Management Comments

IEvD Evaluation of EBRD's Investments in Green Bonds (2017-22)

Executive Summary

Management welcomes IEvD's draft evaluation of EBRD's support to green bond markets developments and finds the report to be well-balanced overall in addressing the key evaluation questions.

Management appreciates the recognition of the Bank's contribution to developing nascent green bond markets and efforts to support issuers in their green bond issuance journey by becoming a trusted anchor investor, supporting inaugural issuances, and acting as a catalyst for demand.

Management acknowledges the suggestions for improvements focusing on the Bank's development role in the market via technical assistance, assessment, and reporting. Management is also pleased to have been confirmed that most transactions in the sample have resulted in a significant demonstration effect supporting the market development, resulting in a positive impact.

Management welcomes the recommendation to scale up effort with the policy dialogue and Technical Assistance (TA) that is currently bound by limited resources, but disagrees with the overall conclusion on the TA programme, and its factual use.

Management does not concur with the conclusion that the characterisation of ex-ante impact reporting is unreliable, untransparent, or incompatible with issuer's calculation. Management is aware of general challenges related to an ex-ante impact estimation.

Management would also like to emphasise that EBRD's investment criteria are public, namely in the GET handbook and its annexes, ESP 2019 and joint MDB principles for mitigation and adaptation finance. This makes the finding that "… EBRD should publish green bond investment criteria, so that issuers and investors can clearly understand the minimum EBRD standards" inaccurate. Management constantly makes effort to improve the selection criteria and the communication channels. The GET handbook is currently undergoing a process of revision and updating, including, but not limited to a review of the Bank's approach to green bond investment. The GET methodology is designed to assess if an investment qualifies for GET finance, not to attribute a level of green intensity.

Management welcomes the recognition of the Bank's efforts to maximise mobilisation levels and to expand its strategic and policy engagement on the capital markets. With respect to the finding "the Bank should lead by example and consider setting specific limits on the share of re-financing (at portfolio level)", Management agrees that EBRD should continue to encourage the adherence to the best market practice such as disclosure of information. Management, however, does not agree with a prescriptive limit on re-financing. This is not in line with our GET methodology or the ICMA principles, nor it is a common practice for large green bond investors.

Management would like for the report to be more circumspect in the way the side-letter carve outs are discussed. The study should avoid giving the slightest impression that the *carve-outs* are a reality. Management holds a view that the Bank should understand that when it buys into capital markets transactions, EBRD should seek to ensure that these are consistent with "Best Practice" even if that approach differs from the Bank's own standards and/or should ensure that any UoP that are not consistent with those standards are de minimis (perhaps below a 5% or 10% threshold).

Management comments to the recommendations and key findings of the study are presented below:

1. Management Comments on Recommendations

Recommendation 1: "*Establish a formal approach to green bond investments and related technical assistance (TA), with clear guidance on priorities, to reflect the current and changing state of the market and position the Bank at the forefront of its further developments.*"

Management ***Agrees*** with this recommendation.

Management already implements an agreed operational approach to green capital market investments, which is established "de facto" through a strong collaboration across functions (Banking, CFMD, CSD, ESD, Portfolio management etc.). It is important to note that in particular for capital market instruments, the Bank needs to remain flexible with its investment approach and the ways it interacts with clients in countries with varying levels of sophistication in terms of economy and capital markets. Green capital markets generally is an area where standards and market practice are evolving rapidly.

The Bank needs to find a balance between flexibility and structure in its approaches to avoid becoming excessively bureaucratic. The Bank intends to strike that balance by preparing a management guidance note that provides a consistent statement of the Bank's approach at any given time, but which can be revised rapidly and efficiently to respond to changing circumstances.

In relation to a dedicated TA proposal for green capital market development, Management agrees that a more structured and comprehensive TA program to support capital market readiness at country or client level would increase the Bank's impact. This will also take into account work done with CBI/ICMA to continue promoting the best and market relevant practices.

Management disagrees with the overall conclusion of the report regarding the use of past TA. Management tailored its support in accordance with a client's individual needs, implying a different scope of work from project to project. In addition, TA requirements also reflect the level of development of local capital markets, as well as well as specific donor priorities and donor funding availability (e.g. EU in Eastern Partnership/EEC region), with programs targeting corporate issuance from a variety of sectors effectively deployed in some ETCs (e.g. Georgia, Armenia).

