

Enhancing market transparency in green and transition finance

**Virtual session (joint with CEBRA) at
ABFER Annual Conference
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CHAPTER 2

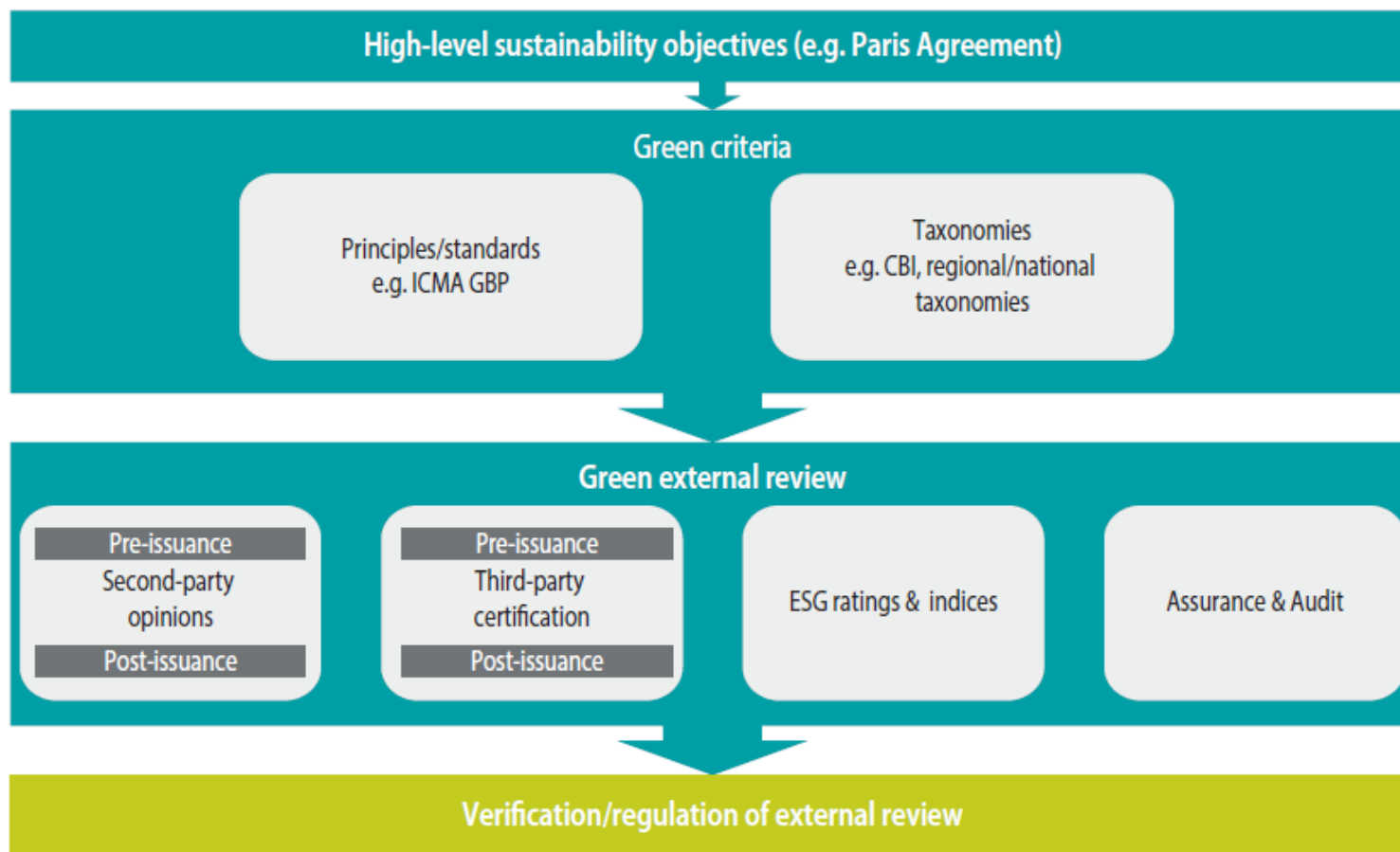
Executive Summary

- **II. Green External Review and Assessment**

- Private sector solutions currently dominate the green external review market, and offer a range of different approaches, such as second-party opinions, third-party certifications, ESG ratings, assurance, and audit.
