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Green Finance from a Bank Management Perspective: Refinancing Options, Reporting Obligations, Green Bond Standard

7. Oktober 2021

Agenda

Green Refinancing Options

The intended benefit of green bonds

Through various bond designs, green bonds create targeted capital for projects with specific environmental benefits

Use of Proceeds Bond

- Proceeds from sale of bond allocated to green projects
- A conventional bond with full right of recourse against the issuer, given same credit rating as other bonds of the issuer

Securitized Bond

e.g. covered Bonds, ABS, ….

- Secured through green projects
- Primary source of repayment is the cash flow from the underlying
- <u>examples:</u>
- **“Green Storm 2016”** (Originator Obvion)
    - Securitization of Dutch residential mortgages, energy efficient acc. to GBP
    - Greenest 15% of Dutch residential real estate
    - Almost no pricing differences between "green" and "regular" transactions
- **“Green Auto-ABS”**
    - Securitization of loans/lease receivables for electric/hybrid vehicles.
    - Toyota Finance (2014-16)

Use of Proceeds Revenue Bond

- There is no right of regress against the issuer
- Proceeds are directed to green projects
- Repayment of the bond is made from revenues of the issuer

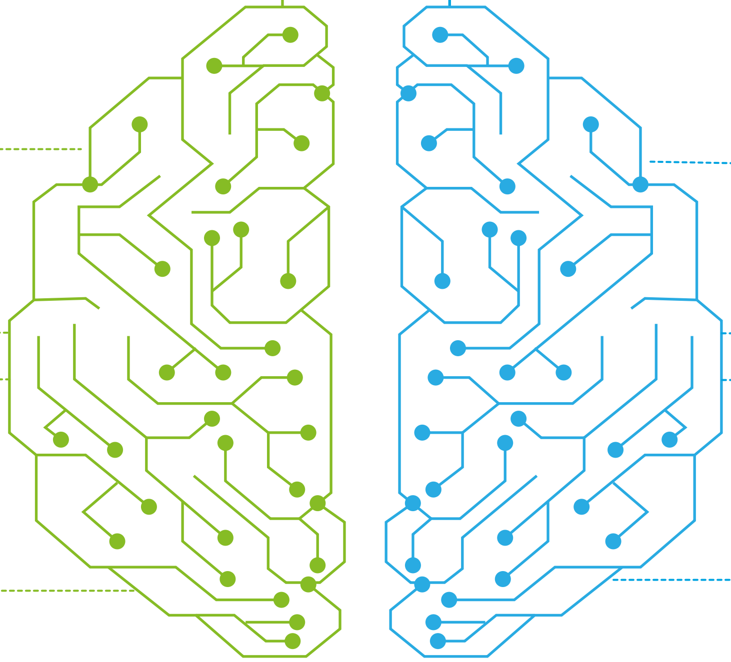
Project Bond

- Dedicated to specific underlying green project
- Right of regress is limited to assets and balance sheet of the project
- The investor is directly exposed to the project risks

Sustainability Linked Bonds

The difference to Sustainable Bonds is that while with a Green Bond the proceeds can only be used for sustainable projects, with Sustainability Linked Bonds the purpose of use is free.

Green, Social & Sustainable Bonds	Sustainability Linked Bonds (SLB) or KPI Linked Bonds
Fully or partially financing or refinancing of new and/or existing "green" projects.	Do not serve to (re)finance a "green" project
Established criteria for climate mitigation	KPIs and trigger points individually determined by issuer
Fixed cash flow structure	Cash flow changes depending on KPI target achievement
Established Green Bond Standards	Established but still to be individually agreed ICMA Sustainability Bond Standards, Letter of Intent EU Standard



→ Use of proceeds **only finances the status quo** and only focuses on a **limited section of the overall portfolio**

→ SLBs make a company's intention to achieve certain sustainability goals apparent by **linking financing to sustainability**

Green refinancing options of mortgage banks

Mortgage banks can offer their green refinancing through three different bonds

Covered bonds are used to refinance loans secured by e.g. real estate mortgages. The cover pool of the covered bond must be congruent with the issued covered bonds.

For green covered bonds, the mortgages taken as cover must meet special requirements in order to be classified as green. The criteria for this can be defined in a framework. For this purpose, the vdp has formulated a minimum standard in accordance with the ICMA-GBP.

In accordance with the framework, the issue proceeds are usually dedicated to further green financing.

