Partners:

ABM, GIZ and SEB Launch
Green Bond Workshop Series in Mexico

Parties Sign Memorandum of Understanding to Foster Collaboration for the Growth of a Prospering and Sustainable Green Bond Market in Mexico

10 & 11 October 2016, Mexico City

Kick-starting its activities in Mexico, the Strategic Alliance (STA) on *Green Bond Market Development in G20 Emerging Economies* organized two Green Bond workshops in Mexico City on 10 & 11 October 2016. The workshops, representing the first within a series, focused on the topics of *Definitions, Selection & Verification* and attracted about 130 participants from a wide range of Mexican institutions from the private and public sector.

The first workshop on 10 October was hosted by the Asociación de Bancos de México A.C. (ABM), the STA's implementation partner in Mexico, and addressed potential issuers, investors and underwriters. On the second workshop day, which took place at Monterrey Tec, policymakers and regulators as well as potential second opinion providers were invited. Both workshops were moderated by Marcos Mancini, Chair of the Sustainability Committee at ABM and Yannick Motz, Head of the Emerging Markets Dialogue on Green Finance at GIZ.

Day 1 was opened by the inspiring words from Luis Robles Miaja, Chairman of ABM and the Board of BBVA Bancomer, as well as Dr. Annika Thunborg, Swedish Ambassador to Mexico.

In his speech, Luis Robles highlighted the **banking sector's role** to create additional value for the Mexican economy by incorporating sustainability factors in business models to foster economic growth while at the same time supporting inclusive and sustainable development and contributing to a sound financial system. He further recalled Mexico's commitment, as established by the Energy Transition Law, to achieve 35 percent of the country's electricity generation through clean energy sources by 2024. To meet this goal, he considers it key to encourage the use of innovative financing mechanisms such as green bonds to attract the investments needed – estimated to amount to USD 75 billion.

Ambassador Dr. Annika Thunborg put her focus on the **Paris Agreement** as a milestone in combating climate change. The ambitious contributions for a more sustainable future as announced by governments around the globe must now, however, be followed with concrete actions on national level. At the same time, global challenges required global solutions. Therefore, in the light of the urgent need for innovative green financing, the Ambassador stated Sweden's support for the Strategic Alliance to promote Green Bond market development and contribute to overcoming the apparent financing gap. The Ambassador showed to be delighted by having two pioneering banks present at this event, with SEB, the co-developer of the Green Bond concept and leading underwriter, and Nacional Financiera (NAFIN), the first Mexican Green Bond issuer and winner of the *Green Bond of the Year – SSA* awarded by Environmental Finance in 2015. The Ambassador closed by looking forward to the many more opportunities Green Bonds would generate in the future and wished a successful workshop.

The opening remarks were followed by the **signing of a Memorandum of Understanding** (MoU) by Luis Robles in the name of ABM and Yannick Motz from GIZ – on behalf of the STA –, and with Ambassador Thunborg as honorary witness. With this MoU, the parties intend to foster a strong and fruitful cooperation for jointly promoting the Green Bond market development in Mexico.

The signing was followed by a brief **introduction to the STA and its activities** by Christine Majowski, Jr. Project Manager in Green Finance at GIZ. With the objective to support the development of a prospering and sustainable Green Bond market in Mexico and other thriving G20 emerging economies, she explained the approach pursued by the parties of this public private partnership: As one of the main activities, the STA offers theme-focused workshops, through which local and international experts share their technical knowledge and hands-on experience with participating stakeholders to gain profound knowledge on Green Bonds. These public workshops are complemented by the offer of individual meetings, to provide those market participants, who intend to engage further in the green bond market, with tailored advisory support and structural advice.

Giving background to the rise of green finance in the **context of major international initiatives** such as the path breaking Paris Climate Agreement, Santiago Lorenzo Alonso, Global Expert on Climate Finance at WWF, illustrated the implications and reactions by the financial sector to the long-term inversion of the risk/return profile, which are accelerated by such agreements. The reactions can be observed, for instance, in changing investment strategies, with major international investors announcing to divest from fossil fuels, or in global market-led initiatives, exploring how to make the financial sector more resilient to climate change, as reflected in the Financial Stability's Task Force on Climate-Related Financial Disclosure.