- Clear and meaningful reporting underpins any effective external review or assessment of green bonds.
- New green finance instruments, and most particularly sustainability-linked debt (such as sustainability-linked bonds, or SLBs), have built-in quantitative targets against performance indicators.
- Lastly, greater availability of data is needed to broaden the scope for verifying outcomes related to environmental objectives.

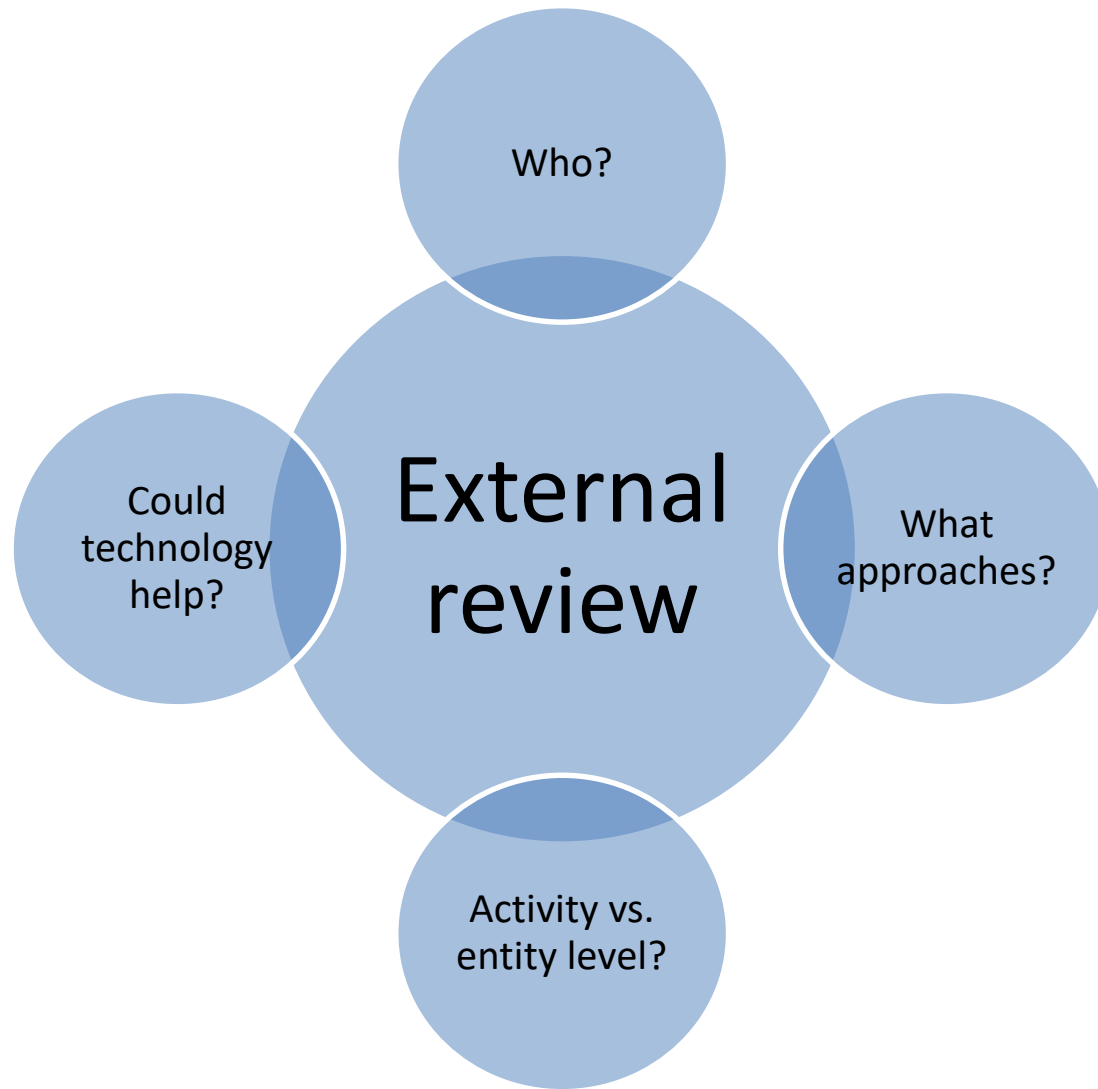
From green criteria to green external review

