finance a whole-economy transition to net zero. This will turbocharge the sustainable finance market, driving more and more capital towards greener and more sustainable companies, projects and countries and putting extractive, polluting and less sustainable business models at heightened risk. Along with increasing amounts of ESG-related EU legislation, national initiatives as well as rising corporate, consumer and societal awareness, CEE market participants are expected to swim with the tide.

National standards gaining traction

Many economies in the CEE region still rely heavily on fossil fuels for their energy supply. For example, nearly 70 per cent of Poland's energy comes from coal. Other countries, such as Bulgaria, have a less coal-dependent energy sector due to greater use of nuclear power but still have plenty of scope to upgrade and diversify their energy infrastructure.

In this context, a number of CEE countries have introduced initiatives to encourage sustainable finance as a means to support the transition to greener economies. For example, in March 2021, Bulgaria launched its Green Finance and Energy Centre, a grouping of senior figures from private companies, government ministries, universities, industry bodies and regulatory authorities tasked with driving the debate on sustainable finance and energy. Two months later, the Ukrainian government created an interdepartmental working group on the country's green bond market and very recently started a broader initiative focused on hydrogen.

Debt issuances – both corporate and sovereign

Despite the sustainable finance market in CEE still being in a developing stage, the region has also already seen several corporate and sovereign debt issuances.

For example, the end of 2020 saw two Polish state-controlled energy companies — TAURON Polska Energia and PKN Orlen — issue unsecured sustainability-linked bonds totalling PLN 1 billion (EUR 230 million) each. More recently, R.Power established a PLN 1 billion green bond programme to (re) finance solar projects in Poland and other EU countries.

In 2018 Lithuania became the first Baltic state to issue green sovereign bonds. The EUR 20 million issuance was increased twice in 2020 to reach EUR 68 million, with the proceeds used to improve the energy performance of apartment buildings. In July 2021, Slovenia issued EUR 1 billion of "sustainability bonds", the proceeds of which will help finance environmental and social projects, making Slovenia the first CEE country and second EU country to issue an ESG bond.

EU as a driver for change

In 2019, the European Commission launched the "Green Deal", a suite of legislative changes and broader initiatives that aim to make Europe the first climate-neutral continent by 2050. To achieve this ambitious target — the costs of which are estimated at roughly EUR 350 billion a year for the next three decades — funding will be key and will come from both private and public sources. For example, the Recovery and Resilience Facility (RRF) will make EUR 723.8 billion in loans and grants available to member states, which in turn will need to show that at least 37 per cent of their RRF spending relates to projects furthering climate protection.

This is not the only way in which the EU has clearly positioned itself as the global champion of sustainable finance. Minimum or even common and fully interlinked standards, such as the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation, the Non-Financial Reporting Directive — to be replaced by the Corporate Sustainability Reporting Directive — and the proposed regulation on a European Green Bond Standard, are prime examples.

These developments will leave traces also in the CEE region (in primarily EU but also non-EU countries), fostering sustainable projects and their financing and affecting market players as well as the general legal framework to become more sustainability-oriented.

Outlook

While CEE countries are feeling their way in the world of sustainable finance, they offer plenty of potential for growth as local governments and corporates seek to demonstrate their commitment to, and ambition for, a more sustainable future.

With the EU currently a major trendsetter and driver with respect to the sustainability transformation, we also expect a new surge in issuance in the — already active — CEE ESG debt market, especially once the EU green bond rules come into force.

Keeping abreast of sustainability-related initiatives and legislative changes can be challenging, and understanding how such developments impact financing markets is key for all market participants.

Against this background, the following articles have been put together by Stronger*Together* firms attending the CEE Finance and Capital Markets Workshops 2021. We would like to express our sincere thanks to all Stronger*Together* colleagues for their contribution and wish you an interesting read.

Contents

Bulgaria

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Bulgaria

Doomed to be greener

Bulgaria is already transitioning from using coal to greener energy sources.

There are many factors that will impact Bulgaria's gradual transition to full, or close to full, use of green energy sources, however, a lack of coal is not one of them. Approximately 37 per cent of the country's electricity is generated by thermal power plants using local lignite coal. While such coal's energy quality is low, the key coal-fired power plants in Bulgaria are conveniently constructed nearby to the country's biggest open-pit coal mines (located in in South central Bulgaria in the Maritsa river region) and there is enough coal to power these power plants for at least the next two or three decades.

Due to the financial and social costs associated with the transition to greener energy sources (for example, the mines and the coal-fired power plants help approximately 100,000 families in Bulgaria's regional economies), Bulgaria is facing a challenging transition away from coal-fired power plants.

The remainder of the generation of the country's electricity has already been "greener" for quite some time, with approximately 42 per cent generated from nuclear power plants and 21 per cent from renewables (primarily comprising wind, water and solar). That being said, greenness is not only about the source of power generation but also about how it is consumed. For example, old buildings will need to be refurbished to become more energy efficient, old vehicles will need to be gradually phased out and replaced with greener ones, and consumer habits will also need to change.

1. Plans at government level concerning the energy sector transition

Bulgaria's current plans to achieve a greener economy are outlined in the "National Recovery and Resilience Plan of the Republic of Bulgaria" (the "Plan"). The Plan was submitted to the European commission in the second half of July this year, but, in light of the current political situation in Bulgaria, the Plan is likely to undergo some changes once a new regular government of Bulgaria is elected (currently, the country has a caretaker government). Subject to that caveat, the current Plan is based on the following pillars:

(a) Decarbonization by building a highly efficient gas power plant with a combined cycle, replacing a minimum of 1.0 GW of capacity from the state owned TPP Maritsa East 2 thermal power plant

The new gas power plant is ambitiously planned for commissioning by 2025. It is intended to be fuelled on natural gas until December 2029 and on hydrogen thereafter. The total funds budgeted for the project are in the region of EUR 850 million, approximately one third of which will be granted by the Recovery and Resilience Facility and two thirds of which will be sourced from private co-financing.

(b) Support for the construction of a minimum 1.7 GW of renewable energy sources ("RES") and batteries

Starting from 2022, six auctions will be conducted, each for the design, construction and operation of 285 MW of RES installed capacity. Each power plant should be equipped with a battery system that can accumulate power within no less than four hours and have capacity equivalent to at least 25 per cent of the total installed capacity of the power plant. The total amount budget for this project is estimated to be EUR 1.36 billion, approximately one third of which will be granted by the Recovery and Resilience Facility and two thirds of which will be sourced from private co-financing.

(c) Digital transformation and development of information systems and real-time systems of the Energy System Operator in the conditions of a low-carbon economy

This investment is necessary for the complete modernization of the planning, management and maintenance activities of the country's electricity transmission network by introducing modern digital technologies to ensure the necessary manoeuvrability, security, reliability and speed in the operation of the electricity system in low-carbon production, increasingly high penetration of renewable sources and intermittent generation. The total funds budgeted for this project amount to about EUR 312 million.

(d) Design, construction and commissioning of infrastructure for transmission of hydrogen and low-carbon gaseous fuels for power plants and other consumers in Bulgaria's coal regions

This project is associated with the project in (a) above. It will connect the three thermal power plants in the Maritsa Basin with sources of hydrogen through the construction of 125 km of pipelines. The funds necessary for this investment are estimated to amount to EUR 169 million.

(e) Scheme to support pilot projects for green hydrogen and biogas production

The project represents an elaboration of advanced demonstration installations for the production of green hydrogen and biogas within the industry and will be used as the basis for the further development of large-scale production. The total amount budgeted for this project is roughly EUR 70 million and each individual grant will be limited to an amount of EUR 7.5 million.

(f) Funding of the above projects

The above-mentioned projects are the current vision of the public administration. Even though not all of these projects may materialise, it is likely that at least a few of them, or replacements for them, will. Furthermore, The level of public, as well as private, funding required for such projects will be unprecedented.

2. General public-private initiatives, Green Finance and Energy Centre

March 2021 saw the launch of an ambitious initiative, the Green Finance and Energy Centre, a think tank of senior figures in the public and private sectors sponsored by their institutions. The sponsors include private companies, public authorities, such as the Ministries of Finance and of Economy, universities, and market associations. The platform was founded by the CEOs of the Bulgarian Stock Exchange and the Independent Bulgarian Energy Exchange, a deputy chairperson of the Financial Supervision Commission, the CEOs of several prominent Bulgarian banks, representatives of FinTech and start-up ecosystems, including the state-managed Fund of Funds, and business media professionals.

The goal of the Green Finance and Energy Centre is simply to promote sustainable finance and energy practices.

Given the driving role of the Bulgarian Stock Exchange, expectations are that the policies of this think tank will gradually transfer to all companies who fund themselves on the Bulgarian Stock Exchange, i.e. such companies will gradually have to develop their own green energy policies in order to attract investors who are increasingly ecologically- and sustainability-aware.

3. The current state of play

Further to the above, major banks in Bulgaria and many institutional investors have already designed their SFD policies, and in particular their green policies, or are expected to do so in the near future. Multilateral financial institutions, from heavyweights such as the EBRD to strong local players such as the Black Sea Trade and Development Bank, are, by definition, demanding ecological and other sustainable policies.

But against the above background, we still don't see much (if any) "green" finance in Bulgaria as of yet. The most likely reason is due to a moderate slowdown in project financing during the COVID-19 years, 2020 and 2021, and the pending adoption of official government policies.

Nevertheless, the transition is assumed to be only a matter of time. When green finance takes centre stage, we expect that, depending on the source of funding, the documentation will be based on the models used for other international transactions, which will in turn dominate any local designs.

4. Room for optimism (if it were up to Bulgaria)

We have seen a strong re-bound in the economic activity of Bulgaria as early as spring of 2021, with borrowing and capital markets transactions on the rise.

And given the pan-European, but also Bulgaria's own, green imperatives, it will be very soon that Bulgaria will have its first green bonds, loans and instruments issued or granted.

Green financing will become commonplace. It will quickly expand from major nation-wide projects, such as those described above, to many smaller projects across cities and towns, including with regard to energy communities, household facilities, municipal traffic initiatives (of which there are many already in the major cities, such as those concerning tax, refuelling and parking fee exemptions for electric vehicles and scooters), and much more.

Ideally, all such projects will bring us closer to the ultimate goal: a greener and cleaner environment.

Croatia

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Croatia

Are financings and bonds green in Croatia and does ESG matter?

Developments at the EU level regarding sustainable investments and ESG, i.e. the enactment of, among others, the Disclosure Regulation, Taxonomy Regulation and LCBR Regulation (all those regulations jointly referred to hereinafter as the "Sustainable Finance Legislation") have, to a certain extent, impacted players operating in the financial and non-financial sectors of the Croatian market.

Forced by measures envisaged in the European green investment plan, prepared by the European Commission, and provisions of the Sustainable Finance Legislation, entities operating in the Croatian market have followed such changes. However, there is still room to twist from traditional finance and investments into sustainable ones in order to reach a higher level of preservation of social rights, good corporate governance and creating a low-carbon economy resistant to climate change, etc.

The Croatian response to sustainable standards for finance and investments and ESG is: it is getting there, but it is also right to state that green financing, sustainable financing and sustainable investments, as well as the ESG-relevant investments, are in an early phase with very few transactions aimed at boosting sustainability and ESG so far in terms of using the LMA, APLMA and LSTA sustainability linked principles on granting loans or by issuing bonds under the ICMA sustainability bond principles, green bond principles, social bond principles or sustainability bond guidelines.

The purpose of this article is to outline certain points on sustainable finance (e.g. current market developments and sustainable finance going forward) and ESG investments (e.g. current developments and investor perspectives) from a Croatian perspective.

1. Sustainable finance – green transition

Sustainable finance is at the very heart of the financial system, helping the European Union and each Member State to become greener, reach a higher level of social relevance and push corporate businesses to mitigate those factors when making investment or financing decisions.

