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Not charged up and plenty of places to go!

Crude oil producers got a sharp wake-up call with the recent Dutch court ruling against Shell. In a fast changing world many of the big oil producers need a wake up to the full reality of reducing emissions. At the same time some realism needs to remain during such transitionary periods.

Jonathan Bell (https://www.txfnews.com/Tracker/keyword/Jonathan Bell)
Editor-in-chief & Director 10 June 2021

8 min (2259 words)

Apart from riding my bicycle, my favourite form of A to B travel has to be on the train – and of course in the UK the majority of these are electric, with some diesel freight locos also still in operation. Rail travel gives me the luxury of being able to work, relax, think/dream and sleep (not necessarily in that order mind you) while getting from A to B without any stress or hassle. But – probably like many of you - my most frequent form of transport is the motor car/automobile. And, unless you have the luxury of an electric vehicle (EV) that still means the use of petrol/gasoline and oil. Shock, horror!

With the increased push on the global phase-out of fossil fuels – the dirty world of crude oil has become even dirtier. The motor vehicle industry is wrapped in the huge transitional process to electrification. Now, how many of you have an electric vehicle? Not a big percentage I will bet! How many of you would like to have an electric vehicle? Quite a lot I would say! I certainly would!

But the transition phase is just that – a transition, and in certain sectors it will take longer than others. Coal has been battered in recent years (even though some 40% of power globally is still generated by thermal coal) and now most financial institutions won't directly touch it. Oil – particularly upstream – is under increasing pressure (see below). And other 'cleaner' fossil fuels such as natural gas/LNG are also wrapped into the debate as the pressure is turned up.

However, the Paris Agreement on Climate is very clear not only on the goal of zero carbon emissions by 2050, but also in its framing of a significant transition period as part of that. The end goal is of course a long way off. It does not prevent pressure groups, environmentalists, institutions, corporates and governments etc trying to push the agenda faster. I believe that trying to speed up the process is good overall as it keeps us all firmly on our toes – and we really need to get there for the sake of the planet. But there has to be proper transition. And as I have said in previous blogs there also needs to be a significant degree of consideration given to low-income countries that are using or hope to use commodities such as oil/LNG to develop part of their economy.

So, probably like many of you, I want to try and do my bit somewhere along the line. I don't live in a mega city like London – because if I did I don't really think I would need a car as pubic transport is pretty good. If I did live in a big town then I would probably want to go electric. The UK government has declared that after 2030 there will be no new petrol, diesel or hybrid cars for sale. The problem in the UK currently is that there are very few charging points for electric vehicles overall. For a country hosting COP26 late this year, the roll out of EV charging has been nothing short of useless. In addition, at least 40% of the population live in terraced houses or high-rises with no chance of being able to charge a vehicle from their property.

About a month ago my 13-year old VW diesel Passat Estate – which has served me well for the past 12 years (as I bought it second hand) suddenly died on me. I live in a terraced house in a very small town in middle England and we are not allowed to have cables across the pavement (sidewalk) to charge EVs. The nearest public charging point is some 12 kilometers away. So, as I'm not going to be buying a new detached house with a driveway, I will be buying a ''new' second hand car – which will be the cleanest (lowest emission) petrol driven estate car I can – hopefully! And hopefully petrol/gas stations will be there over the coming years to allow me to fill it.

Perhaps when I do come to changing that vehicle in some years to come, the UK will by then have invested in public charging points supplying electricity from renewables. And hopefully, affordable EVs available will have improved so that they have a better range than most current EVs. I did see a press release yesterday that the Chinese electric vehicle producer BYD had started shipping Tang all-wheel-drive SUVs to Norway which have a range of over 500km from a single charge. This is exceptional in the current EV market.

Increasing pressure on the oil/hydrocarbons sector

Oil producing companies have certainly come under increasing pressure, particularly in the last couple of years to 'clean up their acts'. What does that mean? For some it probably means stop producing altogether – which of course isn't going to happen, for others it means lowering carbon emissions in all processes of producing, processing and transporting crude and oil products. It also

means the ultimate phasing out of new upstream production – and pressure is mounting for institutions to stop funding this segment.

At the end of May a court in the Netherlands ruled in a landmark case that by 2030 the oil major Shell must reduce its CO_2 emissions by 45% compared to 2019 levels. According to Friends of the Earth this is the first time a company has been legally obliged to align its policies with the Paris climate accords. The environmental group brought the case to court in 2019, along with six other bodies and over 17,000 Dutch citizens. The decision only applies in the Netherlands, although it could have wider effects elsewhere.