Green covered bond

Green refinancing

Green bond

Unlike covered bonds, the bank's balance sheet assets serve as collateral. For a green bond, there must be sufficient green loans on the balance sheet.

Sustainability-linked Bond

The structure of the bond is based on the achievement of an ESG target within a certain time frame. The bond thus serves to improve, make transparent and make measurable the sustainability performance of a company.

Green Covered Bond | Market overview of green covered bonds in Europe

Green covered bonds have been issued by various issuers in Europe; German, Danish, Norwegian and French providers in particular are very active in this market

Country	Institution	Product offerings

Germany	Berlin Hyp, KFW, DEUTSCHE HYPO, DZ HYP, MünchenerHyp, LBBW	• Germany has the largest number of issuers and German banks have the second highest volume in this market
		• Traditional offering:
		  • Green „Pfandbriefe“ (covered bonds), green building credits
		  • Transformation credit for the financing of energetic renovations is elaborated

France	BPCE SFH, SOCIETE GENERALE	• French banks have the highest volume (EUR) in this area on the market and the third largest number of issuers • Sustainable development bond programs • Renewable energy, green buildings • Also: positive impact covered bonds
Denmark	Nykredit, Realkredit Danmark, Nordea	• Nykredit is the world's largest issuer of covered bonds backed by mortgages on real estate • Realkredit Danmark A/S (RD) is the second largest mortgage bank in Denmark with a market share of 26.2% • Nordea Kredit is a Danish subsidiary of the Nordea group,granting mortgage loans to Nordea's customers in Denmark
Norway	DNB, SparebankenVest, eika. Boligkreditt	• Norwegian banks have the third highest volume in this market and the second largest number of issuers • Energy-efficient residential buildings
Further European countries	NORD/LB, SCBC	• Further active countries: Luxembourg, Sweden, Netherlands, Spain • Nord LB Luxembourg offers renewable energy covered bonds • Swedish Covered Bond Corporation issues a covered bond backet by energy-efficient mortgages – first in Sweden – in 2019

The European green covered bonds market is dominated by institutions from France, Norway and Germany and the market is still growing

Reporting Obligations – Artikel 8 Taxonomy

Taxonomy Article 8 - Overview

Article 8 of the Taxonomy Regulation requires that companies covered by the NFRD (In future: CSRD) must provide information on the share of their sustainable economic activities

The CSRD extends the scope of the affected companies

Non-financial undertakings (NFRD)

Companies that are covered by Non Financial Reporting Directive (NFRD) must report the taxonomy-compliant share of

- Turnover
- Capex
- Opex

Companies must report Taxonomy eligibility from January 2022 for FY 2021 for the environmental objectives (1) Climate change mitigation and (2) Climate change adaptation. From January 2023 for 2022, the disclosure obligation for taxonomy alignment will apply – but only for env. objectives 1 and 2. The disclosure requirements for environmental objectives 3-6 begin twelve months after publication of the final criteria.

Financial undertakings (NFRD)

These KPIs are for **banks, insurance companies and asset managers** not very meaningful; no equivalent indicators for financial service providers are specified within the Taxonomy. The EU Commission has asked the European Supervisory Authorities (ESAs) to propose alternative indicators.
On 1 March 2021, the European Supervisory Authorities (ESMA, EBA and EIOPA) published their proposals. These have been incorporated into the proposal for the delegated act.

Europäische Kommission

The delegated act on article 8 of the Taxonomy Regulation

The delegated act complements the disclosure requirements laid down in Article 8 of the Taxonomy Regulation. In particular, the content, methodology and presentation of information from both financial and non-financial companies is further specified. The standards introduced are intended to increase transparency in the market and prevent greenwashing by informing investors about the environmental performance of companies.

Delegated Act regarding Article 8 Taxonomy

KPI for credit institutions: Green Asset Ratio

Green Asset Ratio (GAR)

- **Basis indicator:** Share of financial assets in total covered assets relating to taxonomy-aligned economic activities.
- Credit institutions should disclose aggregate GARs for total balance sheet eligible assets, as well as the breakdown by environmental objective and by type of customer. **The definition of the KPIs builds on the following components:**
  - **Numerator**: loans and receivables/debt securities and bonds/shareholdings and equity positions/guarantees assumed that finance taxonomy-aligned economic activities
  - **Denominator:** Total amounts of the above items (taking into account the scope of eligible assets defined in the recommendation).