At the Croatian level, the following are sustainable finance matters which are seen in practice and the various steps undertaken in that respect.

(a) Current market developments – legislative developments and standards

Although the Sustainable Finance Legislation is directly applicable to EU Member States, including Croatia, in June 2021, the Croatian Parliament enacted the Law on Implementation of the Disclosure and Taxonomy Regulation ("Implementation Act") and took advantage of widening the number of applicants to whom the Disclosure Regulation applies.

Pursuant to the Implementation Act, the Disclosure Regulation applies to pension companies managing open-ended pension funds. The reason for such provision can be found in the fact that pension funds create value for their members when they retire, so investments in such funds are linked to the sustainable pension products such funds offer.

The Implementation Act also regulates people to whom the Disclosure Regulation and Taxonomy Regulation applies, and further regulates the mode of conduct and authority of the Croatian Financial Service Supervisory Agency (the "Croatian Regulator"), cooperation between the competent authorities of EU Member States and the Croatian regulator and contains misdemeanour provisions for acting contrary to the Implementation Act.

On 28 January 2021, the European Investment Bank ("EIB") and the Croatian Ministry of Economy and Sustainable Development signed a memorandum of understanding agreeing to develop joint operations in sectors such as (i) renewable electricity generation and transmission, (ii) clean energy and energy efficiency measures, and renovations and conversions of buildings, (iii) green mobility and (iv) support for the Croatian economy's transition to a circular economy.

This was followed by an agreement between EIB and the Croatian National Bank for Reconstruction and Development ("HBOR") based on which EIB expressed its willingness to support HBOR to set up its own advisory service and enhance its capacity to support investments in key sectors of the Croatian economy, such as improved protection and conservation of the environment, the development of sustainable water management practices, the development of a system to monitor weather and climate conditions, the strengthening of the Croatia's energy and hydrocarbon management systems, social infrastructure and smart cities.

Important steps in terms of sustainable investment and finance were boosted by the three most prominent global players on the Croatian market; i.e. the EIB, the European Investment Fund ("EIF") and the European Bank for Reconstruction and Development ("EBRD").

The EIB provides financing to the Croatian public (e.g. for water, healthcare, transport and energy infrastructure, and the national railway network and motorway) and private sectors (e.g. through local banks improving credit lines available to SMEs or directly to Croatian businesses, such as Valamar Riviera and Rimac Automobili) while the EIF is more specialized in providing risk finance for Croatian SMEs and offers a number of financial instruments (e.g. guarantees, equity and inclusive finance instruments) supporting small and medium-sized enterprises across Croatia as well.

The EBRD is also boosting sustainability in Croatia, especially in the areas of infrastructure and water management systems, wastewater systems and water supply systems. All of those financings were supported by the EU Cohesion Fund and, to a certain smaller extent, the Croatian state since, as per the EIB's report, the entire Croatian region qualifies for funds allocated from the EU Structural and Cohesion Funds.

(b) Green bonds / sustainable finance – current practice

Green bonds as a type of financing are rarely used in the Croatian market. Therefore, the ICMA Sustainability-Linked Bond Principles, Social Bond Principles or Sustainable Bond Guidelines are rarely, or only modestly, used in practise, although there is an increased use of corporate bond issuances as type of financing. The same applies to loans as well: the LMA, APLMA and LSTA Sustainability-Linked Loan Principles and Guidance are rarely incorporated into the loan documentation of Croatian borrowers.

One of the very first projects involving "green" finance in 2021 was the issuance of bonds by Erste&Steiermärkische Bank d.d. ("Erste Bank") whereby the International Finance Corporation subscribed for bonds in the amount of EUR 75 million in order to support the issuer's financing portfolio, including green housing loans. The International Finance Corporation's support allowed the bank to finance mortgage borrowers in Croatia, with 40 per cent of the issuance proceeds earmarked for green housing loans.

The EBRD has also invested EUR 9 million in MREL bonds issued by Erste Bank. This was the first time that a bond issued by a Croatian bank adopted the Green Economy Transition eligibility criteria, with Erste Bank allocating the majority of the EBRD's investments to GET-eligible projects, mainly comprising renewable energy and, internationally, certified green buildings.

(c) Sustainable finance – opportunities for lenders and borrowers

Some banks operating in Croatia have already started implementing sustainability policies and ESG standards into their core businesses. However, in order to reach the level of sustainability set forth by the European Finance Legislation and to transform from the traditional system of banks granting traditional loans (e.g. without a "green" focus) into one where banks grant loans for cleaner energy and production, enormous investments will need to be made, especially in sectors such as energy, waste management, infrastructure, etc.

Financial institutions, such as banks, who are key players in the Croatian market when it comes to borrowing, will play a large role in the future in order to establish "green" financial products, transform their business models to enable sustainable activities and develop strategies to help borrowers accomplish long-term sustainability plans. There is large potential on the lenders' side to develop "green" and "sustainable" financial products and to make them available on the Croatian market.

On the other hand, in order to obtain sustainable finance for their operations, borrowers will need to be sustainable, determine their exposure to climate change and understand the risks they will have to cover, not to mention the reputational risks they would face if they do not comply with the relevant ESG standards. In particular, this will mean that borrowers will need to manage and mitigate environmental and social risks factors, employees and corporate governance in a manner that allows them to be more sustainable. This will place new strategic and organisational requirements and regulations on borrowers as well as require the implementation of a sustainable strategy, which lawyers will play an important role to assess and develop.

2. ESG matters begin to matter

ESG matters, as well as the sustainability-focused market, are beginning to matter a lot, not only to the financial institutions but also to investors and companies trying to find investors. ESG matters, together with climate change mitigation, have therefore become core to the investment and business strategies of issuers, borrowers and investors.

It can clearly be seen that companies now show a deeper interest in ESG matter, which is mostly due to pressure from investors, customers and regulators and which will only accelerate over the coming years.

Borrowers and issuers are forced to comply with ESG standards by regulators and investors who are searching for investments into sustainable companies who have a clear ESG strategy, since nowadays investors have clear ESG requirements and allocate equity into ESG-friendly investments accordingly.

(a) ESG current legislation developments

In its 2030 National Development Strategy, the Croatian government announced that it will direct national and European sources of financing for the purpose of fostering a sustainable economy and society, recovery and increasing resilience to crises, the green and digital transition and balanced regional development over the next 10 years.

In 2021, the Croatian Regulator published guidance to issuers on drafting and publishing ESG-relevant information. This shows that the Croatian Regulator is focused on enabling all issuers on the Croatian market to take the same approach to disclosing sustainable development and ESG matters, with the aim that their information is comparable, reliable and understandable.

Furthermore, the Zagreb Stock Exchange and the Croatian Regulator have implemented a Corporate Code of Conduct, which obligates issuers to comply with the financial sustainability requirements to assess the impact the issuer's business activity has on the environment and society, the preservation of human and employees' rights and the prohibition and sanctioning of corruption. Issuers are obligated to report on their corporate governance and publish information regarding the company's strategy, taking into account the potential impact its activities might have on the environment and society, ethics, human rights and the work environment.

Accordingly, issuers and companies are being pressured by regulators to be ESG compliant and sustainable.

(b) What does sustainability and ESG compliance mean on the Croatian market?

It is hard to answer the above question. Croatian investors more or less depend on the ESG criteria set forth by the Sustainable Finance Regulations and their classification of what is deemed to be sustainable. Therefore, there is a lack of criteria upon which a particular investment may be deemed to be an investment into a sustainable target (and to what extent) as well as a lack of criteria to identify greenwashing.

There is no publicly available information as to what extent sustainability is used as a criterion for investment decisions on the Croatian market and to what extent investment decisions depend upon disclosure standards. In fact, an increasing number of Croatian companies have started to report in accordance with the Sustainable Finance Regulation.

Various funds focusing on sustainability investments have been incorporated on the Croatian market, with one such fund, the Feelsgood Social Impact Investment Fund, being incorporated in 2019. This EUR 30 million venture capital fund, is designed to spot, invest and support businesses having a sustainable strategy. Its purpose is mainly to target early-to-growth-stage Croatian and Slovenia start-ups who have an environmental and social impact. The EIF's contribution to the fund amounts to EUR 15 million. The Erste Green Equity Fund as well as funds operated by Raiffeisen Invest are also focused on investing in companies compliant with ESG regulations.

Although there is no publicly available data on information asymmetry between investors and investment targets, the more ESG information and policies are available on the websites of companies, the more attractive those companies will become.

3. Sustainable finance going forward

Sustainable finance does not have alternatives, and as such, it has the tendency to become the market standard. It is relevant both for banks, who may provide financing only to sustainable industries and borrowers with clear ESG standards, as well as for borrowers, who will want to obtain better terms and conditions linked to sustainability-linked principles.

The current COVID-19 pandemic and the earthquake in Zagreb and the surrounding region showed how sustainability is relevant and how companies (mostly real estate operating companies) should be resilient to climate change and environmental matters. Thus, clear definitions and criteria for sustainability and ESG standards should be set forth in the future and going forward.

Czech Republic

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Czech Republic

Czech FinTech market as the regulation-free, yet ESG and sustainability-minded Hub

The Czech FinTech market has certainly stood out as an innovation and technology hub in the CEE and Czech FinTech players certainly do not want to lag behind their foreign competitors when it comes to international "hot topics", including ESG and sustainable investments.

FinTech companies in the Czech Republic have, however, one significant advantage compared to some of their FinTech peers abroad, being that ESG and sustainability-wise, the Czech legal and regulatory environment is free from any burdensome regulations and restrictive policies which unnecessarily restrain innovation and FinTech developments.

1. No sustainability constraints in the legal and regulatory environment promotes innovation and freedom for sustainability initiatives

Based on the 'technology neutrality principle' widely promoted by the Czech legislators and regulators, the legislative and regulatory environment provides equal standing for all companies, irrespective of whether they categorize themselves as 'FinTech'.

As you can imagine, the Czech Republic offers a highly regulated environment, involving extensive domestic legislation which, *inter alia*, implements numerous EU directives, such as the Czech Act on Payment implementing the Directive (EU) 2015/2366 on payment services (PSD2), the Czech AML Act implementing the fifth EU AML Directive and the Czech Act on the Capital Market Business implementing the Directive (EU) 2014/65 on markets in financial instruments (MiFID 2).

However, none of these Acts, related executive orders, or even anticipated legislation (such as domestic legislation implementing Regulation (EU) 2020/1503 on European crowdfunding service providers for business) attempt to regulate ESG factors or sustainable investments; this lack of sustainability constraints therefore presents great opportunities for innovation and freedom of self-engagement by FinTech companies in sustainability investments.

2. The sustainability supporting approach of the Czech regulators remains 'without commitment'

Despite the lack of any formal sustainability-related hard rules, the Czech regulators, such as the Czech National Bank ("CNB") and the Prague Stock Exchange ("PSE"), thrive on promoting various sustainability initiatives and informal policies by way of participating in public talks on ESG topics, issuing articles and engaging in international associations and projects with a view to encouraging sustainability mindfulness.

Members of the banking committee of the CNB have become prominent contributors of ESG-related articles and opinions, particularly those published on the CNB's website, and have engaged in many workshops and public discussions on ESG topics, having been invited by various corporations and non-profit associations focused on FinTech regulation and/or sustainability.

Despite the active approach of some 'sustainability-promoters' at the CNB, the CNB as such does not have the legal power to officially promote environmental protection and sustainability in their formal policies, let alone by way of a binding regulation. On the contrary, the CNB must maintain an impartial and objective attitude towards any such environmental and sustainability initiatives. As a result, any ESG initiatives must continue to be concentrated in the hands of some environmentally-mindful representatives of the CNB on a rather informal platform.

Thanks to our close networking connections with the CNB, we have inquired about any anticipated projects or binding initiatives in which the CNB might be keen on participating. We were, however, re-assured that the CNB's initiative shall remain on an informal basis and no hard regulation is currently in the pipeline.