In response to the decision, Shell said: "Urgent action is needed on climate change which is why we have accelerated our efforts to become a net-zero emissions energy company by 2050, in step with society, with short-term targets to track our progress."

It also added: "We are investing billions of dollars in low-carbon energy, including electric vehicle charging, hydrogen, renewables and biofuels. We want to grow demand for these products and scale up our new energy businesses even more quickly. We will continue to focus on these efforts and fully expect to appeal today's disappointing court decision."

What this ruling does point to though is that people want to see oil producing companies take faster and meaningful action, rather than simply going through the motions. Some of the oil majors have done little to remove emissions from their production cycles as yet. Other producers are beginning to make changes and a few are making considerable efforts in this direction.

Commenting on these developments, Jean-Francois Lambert, founder of Lambert Commodities says: "The Shell ruling and Total changing its name into Total Energies both show that being at the helm of the largest oil companies is not an easy task. Leading these companies into the oil transition was in itself a challenge as common sense suggests that this would require several years of efforts: indeed identifying alternative sources of energy is one thing, but creating a profitable business out of them is an entirely different ball game.

"However, the meaning of 'energy transition' is not the same if you are an oil major on the one hand or a bank, an investor or society at large on the other hand. What will take many years should be done now. No more green washing or aspirational ideas. Banks will not finance companies much longer which are perceived as dinosaurs. Investors will not put their money into the 'old world' juggernauts and even more striking, young graduates will not join 'oil' majors much longer. Evolution will have to be swift or else…

"There is a major challenge when the reliance on oil is pervasive and will remain so for the next decades…. When Ben Van Beurden took the head of Shell in 2014, or Patrick Pouyanné was appointed to lead Total in 2015, they both were not expecting the current turn of events. Now their main task is not only to steer two highly successful companies, but to convince banks, investors and fresh graduates that they can successfully dismantle their traditional business model to accommodate the future, yet uncertain, requirements of tomorrow's world."

Adds Lambert: "Of course major trading houses will face the same challenge: how to make as much money trading renewables rather than oil? What does it mean for the large trading houses' business models to embrace the energy transition? Damned if they don't – banks will stop funnelling money, damned if they do – trading wind or becoming producers of renewables?"

Proactive responses from some

In August 2020, BP announced it will slash its oil and gas production and ramp up its renewable energy business over the next 10 years. By 2030, BP has said it will: produce 40% less oil and gas, generate 20 times more renewable energy, and invest 10 times more in low-carbon technology.

But real progress is also being made by smaller producers – and is being driven by certain industry leaders such as the Nordic independent oil and gas producer Lundin Energy which has been striving to reduce CO_2 emissions in its oil production. Last year, Intertek - a Total Quality Assurance provider to industries worldwide - awarded the first CarbonClear certification in 2020 to Lundin Energy for its Edvard Grieg oilfield in the Norwegian North Sea.

Then in April this year, Intertek announced the award of the first Intertek CarbonZero certification to Lundin Energy, for the verified carbon neutral sale of 600,000 barrels of Edvard Grieg oilfield production. The sale carried the Intertek CarbonZero verified mark where full details and all traceable certifications are publicly listed for investors, traders, regulators, and other stakeholders on Intertek's global sustainability directory. The Intertek CarbonZero mark is promoted as an independent and traceable carbon neutral certification programme for products and services.

Commenting on this significant development for the oil sector, Nick Walker, president and chief executive officer of Lundin Energy, said: "We were the first energy company to have one of its field's carbon emissions independently certified as low carbon, and the Intertek CarbonZero certification is the next stage on our journey to carbon neutrality from 2025 from operational emissions. By certifying the carbon neutrality of this trade, Intertek CarbonZero will enable us to reach the next stage in differentiating our leading decarbonisation strategy and building a market for low and net zero carbon produced oil and gas. We look forward to continuing our partnership with Intertek, as we drive towards all oil and gas produced by Lundin Energy being carbon neutral from 2025."

One of the benefits that Lundin has is being able to produce its product a lot cheaper than many of its competitors. That said the age of the corporate dinosaur is clearly over. Other producers and companies have to wake up to the fundamentals of responsibility for their actions and move to sustainable practices.

As Intertek has also noted: "Sustainability-conscious companies are investing in technologies, processes, and applications to drive structural and market-leading reductions in carbon emissions across their value chain. Continuing the drive towards innovative solutions allows companies to demonstrate their end-to-end commitment to carbon neutrality."

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Eat your greens: Will incentive issues stymie ESG ambitions for ECAs?

Is financing ESG-linked projects and exports going to be limited by what exporters and project financiers cannot do rather than what they can? How can (or should) incentives be improved and how can more deals that improve ESG outcomes be made bankable?