Graph 2.1 From green criteria to green external review: various approaches possible



Source: Authors' depiction.

We address four questions in this chapter



Institutional design of green external review

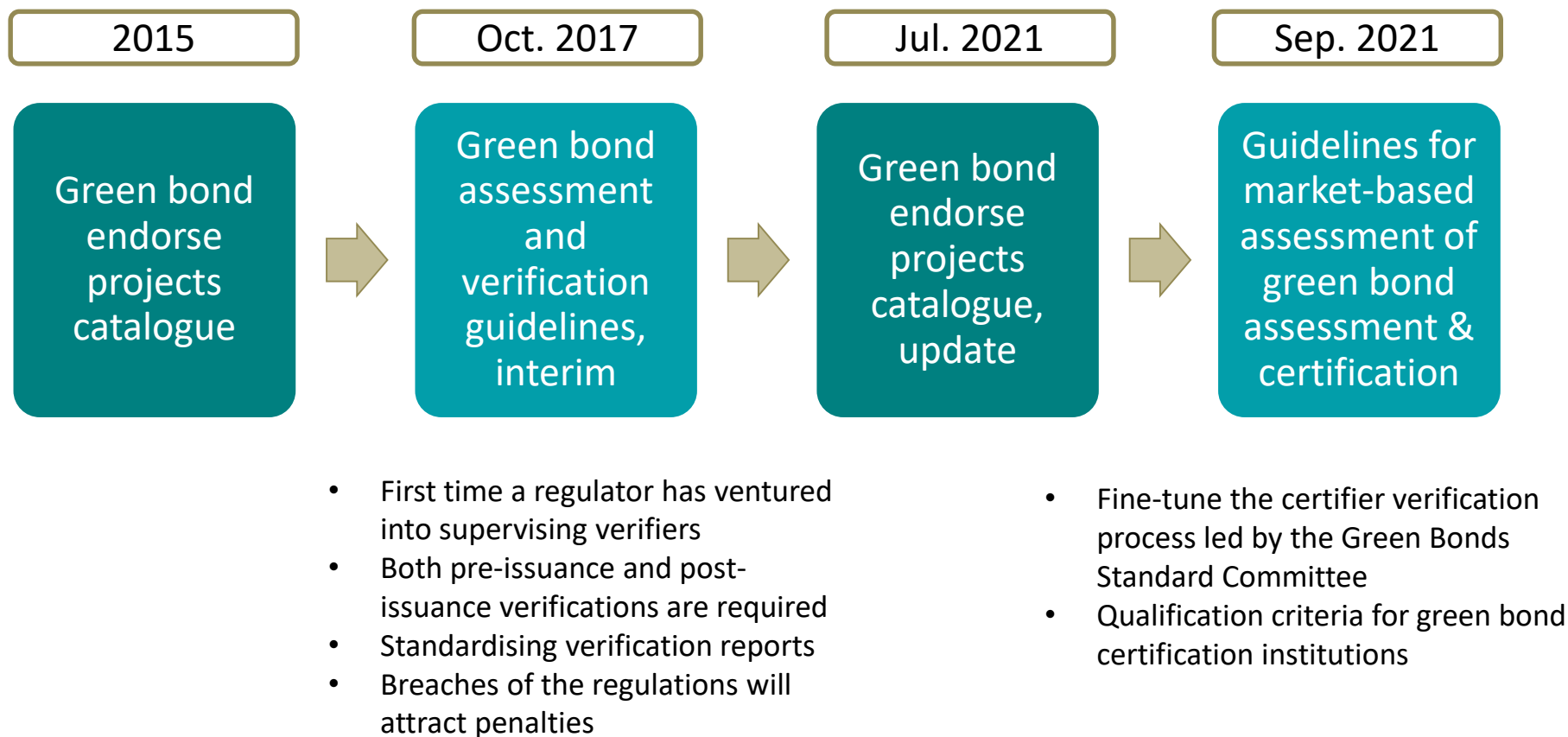
Which institutions are the best suited to conduct an external review of the greenness of an asset, an instrument or an issuing entity?