Similarly, the PSE has become a keen signatory and promoter of various sustainability-focused agreements, such as the Green Deal for Europe and the European Green Bond Standard, and an active participant in the Sustainable Stock Exchange Initiative under the auspices of the United Nations, whereby the PSE, *inter alia*, supports the increasing trend of investors putting environmental factors at the forefront of their investment decisions. Similarly to the informal initiatives of the CNB, the PSE's numerous memberships and sustainability-related promotions lack any binding effect upon the PSE's participants, let alone FinTech companies.

3. Market players do not want to be left behind their foreign peers with 'green' technology initiatives

The zealous attitude towards ESG and sustainability is also apparent amongst the innovative players in the Czech market, supporting various 'green' and technology initiatives leading to, for example, more than half of all transactions being cashless, with more than 87 per cent of those payments being contactless, or the highest number of people paying by tokenized payment cards (in smartphones or smartwatches) in the CEE region.

The FinTech market in the Czech Republic is indeed bustling with the Czech Republic becoming one of the most crypto-friendly countries, with the world's first hardware crypto-wallet, Trezor, or the first bitcoin mining pool, Slush Pool.

Crypto-investors are becoming, however, increasingly mindful of the extensive energy consumption of some DLTs.

It has become clear that innovative ideas promoting sustainability and ESG do not need any hard rules or binding regulations in order to thrive, as the perception amongst FinTech companies and investors continues to strengthen towards sustainable initiatives and 'green' investments. It therefore comes as no surprise that investors in the Czech Republic are increasingly putting sustainability at the forefront of their decision-making.

4. Czech FinTech players are keen on developing sustainability-focused market standards

Given the prevailing trend towards 'green' initiatives worldwide, Czech FinTech players have not stayed behind their foreign FinTech peers and have taken the lead in various sustainability projects and ESG developments, for example: one of the Czech unicorns, Twisto, has committed itself to reducing plastic waste by getting rid of payment cards by 2025; the investment platform, Portu, offers its investors the opportunity to invest into the 'responsible future' platform whereby investors may choose to invest into ESG-mindful companies; similarly, Fondee offers its investors the opportunity to invest into sustainable projects; the reward-based crowdfunding platform, Hithit, is proud of promoting sustainable projects accessible to small donors, and the list goes on.

The Czech FinTech market, as one of the most advanced markets in the CEE region technology-wise, has also become an attractive destination for foreign FinTech companies; for example, 'UK-born' Revolut has grown to have more than 300,000 domestic customers making use of its services, such as currency exchange, P2P payments or investments and has become known for expressing its support for sustainability by, for example, joining the UK project “Tech Zero” task force to tackle climate change.

5. Conclusion: regulatory freedom supports innovation and self-developed sustainability initiatives amongst our clients

The Czech FinTech market can be characterised by its regulatory freedom with increasing investor hunger for, and FinTech-peer pressure towards, promoting and developing ESG and sustainable investments.

We consider the ESG-wise regulation-free environment to be a unique opportunity for our FinTech clients and incoming FinTech players and investors to thrive on innovation and exert their valuable resources into sustainability projects promoting their particular businesses with which we are fully equipped to assist with our in-depth expertise and vast experience in the area of FinTech.

Hungary

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Hungary

Trends on the Hungarian renewable energy market

1. Installed capacities, market overlook

Installed capacities in the Hungarian photovoltaic capacities have grown steadily and are currently reaching 2,200-2,300 MW from 5-10 MW which was installed around 2012. This includes the total utility and household segment, i.e. all capacities in the household size and the licensed power plant size over 50 kW. This might sound as if renewable energy would have taken over a major role in the energy supply of Hungary, however renewables only contribute slightly over 10 per cent of the energy production of Hungary, despite such a rapid increase. Such growth of the renewable energy production is a huge step for reaching CO2 neutrality goals on a long term basis and contributes to a decrease of CO2 emissions, with Hungary having a 20 per cent renewable energy usage goal by 2030.

However, because of the dependency on the weather and therefore the relative unpredictability of the production curve of renewable producers, the balancing needs of the system have also increased rapidly and are currently presenting an imminent issue for the system operator. This is also due to the fact that, from the 2,300 MW installed solar capacity, around 700 MW is realised in household size power plants where no forecasting or real time production information is available for the DSO or the system operator. Therefore, MAVIR, who is the system operator, has already warned that it will need to revisit the growth curve and to have the infrastructure and financial needs of the system development re-calculated and assessed before new capacities are permitted.

The main issue is that the current system can barely cope with the changing production curves of renewable energy producers and the implementation of potential solutions may take years. It may take 3-4 years to license and build new power plants providing for flexibility in the system, which will be mainly gas power plants — no new sizable gas power plants were built in Hungary since 2011 when cogeneration plants were dismissed from the KAT subsidy system. The international market of balancing energy providing for flexibility and potentially reducing prices, also supported by EU requirements, is only expected to be implemented in 2-3 years. As another alternative, solar power plants may be equipped with remote control tools through which their production could be regulated down based on real time information, or the installation of such equipment may also be required for newly installed power plants — it may take approx. one to one and a half years to have such installations realised at existing plants. Finally, storage capacities may also be installed into the system, however this may also take years.

The above issues are investigated by the system operator continuously, however we do not see any downturn generally in the rhythm of new project development and, in terms of new capacities, there are still a large number of projects under development or construction.

2. Project sizes on the market

While the project development boom started in 2016 in Hungary and has increased until recently, the characteristics of solar projects have changed over the years. The majority of solar projects were developed in the 500 kW range these times with fewer larger projects, however this has changed in the last few years. We have experienced robust growth in project sizes. Firstly, project sizes have increased through the multiplication of the 500 kW projects and, for instance, a 5MW power plant was realised through 10 pieces of 500 kW due to the licensing and regulatory benefits of smaller projects. Following the reaction of the regulator and the introduction of rules pursuant to which such projects were calculated together, project developers have also reacted accordingly. Typically developed project sizes have increased gradually to 1-2 MW and then 5 MW, and thereafter 20 MW projects have also appeared on the market. Since 2020, we experienced among clients and observed on the market that several new 50 MW projects are also being developed and it is also not uncommon to see 50 MW projects on the market for sale in either a development or ready-to-build status.

This has also had a huge impact on the market players. Due to the increase of project sizes, project development and installation costs have also exploded. This has opened up the market for larger organisations, large international players and, on the buyer side, for funds as well. On the other hand, also due to changes in the subsidy regimes, smaller Hungarian developers or investors working on a few megawatts-sized projects are either constructing or selling their previously licensed projects or have disappeared from the market giving over the floor to the more experienced and capital strong international players or a few large Hungarian investor companies.

3. Available subsidies, regulatory environment

The regulatory and subsidy environment has also been re-established during the last few years. The Hungarian renewable subsidy system was operated earlier with a focus on subsidized takeover prices (around 10 cent/kWh) during a fixed period under which the electricity produced by the given plant could be sold, mainly to MAVIR.

However, over the years, such system has been gradually abolished. Firstly, the KAT system was terminated in which a guaranteed 25 year takeover period with a fixed takeover price (corrected by inflation minus 1 per cent) up to a certain maximum MW production was available for licensed plants. Under the new system, firstly the METR-KAT and METAR-

Hungary

Green Premium systems were introduced, which also provided a guaranteed takeover price but for shorter periods and a decreased maximum MW production. As a common characteristic, such systems secured a relatively stable cash flow for a fixed term under which the income of the project was easily calculable through the multiplication of the MW produced and the takeover price. This was changed recently and, under the new subsidy regime, the regulator has introduced a new logic for giving out the subsidies.

Currently developed utility projects are either developed on a market price basis or may benefit from the METAR tender regime. Under the METAR tender regime, there are tenders organised by the Hungarian energy authority a few times a year and project developers may participate at such tenders with their projects which are under development. In the tender there is no guaranteed takeover price offered for the participants, however project developers must compete in more categories against each other in terms of the tender prices they are putting into their bids. Such tender price is not a guaranteed takeover price, however it provides compensation between the ex post price achieved on the market (at the electricity stock exchange HUPIX) and the price put into the tender, while producers must sell their energy on the market. Therefore, the amount of the compensation is also a variable figure which may also be negative (theoretically), if energy prices would go up significantly in the next 15 years under which such compensation scheme is available for the winning bidders. Generally, we see that winning tender prices are drastically below the guaranteed takeover prices under the previous subsidy systems (prices are sometimes 20-40 per cent lower). Nevertheless, a project which has won at a tender is still an advantage over projects where no such compensation is available. Therefore, it was a surprise for project developers that the maximum project size was capped at 20 MW in a recent tender, banning the 50 MW projects from even participating in such METAR tender.

Among the recent regulatory developments, changes in the forecasting/balancing of energy should certainly be mentioned, such as new developments in relation to grid connections. We provide a brief description of such changes below as well as the current challenges.

4. Changes in the financing of solar projects

Financing opportunities for solar projects have also changed in the last few years. In the early boom phase, there were several subsidized loan products available from commercial banks for the financing of the construction costs. These loan products benefited from refinancing sources offered by EXIM Bank or the National Bank of Hungary to commercial banks. Based on such refinancing credit lines and also taking into account the relatively stable cash flow through the fixed price mandatory takeover prices, banks have offered fixed rate loans for solar projects typically at a maximum margin of 2.5 per cent for 12-15 years. With such financing sources, projects have produced attractive yields with a high certainty of these being realised. As the market matured, loan sizes have typically reduced for 500 kW projects over the years, however these still covered around 60-75 per cent of the construction costs.

Access to financing has become more of a bottleneck for new projects since the stability of a project's cash flow is seeing challenges due to the lack of fixed takeover prices and because of the other factors mentioned below. Furthermore, currently there are no sizeable beneficial refinancing sources available to banks based upon which banks may offer lower fixed margin loans — while there is a risk of increasing variable margins in the future.

We believe that currently, one of the largest challenges for investors is to find long term banking products suitable for such type of financing on a project level. Such issue is still not over-discussed on the market yet, because several new projects are still in the development phase to reach the ready-to-build status or are for sale in such development phase.

On the household level, both construction requirements and new subsidized products may facilitate the growth of the currently around 700 MW market. As one of the largest related regulatory changes, new residential buildings in Hungary as of 1 January 2021 may only a receive utilisation permit if at least 25 per cent of their energy needs are covered by renewable energy sources or by an energy source produced around such real estate (the latter mainly means remote heating). The 25 per cent renewable energy usage requirement may either be reached through the installation of solar panels or a heat pump system.

Under a new program of the National Bank of Hungary, there is a new refinancing credit line (green credit line) offered for the purchase of energy efficient new buildings/apartments which is likely to contribute to further demand on the household solar market. However, while these loans are still offered with an attractive long term fixed maximum 2.5 per cent margin, the individual ticket size of such loans is capped for the purchasers, and therefore such loans may not be used in other segments of renewable energy installations.

5. Hot topics, current challenges

We have provided below a very high level overview of the current hot topics without going into too much detail.

(a) Balancing energy costs

Without a doubt, the most discussed topic between project developers, operators and investors in Hungary in 2021 is the drastic increase in the balancing energy costs. As already explained above, because of the increased renewable capacities in the energy supply system during certain periods, the deviation from the MW-forecasts has also become greater, which requires significantly more regulation of the system. This involves increased balancing needs in terms of both the amount of energy required and the required speed of the availability of the balancing energy. As an example, on an unexpectedly cloudy day, solar production may drop rapidly. The largest deviation yet was experienced on 4 March 2021, where there was a rapid 870 MW fall-back in production which had to be compensated quickly.

