Online learning series: Green bonds – an innovative and efficient way of financing green investments

Module II: Setting up a green bond framework

GIZ & SEB Strategic Alliance on Green Bond Market Development
# Webinar II: Setting up a green bond framework

## Content & learning objectives

<table>
<thead>
<tr>
<th>The Green Bond Principles</th>
<th>The steps of a green structuring process</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The five pillars of a green bond framework</strong></td>
<td><strong>Market aspects &amp; transaction considerations</strong></td>
</tr>
<tr>
<td>• Use of proceeds</td>
<td>• Market access</td>
</tr>
<tr>
<td>• Process for project evaluation and selection</td>
<td>• Liquidity</td>
</tr>
<tr>
<td>• Management of proceeds</td>
<td>• Pricing</td>
</tr>
<tr>
<td>• Reporting</td>
<td>• Allocation</td>
</tr>
<tr>
<td>• External review</td>
<td>• Marketing</td>
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</tbody>
</table>
Part 1:
The five pillars of a green bond framework
Recap: What is a green bond?

Green Bond Definition

Green bonds are any type of **bond instrument** where the **proceeds** will be **exclusively** applied to finance or re-finance, in part or in full, new and/or existing **eligible Green Projects** and which are aligned with the **four core components** of the **Green Bond Principles**.

- **Same underlying mechanisms as regular bonds**
- **Main difference** is that only pre-defined projects can be financed
- **Green Bond Frameworks** ensure that green projects are defined and that the issuers deliver on their promise.
The Green Bond Principles

<table>
<thead>
<tr>
<th>Use of proceeds</th>
<th>Process for project evaluation and selection</th>
<th>Management of proceeds</th>
<th>Reporting</th>
<th>External review</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Definitions of eligible projects</td>
<td>• Key to obtain sufficient knowledge</td>
<td>• Traceability and monitoring</td>
<td>• Transparency • Impact reporting • At least annually</td>
<td>• Evaluation through an independent external assessment</td>
</tr>
<tr>
<td>• Mitigation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Adaption</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Environmental</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Green Bond Framework – Definitions and procedures
Example of a green bond - Volvofinans Bank

**TRANSPARENCY**

To enable investors to follow the development and provide insight to prioritised areas, Volvofinans Bank will provide an annual Green Bonds investor letter which will include the following items:

1. A description of the Green Loan Portfolio including:
   (a) impact reporting at portfolio level;
   (b) information about the maturity profile of the Green Loan Portfolio;
   (c) information about the average share of the total value of the vehicles in the Green Loan Portfolio that has been financed by Volvofinans Bank; and
   (d) information about the share of Green Bond financing of the Green Loan Portfolio.


Volvofinans Bank recognises the importance of impact reporting. Volvofinans Bank undertakes to include information in the Green Bonds investor letter about the reduced carbon footprint of the funded Eligible Projects at portfolio level in relation to relevant reference values.

**SELECTION OF ELIGIBLE PROJECTS**

Projects selected in consensus by the Head of Treasury and the Head of Projects (i.e., both departments have a veto). Approved loans and leases will be included in Bank’s green loan portfolio ("Green Loan Portfolio"). The ambition portfolio at all times will be larger than the amount of outstanding Green Loans. The share of Green Bond financing of the Green Loan Portfolio will be made publically available on Volvofinans Bank’s web page, www.volvofinans.se.

In order to be eligible, the projects should be entirely or partially by non-fossil fuels, i.e.:

- electric vehicles
- biogas/natural gas vehicles
- hybrid vehicles
- biogas/natural gas/petrol vehicles
- diesel hybrid vehicles
- biofuel vehicles
- biogas/natural gas/petrol vehicles

Eligible Projects must meet the criteria which are valid at the time of approval of the loan or lease for inclusion in the Green Loan Portfolio. Details of the compliance function will be made publically available on Volvofinans Bank’s web page, www.volvofinans.se.
The five pillars of a green bond: Definition

