External Review & reporting for Sustainable Bonds
15 May 2024
Bhutan
External Review
Issuers seek external reviews for the same reasons more traditional external assurance is sought. For example, to demonstrate:

- Adherence to certain principles and/or standards such as ICMA’s Green Bond Principles
- “Am I following market practices?”
- The environmental and/or social integrity of the financial product
- “Are the activities I am financing green/social/sustainable?”
- Adequacy of internal controls and procedures
- “Are my processes aligned with market practices?”
- Adequacy of Key Performance Indicators (KPIs) chosen
- “Are my reporting indicators descriptive of actual environmental/social performance”?
- Improve overall credibility
EXTERNAL REVIEW

External review providers
Statistics on external review

There are a variety of ways for issuers to obtain an external review on the environmental and/or social credentials of their bond, or bond framework:

Source: LGX DataHub, a universe of 7000+ sustainable debt instrument as per 01/09/2022
Types of External Review
There are a variety of “products” external reviewers can provide to issuers on the environmental and/or social credentials of their bond, or bond framework:

- Second Party Opinion (SPO)
- Certification
- External verification (Assurance)
- Rating
Second Party Opinion (SPO)

- Most widely used form of external review provided by independent organisations
- Usually issued based on a bond framework (validity: n-years)
- It evaluates the bond framework against a specific principle/standard
- Most commonly against the ICMA principles if use of proceeds bond or an SLB
- Generally, includes an assessment of the issuer’s overarching objectives, strategy, policy and processes relating to the environmental and social features of the type of projects that the issuer intends to finance with the proceeds
ADVANTAGES

• It is a valuable improvement on issuer disclosure as it provides some additional comfort to investors on the validity of the issuer's claims

• The second party providers work with the issuer to ensure the information investors are looking for is included

LIMITATIONS

• Relatively high transaction costs for investors, limiting scaling of the market

• Reviews can lack independence

• Reviews often provide limited disclosure of environmental performance criteria

Source: OECD
An issuer can have its green, social or sustainability bond (or associated framework) certified against a recognised external standard or label.

That standard or label defines specific criteria.

Alignment with such criteria is normally tested by qualified third parties which verify the consistency of the relevant bond (or framework) with such criteria.

Source: CBI
Advantages and limitations of certification

ADVANTAGES

» Reducing transaction costs through standardisation
» Certification providers are less reliant on internal environmental expertise of the issuer (Independence from issuer increased compared to second party review model)
» Science-based criteria
» **Diversifying investor base**: Certification signals the integrity of a particular type of investment (e.g., low-carbon). May be important for investors looking for specific types of investments, in addition to other green bond investors

LIMITATIONS

» It is time-consuming and resource intensive to develop robust sector-specific criteria

Source: [OECD](http://www.oecd.org)
An external verification is typically made based on an annual green or social of sustainability bond post-issuance report, or information. A few established issuers, such as the EIB, go this route.

**WHAT DO WE MEAN BY THIS?**

- Larger institutions already commit to an audit of the sustainability/green credentials and decision-making.

**WHY SEEK AN EXTERNAL VERIFICATION?**

- The audit report will contain the necessary assurances required for green bond issuances, so a separate opinion is not necessary.
- For organisations who already have a second opinion, external verification provides investors with extra assurance on reporting, for example:

  - An audit to the sustainability/green credentials and decision-making.
  - A separate opinion provided by external verification.
Advantages and limitations of external verification

ADVANTAGES

» Transaction costs can be lower than those for an SPO as the assurance can be integrated with general financial audits for the issuer

» More independence than the second party opinion; adherence to international assurance standards

LIMITATIONS

» Assurance does not cover the environmental/social impacts of the projects funded by the bond

» Post-issuance auditing might result in a requalification of the green bond and the risk of investors seeing their investments classified as not green

Source: OECD
ADVANTAGES

» Rating agencies could integrate the offering with their credit rating services

» The green bond reviews could benefit from rating agencies’ credibility in the mainstream financial markets

LIMITATIONS

» Certain rating agencies are currently exploring green bond assessments that are focused on rating the process (management of proceeds, disclosure and reporting) rather than providing detailed rating on how green the projects funded by the green bonds are

» Investors may want more on green asset quality, which rating agencies do not directly have the expertise to assess

» As for second party providers, rating agencies might face lack of independence issues

Source: OECD
Reporting
Why is GSS bond reporting important?

For the same reasons traditional financial reporting is undertaken, but especially important for a nascent market, to build investor trust in non-traditional activities:

- Allow the organisation (and investors) to set benchmarks and environmental/social performance goals
- Measure, control and monitor green and social activities
- Demonstrate compliance to certain standards/international goals
- Improve communication among investors, issuers and project owners
What is allocation reporting?

» Mandatory components of ICMA's GBP, SBP, SBG and almost all other standards

» Issuers should make and keep readily available up to date information on the use of proceeds to be renewed annually until full allocation and on a timely basis in case of material developments
  • The annual report should include:
  • List of projects with a brief description of the projects
  • The amounts allocated and their expected impact

» If details cannot be provided (confidentiality issues, big number of projects…) information should be presented in generic terms or aggregated portfolios

Source: ICMA GBP
What is impact reporting?