The actual issue is on one hand the increase of balancing energy prices. Such prices were relatively stable until recently, however they have increased in the last one to two years. This is partly due to the lack of capacity and partly is a result of the fact that, based on the Clean Energy Package of the European Union, price caps have been mainly abolished on this market which has resulted in a harsh increase in prices by the affected energy producers. Therefore, the average price of balancing energy has increased to 3-5 times the price compared to 2019. Extremely high balancing energy costs have also appeared in other European markets as well, for instance in Germany for a short period balancing energy costs have reached EUR 100,000 per MWh, while in Belgium for one hour at peak balancing energy costs have reached even EUR 1.2 million per MWh. Prices have normalised in the meantime, however price levels are still drastically higher than earlier.

In Hungary, such trends were further strengthened by changes in the forecasting/balancing system for solar projects. Under the previous regime, photovoltaic projects were awarded by premiums if their forecasting was more accurate than a certain threshold while a penalty was payable if such threshold was not met. Because of the larger forecasting groups led by a professional service provider, several Hungarian KAT projects have effectively achieved a surplus from the forecasting/balancing regime. Recently, such regime was changed and costs were pushed down to solar producers gradually from 2020, also to comply with the requirements of the Clean Energy Package of the European Union. In 2021 this has resulted in a drastic increase of balancing energy costs, in particular because of the peaking prices in March-April this year and therefore contracts of the forecasting groups had to be renegotiated with completely different terms and pricing for the second half of 2021 or 2022.

It is hard to predict how balancing energy costs will change on the market, however on a short to mid -term basis in relation to photovoltaic projects, balancing energy costs may even reach 6.5-10 per cent of their yearly turnover before an anticipated reduction of such costs.

(b) Land prices

Easily accessible and cheap land suitable for solar projects in Hungary in large sizes have already been identified in several cases or even purchased by project developers. Therefore, current new project developments are facing significantly higher land prices. Available land consists mostly of agricultural land for larger projects and, in several cases, even the lack of suitable land close or relatively close to the grid connection presents another challenge.

(c) Supply of materials, prices

In relation to project construction, long supply chains under COVID, lack of materials or even increased raw material prices (steel, copper, etc.) have presented challenges for investors and EPCs in Hungary as well.

(d) Grid connection

The finding of suitable grid connections was also a highly discussed topic in Hungary in the last few years. Because of the large capacities already blocked in the system, there was sometimes even a secondary market for the grid connection of projects. This was also changed recently by MAVIR. Under the new regime, grid capacities will be made public and therefore project developers may have a better overview of the available capacities for their project developments, rather than placing the individual enquiries they had to make earlier. Most importantly, MAVIR will market the grid connection capacities through regulated auctions with down payments, guarantees, etc. to developers to have a more transparent system with higher incomes for the system operator. Thirdly, MAVIR is likely to charge fees on as yet unused capacities formerly awarded to project developers to force them to hand back such capacities to MAVIR. The new regime is still under formulation, however we expect that this will finally work along these principles.

(e) Rooftop installations

As another trend we see more and more rooftop projects in the industrial segment as well, where the solar panels are placed on the rooftop of the production factories mainly to serve the energy needs of the given plant. The number of such projects is increasing, partly also because of the increased land prices.

(f) Self-consumption model

There are various market players (EPCs and other market participants) preparing for or working on the implementation of the self-consumption model to Hungary either through a production SPV or by other models. Such model targets larger industrial customers whereby solar production facilities are placed mainly around the production site with a long term PPA or through other legal constructions. We have also experienced interest for such projects on the customer side with a need to have their energy consumption covered by green energy. Various regulatory issues are yet to be clarified, models are still under elaboration and financing issues also need to be sorted, however we believe that such model will be used in an increasing number of cases in Hungary as well.

(g) PPA discussions and new insurance-like products

Because of the lack of available fixed takeover agreements for new projects, producers have to negotiate PPA contracts with traders or consumers or other entities to sell the energy they are producing. The terms and standards of such PPA contracts are also an interesting topic on the market. Furthermore, we also see potential insurance-like or insurance products relating to such PPA contracts which may provide for a more predictable cash flow for projects and thus increase the bankability of new projects.

6. Final thoughts

Generally, the golden era of solar projects in Hungary is over, where almost every project could become a success story when it reached at least the ready-to-build status. Currently, professional and larger scale investors have taken over and are dominating a more concentrated market where they are trying to manage the new challenges based on their international expertise, access to international supply chains and financing opportunities with the help of selected advisors. However, photovoltaic projects are still providing good, sustainable and high-yield investments in Hungary, with a COVID-proof cash flow which may benefit from either a high takeover price following inflation as well, or from the currently increasing energy prices.

Lithuania

Eva Suduiko, Partner

Cobalt Lithuania

Lithuania

Green finance in Lithuania: mission possible?

Lithuania is already active in green finance and, taking into account its success in becoming a regional FinTech centre, has declared ambitions to become a leader of sustainable finance in the Baltics.

On the other hand, compared to more developed countries, the Lithuanian green finance market is still at an early stage and its initiative to become a regional hub in the Baltics needs to be supported by the effective development of a favourable environment both for business and investors.

The below article provides an overview of the current state of the green finance market in Lithuania. It also describes the main barriers impeding the growth of green finance products and possible solutions to overcome them. Furthermore, it provides a brief review of the most recent developments in the market.

1. Current situation

Recent transactions and initiatives show that Lithuania is becoming active in the area of green finance.

(a) Green bonds

Lithuania is one of the leading countries to have issued green bonds — being the first to do so in the Baltics, the third in Europe, and the seventh in the world. An initial issue of EUR 20 million of government bonds in 2018 has since been tapped twice to reach a total amount of EUR 68 million in 2020. The proceeds of this issue are being used to implement green projects (namely, modernising multi-apartment buildings and increasing energy efficiency).

In addition to the above-mentioned government bonds, there have been several issues of corporate bonds as well:

- in 2017, the State-owned company Lietuvos Energija UAB (currently Ignitis Grupė AB), which is the largest supplier of electricity and gas in Lithuania, issued a EUR 300 million green bond, which was followed by a second issue of EUR 300 million in 2018 and a third issue of EUR 300 million in 2020 (the proceeds will be used to finance the transition to a sustainable, modern electricity network); and
- in 2019, a privately owned company, Auga group AB, published a base prospectus for green bonds in an amount of up to EUR 60 million and successfully issued its first tranche of green bonds for an amount of EUR 20 million (the proceeds will be used for ongoing sustainability initiatives and R&D projects related to the improvement of sustainability).

(b) Green banking products

In 2020, SEB launched a novelty in the Lithuanian market — green loans for businesses. Using the proceeds of SEB group's green bonds issued in 2017, SEB now offers green loans to Lithuanian companies aimed at financing projects reducing that business's environmental footprint and ensuring sustainable development. Following the launch of this project, SEB has issued a record EUR 45 million financing to E Energija Group to develop a wind farm.

Customers of Swedbank and some other local players can benefit from favourable financing conditions for installing their own solar power plant or purchasing a remote one as well as for improving their house's energy efficiency. Šiaulių bankas is active in providing financing for the renovation of apartment buildings to ensure higher energy efficiency of residential buildings and less negative impact on the climate.

In addition to green loans, green leasing is offered by several market players, including Swedbank and SEB. More favourable financing conditions (lower interest margin, insurance discount, etc.) are offered to the purchasers of electric or environmentally-friendly vehicles.

(c) Investment into/lending to sustainable businesses

The increasing significance of green finance is also demonstrated by both public and private market players (banks, investors, pension funds, venture capital funds, etc.). It has become more and more common to take into account ESG factors before making an investment or providing financing to local businesses. For example, one of the objectives of the recently established State Aid Fund for Business, which provides financing to medium-sized and large enterprises affected by the coronavirus outbreak, is to focus on green and sustainable investments. Further, the national promotion institution UAB Investicijų ir verslo garantijos ("INVEGA") has officially declared that it is already evaluating how companies manage their environmental impact before making any investments.

(d) National action plan for green finance

In 2019, an EU-supported project was launched in Lithuania to promote sustainable (green) investments. In cooperation with the EBRD, experts will prepare a country action plan on green finance. Lithuania is the first country in the Baltics to launch such a project.

As one of the milestones in this project, in April 2021, the experts prepared the draft Assessment and Impact Report (the "Assessment Report", available at https://finmin.lrv.lt/uploads/finmin/documents/files/draft_report_LT_strategy_on_sutainable_finance_2021-04-09_eng.pdf), which maps the current legal and regulatory framework and identifies the main gaps delaying the development of green finance. It also provides detailed recommendations to create a favourable environment for sustainable investments, promotes the development of sustainable instruments and involves the public in the implementation of sustainable development goals. This Assessment Report will serve as a basis to prepare the country's action plan on green finance.

2. Obstacles for further development

While there is visible progress in green finance, the European Commission noted that the current level of capital raised for these types of investments is not sufficient in the long term. According to the Assessment Report, the green finance market is underdeveloped in Lithuania due to various political, social, cultural and regulatory reasons, including the following:

- *Limited development of capital markets in general*: The Lithuanian capital market is still in its early stages. As indicated in the Assessment Report, liquidity is very low making it difficult for institutional investors to take positions in the local market. Further, bond issuance is limited and largely dominated by government bonds. There are also investment limitations on pension funds, which can invest only in listed equities or bonds and only up to 10 per cent per issuer.
- *Reserved approach by foreign investors to investment opportunities in Lithuania*: As stated in the Assessment Report, due to their relatively small size, Lithuanian projects have limited interest from foreign investors. In addition, some of those investors have limited knowledge about the local market and may also have a negative impression due to AML scandals in the Baltics (although these scandals are hardly related to Lithuania).
- *Domestic investor constraints*: As explained in the Assessment Report, green finance development is also held up by a lack of local investor interest or awareness of sustainability (investors still do not sufficiently focus on ESG criteria), lack of investor focus on securities as an investment vehicle and the limitations on investment by pensions funds (as described above).
- *Issuer constrains*: The experts emphasized in the Assessment Report that Lithuanian issuers still do not see the benefits of issuing bonds and usually prefer traditional financing by banks, as this is a more common and cheaper source of funding.
- *Lack of demand for sustainable finance*: The authors of the Assessment Report have carried out a detailed analysis and identified that the main constraints for sustainable finance demand are the lack of a sustainability policy and awareness (i.e., businesses and society are not aware of what they have to do to become more sustainable) and the lack of a sustainable project pipeline, green public procurement and sustainable PPPs.

To boost the development of Lithuanian sustainable finance, the Assessment Report suggests various possible solutions, which correlate with the issues described above. These solutions include measures to develop capital markets (e.g. to adopt a covered bonds law and to change regulations in relation to investments by pension funds), to develop an effective national sustainability policy, which would set a balanced toolset to guide and incentivise sustainable activities and deter unsustainable practices, to enhance sustainable PPPs and public procurements, which could serve as a tool for the State to show initiative and set a good example, and to raise sustainability awareness among a wider society and businesses. In addition to the above, based on the experience of foreign countries, experts suggested establishing a Lithuanian Sustainable Finance Institute, i.e. a specialised body which would act as a leader and promoter of green finance in Lithuania.

3. Recent developments and initiatives

While the country's action plan on green finance is still under preparation and the recommendations listed in the Assessment Report are further discussed and elaborated, there have recently been certain further movements towards the development of sustainable finance in Lithuania.