	What	How	Who
SPO	Issuer framework	ICMA GBP/GLP	Sustainalytics CECERO
Certification	Issue framework, proceeds	CBI, taxonomies	CBI
Assurance	Compliance	Accounting principles	Audit firms
ESG ratings	Sustainability credentials	ESG scorecard	MSCI Vigeo Riris

Institutional design of green external review

- Concerns have also arisen regarding the reliability and comparability of green labels, in particular as regards ESG ratings, with **calls for the green external review market to be regulated**.
- The key institutional design objective here is to develop appropriate regulations to **admit competent private verifiers, ensure a level playing field** for independent and professional assessments, and promote **transparency for both green objectives and definitions, and external review methodologies**.
- Some countries, such as China, and also the EU have started to put in place, or have upgraded, regulatory frameworks to guide private external review activities.

Dynamics between taxonomy development and regulation of green verifiers: case of China



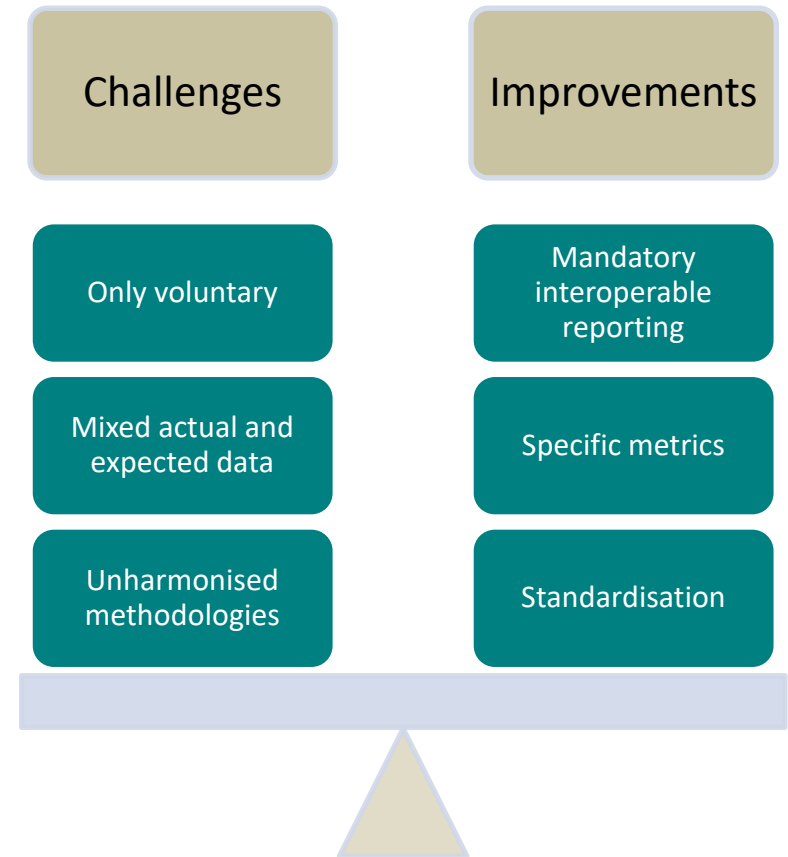
Role of reporting approaches

What reporting approaches and practices are needed to support an effective external review or assessment of green bonds?