Katharine Morton (https://www.txfnews.com/Tracker/keyword/Katharine Morton)
Head of Trade, Treasury and Risk 2 June 2021

3 min (words)

Read the headlines and it's easy to think that the 'greening' of ECA finance is going gangbusters. A lot of the regulation to guide it is moving apace, major ECAs have formed E3F, an international coalition on export finance for the future to address the issues (https://www.tresor.economie.gouv.fr/Articles/2021/04/14/seven-countries-launch-international-coalition-export-finance-for-future-e3f-to-align-export-finance-with-climate-objectives). But how are exporters, banks and export credit agencies able to respond to the challenges of Environment Social and Governance (ESG) without more comprehensive reform to the OECD Consensus? Are the incentives right and will the market continue to be driven only by what it cannot do, rather than what it can, to ensure better ESG outcomes? The question is, are you dealing with risk or good intentions?

Talk to the exporters in 'green' sectors such as the battery manufacturers, there still needs to be an (urgent) mind shift in how the energy transition in particular can be financed, and a need for more flexibility by ECAs in how they price and accept risk. TXF will be discussing all this at the Export Finance World Fair (https://www.txfnews.com/Events/Event/214/TXF-Export-Finance-Virtual-World-Fair-2021) on 8-10 June [and I'm particularly looking forward to my conversations with Northvolt's CFO Alexander Hartman on this].

Gernot Bruch, head of export and project finance at Linde, observes that there is a lot of interest in green/sustainable deals on the part of potential financiers and banks, but 'virtually no' financing so far. "My perception is that in our sector this is not necessarily due to a lack of capacity, but rather to the (poor) bankability or economic viability of the deals. For example, in Central Europe, the production of green hydrogen is still three to four times more expensive than the production of grey hydrogen, but the willingness of potential customers to pay the green premium is still limited. Therefore, these deals usually only fly if they are substantially supported with public funding (allowances and grants)."

Let's start with positive steps though. On 27 May, the Loan Market Association (LMA) issued updates to its guidance on Sustainability Linked Loan Principles and on 4 May it published its Social Loan Principles, which goes some way to help financiers address some of the social and governance issues potentially in tandem with the environment and sustainability. There has not yet been much market uptake of instruments issued using the LMA's Social Loan Principles, but it is early days. The EU Taxonomy and Task Force on Climate-Related Financial Disclosures (TCFD) are also in place to help improve standardisation.

What's my motivation? The potential borrower's perspective

One (Nordic) exporter told TXF: "Essentially the ECAs have not started from the green loan angle, they have more or less started from the opposite by focusing on what they are **not** supposed to do and what they have committed not to do and it's almost as if what is left is supposed to be green."

Starting from a negative is one approach. "I think that that's a fair representation of what we have today," says one export finance head at a European bank. But is it possible for ECAs to incentivise the positive?

"As an exporter, or potential borrower, if something is supposed to be an incentive, there should be a price reduction component in it," the Nordic exporter argues. "If you take any bond or any ECA facility or any commercial debt paper that's labelled green we're talking about a maximum of five basis points up or minus five basis points if you're not able to live up to the covenants or whatever is stated in the documentation. So there's not really any financial upside of being green because there's no framework around it."

ECA hands still tied

Therein lies the rub. A lot of ECAs are unable to incentivise borrowers to any degree. In a world of targets of net zero by 2050 and climate mitigation, financing the energy transition is key. The challenge for banks is to ensure that ESG is not purely exclusive versus inclusive, and many want to help change companies' activities. Many corporates are incentivised by reputational and affirmative actions and want to show that they're pushing forward an ESG agenda too. Some corporates want to be able to show stakeholders accountability and third parties assessing their ESG. Is it enough?

The banker points out that amendments to the OECD Arrangement on renewables were "done at a time when renewables meant the odd 'windmill' or solar farm in the middle of nowhere...things have moved on." Fifteen to 20 years ago, there was some move to encourage renewables by allowing longer maturity tenors for such renewables, but the cables that connected those plants to the grid were not eligible for the same treatment. Such anomalies persist and the banker is not optimistic. "There is nothing in the Arrangement which would support the idea of moving to net zero, and even less to support social and governance elements in ESG."

Getting consensus to change the Consensus does require full consensus (natch). With the smaller groups such as E3F, statements of intent remain broad, and export finance is not the exclusive realm of OECD countries. "The alliances are a step in the right direction, but not game changers. Price and tenor are the incentives that can move markets," the banker says.

Says the head of export finance at another European bank. "There are no capacity issues for ESG deals that I am aware of. Bottlenecks maybe. I think ECAs are grappling with the issue. Some are much more advanced than others. Some benefit from the fact that most of their exporters are in green products whereas those that have an oil and gas footprint with no clear path forward find it more challenging.