(a) Capital markets

To support the development of — including green — capital markets the following main measures have been or should be taken shortly:

- *Compensation of costs for the issuance of securities by SME companies*: As of the beginning of August 2021, the national promotion institution INVEGA started implementing a new EUR 1 million measure to compensate costs of issuing corporate shares and bonds. This measure will help micro, small or medium-sized enterprises to list their securities on Nasdaq Vilnius stock exchange and the alternative market "First North". INVEGA will compensate 50 per cent of the costs incurred in Lithuania in relation to: (i) the preparation and publication of documents such as prospectuses; (ii) the determination of the applicant's business strategy and business structure, advertising, and company presentation meetings with investors; (iii) the due diligence process; (iv) services of external consultants for the transformation of the company into a public limited company; (v) services of a certified advisor (in case of the alternative market "First North"); and (vi) legal, financial, tax, audit and investment consultancy services. The maximum amount that INVEGA will be able to reimburse each applicant will be EUR 100,000 for the issuance of shares and EUR 50,000 for the issuance of bonds. INVEGA will reimburse the costs if the securities are listed within one year following INVEGA's decision to declare the issuer as eligible for the compensation (this term may be prolonged by up to two years) and, for the issuance of shares, the issuer raises at least EUR 500,000 through the stock exchange. All this is also expected to contribute to the development of green capital markets.
- *Anticipated legislative updates*: Despite a certain delay caused by Covid-19, securitisation and covered bonds legislation is on its way and should be adopted by the end of 2021. Once adopted, such legislation will provide an opportunity for credit institutions to become more active in the capital markets as well as to have access to an additional source of funding, which could be further used for green finance products. The recent successful issuance of Luminor bank's (a bank established in Estonia and having branches in Lithuania and Latvia) covered bonds in the amount of EUR 500 million demonstrates that this type of financial instrument is very interesting for investors.

Further, green capital markets might become more active due to the contemplated issuance of certain green bonds. In particular, Lietuvos geležinkeliai AB ("LTG"), the State-owned railway company, has recently announced its intentions to enter capital markets. According to publicly available data, LTG will aim to issue green bonds in an amount of at least EUR 300 million and will use their proceeds to finance green projects. The successful issue of LTG bonds would serve as a positive example for other market participants and make Lithuania more attractive both for local and foreign investors.

In addition, the recently established State Aid Fund for Business (the "Fund") announced that it will issue state-guaranteed bonds in an amount of up to EUR 150 million. The first tranche of EUR 30 million should be launched in autumn 2021. In addition to providing financing to medium-sized and large enterprises affected by the coronavirus outbreak, the Fund also focuses on green and sustainable investments and the promotion of capital markets. The Fund currently has 27 positive investment decisions and the total amount of the contemplated investments is EUR 160 million, 70 per cent of which will be invested in the form of bonds.

(b) Increasing number of sustainable financing instruments

In spring 2021, Swedbank announced that it is preparing, and will offer to the market, sustainability-linked loans. Although this type of loan is already well known in foreign markets, this will be a novelty in Lithuania.

(c) Greater attitude towards ESG in general

Not only is sustainability more frequently discussed at a political level, but it now also receives greater attention in general. Requirements adopted at the EU level, foreign market trends and practical concerns (including greenwashing) are widely discussed in mass media. ESG and various aspects of sustainability have become a hot topic and are widely discussed at various local and international conferences. All of this should increase awareness of sustainability, and, hopefully, demand for sustainable projects and the development of green finance.

4. Outlook

Although Lithuania is giving more and more attention towards sustainability, the green finance market is at an early stage. To develop green finance, Lithuania will have to take a number of measures to create an environment which is favourable for both businesses and investors. Hopefully, the country's action plan on green finance, which is currently under preparation, will be taken seriously and, despite the ongoing pandemic as well as various political challenges, will be implemented practically and will allow Lithuania to achieve the targets of the Paris Agreement on Climate Change and the United Nations (UN) 2030 Agenda for Sustainable Development.

Poland

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Poland

Entering into the new world – the latest developments in sustainable finance instruments in Poland

1. Introduction

Poland is an interesting landscape to observe with respect to the latest developments in sustainable finance and the green transition. With the fifth largest population in the EU, and, consequently, with one of the biggest economies in the bloc, Poland's pursuit of the objectives of the European Green Deal, such as no net emissions of greenhouse gasses by 2050, is particularly important. The ambitious targets of the European Green Deal seem especially challenging from the Polish perspective when considering that nearly 71 per cent of Poland's power production is based on coal. Departing from coal and achieving a sustainable economy will require the involvement of both the public and private sectors. Moreover, the finance and capital markets will play key roles in financing the required changes.

In this article, we will provide an overview of the landscape of sustainable finance in Poland, with a particular emphasis on the latest transactions in the bond market, but we will also touch upon the loan market and other associated topics.

2. Bonds

After a temporary halt during the majority of 2020 due to the Covid-19 pandemic, bond issues are gaining momentum in Poland, although the bond market is still relatively small in comparison to the equity market. Pursuant to data disclosed by Catalyst, the bond trading platform in Poland, and our own research, listed corporate bonds (other than covered bonds and bonds issued by banks) have a total nominal value equivalent to approximately EUR 6.3 billion as of Q2 2021. Bond issuances with the highest value can be attributed to issuers from the real estate, energy and telecommunications sectors, with issuers from the fuel and gas, as well as mining sectors also conducting significant issuances. This fact alone shows that green bonds and sustainability-linked bonds ("SLB") may prove to be a popular manner of financing as these sectors will be on the forefront of the fight for a sustainable economy. Although this simply remains a sign of the future, and corporate issuances of green bonds and sustainability-linked bonds comprise only a fraction of bond issuances, there have been some recent issuances that are certainly worth mentioning.

The end of 2020 saw two major issuances. Two state-controlled issuers, i.e. TAURON Polska Energia S.A., an energy company with a market capitalisation equivalent to EUR 1.3 billion, and PKN Orlen S.A., a multi-energy company with a market capitalisation equivalent to EUR 8 billion, issued unsecured sustainability-linked bonds in the total amount of PLN 1 billion (EUR 230 million) each.

In the terms and conditions of the bonds issued by Tauron, the margin is linked to certain indices (the emission reduction index and the renewable energy sources (RES) capacity increase index), i.e. the margin will be increased if these indices exceed certain levels stipulated in the T&Cs. The purpose of the issue was established as, *inter alia*, the financing of the costs of the construction or acquisition of RES projects, while at the same time stipulating that the proceeds will not be used for the financing of new or existing coal blocks. The respective levels of the sustainability indices will be calculated by the issuer and published together with the opinion of an independent auditor on the correctness of their calculation.

In the case of the bonds issued by PKN Orlen, the link to sustainability lies in combining the margin and the ESG rating, i.e. a rating measuring an issuer's vulnerability to significant risks related in particular to compliance with the principles of environmental and social responsibility and implemented corporate governance measures, as well as the method of managing these risks by the issuer. The associated covenant stipulates that the goal is to maintain the ESG rating at a minimum level of A, whereas a breach of this covenant will result in an increase of the margin. The ESG rating is assigned and published by MSCI ESG Research (UK) Limited (or another rating agency that replaces it).

Another deal on the Polish green bond market occurred in June 2021, when the Polish solar projects developer R.Power established a PLN 1 billion green bond issuance programme and issued the first series of bonds under the programme with a total nominal value of PLN 150 million. The issued bonds are consistent with the Green Bond Principles determined by the International Capital Market Association. The proceeds from the issuance are to be applied towards financing or refinancing the development, acquisition, construction and operation of solar photovoltaic projects in Poland and other EU countries.

It is worth mentioning that under the Polish Act on Bonds, the determination of the purpose of an issue, which is fundamental in the case of green bonds, is optional. However, if an issuer indicates such purpose, it may not allocate the funds generated from the bond issue for any other purpose. A breach of such prohibition will result in criminal liability (a fine up to PLN 5 million, up to two years of imprisonment or both of these penalties jointly). The severe consequences of the misappropriation of funds could give investors additional comfort in the case of green bonds; however, the current trend of not designating the purpose of an issue will need to be changed. Our analysis of listed corporate bonds (out of 206 series of corporate bonds denominated in PLN issued by 71 issuers (excluding banks), we analysed in detail one series of bonds of each issuer) shows that the purpose of the issue is indicated in 49 per cent of the analysed series of bonds; however, such series represent only 24 per cent of the total value of all of the analysed bonds.

The Polish Act on Bonds does not contain provisions that would treat green bonds or sustainability-linked bonds differently. Therefore, issuers must refer to different voluntary market standards and frameworks, whereas it seems that while the European Green Bonds Standard is still undergoing development, the Green Bond Principles established by the International Capital Market Association are the most popular set of principles applied across issuers.

As proposed in the Green Bond Principles, some issuers and borrowers are adopting green bond frameworks and are subjecting them to third-party assessments. One example is PKN Orlen S.A., which published the green finance framework (which is also compliant with the Green Loan Principles) in May 2021 and presented a third-party opinion provided by V.E. confirming the alignment of the framework with the four core components of the Green Bond Principles and the Green Loan Principles. Other examples of such approach are the green bond framework published by Globe Trade Centre SA Capital Group (a real estate company with a focus on Poland and the CEE) in June 2021 and the green bond framework published by the previously mentioned R.Power, both of which were evaluated by Sustainalytics and determined to be aligned with the four core components of the Green Bond Principles 2018.

3. Loans

Unlike in the case of the bond market, where there is no standard template for bond documentation (although the market standards have resulted in many similar terms and conditions and the inclusion of similar covenants), the loan market in Poland (especially in the case of larger financings and syndicated lending) is generally based on the LMA standard. On the other hand, the market as a whole is more difficult to analyse due to the private character of the transactions, the terms of which are not disclosed or are disclosed only to a limited extent.

Nonetheless, the number of sustainable finance deals is on the rise, in particular because of the increasing number of project finance and acquisition finance transactions with respect to solar and other renewable energy projects. In terms of standard loan documentation, green elements may be included within different types of clauses, e.g. information undertakings, general undertakings, representations or sustainability-linked covenants. It is worth mentioning that even in the case of standard corporate financings, some elements of green financings have been introduced by lenders, an example being loans granted by the European Bank of Reconstruction and Development, which requires borrowers to report their compliance with specific performance requirements, which are similar to KPIs in sustainability-linked loans.

The loan market has yet to witness sustainability-linked transactions of the scale of the bond issuances conducted by Tauron and PKN Orlen; however, Polish banks did participate in the sustainability-linked loan for up to the amount of EUR 225 million granted to the Raben Group. Green financing on the loan market currently takes the form of green loans, i.e. loans granted for the purpose of financing green investments. One example of the use of the Green Loan Principles is the green financing framework published by PKN Orlen briefly described above.

4. Summary

Sustainable finance is already present on the Polish market, but it certainly remains under development. In respect of the upper market of sustainability-linked financings, bond issuances seem more popular than loans, although this is not the case within the field of green financings, where loans granted for the purpose of financing green transitions are gaining importance. Some sectors are developing more quickly than others, with the energy and real estate sectors probably being the most active.

The drivers that are currently the most important in respect of green financings are PR and social aspects (as younger and upcoming generations appear less willing to work for companies that do not conduct sustainable operations), as well as long-term planning and preparing for risks that will fully materialise in the future (e.g. mandatory reductions in CO2 emissions). At present, policymakers and legislators do not provide incentives (e.g. tax deductions or capital maintenance requirements for banks) for participating in green finance transactions, but this is something that will likely change in the future. However, taking into account that pan-European and global policies such as the European Green Deal or the Paris Agreement, which have already had an impact on domestic markets and will only increase in number in the future, will require the green transition to be accelerated, a wave of new green deals is rather certain.

Romania

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Romania

The rise of sustainable finance in Romania – direction for the future and opportunities for investors

Recent data shows that out of the estimated EUR 60 billion allocated for green projects which are anticipated to be developed in Romania until 2030, only a fraction will be financed from public or EU funds (such as the ones made available as part of the Next Generation EU recovery instrument). This presents an important opportunity for the Romanian financial sector to play a key role in building a system that supports sustainable growth.

The incentives for the financial sector stemming from green financing are further enhanced by the risk of a slow-down of Romania's economic growth, or even the risk of a net negative impact on the economy should the country experience any delay in implementing the contemplated green projects and transition to a more sustainable economy. In this article, we will thus look into the current situation and recent developments, as well as discuss potential challenges and opportunities for various investors and actors when it comes to green loans and bonds.