The technical part of the workshop was opened by Mats Olausson, Senior Advisor for Climate & Sustainable Financial Solutions at SEB, who started by showing the **rise and rapid growth of Green Bond markets** – driven by the strong investor demand! – and illustrating the current **state of the market** as well as SEB's role in the market as developer of the Green Bond instrument for mainstream investors and as leading underwriter. The finance expert then focused on pointing out the **peculiarities of Green Bonds** compared to regular bonds by explaining the Green Bond Principles, the voluntary guidelines that are internationally recognized as *the* framework for Green Bonds. In order to give a better understanding of the extra work included when issuing a Green Bond instead of a regular one, he showed the four key documents essential for Green Bond issuers, investors, underwriters and verifiers. These documents include the Green Bond Principles, the issuer's Green Bond framework, a Second Opinion and a Green Bond report for investors. Considering this extra work with respect to internal processes and additional disclosure an issuer of a Green Bond has to take into account, Mats plausibly explained the **benefits for issuers** to assign a green label to their bond: Beyond marketing and other reasons, the most relevant and valid argument for green issuers is the experience made in broadening their investor base and deepening relationships. This will strengthen the issuer's financial position with particularly two medium- to long-term benefits: First, providing institutional investors with the opportunity to allocate money into a green bond may be what is needed to attract new investors. If so, these investors will need to make their due diligence regarding both the greenness of the bonds and the financial risk they take to get the exposure. Once the financial due diligence has been made and a new name has been added to their portfolios, these investors will be more likely to also consider buying future regular bonds issued by that issuer. Secondly, the extra costs may be viewed as "insurance premium" that may pay out during the next crisis when frictions in the financial system are cushioned by the more diversified and stable investor base. Fiscal incentives, on the other hand, have not yet been and are not expected to be introduced broadly anytime soon by governments in order to offset extra costs, although China's Green Finance Committee is exploring potential mechanisms, Mats Olausson answered a question from the audience.

The **strengths and weaknesses** in the Green Bond market were further explored by Harald Francke Lund, Senior Advisor at CICERO, an independent non-profit climate change research center and, with a market share of 70 percent (in number of second opinions) or over 40 percent (in volume), the world-leading provider of second opinions on green bonds. As a major strength of Green Bonds, he views their function as *communication tool* for issuers to signal their green ambitions to investors. But – in order for the market grow and diversify with integrity in environmental terms – he explained the steps to build *investor confidence* in the instrument: First, the issuer needs to *define* the green categories. The list provided by the Green Bond Principles thereby gives a good though not complete orientation. Technologies must be carefully assessed, considering in particular potential rebound and lock-in effects or the exposure to the supply chain. Secondly, the issuing institution need to have in place procedures for *identifying* potential green projects in its portfolio and eventually *select* eligible ones, aligned with the established definitions and in a dialogue between financial and sustainability departments within the issuing organization. The increased exchange and cooperation between experts from these departments may be one of the major positive side effects Green Bonds bring about. Third, he emphasized the significance of second opinions, which are independent environmental quality *reviews* of a Green Bond issuer's framework for selecting eligible projects. With the objective to provide investors with transparent and sound information, beyond national standards and peculiarities, science-based second opinion providers thereby assume the role of bridging climate science with the needs of the financial sector on a global level.

Santiago Lorenzo from WWF resumed, focusing on **green washing** as the major risk to the robust long-term development of the rapidly expanding and diversifying Green Bond market. While agreeing on the necessity for a sound underlying framework of a Green Bond to address this risk, he called rather for a policy-driven than a demand-driven approach to ensure integrity. He emphasized the importance of clearly defining what is green. Such standards need to be comprehensive, focus on investments with material and verifiable environmental benefits, be science-based, i.e. long-term valid and resilient, sector-specific, independently reviewed, and aligned with already existing environmental standards.