» Recommended components of ICMA’s GBP, SBP, SBG and almost all other standards
  • GBP recommend the use of qualitative performance indicators
  • Where feasible, quantitative performance measures and disclosure of the key underlying methodology and/or assumptions

» Issuers with the ability to monitor achieved impacts are encouraged to include those in their regular reporting

» Different voluntary guidelines have been published in an attempt to standardise impact reporting
  • Goal: Create a harmonised framework for impact reporting that issuers can adapt to their own circumstances

» Mandatory pillar of the draft EU GBS

Source: ICMA GBP
ICMA Harmonised Framework for Impact Reporting

» Provides issuers with a reference as they develop their own reporting

» Recommends the use of both qualitative performance indicators and, where feasible, quantitative performance measures with the disclosure of the key underlying methodology and/or assumptions

» Offers impact reporting metrics and sector-specific guidance for the project categories

» Reporting templates are included for issuers to use and adapt to their own circumstances

Source: ICMA Harmonised framework for impact reporting
Best practice for post-issuance reporting
Example: What does a best practice post-issuance report look like?

- **Availability:** Public
- **Frequency:** Annual, until maturity of the bond/full allocation
- **Content:** Use of proceeds (allocated and unallocated), environmental/social impact with appropriate metrics
- **Complete project list
- **Accuracy:** Figures specific to each bond and project

<table>
<thead>
<tr>
<th>ISIN</th>
<th>Total proceeds allocated</th>
<th>Total proceeds not allocated</th>
<th>Proceeds allocated to eligible activity X</th>
<th>Proceeds allocated to eligible activity Y</th>
<th>Proceeds allocated to eligible activity Z</th>
<th>Etc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>XS12345678 9</td>
<td>EUR 400 million</td>
<td>EUR 100 million</td>
<td>EUR 85 million</td>
<td>EUR 10 million</td>
<td>EUR 5 million</td>
<td>Etc.</td>
</tr>
</tbody>
</table>

Source: Luxembourg Green Exchange observations
Example: What does a best practice post-issuance report look like?

<table>
<thead>
<tr>
<th>Project/Portfolio name</th>
<th>Project/Portfolio description</th>
<th>Eligible activities category</th>
<th>Tangible or intangible asset (private or public)</th>
<th>ISIN of Green Bond(s) proceeds used</th>
<th>Total project/portfolio investment</th>
<th>Amount of green bond proceeds allocated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northeast Wave Power One</td>
<td>Construction, installation and operation of 10 wave power units</td>
<td>Renewable energy</td>
<td>Tangible</td>
<td>XS12345689</td>
<td>EUR 100 Million</td>
<td>EUR 75 Million</td>
</tr>
</tbody>
</table>

### Share of proceeds

<table>
<thead>
<tr>
<th>Project start date/end date</th>
<th>Share of proceeds used for direct financing vs. refinancing</th>
<th>Share of co-financing by others</th>
<th>Share of proceeds allocated</th>
<th>Impact metric (absolute, annually)</th>
<th>Impact metric (relative)</th>
<th>Qualitative impact description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016 ongoing</td>
<td>100% direct</td>
<td>25%</td>
<td>90% CAPEX 10% OPEX</td>
<td>0 kt CO2e</td>
<td>-25kt CO2e</td>
<td>Replacement of local gas-fire combined heat and power</td>
</tr>
</tbody>
</table>

Source: Luxembourg Green Exchange observations
USE OF PROCEEDS CASE STUDIES

Philippines sustainability bond: Reporting

ALLOCATION & IMPACT REPORTING COMMITMENTS AT FRAMEWORK LEVEL

The Allocation Report may include:
- Amount of net proceeds raised
- Balance of unallocated net proceeds
- Total amount of net proceeds allocated per Eligible Expenditure
- Details of the split between financing and refinancing

The impact report:
Where feasible, it will aim to report on the estimated environmental and social impacts arising from the implementation of the Eligible Social Projects and/or Eligible Green Projects, in coordination with the concerned implementing NGAs

ACTUAL REPORTING : PUBLICLY AVAILABLE ON THE WEBSITE OF THE BUREAU OF TREASURY (BTr)

Philippines Sustainability Bond Report
Example on allocation reporting

Source: Luxembourg sustainability bond report
**Example on impact reporting**

**Low Carbon Transport**

- **30**: Deploy 30 low carbon vehicles by 2020 (buses)
- **31 mil.**: Serve 31 million users on trams/year by 2020
- **17**: Deployment of 17 low carbon transport projects
- **15 mil.**: Serve 15 million users on trains/year by 2023

- **469 mil.**: Create 469 million passenger-kilometres per year by 2025
- **600 000**: Enable 2.7 billion tonne-kilometres per year of road transport
- **88.8 mil.**: Enable 88.8 million passenger-kilometres/year in 2022

- **163 500**: Transfer 163 500 TEUs from road to rail transport in 2020
- **1.4 million tons of freight**: Transfer 1.4 million tons of freight from road to rail transport in 2023

Source: Luxembourg sustainability bond report
ICMA Harmonised Framework for Impact Reporting

THE OBJECTIVE IS TO ENHANCE THE USABILITY OF THE INITIAL DOCUMENTS AND TO AVOID REPETITIONS

» Voluntary guidelines, unites the already existing harmonised frameworks in one document

» Existing harmonised frameworks are:
  • The first Harmonised Framework for Impact Reporting by 7 MDBs (2015) on renewable energy and energy efficiency sectors
  • Sector specific guidelines under ICMA GBP:
    • Sustainable Water and Wastewater Management Projects (June 2017)
    • Sustainable Waste Management and Resource-Efficiency Projects (February 2018)
    • Clean Transportation Projects (June 2018)
    • Green Building Projects (February 2019)
    • Biodiversity (April 2020)
    • Climate change adaptation (December 2020)

Source: ICMA Harmonised framework for impact reporting
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