<table>
<thead>
<tr>
<th>Definition</th>
<th>Use of Proceeds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-defined</td>
<td>Pre-defined</td>
</tr>
<tr>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>• Good flexibility</td>
<td>• Large range of definitions</td>
</tr>
<tr>
<td>• Encourages communication</td>
<td>• May require in-depth knowledge</td>
</tr>
</tbody>
</table>

Certificates
PEFC/ FSC
BREEAM/LEED
1. Definition: Case study - Kommuninvest

- **Production and distribution of renewable energy** – such as wind, wave, solar, hydro, geothermal, bioenergy, biogas and excess heat – or conversion from fossil to renewable energy.
The five pillars of a green bond: Selection

A concept of simplicity built on five pillars

Committee w/ veto right
Limited mandate
Training certificate

Definition
Use of Proceeds

Selection
Process for project evaluation
2. Selection: Case study - Kommuninvest

3. SELECTION OF ELIGIBLE LOANS

Eligible Projects will, on an ongoing basis, be:

1. identified and verified by the environmental functions in Kommuninvest’s member municipalities/county councils;

2. selected by the Treasury Departments in Kommuninvest’s member municipalities/county councils, and submitted to Kommuninvest for approval as a Green Loan together with appropriate documentation according to Kommuninvest’s instructions.

Eligible Projects will, on an ongoing basis, be:

3. pre-approved by Kommuninvest’s Lending department

and, on a quarterly basis, be:

4. reviewed and finally approved by consensus vote in the Green Bonds Environmental Committee in terms of coherence with the criteria for Eligible Loans as defined in section 2 above. The Green Bonds Environmental Committee consists of representatives from the environmental function of two or more member municipalities/county councils, environmental experts from other relevant public sector organisations/academia/NGOs, as well as Kommuninvest’s Management.
The five pillars of a green bond: Monitoring

A concept of simplicity built on five pillars

- **Definition**: Use of Proceeds
- **Selection**: Process for project evaluation
- **Monitoring**: Management of proceeds
  - Earmarked account
  - Balanced earmarked account
  - Virtual green balance sheet
3. Monitoring: Case study - Kommuninvest

The proceeds from Green Bonds issuance will be tracked by Kommuninvest in accordance with its internal instructions, and will be verified by an external audit firm.

For conservative purposes, and in accordance with Kommuninvest internal instructions, Kommuninvest will manage proceeds with an ambition for aggregate Green Bond Proceeds not to exceed total disbursements to Eligible Loans. Any excess amounts will be held in cash, Green Bonds, municipality and/or government risk with a minimum, average credit rating of A by Standard & Poor’s or corresponding credit rating by another rating agency approved by Kommuninvest. If a financed Eligible Project no longer meets the eligibility criteria upon approval, Kommuninvest will remove it from the pool of Eligible Loans.

Kommuninvest will communicate on the nature of allocations to Eligible Projects in its Green Bonds Impact Report, see section 4 below. The allocations will be verified by an external audit firm.
The five pillars of a green bond: Reporting

<table>
<thead>
<tr>
<th>Definition</th>
<th>Selection</th>
<th>Monitoring</th>
<th>Reporting</th>
<th>External review</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of Proceeds</td>
<td>Process for project evaluation</td>
<td>Management of proceeds</td>
<td>Transparency</td>
<td>Assesment through external evaluation</td>
</tr>
</tbody>
</table>

A concept of simplicity built on five pillars
4. Reporting: Case study - Kommuninvest

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Comparison figures relate to the preceding year (1 January - 31 December 2016) unless otherwise stated.
The five pillars of a green bond: External review

A concept of simplicity built on five pillars

- Assessment of sustainability aspects
- Verification of procedures
- Certification
- Second opinion
- Audits
- Ratings

Assessment through external evaluation of sustainability aspects and verification of procedures.
4. External review: Case study - Kommuninvest

‘Second Opinion’ on Kommuninvest’s Green Bond Framework

27th March 2018
Part 2: The steps of a green structuring process
# The steps of a green structuring process