1. Market status quo and recent developments

According to the National Committee for Macroprudential Oversight ("NCMO") (the body tasked with coordinating the macroprudential oversight of the Romanian financial system) the overall estimated value of green projects to be implemented in Romania by 2030 is EUR 60 billion, both at a governmental level and in the private sector. The impact of implementing the abovementioned sustainable projects on the economy may reach up to 5.7 per cent in the next six years, according to National Bank of Romania representatives. As only a fraction of such sustainable projects are currently expected to be financed from public and EU funds, it is currently expected that ESG financing (loans and bonds) will see rapid growth in Romania over a short period of time.

In this context, Romania has seen a rise in the interest of investors for both ESG financing and ESG-linked financing (both from banks as well as the capital markets) in recent years, in line with EU trends. Similar to other EU countries, in Romania the focus on ESG matters and sustainable finance was accelerated in the context of the EU's increased support for the transition to a low-carbon, more resource-efficient and sustainable economy, with sustainable finance playing a key role in delivering such policy objectives. In particular, in the context of the Covid-19 pandemic, ESG-conscious finance was deemed as essential to building a resilient economy, ensuring a sustainable recovery from the effects of the pandemic.

This change in investor perspective kicked-off a process which is reshaping the business models of Romanian companies and the way investors look at such businesses. While financial information continues to be the main driving factor in the decision-making process, sophisticated investors (such as institutional investors or private equity funds) are also increasingly looking at non-financial information, including the impact on the ecosystem, when evaluating a business. This approach is driven by the need to de-risk investment portfolios (replacing carbon-intensive investments with future-proofed ones), as well as by the availability of "cheaper" financing for green projects. However, at a local level, the interest of institutional investors for green projects is moderate when compared to their interest — which is generally higher (when assessed at group level) — in investing in green projects in other jurisdictions. Therefore, there may be a delay in the alignment of the local investment strategy of such investors with their corresponding strategy at the group level.

Romanian entrepreneurs' awareness as to the importance of ESG to their businesses has also progressed, with entrepreneurs shifting towards integrating ESG into their business models, making their companies more attractive to potential investors and allowing ease of access to more affordable financing. Nevertheless, the allocation and training of specialised personnel in the ESG area currently remains a challenge in particular for small and medium-sized enterprises.

2. Investment journey or the story of a winding road to sustainable investment

As the Taxonomy Regulation (which has established a classification system intended to allow, *inter alia*, investors to identify whether economic activities can be considered sustainable and, thus, potential investment targets) is yet to be implemented (with the earliest of the objectives, i.e. those referring to climate change mitigation and adaptation, taking effect from 1 January 2022), we have seen little to no uptake of the relevant provisions from asset managers and investment firms who offer financial products in Romania or from companies which are subject to the transparency requirements pursuant to Directive 2014/95/EU as regards disclosure of non-financial and diversity information by certain large undertakings (known as the Non-Financial Reporting Directive, "NFRD").

Consequently, the issues faced by investors in other EU jurisdictions regarding the identification of suitable investment targets from an ESG perspective are even more pronounced in Romania, with the majority of companies which are subject to NFRD publishing truncated or not sufficiently relevant, comparable, reliable or easy to access and use information. To illustrate this point, according to the latest available data, in 2019, out of the 730 entities who were required to publish a non-financial report pursuant to the NFRD, only 46 made such report publicly available, with the vast majority of information provided being unaudited, hard to compare or incomplete.

There is also little to no strategy developed at the level of Romania's most prominent investors in financial products (such as pension funds or other local asset managers) when it comes to medium or long term sustainable investments, with no particular preference currently being given to ESG-compliant products when compared to other investments, with limited suitability assessments incorporating ESG considerations being performed for financial products.

Nevertheless, the respondents to a recent survey (encompassing over 80 per cent of assets under management in the Romanian market) showed that such suitability assessments and strategies are currently in the process of being crystallized at the level of Romania's asset managers and large investors, in anticipation of the enactment of new ESG rules amending current MiFID II / UCITS / AIFMD / insurance regimes, released as part of the EU's bumper package of sustainable finance legislation in April 2021 (which go beyond disclosure-based obligations, into the territory of imposing positive obligations on the relevant firms). This process is aided by the demonstrated performance of existing ESG-driven investments, which shows a sample of local companies, each of which are recipients of ESG financing, as outperforming their peers, being competitive not only on the local market, but also on external markets, as well as maintaining a strong financial health.

3. Policy and legal developments in the field of ESG finance – a resounding "YES" from Romania to "green" money from the EU, with push-back on climate taxonomy

Romania is making small, but steady steps towards implementing regulatory measures in the ESG financing field and is generally following the EU trends.

Following the Next Generation EU plan, Romania enacted the National Recovery and Resilience Plan ("NRRP") that sets priority investment areas for overcoming the Covid-19 crisis, including provisions related to a green transition in certain economic fields. We believe that in order to achieve the goals desired by the authorities through the NRRP, such manner of public financing should also follow a sustainable design of services and products and focus on financing companies that have strong ESG policies in place.

Another big step towards green financing was taken by the National Committee for Macroprudential Oversight in early June 2021, when a report on supporting green financing was published. Through this report, the NCMO issued 16 recommendations towards authorities, such as the National Bank of Romania, the Financial Supervisory Authority and the Romanian Government, in order to enact regulations primarily related to a sustainable increase in funding for green projects. Therefore, we expect that, starting from 2022, we will see more activity in the green regulatory area, especially by authorities analysing the possibility of making prudential requirements for green funding more flexible, in line with similar concerns at the European level, or by potentially implementing new support schemes for certain business activities.

Speaking about support schemes, we believe that in the foreseeable future we may again start seeing legislative novelties for the purpose of implementing new support schemes, mostly for incentivising the green energy sector, which has once again become a hot topic, in contrast with traditional energy sources.

Furthermore, considering that in Romania the green bonds market is still in its early stages, we also expect to see certain regulatory approaches be taken by the Romanian Government in connection with this topic. The enactment of any legislation on green bonds will take place bearing in mind the Ministry of Public Finance's intention to issue green bonds, as well as in the context of trying to establish certain criteria for identifying eligible projects to which the funds obtained from the green bond issues will be allocated. However, the Romanian Government did indicate that its support for the European policy objectives in the field of sustainable finance is not unconditional — most recently, Romania, alongside Bulgaria, Cyprus, Greece, Hungary and Slovakia supported the Czech Republic in its pushback against the EU's planned rulebook for green investments in the field of wind and solar energy, transport and manufacturing, arguing that the taxonomy should be used as a transparency tool, not as a limitation, expressing concern over each country's right to decide on its energy mix, as well as arguing that the package does not respect the principle of technological neutrality.

4. Romania's positive outlook

With the European Green Deal covering a broader spectrum of economic activities, we expect the interest towards green projects to spread throughout various sectors of the economy, such as agriculture, infrastructure and IT. In particular, we expect more bank financings to be directed towards green projects (with particular interest on energy efficient technologies) or to be ESG-linked, through margin increase/ decrease mechanisms depending on ESG KPIs and with specific ESG reporting and disclosure obligations imposed on borrowers.

The same expectations extend to capital markets transactions — we anticipate investments in green bonds to be a top choice in investors' preferences over the coming years, with the Bucharest Stock Exchange officially positioning itself as being ready to become the main financing channel for green sustainable investments, its representatives declaring that they are considering allocating a special segment to these types of instruments on the markets (regulated and MTF) operated by it. The green bonds market is also expected to include sovereign instruments in the near future, with the Ministry of Public Finance in Romania expressing its intention to issue its first green bonds in the 2021 — 2023 period, as well as to elaborate the general framework for green sovereign bonds.

5. Conclusion

The current landscape shows that green bonds issuances and green bank financing are still in their early days in Romania, with the most active investors currently being the international financial institutions (such as EBRD and the International Finance Corporation), providing financing (bonds and equity) to ESG-conscious businesses, as well as to Romanian banking and non-banking financial institutions (such as financial leasing companies) for the purpose of financing ESG-compliant projects. Although local investors and actors have shown moderate interest in ESG finance and investments up until now, this is expected to change in the near future, with such entities expressing a clear intention of seeking to create a strategy for sustainable financing and investing.

Therefore, there are solid signs that green financing will continue to grow, as: (i) only in the last year we have seen the first ESG and ESG-linked financing through bonds or bank financing in sectors such as real estate, energy, telecommunications, manufacturing industry and the financial sector; and (ii) it is expected that both the Romanian National Bank, as well as the Romanian Financial Supervisory Authority, will tighten the requirements for financial institutions, regulated entities and publicly traded companies when it comes to governance, strategy, risk management and stress-testing linked to ESG aspects (in anticipation of the implementation or enactment of new ESG rules at the EU level), which can only lead to a progression in such entities' portfolios towards green loans and ESG-compliant investments.

Serbia

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Serbia

Leading green innovation in the Balkans

The EU ESG legal framework is not directly applicable in the Republic of Serbia as it is still not an EU member state. Nevertheless, awareness of the need to comply with ESG principles in Serbia is increasing with the presence of international corporates, who are applying their group-wide sustainable policies to the business operations and corporate governance of their local subsidiaries. An additional push for compliance is also being made by international banking groups, who are basing their decision-making on the level of incorporation of ESG principles into the business models of their clients.

On the systemic level, the Government of the Republic of Serbia remains committed to the UN's Sustainable Development Goals of the 2030 Agenda for Sustainable Development ("Agenda"). In this regard, the Serbian government is constantly developing a legislative framework aimed at integrating technology to improve governance, reduce paper waste, improve energy-efficiency and increase the transparency of everyday processes. A significant focus is placed on supporting digital innovations which will lead to improved sustainability in all aspects of business and everyday life. A huge impact was already made in 2017 by introduction of e-governance, a central platform that integrates all local municipalities, governmental bodies and public services, through which each citizen may make a request for the issuance of certain personal documentation and to obtain certain approvals online. This switch alone has already led to a saving of 180 million pages of paper. An entirely online one-stop shop procedure is also available for incorporation of limited liability companies, which has been available since 2018.

Further room for improving digitalisation is seen in the development of blockchain technology and tokenization for the financing of innovative projects. An initial step in this direction was made through the adoption of the Law on Digital Assets ("Law"), applicable as of 29 June 2021. This Law makes the Republic of Serbia one of the first countries to regulate in detail the issuance, trading and exchange of cryptocurrencies and digital tokens and has already singled it out as a crypto and blockchain friendly jurisdiction, similar to Switzerland, Estonia, Cyprus and Malta. Simultaneously with the adoption of the Law, an entire set of the tax laws were amended to accommodate the regulation of the digital assets.

The adoption of the Law comes on the wave of a Serbian tech boom, with the industry accounting for more than 6 per cent of the country's GDP. The main advantages of the Law are primarily seen in its potential to provide for a range of innovative financing opportunities for start-ups and to attract major foreign players. However, digital assets also have vast potential to speed up the green transition, reduce society's carbon footprint and enhance ESG compliance, which is yet to be grasped by the market players and the regulator.

1. Digital assets as an opportunity for sustainability

Acknowledging the dynamics of the development of digital assets, the Law applies to any digital asset regardless of the technology it is based upon. A digital asset represents a digital record of value that can be digitally bought, sold, exchanged or transferred, while excluding the legal means of payment and other regulated financial assets. Two main types of digital assets regulated by the Law are virtual currencies and digital tokens.

The market notion of a virtual currency remains unaltered by the legislator, which regulates it as a digital asset that is not guaranteed by a central bank and which does not have the legal status of the currency. This definition already encompasses existing cryptocurrencies known to market participants, such as Bitcoin and Ethereum, but also leaves room for developing new cryptocurrencies, such as the first Serbian virtual currency "Lazar" issued in July this year.

A digital token is defined as any intangible property right, representing one or more property rights in digital form, which may include the right of the holder to be provided with certain services. This term includes most commonly globally present tokens, such as the so-called utility and security tokens.