If anything, everyone is trying to get credit and jump on the bandwagon to get the publicity that goes with it where they can. Until we come up with consistent and measurable criteria for the industry, it is going to be challenging."

The green grammar with no shades of green

The green 'grammar' of the EU Taxonomy (an appraisal of its impact on export finance is in this interview for TXF Members (https://ecatv.txfmedia.com/session/Play/1722) does not allow for shades of green. The binary approach does give a robust view of what is, or is not supportable in terms of sustainability. The taxonomy will particularly impact European banks (and European ECAs) who will need to comply – and that is a large percentage of the export finance market after all. Taxonomies for Asia are also in the process of being developed by the Green Finance Industry Taskforce GFIT out of Singapore (calls for contributions ended in early March).

Consistency in definition has been welcomed by many, particularly as there have been so many methodologies and definitions created in isolation. But critics argue that the EU's effort is not helpful from the perspective of needing capacity in the energy transition.

"The EU Taxonomy is a nightmare from many perspectives," warns the Nordic exporter. This, in particular, he argues is because of its treatment of the gas transition is too heavy handed, and he argues that European banks will be reluctant to finance energy transition when Europe still needs gas (although he concurs that coal and oil are 'dead for our generation').

That latter point was underlined at the end of May by a court in the Netherlands ordering Shell to cut carbon emissions at an accelerated rate. The International Energy Agency has also pushed for curbs on oil exploration projects from the end of this year. There are stark choices to be made, and as the European banker says, "some of those choices will be brutal."

Monitoring transition may be better handled when, and if, the EU's so called Brown Taxonomy emerges. While the EU still hasn't fully decided about the treatment of nuclear and gas within its green taxonomy what a brown taxonomy will look like is still unknown.

In spite the multiple guidance now in the market, the exporter argues there remains a wooliness and lack of definition. "There are instruments and there are these principles that the commercial banks have signed up to. But I think they're very flexible in a way that they interpret them and that's why you see a lot of things that have been done and they say that it's been green, it's only the marketing that has been green."

Green bonds evolution – can they help?

To rewind, there have typically been two types of incentive structures used in the capital markets in what's been governing bank origination of ESG products. First has been the 'green' use of proceeds facilities – based on where the proceeds are going to be applied (renewables, manufacturing, etc) and the criteria gives it a 'green' badge.

Second has been sustainability-linked facilities. These are not restricted by use of proceeds and, can be for general corporate purposes – driving sustainable behaviours, aligned to corporates' own goals and ambitions on their ESG trends – and in this, there may be a pricing benefit for corporate borrowers. To ensure accountability and transparency, these behaviours should be independently monitored to adhere to best practice.

Most ESG products started in capital markets, and green bonds have been around for a while but in the past 18 months have accelerated, as have sustainability-linked structures – in both term lending and revolving credit facilities (RCFs) – which are also moving into trade finance areas.

The market is moving from purely environmental and green type targets, to a broader ESG mix (although it remains early days for the social and governance elements). When looking at green use of proceeds facilities, these can also have a social or governance element added to it. This is what the new LMA guidance is trying to address too.

But what about the ECAs – green guarantees?

Swedish ECA EKN is at the vanguard of what ECAs are doing in terms of sustainability and its fossil-free ambitions are widely reported. It plans to be reporting under TCFD, starting with a preliminary project later this year. It has developed the first green (working capital/investment) guarantee for climate-friendly domestic projects in Sweden which will be launched imminently, says Victor Carstenius, analyst at EKN. Nonetheless, this remains domestic, and will cover up to 80% of bank risk. "The next step will be export credits, using the domestic green guarantee project as a template to have more favourable conditions for exporters."

Carstenius agrees that up to now, ECAs have largely been focused on the negative – what they will no longer do (in terms of stopping financing fossil fuels, etc), but now he hopes that more incentives to promote green outcomes can come into play.

In terms of premiums or pricing incentives, there is less wriggle room. "It's difficult to get past the OECD Arrangement and domestic Swedish laws which ensure the agency's premium is in accordance with the credit risk taken, and legally cannot subsidise transactions for other reasons," Carstenius points out. "We could look at cover ratios and national content requirements – and allow, for instance, higher foreign content for green transactions or higher cover ratios for them, but we haven't decided on those yet."