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kick-off meeting with relevant representatives from finance, environment/sustainability, legal and communications departments</td>
<td>Issuer &amp; structural advisor</td>
</tr>
<tr>
<td>2</td>
<td>First draft green bond framework for the issuer</td>
<td>Structural advisor</td>
</tr>
<tr>
<td>3</td>
<td>Tailor the framework to match the ambitions and preferences of the issuer</td>
<td>Issuer &amp; structural advisor</td>
</tr>
<tr>
<td>4</td>
<td>Prepare information package to the independent external reviewer, potentially including:</td>
<td>Issuer (with guidance from the structural advisor)</td>
</tr>
<tr>
<td></td>
<td>• Environmental vision, goals, strategies and policies (external and internal)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Internal working guidelines</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Information on technologies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Routines for impact measurements</td>
<td></td>
</tr>
</tbody>
</table>
The steps of a green structuring process cont.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>The framework and information package are sent to the independent external reviewer</td>
<td>Structural advisor</td>
</tr>
<tr>
<td>6</td>
<td>A draft external review and a set of questions is delivered by the external reviewer</td>
<td>Independent external reviewer</td>
</tr>
</tbody>
</table>
| 7    | Response to the independent external reviewer  
   - Answers to the questions (+extra material and/clarifications if needed)  
   - Adjustments to framework (if desired)                                                                                                     | Issuer (with guidance from the structural advisor)                              |
| 8    | A call is arranged with the independent external reviewer and the issuer                                                                                                                               | Structural advisor                                                            |
| 9    | Final external review is delivered                                                                                                                                                                         | Independent external reviewer                                                  |
| 10   | Prepare communication strategy, investor presentation, transaction strategy and open a separate account                                                                                                  | Issuer (with guidance from the structural advisor)                              |
| 11   | Investor road show followed by the inaugural green bond transaction                                                                                                                                   | Issuer (with guidance from the structural advisor / underwriter)               |
Part 3: Market aspects and transaction considerations
Market aspects and transaction considerations

Five market aspects to consider:

• Market access
• Liquidity
• Pricing
• Allocation
• Marketing
Market access

Investor diversification

- Number of investors
- Geographical reach

Issuance flexibility

- Maturity
- Currency
- Volume
- Format

Source: Green bond pricing in the primary market: October - December 2017 Prepared jointly by the Climate Bonds Initiative and the International Finance Corporation.
Liquidity

• Poor

• Asymmetric

• Frustration and loyalty
Pricing

Primary market

New issue premiums for green bonds in our sample, 2016 & 2017


Secondary market

Percentage of bonds tightening by a greater percentage than their corresponding index after 7 and 28 days

EUR Green bonds - Spread changes compared with baskets of vanilla bonds

<table>
<thead>
<tr>
<th>Bond</th>
<th>Spread change 7 days</th>
<th>Spread change 28 days</th>
<th>Spread change 28 days, basket</th>
</tr>
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<tbody>
<tr>
<td>Citigroup (Hedged)</td>
<td>-0.58</td>
<td>-0.36</td>
<td>-0.04</td>
</tr>
<tr>
<td>Bank of America</td>
<td>-0.60</td>
<td>-0.44</td>
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USD Green bonds - Spread changes compared with baskets of vanilla bonds

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Webinar II: Setting up a green bond framework

Source: Green bond pricing in the primary market: October - December 2017 Prepared jointly by the Climate Bonds Initiative and the International Finance Corporation
Marketing

Investors want to be seen in public advertisements

Press releases
Part 4: Wrap-up
Module II: Setting up a green bond framework

**Learnings**

- The Green Bond Principles
- The five pillars of a green bond framework
- The steps of a green structuring process
- Market aspects & transaction considerations

**What’s next**

- Webinar 3: Safeguarding: Definitions, impact reporting & external review
Module 2: Setting up a green bond framework

More information

- ICMA: The Green Bond Principles 2018
- Impact Reporting:
  - Case study: Kommuninvest
    - Green bond framework
    - Second opinion
    - Impact report
- Climate Bonds Initiative: Green Bond Pricing in the Primary Market (Q4 2017)
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