$$\text{GAR} = \frac{\text{Proportion of taxonomy-aligned economic activitites}}{\text{Total amounts of the positions}}$$

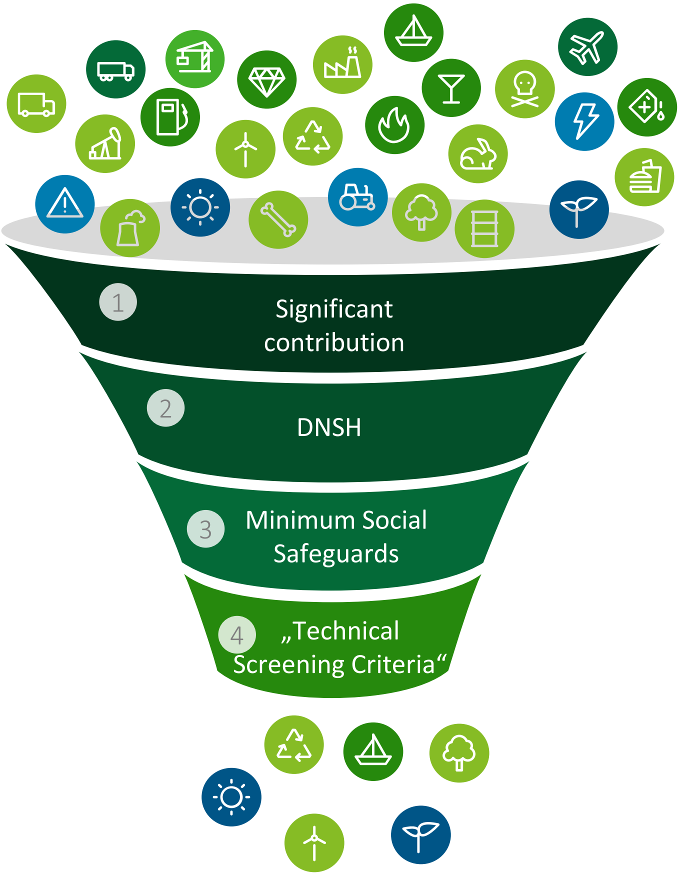
- In addition to the GAR, institutions must disclose the percentage of their total assets covered by the GAR (taxonomy alignment is possible)

The GAR shows the taxonomy-aligned proportions of the credit institution's assets.

EU Taxonomy

The taxonomy is composed of four main conditions

The taxonomy is at the heart of the EU Action Plan. It sets the definition for environmentally sustainable activities and investments. These must meet all of the following four conditions:



1 Substantial contribution to at least one of the environmental objectives:

1. **Climate change mitigation**
2. **Climate change adaption**
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems

1 & 2: Criteria defined

4 & 6: Criteria proposal from PSF

\+

2 Do No Significant Harm (DNSH) to any of the other five objectives

\+

3 Minimum safeguards (for Human Rights and employees)

\+

4 Fulfil the technical screening criteria

Overview of relevant environmental targets for real estate

Technical screening criteria for real estate have only been defined for environmental goals 1 and 2. For the goals 4 and 6, initial proposals have been made

1	Climate change mitigation	**Objectives 1-2:** First Delegated Act was published & formally adopted on June 4, 2021.
2	Climate change adaptation	
3	The sustainable use and protection of water and marine resources	**Objective 3:** So far no relevance for real estate
4	The transition to a circular economy	**Objective 4:** First proposal was published in August 2021
5	Pollution prevention and control	**Objective 5:** So far no relevance for real estate
6	The protection and restoration of biodiversity and ecosystems	**Objective 6:** First proposal was published in August 2021

Comparison of activities

While for environmental goals 1 and 2 the activities are equally applicable, for environmental goals 4 and 6 there are differently relevant activities

Environmental objectives	Activities within these environmental goals				
1 Climate change mitigation 2 Climate change adaptation	Activity 7. 1 Construction of new buildings	Activity 7.2 Renovation of existing buildings	Activity 7.7 Acquisition and ownership of buildings	Activities 7.3 – 7.6 Individual measures	Del. act Annex I Del. act Annex I
4 The transition to a circular economy	Activity 5.1 Construction and major renovations for the transition to a circular economy			Activity 5.4 Demolition or wrecking of buildings and other structures	Platform on Sustainable Finance PART B
6 The protection and restoration of biodiversity and ecosystems	Activity 5.2 Construction and major renovations for protection and restoration of biodiversity and ecosystems		Activity 5.3 Acquisition & ownership of buildings		