Many ECAs do want to more. And the banker says that, within the constraints of the Consensus, ECAs have been developing common lending points whereby they have become more lenient in terms of eligibility criteria for ESG. "The expectation from the banking industry is to see some kind of tangible preferential treatment in terms of price and tenor with projects with the right features." The challenge in using green loans with a sustainability-linked label is, according to the banker, "it's a learning curve that we're all in the middle of, and some things that have been given a green label that is, at best, a bit of a stretch."

Are other incentives possible to change beyond the confines of the total reform of the Consensus? Tools like CIRR are regulated by the Arrangement and in countries where it is deployed, it could in theory be tweaked. Pricing is more complicated and would require consensus. The banker points to technical reform to sector understandings on renewables and tenors. "They could look to expand on the renewables Sector Understanding to update it to today's challenges not the 2-3% of the grid which was the case when the current Sector Understanding was rolled out all those years ago. A technical change to an annex is easier than wholesale reform."

Rewiring for green loans?

And in terms of ECAs supporting ESG-tied loans under, say, the new LMA guidance? "I'm keen to be promoting sustainable KPI features integrated into export credit facilities, but it's not been done yet," says the banker. The difficulty, he points out is that sustainability-linked facilities tend to be for general corporate purposes, while export finance by definition is mostly project related or tied export credits. "Nevertheless, it should be feasible to get export finance with sustainability-linked KPIs, and that is the sort of exercise we are trying to develop."

The complication is that once bankers and corporate borrowers have agreed, the ECAs also need to be on board with the rationales and incentives, and that, the banker says, can be a challenge. "I can see them being onboard with the idea, but if the consequences of achieving the sustainability KPI is getting a rebate of a premium, or reducing the premium if not achieved, that is not easy. We will be having conversations with the ECAs, but I'm not wholly optimistic."

Still all about the fundamentals

The Nordic exporter asked a direct hypothetical question about maritime financing to a banker. "Right now would you prefer to do Maersk or a Hapag-Lloyd commensurable financing for a vessel being run on LNG or oil? Or would you want to fund a ship owner who is basically bankrupt but has a very green idea and green finance attached?" He agrees that it's a daft question and answer, but it shows that no matter how green you go, you won't change the fundamentals, that the credit risk needs to be acceptable. "Credit risk is credit risk. And as a bank, you need to make a profit and you need to be sure and know what you're doing. Just because something is labelled green doesn't mean you can act in a daft way. The best way to approach this," the Nordic exporter says is: "Find a good project, make sure it's creditworthy, make sure it's bankable, and then add in ESG elements."

Certainly accelerating the energy transition will demand more capital – in the battery industry alone, an estimated $40 billion in capital is needed, which will need to be supported by ECAs – and taking on more risk (and pricing and allocating it properly) will be key. It may well be a culture shock.

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Sucafina: The digital borrowing base benchmark (https://www.txfnews.com//News/Article/7186/Sucafina-The-digital-borrowing-base-benchmark?utm_source=newsletter&utm_medium=email&utm_campaign=txf/subscriptions_weekly)
Sucafina has returned to the debt market for an ESG-tied borrowing base - sporting a debut digital tool courtesy of Komgo – as well as an upsized deal volume and extended KPIs. The deal has also provided a seedbed for future digital borrowing base transactions, and other types of structured commodity trade financings...Read on here (https://www.txfnews.com//News/Article/7186/Sucafina-The-digital-borrowing-base-benchmark?utm_source=newsletter&utm_medium=email&utm_campaign=txf/subscriptions_weekly)

ECA direct lending: Why is it so appealing? (https://www.txfnews.com//News/Article/7188/ECA-direct-lending-Why-is-it-so-appealing?utm_source=Pardot&utm_medium=Email&utm_campaign=txf/subscriptions_news_tracker)
With bank liquidity increasingly allocated to fewer but larger big-ticket deals, impending regulation and a record low commercial interest reference rate (CIRR) on offer, many buyers are looking to ECA direct lending to tap cheap debt. But what makes direct lending so attractive, and how prevalent is it?...Read on here (https://www.txfnews.com//News/Article/7188/ECA-direct-lending-Why-is-it-so-appealing?utm_source=Pardot&utm_medium=Email&utm_campaign=txf/subscriptions_news_tracker)

Zijin Mining out to new lenders in $500m deal (https://www.txfnews.com/Tracker/GetExternalPost/39268?utm_source=newsletter&utm_medium=email&utm_campaign=txf/subscriptions_weekly)
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Asian Infrastructure Investment Bank (AIIB) has proposed to up its funding from...Read on here (www.txfnews.com/Tracker/GetExternalPost/39232?utm_source=newsletter&utm_medium=email&utm_campaign=txf/subscriptions_weekly?utm_source=newsletter&utm_medium=email&utm_campaign=txf/subscriptions_weekly)

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