Such a tech-neutral and wide definition of digital assets enables innovative solutions in tokenising the value of a company and enables them to unlock their value by using more liquid and accessible means of financing. Below we provide some of the opportunities which are expected to be used by the companies to foster sustainability under the current framework.

(a) Paperless procedure for raising funds

The usual procedure for IPOs and bond issuances regulated under the capital markets framework is paper-intensive and administratively burdensome. As a means to swiftly raise financing, the Law permits digital assets which have all of the characteristics of a financial instrument and whose value does not exceeding EUR 3 million over the course of 1 year to be issued in a more environmentally friendly and less time-consuming procedure. This is possible as the exchange of documents between the issuer and the regulator is, in this case, made in an electronic manner via the e-governance platform. The EUR 3 million threshold is seen by the regulator as sufficient taking into account the average financing needs for companies in Serbia and it is expected to incentivise the financing of start-ups from a larger base of investor base. It is further anticipated that family-owned businesses and entrepreneurs will seek to benefit from this fund-raising opportunity by being innovative in devising the types of tokens they issue. The opportunity to include this category of issuers adds to the potential of digital assets to bring social benefits.

(b) Potential for green bonds

The Government of the Republic of Serbia has recently adopted the Green Bond Framework for issuing sovereign bonds. As under this framework the proceeds of any green bonds will be used to fund Serbia's transition to a low-carbon, climate resilient and ecological economy, as well as contribute to the goals set out in the Agenda, introducing the possibility for such bonds to be issued under the Law would certainly put further emphasis on the promoted goals of the Government and would make such bonds available to a larger base of foreign investors.

(c) Blockchain as a way for reducing transaction costs

Blockchain technology should be integrated wherever possible as it has significant potential to deliver a positive impact on society and the environment. Some of such benefits are reduced transaction costs, programmability and regulatory compliance, as well as increased liquidity through access to a global investor base. Identifying blockchain protocols with a positive environmental impact would, however, be crucial to refute the negative press surrounding blockchain-based technology as being energy intense.

(d) Granting of tokens as a means of tackling employee turnover

As compliance with ESG is often measured by the employee turnover of a company, keeping a stable employee base should be high on the agenda of companies. As high staff turnover is an especially pressing issue for the IT sector, one of the emerging trends on the market for combating this problem is through offering tokens as a type of remuneration and incentive for employees.

(e) Remittance of cryptocurrency as a means of achieving sustainability

Remittances are recognised as a factor that can contribute to reaching sustainable economic growth and a reduction in inequality, which are goals set under the Agenda. In order to achieve such goals, UN Member States have pledged to reduce by 2030 the cost of transfers from an average of 7 per cent to less than 3 per cent, and to eliminate remittance corridors with costs higher than 5 per cent. Therefore, more frequent use of remittances of digital assets seems to be a way forward to achieving this goal as such transfers are devised to have less intermediaries and be cheaper. As Serbia is traditionally an active remittance market, promotion of the frequent use of cross-border remittance for digital assets from expats, as well as for the local remittance of digital assets, would accelerate reaching this goal.

2. Outlook

With the complete set of regulations in place, Serbia is a stable investment hub for digital assets in the Balkan. A change of perspective for the use of digital assets from a financing tool to a powerful instrument for a swift switch to a greener economy and sustainable business will certainly induce more innovative manners of use for digital assets and the associated technology. Education of companies in this regard is therefore crucial.

For the time being, market players are already exploiting relaxed rules for issuing digital assets, which is expected to continue in the future. A trend is also visible in the practice of employers in the IT sector, headed by the versed global crypto developers, to additionally incentivise their employees by granting them free of charge tokens which "vest" over a reasonable period of time with the view to maintain their employee base. However, it seems that a larger impact of digital assets for the promotion of sustainable goals may only be seen through a systemic approach to utilising the benefits of blockchain. In this regard, a decrease in costs and an improvement in the efficiency of administrative processes could be made for the running of certain centralized registers, such as the companies' register, securities' register and real estate register, on blockchain technology. Further, the automation of decision-making processes on a nation-wide scale by placing the e-Government on the blockchain would also be welcome. However, such substantial reform requires changes to a wide range of regulations and is therefore not expected in the near future.

Slovakia

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Slovakia

Emerging Western CSR policies in Slovakia – accelerating adoption, or continuing local approach?

1. Key understanding of the rationale

It now seems that long gone are the days when virtually the only issues boardrooms had to be concerned with were the expansion of their business and increase of profit. Scientific research coupled with changes in the general public´s perception of what behaviour is ethically acceptable and desirable are now reflected in the expectations that investors — and, more widely, society as a whole — have towards businesses. Slovakia is no exception. For example, surveys find that up to 97 per cent of Slovak companies consider diversity and inclusion to be one of their desired values.

The aim of this article is to provide an overview of the rationale behind the current and (probable) future Slovak approach to the implementation of corporate social responsibility (CSR) and environmental, social and governance (ESG) policies.

2. Legal and regulatory framework

Slovakia is a Western-oriented open economy, firmly established within the EU. As such, Slovakia is not only a party to basically all major international treaties on issues which have traditionally entered CSR policies of companies, such as human rights, environmental protection, or prohibition of all forms of discrimination, but also transposes EU law into its domestic legislation, including the Non-Financial Reporting Directive ("NFRD"). Hence, Slovak companies with shares admitted to trading on a regulated markets or multilateral trading facilities must (if certain additional conditions are met) include a description of their respective diversity policies and other data on adherence to social and environmental responsibility in their annual reports. A similar obligation applies to larger public-interest entities.

In addition, Slovakia has adopted and enforces several key pieces of domestic legislation dealing with issues typically addressed in CSR policies (such as the Anti-Discrimination Act). Also, the Slovak central and local governments not only regularly publish relevant materials (such as the annual Report on Gender Equality), but also cooperate with private organisations focusing on such issues (such as the Business Leaders Forum).

3. Scarce domestic debates on new ESG legislation – yet to emerge, or not relevant?

The domestic legal framework, as summarised above, focuses primarily on human rights and anti-discrimination issues. In our experience, other ESG topics are currently of minor relevance to both the general public and political debate in Slovakia. Upon a first glance, this seems to contradict the outlook of modern Slovakia described above. However, considering key local circumstances, the Slovak public rather has its very own approach to tackling broader ESG-related matters.

(a) Missing public demand

Firstly, it must be emphasised that some of the trending ESG issues, such as diversity and inclusion in the area of national, racial, religious and cultural differences, do not resonate in Slovakia as loudly as in some other countries due to objective demographic reasons. Among the countries of the EU, Slovakia ranks among those with the lowest percentages of non-nationals among its population, approximately a mere 1 per cent. The vast majority of Slovak nationals are also of the same racial origin (Slavic). Further, despite a long Catholic tradition in Slovakia, public matters are convincingly divorced from religion under the secular Slovak Constitution. As such, it is obvious that, compared to countries with populations with a more varied mix of national, racial, religious and cultural backgrounds (such as the UK, France or Germany), public and political debates on diversity and inclusion in relation to the aforementioned areas are simply less likely to attract attention in Slovakia.

(b) Economic rather than "behavioural" solutions

Another major factor is that Slovak legislation traditionally focuses more on the adoption of economic incentives that indirectly lead to the promotion of ESG goals than on "behavioural" solutions, such as those in the NFRD (i.e. solutions directly implementing obligations governing the actions of businesses). This means that most of the relevant legislation adopts tax cuts and other economic advantages that favour market players who promote diversity and inclusion by their factual actions. For example, workplaces that employ disabled citizens or increase the employment rate among groups with more difficult access to economic opportunities and/or education (e.g. Roma minority) qualify for economic advantages originating from both EU and domestic funds. Conversely, economic disincentives apply to businesses acting against generally recognized ESG values (penalised conduct being environmental pollution, discriminatory behaviour, etc.). The effects of these economic tools are regularly evaluated (by both public bodies and businesses) and reconsidered in order to maximise their benefit in respect of targeted ESG values.

4. Day-to-day business reality

Despite the limited applicable legal and regulatory ESG framework, Slovak businesses are not unfamiliar with various forms of ESG policies. International players have brought and adopted their own internal rules on ESG to the Slovak market, in particular, via their Slovak branch offices.

Slovenská sporiteľňa, a member of Erste Group, Generali Slovensko or Tatra Banka, a member of Raiffeisen Bank International, publicly oblige themselves to adhere to their own internal codes of conduct/ethics addressing, among others, ESG values. However, the implementation of ESG-related codes is no longer a practice exclusively adopted by non-Slovak origin entities. ESET, a leading Slovak software company specialising in cyber-security, adheres to its own Code of Ethics, which stipulates its basic ESG values as well as the principles of its functioning (no-tolerance of mobbing, bossing or other forms of discrimination, anti-corruption rules, etc.) and provides mechanisms to report code violations. The ESET Foundation also actively supports local communities.

It is tricky to argue whether individual tools aimed at the promotion of ESG actually manage to fulfil their goals. Looking at possibly one of the most frequently-discussed ESG aspects worldwide or at least at EU level — gender equality, on one hand, the numbers unfortunately evidence that the gender pay gap in Slovakia is slightly above the EU median (however, it is similar to those reported in Switzerland and better than in Germany), with a significant percentual difference in financial and insurance activities. On the other hand, certain figures related to the representation of women in higher business positions provide a more positive story. Despite the absence of binding quotas on the minimum percentage of women in top managerial positions, statistics show that women hold 31.4 per cent of board seats within the largest listed companies in Slovakia, which is above the EU average of 29.5 per cent. Needless to say, due to the absence of obligatory quotas, the representation of women on corporate boards varies greatly among the listed companies in the banking and insurance sectors, ranging from as little as less than 1 per cent to as much as over 50 per cent. Notably (or absurdly, even), the representation of women in the public financial sector lags behind the private area. All of the current members of the Bank Board of the Slovak National Bank are men, as were most of its former members. Also, the representation of women in the government has actually declined in recent years.

5. Conclusion

ESG values are generally recognised within the Slovak market, including the finance and capital markets. The vast majority of Slovak enterprises and their local customers consider the major trending ESG issues as valuable and worth promoting. Further, compliance with fundamental generally acknowledged common goals — such as anti-discrimination efforts or the preservation of the environment — can in practice not only increase the ratings of Slovak companies and their financial products, but also qualify the complying enterprises for specific economic benefits.

We expect that Slovak businesses will continue to seek counsel ready to not only help them utilise the available public economic benefits aimed at the promotion of ESG, but also to draft, implement and maintain the respective internal policies. We also expect that the Slovak government will continue to maintain its policy of creating positive and negative incentives instead of adopting specific behavioural legislation. However, the same will presumably not apply to EU legislation and, thus, Slovak law will have to catch up with the accelerating regulatory tendencies within the EU. It is currently impossible to anticipate whether the foreseeable legislation will actually shift the day-to-day routine of Slovak businesses, or if it will collide with the already established Slovak mindset of focusing on different means of ESG promotion.

Slovenia

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Slovenia

Staying on course with ESG trends

Slovenia is keeping on course with the EU's legislation on environmental, social, and corporate governance matters.

Notwithstanding that Slovenia is one of the smallest EU countries by number of residents and is compliant with the EU's "golden rule" on structural deficits in terms of GDP per capita, Slovenia is in the process of raising its standards of green financing as well as ESG governance. Slovenia is achieving this not only by transposing the relevant EU legislation, but also by facilitating it in business practices, as many Slovenian companies are now moving towards more sustainable business models. In this article, we discuss the mandatory non-financial reporting in Slovenia on ESG-matters, as well as national regulatory initiatives, and how they are being exercised in practice.

1. ESG reporting trends

The ESG concept has found its way into boardrooms and corporate structures in Slovenia mainly through non-financial reporting as a consequence of the national transposition of the Directive 2014/95/EU (the "Non-Financial Reporting Directive").

Pursuant to the Slovenian Companies act, the obligation of non-financial reporting applies to public-interest entities under national law (e.g., listed companies, credit institutions, insurance companies, companies subject to audit and State-related entities) employing more than 500 employees.