EU Green Bond Standard

The Development of the European Green Bond Market

Based on the Paris Climate Agreement, various regulations have been adopted that make it easier for investors to implement a sustainable finance strategy

2007 2009 2014 2015 2018 2019 2020 2021

July 2007:
EIB issues world's first Green Bond

December 2009:
The Climate Bonds Initiative is founded

Q1 2014:
Introduction to the Green Bond Principles

December 2015: Paris Climate Agreement

March 2018: Action Plan for sustainable finance

December 2018:
EU Clean Energy Package*

June 2019:
TEG expert group publishes suggestions for an EU Green Bond Standard

December 2019:
European Green Deal

January 2020:
Publication European Green Deal Investment Plan

June 2020:
Adaption of EU Taxonomy Regulation

July 2021:
Draft EU Green Bond Standard

July 2021:
New EU strategie for sustainable finance

July 2021:
„Fit for 55": Achieving the EU's 2030 climate target on the path to climate neutrality**.

*2030 EU targets: reduce greenhouse gas emissions by at least 40% compared to 1990 levels, increase the share of renewable energies to at least 32% and optimise the EU's energy efficiency by at least 32.5%.

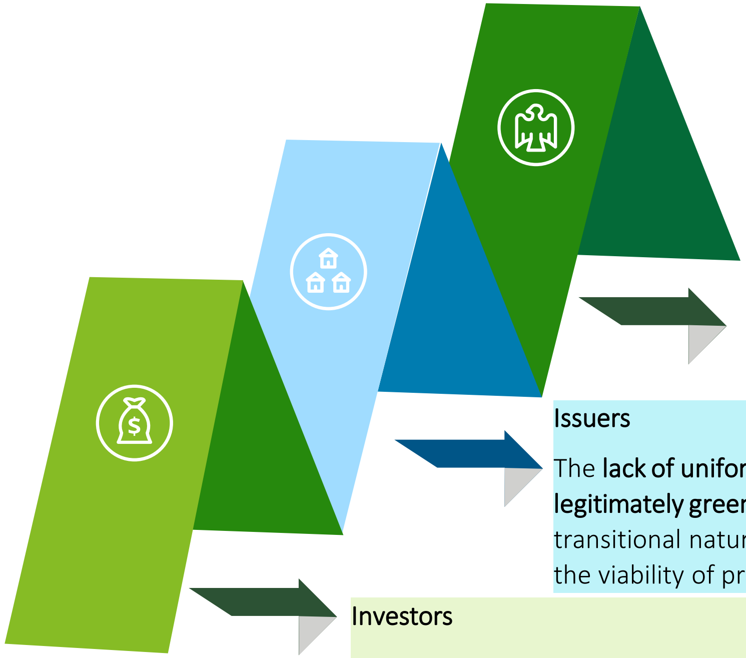
** New EU 2030 targets: Reduce greenhouse gas emissions to at least 55% below 1990 levels by 2030.

market-driven developments

politically and regulatory driven developments

Motivations for the EU Green Bond Standard

The EU GBS will set a "gold standard" for how companies and public authorities can use green bonds to raise funds on the capital markets to finance ambitious investments while meeting strict sustainability requirements and protecting investors from greenwashing



Legislation

The EU Green Deal has made it clear that significant investments are needed in all sectors of the economy **to finance the transition to a climate-neutral economy and to achieve the Union's environmental sustainability objectives.** A substantial part of these financial flows will have to come from **the private sector**.

Despite strong market growth, green bond issuance represents only a fraction of total bond issuance (about 4% in 2020). Further growth of the high quality green bond market **provides a source of significant green investment,** helping to close the EU Green Deal investment gap.

Issuers

The **lack of uniform definitions** for environmentally sustainable economic activities creates **uncertainty** about which economic activities can be considered **legitimately green**. Under such conditions, issuers may be exposed to **reputational risks** from potential accusations of **greenwashing**, especially in areas of transitional nature. Furthermore, the fragmentation of practices in the area of **external review** may create additional costs for them. These barriers can affect the viability of projects with significant climate and environmental impacts.

Investors

Due to the widespread use of market-specific green bond frameworks, and despite the fact that some of these frameworks are widely accepted as standard, it can be **costly** and difficult for investors to determine the **positive environmental impact of bond-based investments** and to **compare different green bonds** in the market.