Getting more into technical details, Mats Olausson from SEB explained in depth the elements of the **Green Bond Principles**, which are designed in a way to be both simple and sincere, serving both issuers' and investors' needs: 1) *use of proceeds* – defining eligible project categories covering different areas of climate change mitigation & adaptation and environmental preservation; these categories can be defined by the issuer either narrow or more broadly, depending on the issuer's sector and portfolio; 2) the *process of project evaluation and selection* – safeguarding environmental integrity by selecting projects in line with eligible project categories through a dialogue with environmental or sustainability experts; if there is no in-house expertise, it is recommended to insource this through external environmental experts or to design the criteria in a way that requires external environmental certifications; 3) *management of proceeds* – ensuring that structures for earmarking and tracking of proceeds, including the allocation of funds and temporary placement of unallocated proceeds, are in place; this may be done via creating a sub-account; 4) *reporting* – disclosure on allocation of proceeds and preferably with information about the expected or actual environmental impact. This aspect will be in focus in the upcoming workshop.

After the lunch break, the session on **external reviews** was opened by Santiago Lorenzo from WWF: His key message was that *framing integrity* for a strong and healthy market required *joint action* by all stakeholders. This includes in particular: (i) further enhancing a common understanding and harmonization of approaches for Green Bond issuance as promoted by the Green Bond Principles and the Climate Bonds Standard; (ii) the responsibility of Green Bond issuers to comply with standards and disclose relevant financial and environmental information; (iii) the pivotal role of verifiers to safeguard the integrity of the market and promote requirements for the publication of information and legal frameworks; (iv) the role of investors to develop sustainable investment strategies and communicate their expectations to the market, advocate transparency and the development of standards to voluntarily disclose the environmental impact of investments and enhance fund managers' and analysts' expertise on ESG factors; (v) third-party assessors to develop and align solid revision practices and methodologies and ensure that the fulfillment of standards and principles is verifiable; (vi) governments' role in enhancing supervision, adjust emission standards and advance international harmonization of standards; and (vii) industry organizations to actively and globally engage jointly to enhance standards and practices.

In the following, Harald Francke Lund from CICERO went into the technical details of external reviews, i.e. **second opinions**. He explained the process of CICERO's second opinion provision in three steps: The most central document the issuer needs to provide is the issuer's Green Bond framework, which contains information on the definition of green project categories, the internal process of project selection, structures for management of proceeds and reporting practices that are in place. Furthermore, the issuer's sustainability reports and other relevant available documents are requested for review. Based on these documents and the direct dialogue with the issuer, CICERO reviews the robustness of the Green Bond framework with the objective to bring highest transparency to investors. In order to provide a second opinion that is both scientifically sound and simple to understand, CICERO developed its *Shades of Green* methodology. Thereby, Harald Francke Lund emphasized, CICERO does not look at single projects on the ground but instead scrutinizes the selected project *categories* with respect to their short, medium and long term contribution towards a low-carbon and climate-resilient future – reflected in a light, medium or dark green shading. The climate experts also assess rebound, lock-in and other external effects or supply chain related risks when assigning the shading. Beyond (a) *Definitions*, CICERO's second opinions also take into consideration the following aspects: (b) *Selection*: Who selects eligible projects? To what extent are climate and environmental expertise involved (either in-house or external)? (c) *Monitoring* and *Reporting*: Are procedures for monitoring of use of proceeds and verification of project outcome and impacts in place? (d) *Transparency* and *Soundness*: Is the overall approach pursued by the issuing institution transparent and sound? (e) *Credibility*: Are the broader business model and practices aligned to climate and environmental goals and achievements? Based on an assessment of these issues, the strengths, weaknesses, and pitfalls of the Green Bond framework will be pointed out in the second opinion. Differently from audits, which provide a post-issuance review against certain principles or standards, a second opinion serves to help investors make their initial investment decision, reviewed against science, Harald Francke Lund clarified. Given more insights, he shared his experience that one of the major values added through second opinions – besides providing scientifically sound and transparent, pre-issuance information to investors – is the improved internal dialogue between finance and environmental experts that is experienced and reported by issuers as large gain to the mutual understanding and alignment of these different fields of business. Lastly, the second opinion expert illustrates the standard structure of a second opinion report with a practical example of MuniFin, a Finish credit institution specialized in financing the local government sector and state-subsidized social housing production.