Companies that are obligated to include non-financial ESG statements must include them in the business report as a part of their annual financial reports. Annual financial reports of companies such as Petrol, SID bank and Triglav Insurance company, are notable examples. Such statements must include information necessary for the understanding of the company's development, performance, position and impact of its activities, relating to, at a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery. In practice, four substantive topics are usually covered: (i) policy description and policy results on environmental, social and human resources issues, human rights and anti-corruption and anti-bribery issues, (ii) the main risks associated with these areas, (iii) a description of the business model or added value model, and (iv) a description of the diversity policies implemented in relation to administrative, management and supervisory bodies.

Not only private but also key public entities engage in the ESG reporting trend. For example, the Slovenian Power Market Operator (Borzen), the Motorway Company of the Republic of Slovenia (DARS) and the Slovenian Sovereign Holding (SSH) annually prepare a sustainability report. The companies seem to be very well aware of the importance of sustainable governance, which becomes also apparent in company boards demanding ESG-related topics to be covered in due diligence reports, especially in sectors that are environmentally sensitive.

In our practice, we have seen a recent shift in the awareness of potential investors when assessing potential acquisition targets, including cases of buyers stepping away from ongoing acquisitions due to the fact that the local target was assessed as being long-term environmentally unsustainable.

2. Regulatory initiatives for ESG reporting

While ESG reporting started as a voluntary initiative, a compulsory regime involving detailed requirements is well underway.

Apart from initiatives on the European level, Slovenia decided to implement the Sustainable Development Goals of the EU on a national level by embedding them into Slovenia's new Development Strategy 2030. Adopted by the Government of the Republic of Slovenia in December 2017, this is a development framework that builds on the Vision of Slovenia 2050 and the current state of the economy, the society, and the environment. It takes into account global challenges and trends and is designed to incorporate the Sustainable Development Goals.

As noted above, Slovenia has implemented the obligation to prepare and include an ESG-related non-financial statement in the company's financial annual reports in the Slovenian Companies Act. Importantly, non-financial statements must also be audited. The audit comprises of a check on the inclusion of the relevant non-financial statement as well a review of the formal completeness of the statement. Discussions have been moving into the direction of there being an actual check of the correctness of the statement.

In addition, there have also been several national policies and accounting standards adopted, which provide company boards with guidelines on the socially responsible behaviour of their firms. Furthermore, companies use the guidelines for non-financial reporting of the Communication of the Commission and Global Reporting Initiative standards. Regarding the effects on sustainable governance, a company's management should take into account ensuring equal opportunities and gender equality for sustainable development, poverty eradication, inclusive growth, and the well-being of society as a whole, according to Slovenia's Development Strategy 2030.

Fines can be imposed for failing to prepare the annual financial reports according to the above requirements regarding non-financial statements. They vary from EUR 6,000 to EUR 30,000.

3. Outlook

In practice, Slovenian companies are still insufficiently aware of the importance of a sustainable strategic direction and mostly only partly comply with reporting in accordance with the legal requirements and only rarely go beyond what is legally required. According to the latest publicly available information, approximately 90 Slovenian companies meet the criteria for mandatory non-financial reporting, whereas only 33 reports were totally compliant with the Non-Financial Reporting Directive and the Slovenian Companies Act. In addition, six companies did not include a single statutory sustainability element in their report, and more than half had deficient disclosures. Companies paid the most attention to reporting on environmental and human resources issues and the social aspect, while most did not disclose information on human rights and the fight against corruption.

As indicated above, there is still much work to be done in practice in Slovenia. As a law firm, we are only sporadically approached with queries relating to the ESG related reporting obligations but the increasing awareness of investors and companies is an indicator this will change in the near future.

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Sustainability legal framework in Turkey

1. Introduction of the sustainability principles

Sustainability principles were introduced to Turkish regulatory framework on 2 October 2020 with an amendment to the Communiqué on Corporate Governance numbered II-17.1 ("Communiqué") issued by the Capital Markets Board of Turkey ("CMB").

The Corporate Governance Communiqué contains principles relating to:

- the listed company's shareholders;
- public disclosure and transparency;
- the stakeholders of the listed company;
- the board of directors of the listed company; and
- related party transactions.

A number of the Corporate Governance Principles are mandatory, and the remainder apply on a "comply or explain" basis.

Before the above-mentioned amendment, there were no corporate governance rules in Turkey relating to sustainability and, following the amendment, the CMB issued a set of recommended voluntary sustainability principles for public companies, which apply to those companies on a "comply or explain" basis.

The Corporate Governance Communiqué classifies listed companies into three categories according to their market capitalization and the market value of their free-float shares, subject to recalculation on an annual basis, as determined by the CMB. Apart from the following entities, all other companies are subject to the sustainability principles:

- publicly held companies whose shares are not traded on the exchange;
- companies whose shares are traded on markets, market places or platforms other than the National Market, the Second National Market or the Collective Products Market;
- companies which have applied for the public offering of their shares for the first time and whose shares will be traded on markets, market places or platforms other than the National Market, the Second National Market or the Collective Products Market; and
- companies which are considered as residing abroad in accordance with the Decree numbered 32 regarding Protection of the Value of Turkish Currency.

With this first piece of legislation, the CMB obliges public companies to report the following information with their annual activity reports starting from the year 2021 (for information relating to the year 2020):

- whether they comply with the sustainability principles;
- the reasons for any failure if they fail to do so; and
- the effects of such non-compliance on environmental and social risk management.

In case of any material change regarding those disclosures, the respective public company is required to announce such change in its interim activity reports.

2. Scope of the sustainability principles

The sustainability principles issued by the CMB require the board of directors of the public companies falling within the scope of the sustainability principles to:

- determine the company's strategy, policy and objectives on the three areas listed under the principles;
- appoint a committee responsible for implementing and monitoring the company's policies; and
- publicly announce the company's performance and activities on an annual basis.

There are three main categories provided under the sustainability principles: environmental principles, social principles and corporate governance principles. Certain main responsibilities under those categories are briefly described below:

(a) Environmental principles

Companies are required to:

- disclose their policies, action plans and environmental management systems regarding environment management and their programs;
- comply with environmental legislation;
- disclose the highest ranked person that is responsible for these issues and the related committees;
- set and disclose their short and long-term goals in order to reduce their environmental impact;
- disclose its incentives for the management of environmental issues;
- disclose its strategy and action plan to cope with an environmental crisis; and
- disclose its total energy consumption data, including its renewable energy generation and consumption data.

(b) Social principles

Social principles consist of two main areas: (i) human rights and employee rights and (ii) stakeholders, international standards and initiatives. Companies are required to:

- set corporate policies on human rights and employee rights where they undertake to wholly respect the legal framework on these areas and to disclose such policies and respective roles in relation to its implementation;
- set and disclose occupational health and safety and data protection policies;
- ensure equality of opportunity throughout their value chain;
- take all of the stakeholders' interests into account while acting for sustainability issues; and
- make a concrete effort to be included in the Borsa Istanbul Sustainability Index and other international sustainability indexes.

(c) Principles of corporate governance

Companies are required to:

- make a concrete effort to comply with all the corporate governance principles including non-mandatory ones;
- take sustainability and the environmental impact of their activities into account while setting their governance strategies; and
- disclose their anti-corruption and anti-bribery policies and programs.

3. Conclusion

The announcement of the sustainability principles boosted the sustainability disclosures of public companies that are on the sustainability index of Borsa Istanbul Stock Exchange and motivated those companies to develop new projects so as to comply with the principles. Although the CMB's principles apply to public companies, several Turkish companies whose shares are not traded on any exchange have adapted their business strategies towards achieving sustainability goals so as to take advantage of the principles once they decide to go public.

Ukraine

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Ukraine

Funding the green transition: green bond opportunities in Ukraine

Sustainable energy finance is one of the most promising sectors in Ukraine. Significant policy reforms are underway in Ukrainian energy markets, and much has already been done to create a market opportunity for sustainable energy finance in Ukraine and reach the national targets established by the Energy Strategy of Ukraine until 2035 — in particular: (i) to increase the share of renewable energy in the total primary energy supply of Ukraine to 25 per cent by 2035, and (ii) to reduce greenhouse gas emissions in final fuel consumption by 20 per cent by 2035 as compared to 2010. Green bonds play a key role in achieving these ambitions.

1. New legal framework for green bonds

One of the key recent developments in sustainable energy finance is that Ukraine introduced green bonds as a separate type of security. On 1 July 2021, the amended Law of Ukraine "On Capital Markets and Organised Commodity Markets" entered into force (the Law). The Law outlines the general framework for green bonds regulation in Ukraine as follows:

(a) Use of green bond proceeds

Green bonds should be used exclusively to finance or refinance environmental projects: (i) alternative energy, (ii) energy efficiency, (iii) waste generation minimisation, utilisation and processing, (iv) environmentally friendly transport, (v) organic farming, (vi) conservation of flora and fauna, water and land resources, (vii) adaptation to climate change, and (viii) other projects with a focus on climate and environmental benefits.

(b) Green bond issuers

Both corporate and public issuers may issue green bonds in Ukraine. Public issuers will be able to issue green bonds after the Government of Ukraine approves the procedure for selection and maintenance of environmental projects financed from the state and local budgets.

(c) Additional disclosure and reporting requirements

Any issuer of green bonds must (i) include a project description covering its technical and economic parameters, the implementation period, and the environmental effect expected from the project implementation (in the bond issue decision for public issuers and in the prospectus for corporate issuers), and (ii) disclose information on the stage of the environmental project implementation and the amount of funds used to implement or finance the environmental project in the annual reports.

The Law protects the rights of the green bonds investors by prohibiting the issuer to take any actions, which may result in early termination, cancellation or other loss or encumbrance of their rights to the environmental project.

2. Green bond market developments

In May 2021, the State Agency for Energy Efficiency created the Interdepartmental Working Group on the green bond market in Ukraine. In July 2021, the National Securities and Stock Market Commission of Ukraine adopted recommendations for implementing or financing environmental projects through the issuance of green bonds. These were developed according to the Green Bond Principles (GBP) of the International Capital Markets Association (ICMA), the European Green Bond Standard and the Environmental, Social and Governance (ESG) standards adopted by the International Finance Corporation (IFC).

The recommendations provide, inter alia, that the issuer of green bonds must also (i) publish reports on the environmental impact of the projects, which are fully or partially financed and/or refinanced by the funds raised through the issuance of green bonds, and (ii) have its own policy on green bonds.

Some of the Ukrainian energy market participants have already elaborated their own green bond policies. For example, DTEK, a Ukrainian green energy producer with 1GW of installed capacity, has developed the Green Bond Framework, which follows the guidelines specified in the GBP. Besides, DTEK was the first Ukrainian company to make a green Eurobond offering in 2019.

3. Outlook

The Government of Ukraine expects to launch a full-scale green bond market in 2022 to 2023. A draft concept of the development of the green bond market in Ukraine has already been elaborated and is currently under consideration of the Government of Ukraine.

According to the State Agency for Energy Efficiency, Ukraine also intends to streamline the market for independent appraisers and green bond verifiers to eliminate the risks of greenwashing and create a technical office for the examination and support of environmental projects.

Overall, we are very excited about the developing Ukrainian green bond market and believe that it would strengthen Ukraine's energy independence, help reach national strategic goals and fulfil Ukraine's international obligations.

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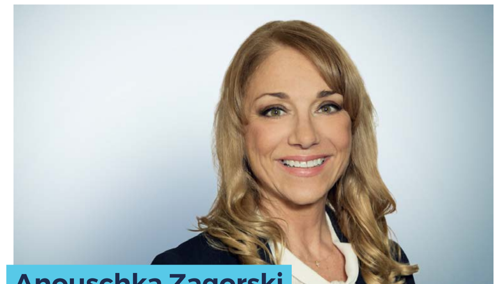

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