Management agrees with the proposal to scale up policy dialogue and TC in the area, however would like to draw attention to constrained resources available to realise that ambition.

Recommendation 2: "*Improve assessment of green bonds and issuers' credentials and encourage transparent investment criteria to raise robustness of the EBRD green bond portfolio and overall transparency of its approach to green bond investments.*"

Management **Partly Agrees** with the recommendation.

The methodology to assess a green bond is governed by the publicly disclosed GET handbook and the associated annexes. It integrates various policies from publicly available documents such as the Environmental and Social Policy of the Bank, the MDB common principles, and EBRD's Establishing Agreement.

When analysing a transaction, the Bank relies on SPOs, rating agencies' reports and additional publicly available documents, which are assessed against the EBRD's GET/ PA methodology, as well as the Bank's knowledge of the sector and issuer. Management continuously benchmarks its approach against evolving industry standards (including ICMA, the Climate Bonds Initiative, EU regulation, market practice and other IFIs' approach) and intends to continue doing so.

In this context, Management notes that multiple indicators can be used to assess consistency between use of proceeds and the issuers' sustainability strategies (not only the green financial ratio example used in the evaluation report)

Management agrees to enhance the post impact reporting expectation and tracking, in line with internal divisions of roles and responsibilities and Green Finance RACI and notes that the same proposal is also made in the Recommendation 3.

Recommendation 3: "*Strengthen the standards related to issuers' pre-issuance Green Bond framework commitments to impact reporting and to issuers' post-issuance allocation and impact reporting to contribute positively to their robustness, and market standards more broadly*."

Management **Agrees** with the recommendation to strengthen issuers ex-ante reporting commitments, which is in line with the Bank's GET handbook and ICMA principles. This is already the practice when investing in a labelled bond and is part of the established due diligence approach, client engagement and TA offering. EBRD aims to only invest with issuers that are expected to have the ability to provide adequate reporting. The ICMA Harmonised Framework for Impact Reporting is indeed referred to in the Bank's GET handbook as the best market practice and is used when engaging with issuers.

Management also agrees on the importance of post issuance allocation and impact reporting and to maintain regular contact with issuers. It is current practice to engage with issuers on best reporting practices and Management agrees to regularly review the monitoring process. Management agrees that EBRD should continue to encourage adherence to best market practice, including on the tracking and disclosure of refinancing and look-back period information. Management notes that post-issuance monitoring requirement will at times be subject to constraints that arise from MNPI issues.

Recommendation 4: "*Adopt operational improvements in the approach to GET outcomes management for green bonds to introduce greater transparency and comparability*."

Management **Partly Agrees** with the recommendation.

Management fully embraces the need for clear assumptions on how GET finance is attributed and ex-ante GET impact calculated, and the possibility to revise the GET allocation methodology in line with market context. The information is already being summarised in Section 7 of the GET information table (created specifically for that purpose) as well as detailed assumptions and calculations of ex-ante impact which are provided as part of the required documentation under green assessment processes. The Bank already seeks to enhance procedures to avoid double counting in the attribution of GET finance and physical impacts of projects. The Bank already seeks to enhance procedures to avoid double counting in the attribution of GET finance and physical impacts of projects. The Bank seeks to further develop a systematic process for post-signing impact data collection and reporting for green bonds.

While Management recognises the need to be additional/ improve existing standards, a better way to do this would be by working with the relevant standard-setting bodies, and with local capital market authorities to ensure such standards are mainstreamed in our CoOs, rather than imposing these at project-by-project level.

Management believes that operational improvements proposed in Recommendation 4 are not necessary as they are already ongoing.

Recommendation 5: "*Monitor, report and, when opportunities arise, reduce the overall use of EBRD proceeds to re-finance and favour investment in new assets*."

Management ***Partly Agrees*** with the recommendation.

Management agrees and is aware of the importance of monitoring the share of re-financing. The part of this recommendation will be dealt as part of the action point on recommendation 3 above.