In order to apply and discuss the knowledge gained throughout the workshop, participants split up into sub-groups to assess two **case studies**: the second opinion on MuniFin's and Apple's Green Bond Frameworks. Participants showed a very good understanding of the critical aspects relevant for both issuers and investors and grasped the chance to raise further questions, share their ideas and jointly discuss.

The breakout sessions were complemented by two further case studies presented by SEB in its role as underwriter and NAFIN, a Mexican development bank focused on MSME financing, as issuer. **NAFIN's** two **Green Bond issuances** – the first ever Mexican Green Bond issued in October 2015 over USD 500 million (representing NAFIN's first bond issuance in 18 years!) and the second one being the first Mexican Green Bond in Pesos issued in August 2016 over MXN 2 billion – were presented by Hugo Aguirre Lopez, Subdirector of the International Treasury. He started by stating that Green Bonds always had the same financial characteristics and requirements as conventional non-Green comparable transactions, i.e. regarding pricing, seniority, rating as well as execution and financial documentation processes, - but with proceeds earmarked for green projects. Hugo Aguirre depicted the key additional steps to launch a Green Bond – from defining criteria to selecting eligible projects, the fund allocation process, the attainment of an independent external second opinion, to the necessity of periodic reporting of the allocation of proceeds and – if possible – the environmental and social impact. As a key element of communicating to investors the robustness of its Green Bond framework and credibility of effectively reducing GHG emissions through the selected wind and small hydro projects, Hugo Aguirre pointed to the second opinion. Aligned with that, he further advocated the transparent and regular reporting on various aspects, including the amount of proceeds being allocated, a list of funded projects, and the (estimated) environmental impacts of these projects. He showed how this can be implemented in practice as presented in NAFIN's annual report. Being asked for NAFIN's motivation to issue a Green Bond instead of a regular one given the similar expected pricing but additional costs involved, Hugo Aguirre brought forward two rationales: Most importantly, the broader investor base based on the expectation that large global investors would show a higher interest in Green Bonds than in regular bonds – which might be confirmed by the heavy oversubscription (five and three times, respectively). Lastly, as a national development bank, Green Bonds offered a very good opportunity to start implementing Mexico's commitments as declared by ratifying the Paris Climate Agreement.

NAFIN's experience in issuing a Green Bond was complemented by Mats Olausson's (SEB) structured depiction of a typical **Green Bond issuance process**, which the bank has accompanied as underwriter for a vast number of times – from the initial internal decision to finance green projects to preparing the actual transaction. He ended his presentation by showing a video by the World Bank on the implementation of a project in Mexico on the reduction of energy consumption that was financed by a World Bank Green Bond.

The closing remarks were held by Marcos Mancini, the Coordinator of ABM's Sustainability Committee, who summarized the key-takeaways and gave an **outlook** on the upcoming, jointly conducted consecutive workshops that will focus on the remaining pillars and follow in early 2017.

On the second day, representatives from policymaking and regulatory bodies as well as academia, research institutions, consulting and rating agencies joined the workshop. The opening remarks were given by Dr. Hugo Fuentes, Dean of the Economics Department of Monterrey Tec, Campus Ciudad de México, who recognized the important and effective role Green Bonds can play in combatting global warming in order to achieve a better life quality for everyone

Following the sessions on *Definitions & Selections* as well as *Verification*, which were again enriched by the expertise from Santiago Lorenzo (WWF), Mats Olausson (SEB), Harald Francke Lund (CICERO) and Hugo Aguirre (NAFIN) and complemented by the interactive engagement of the audience in the case studies working groups, Marcos Mancini and Humberto Alarcón from

ABM recapped the covered topics in the context of the vast opportunities to invest in Mexico, also against the background of Mexico's way forward paved by the energy reform. Lastly, Humberto Alarcón found inspiring words for the crucial role participants of the workshops could play in this – supported by the platform established by the STA – in enhancing the development of the Mexican Green Bond market in a robust and long-term sustainable way. Closing the event, he expressed a special thanks to all participating institutions.

For more information on the STA and its activities, please visit www.emergingmarketsdialogue.org.