		What	Method	Handbook
Post-issuance reporting	Allocation reporting	How proceeds are used	Factual reporting	Diverse
	Impact reporting	Climate impact	Science-based assessment	ICMA

Impact reporting: challenges and improvement

- Currently, there is a **general lack of consistency and comparability** across the reporting scopes, formats, measurement methodologies and metrics used by different issuers.
- **A call for standardisation of impact reporting and moving to a comprehensive sustainability reporting system**
 - A few ongoing initiatives: ISSB, Paris Europlace, etc.

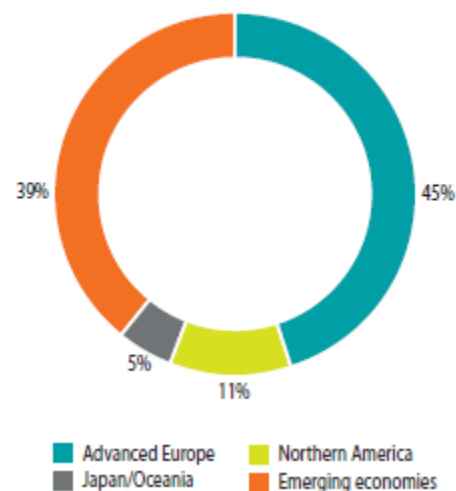


Instruments with built-in targets: the case of Sustainability-Linked Bonds (SLBs)

Can new financial instruments help to move green external review from instrument-based verification to entity-based verification?

- The built-in mechanism allows **issuers** to achieve some defined and usually verifiable green or sustainability objectives while **securing funds for a general purpose**.
- **The SLB market has expanded rapidly since 2019**, with Europe featuring strongly and both corporate and sovereign issuers tapping the market.
- **A further development of industry-specific assessment indicators and targets** will be needed to make this market attractive.

Geographical breakdown of sustainability-linked bond issuers



Potential benefits of SLBs, esp. for sovereigns

Table 2.1 SLBs vs. standard green bonds

	Sustainability-linked bond	Green bond
Use of proceeds	General financing purpose	Green projects
Issuer type	Potentially any entity with a commitment to an ambitious sustainability trajectory	Entities able to generate large-scale green projects
Performance indicator	Metrics-based KPIs at the issuer level and associated SPTs	Impact evaluation relying on metrics-based KPIs at the activity level
Penalty for missing green targets ¹	Reputational costs and financial penalty	Reputational costs
Pre-issuance review	Second-party opinions, notably on alignment with ICMA's sustainability-linked bonds principles	<ul style="list-style-type: none"> - Second-party opinions, notably on alignment with ICMA's green bonds principles - Certifications (Climate Bonds Standard)
Post-issuance review	Systematic external verification of KPIs vs. SPTs integrated in the bond documentation	<ul style="list-style-type: none"> - Generalization of use of proceeds reporting - More variability regarding the availability and quality of impact reporting