Management disagrees with a suggestion to limit or target a specific volume of refinancing. This is not in line with market practice, other IFIs' practices, the Bank's GET methodology, or the ICMA principles. This is also not a common practice for large green bond investors who are in favour of increasing the share of new financing, because it often not possible to identify a pre-defined number of new projects over the life of the bond issuance. Hence, setting fixed targets would be detrimental to EBRD's role to develop green capital markets in its CoOs and limit the ability of issuers to participate. Many companies finance "green" and highly impactful investments with relatively long payback periods with a debt of maximum 5–7 years tenor/maturity, which at some point must be refinanced. Refinancing activity forms a significant part of all capital markets transactions. This also reflects the commercial nature of many green infrastructure investments, that typically have a lengthy construction period with uncertain cashflow requirements followed by a long, stable operating period with stable cashflows. This makes them well suited to short-term bank financing for construction followed by refinancing with long-term capital markets finance. This is a model that the Bank should be encouraging, not avoiding.

Should EBRD try and limit or significantly restrict the use of proceeds from green bond issuances on refinancing, when its additionality is justified, the likely consequences would be a reduced number of deals in which EBRD can participate (a significant portion of issuances include a refinancing), limiting its impact on green capital market development, as well as an overall reduced volume of green financing.

Furthermore, there is a difference between an issue that supports one or two investments and an issuance (especially a programme of issuance) that is intended to support a portfolio of green projects that are expected to grow over time. The latter will necessarily include a refinancing.

Finally, Management notes that the reporting on allocations and monitoring should be done at a portfolio level.

2. Comments on study analysis and findings

Management would like to clarify that the timeline for EBRD to invest in green bond is usually short, as the Bank is often presented with a readily investable transactions in which the sustainable framework and investment parameters have already been established. A key characteristic of bond issuances is that the issuer engages with many potential investors at a time and is obliged to provide the same information to each. This means that, despite of the ongoing engagement with clients, EBRD will not always have the opportunity to shape the terms of the transaction and will be placed as a "transaction taker" like any other investor. This does not preclude strict due diligence, but it needs to be clearly distinguished from a traditional lending activity which is bilateral and enables EBRD to shape the terms of investment at a granular level. Prior to a transaction, the client tests the framework with a number of investors, including - but not solely - EBRD, which means that the Bank is not able to exert the same level of influence over the structure of a deal, compared to direct lending. Having said this, the Bank aims to progressively drive the green capital market practices to the highest level possible.

Moreover, Management would like to emphasise that an important overarching "success story", in terms of the EBRD impact which has not been duly reflected in the report is the long-term engagement and the "learning journey" that clients undergo with EBRD prior to a green bond issuance. Capital market transactions are sophisticated and do not happen in isolation and would rarely be the first investment with a client supported by EBRD. Especially in the FI segment, where the vast majority of deals are repeat business, clients "learn green" through their business interaction with the Bank over time. Such a pathway will typically begin with some short-term financing, such as TfP, and/or an SME line, often progressing to dedicated green lending such as through GEFF and culminate in the client's ability to issue a green bond. During this long-term engagement accompanied by close interactions, clients learn to adopt and apply environmental and social safeguarding standards (through ESP application), green eligibility and verification (through GET-eligible instruments) and the attached capacity building technical assistance (project consultants supporting GEFF implementation, for example, or the transition planning capacity building program). This helps clients to get ready to design their own green bond framework before considering issuing a bond.

To be classified as a green bond, the eligibility criteria includes a four-step process, including (i) identification of environmentally themed bonds, (ii) reviewing eligible bond structures, (iii) evaluating the use of proceeds and (iv) screening eligible green projects or assets for adherence with the Climate Bonds Taxonomy. Hence, the due diligence of an issuer and the understanding of its profile by EBRD goes far beyond the individual green bond transaction.

Management notes that there exists minor, yet material difference between bonds issued by financial institutions and other market players. The report seems to have missed the opportunity to highlight the nuances, which are significant and stand the approaches apart.

There should be a clear(er) distinction made between issuance that is deemed to be in the local market (i.e. where it is local currency denominated, cleared through the local clearing system, listed on the local exchange and predominantly targeted to local investors) from issuance in local currency cleared through the ICSDs (i.e. Euroclear and Clearstream) and therefore substantially targeted to international investors, even if it is also listed on a local exchange. Issuance that is in hard currency, irrespective of whether listed on a local exchange or not, is even further away from being able to be considered as “local”, albeit that it may help the stock exchange improve its standard setting and focus on Green Bond characteristics (for which some kind of assessment would need to be made if that position were taken).