Goals of the EU Green Bond Standards

The EU GBS aims to remove barriers to issuing and investing in green bonds by setting a standard for high-quality green bonds

1

Trust

The standard aims to improve the ability of investors to recognise and trust high-quality green bonds...

2

Clarity

...facilitate the issuance of these high quality green bonds by clarifying the definitions of green economic activities and reducing potential reputational risks for issuers in transition sectors, and...

3

Integrity

...standardise the practice of external audit and improve confidence in external auditors by introducing a voluntary registration and oversight regime.

Contents of the Regulation

The Regulation establishes uniform requirements for bond issuers wishing to use the designation "European Green Bond" or "EuGB" for their environmentally sustainable bonds and creates a registration system and oversight framework for external auditors of EuGBs

The proposed framework contains four main requirements:

1. The funds raised by the bond should be used entirely for projects that are **in alignment with the EU taxonomy**
2. The use of bond proceeds must be fully transparent through **detailed reporting requirements**
3. All EU green bonds must be **audited by an external auditor** to ensure that the rules of the regulation are complied with and that the projects financed are in line with the taxonomy. For government issuers, a special, limited flexibility is provided here
4. **External auditors** providing services to EU green bond issuers must be **registered** with and supervised by the European Securities and Markets Authority. This will ensure the quality and reliability of their services and audits to protect investors and ensure market integrity. For government issuers, a special, limited flexibility is provided here

Central content

Conditions for the use of the designation "European Green Bond" or "EuGB	Regulations for external auditors for European Green Bonds	Supervision by competent authorities and ESMA
Bond-related requirements	Conditions for taking up the activity as external auditor for European Green Bonds	Competent authorities
Transparency and external review requirements	Organisational requirements, processes and governance documents	ESMA
	Tests before and after the emission	

Conditions for the use of the designation "European Green Bond" or "EuGB

The designation "European Green Bond" or "EuGB" may only be used for bonds that meet precisely defined requirements until their maturity date

„European Green Bond“

For EuGB purposes, the Commission proposes that the Taxonomy Regulation and its delegated acts should define what is considered "green".

Use of proceeds - taxonomy conformity

Revenues must be directed exclusively to economic activities that meet the requirements of the taxonomy or that will meet the requirements of the taxonomy within a specified period of time (<5 or 10 years) pursuant to a taxonomy adjustment plan.

European Green-Bond-factsheet and pre-emission review

Prior to issuing an EuGB, issuers must complete the European Green Bond Factsheet set out in Annex I and ensure that the completed European Green Bond Factsheet has been reviewed by an external reviewer with a positive opinion prior to issuance.

Allocation reports & post-issuance review of allocation reports.

Each year and until the proceeds of the relevant EGB have been fully allocated, issuers must prepare a report on the allocation of proceeds using the template set out in Annex II. Issuers must obtain a review of the allocation report by an external reviewer after the full allocation of the EuGB proceeds.

Report on the impacts of EuGB

EuGB issuers must prepare an impact report on the environmental effects of the use of bond proceeds using the template set forth in Annex III after the proceeds of such bonds have been fully allocated and at least once during the life of the bond.

Outlook for Green Bond Certification

The EU Green Bond Standard does not replace other existing labels, but will become more relevant in the future. Further sustainable bond labels are to be expected from the EU.

EU Green Bond Standard

- Firstly, the market does not believe that the EU GBS presented could render the market initiatives obsolete. It is a purely European standard, which is based on the European taxonomy, which to date has no international binding force.
- Another limitation is the criteria of the taxonomy. Some companies have few economic activities that could be taxonomy-aligned at all. Thus, there are not enough investment objects that are eligible. Conversely, this means that these companies are currently more likely to rely on current market initiatives.
- Nevertheless, it is expected that the envisaged EU-GBS will take on a benchmark function in the European Green Bond market and will also serve as a basis for further international frameworks.

New EU Sustainable Finance Strategy

- In its new Sustainable Finance Strategy, the Commission has expressed its intention to expand sustainable finance standards and labels that support sustainability transition financing and incremental transition efforts. The Commission will work on additional bond labels such as transition or sustainability-linked bonds by 2022.

The final assessment of the benefits of using the various frameworks can, for both issuers and investors, only be made on an individual basis, applying the principle of proportionality of the objective and the investment objects.

Your Deloitte Contact

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