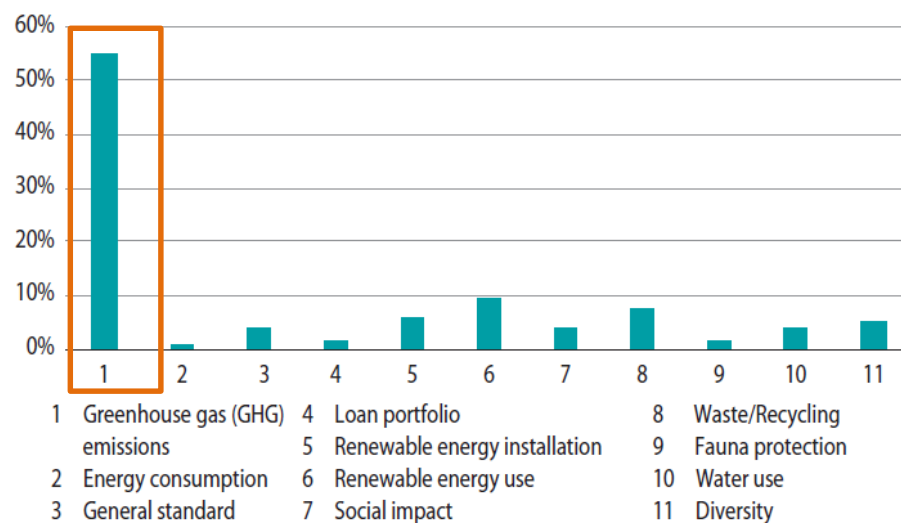
¹ This means missing the preset sustainability performance target in the case of a SLB or misallocation of green proceeds in the case of a green bond.

Source: Authors' depiction.

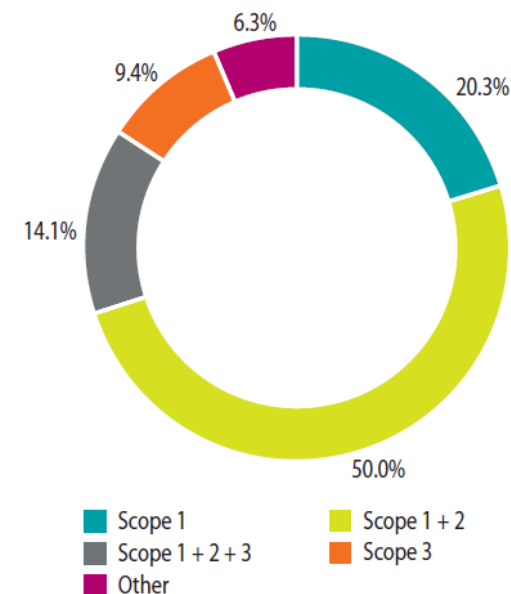
A closer look at SLB KPIs

Graph 2.3 **SLBs feature various underlying KPIs, though GHG emissions dominate with different scopes**

Categories of KPIs used in sustainability-linked bonds



Scope of emissions covered by GHG KPIs



Sources: Bloomberg, EBRD calculations.

SLB market: looking forward

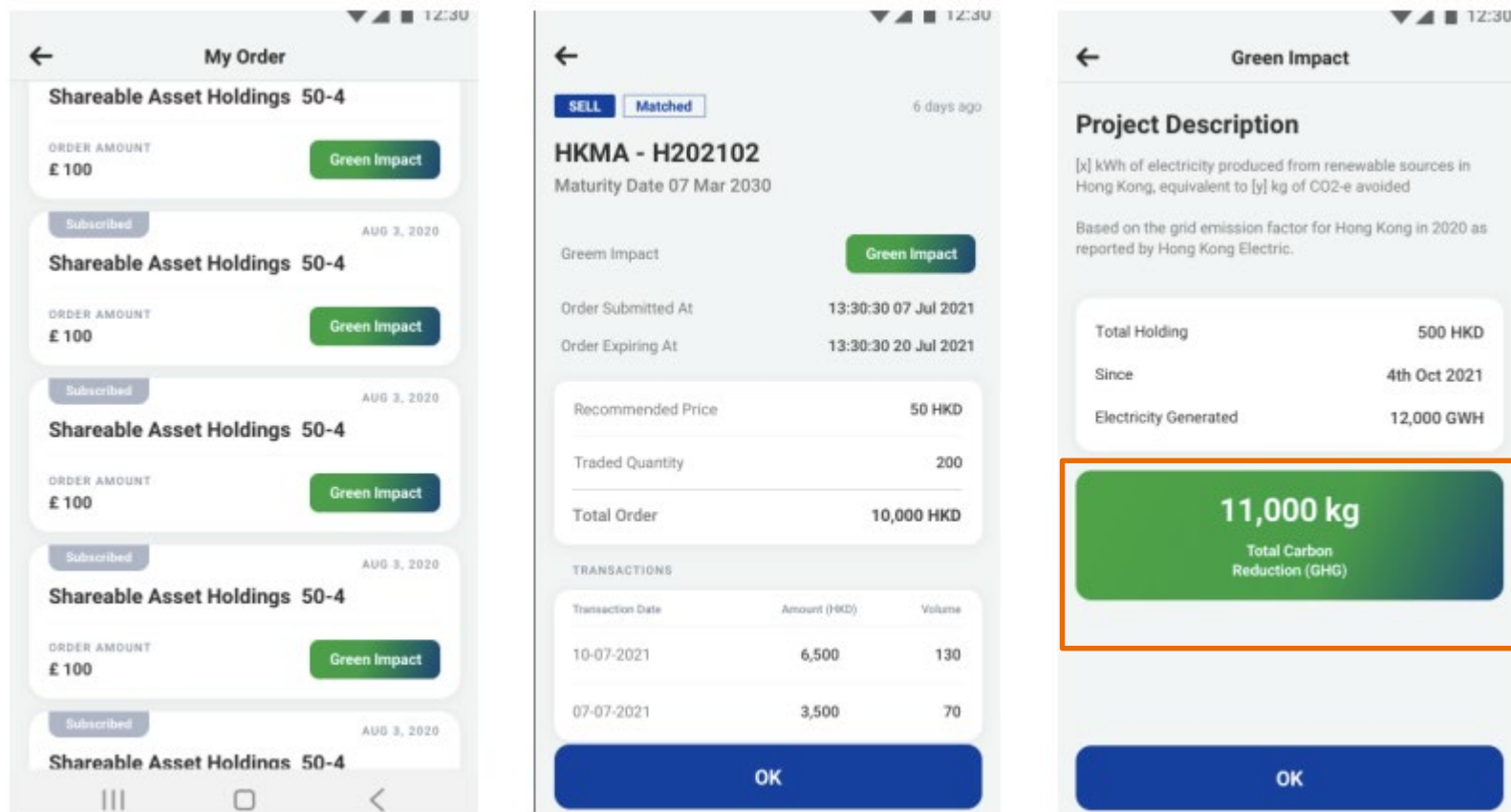
- Investors largely interested in assets that support GHG emissions reductions
- It is paramount to ensure that forward-looking indicators and targets used by issuers are sufficiently credible
- Simple KPIs should be preferred over composite or more sophisticated indicators such as temperature metrics or ESG ratings which are currently highly dependent on the assumptions used by data
- A higher degree of standardisation might be achieved notably by providing more guidance on the choice of industry-specific indicators.
- Relying on indicators promoted by global reporting standards setters (such as the one being developed by the ISSB) will allow comparison with other non-SLB issuers that abide by these standards

Technology and future data collection

Will technology enhance data collection for green external review?

- Greater availability of data is needed to broaden the scope for verifying outcomes related to environmental objectives.
- Technological advancement holds promise in this regard.
 - To enhance market transparency by improving the management of disclosures on sustainability impacts and outcomes
 - To allow real-time data collection and storage: example of BIS Project Genesis leveraging Internet of Things and Blockchain technologies
- Some jurisdictions, for instance in the EU with the proposed EU Corporate Sustainability Reporting Directive, have already started to make progress in this regard

An example from Project Genesis



Source: BIS Innovation Hub (2021)

Some ideas for further research

Green verification practices

- Do different forms of green review/reporting affect “greenium”?
- Does the stringency of green review affect issuers’ incentives to stick to their climate objectives?

SLBs

- How are SLBs priced compared to conventional bonds and green bonds?
- How to measure the “greenium” / “sodium”?
- What is the impact on liquidity?

Acknowledgement

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