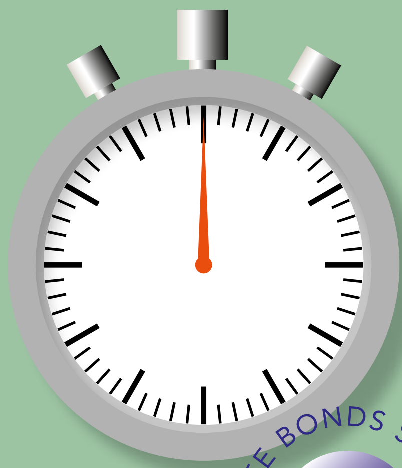

Discussion Paper

Certification of Short-Term Debt Instruments

Climate Bonds Initiative

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About the Climate Bonds Initiative

The Climate Bonds Initiative (Climate Bonds) is an international organisation working to mobilise global capital for climate action. It seeks to promote climate-related investment in every corner of capital markets, from project financing to re-financing.

To support the growth of a market for climate capital, Climate Bonds developed the Climate Bonds Standard and Certification Scheme (Scheme), a labelling scheme for bonds, loans, and other debt instruments. The aim was to provide gold standard labelling that would help drive the burgeoning global green bond market towards investments consistent with addressing the goals of the Paris Climate Agreement to limit warming to 1.5°C. At the end of 2021 the labelled green bond market had reached a cumulative volume of USD1.6tn, of which around 14% was Climate Bond Certified.

The Scheme is used by investors, bond issuers, governments, and financial markets globally to apply due diligence on claims that investments contribute to addressing climate change. Rigorously developed scientific criteria underpin the Scheme, along with a network of some 70 licensed verifiers who undertake assessments for each instrument against the standard.

Climate Bonds is also active in policy engagement, focused on steps governments can take to support the flow of capital to climate solutions. Its research and data provision tracks, analyses and reports on the growing allocations and issuance programmes.

1. In short

To date, green bond standards and definitions have focused on USD120tn longer-term debt (bond) markets, typically including instruments with a residual maturity of at least two years at issuance. However, the short-term debt market, comprising instruments with a residual maturity of one year or less at issuance, is calculated to be worth an additional USD55tn.

Trade and working capital finance, as well as money market instruments, has attracted little attention in the sustainable finance market. However, to achieve capital flows at the required speed and scale, investors must be able to identify all types of green finance instruments. The rapid growth of investor appetite for green bonds, including some initial short-term paper, suggests that there is potential to develop this market as a deep and liquid source of green capital.To move this market forward, Climate Bonds makes the following recommendations:

1. Short-term debt is deemed to be consistent with the goal of financing Climate Bonds eligible projects, assets, and expenditures; should be labelled green; and should be added to thematic investment strategies.

2. Climate Bonds will design definitions of eligible pure-play entities in the coming months to contribute to the development of the green short-term debt market.

2. Green Short-Term Instruments Steering Group

In September 2021, Climate Bonds established a Steering Group (the Steering Group) to assess the market's potential, and consider rules around the eligibility of short-term instruments under the Climate Bonds Standard.

The Steering Group was invited to prepare a discussion document on proposed rules and to consult on the proposals with banks, issuers and institutional investors who participate in the Climate Bonds Partners programme. Changes to the Climate Bonds' Standard to accommodate new rules would be subject to a 60-day public consultation process.

The Steering Group members are:

Jonathan Stone, former Barclays Group Treasurer, a Trustee of Climate Bonds and a Director of Alaris Corporate Finance. Jonathan is Chair of the Steering Group.

Michel Pinto, former Vice-President Treasury, International Funding at Unilever, and former Member of the Technical Expert Group on Sustainable Finance at European Commission.

Sean Hanafin, Co-Founder of Silver Birch Finance, a private equity backed working capital boutique, and formerly European Head of Corporate Banking, Standard Chartered.

The Steering Group was supported by Marina Strovolidou, Climate Bonds Head of Certification.

3. Definitions

Climate Bonds: Climate Bonds is a company limited by guarantee and a charity registered in England. It is an independent not-for-profit organisation dedicated to mobilising global capital to deliver climate action.

Certification Scheme: A scheme developed by Climate Bonds for awarding the Climate Bonds Certification label to green finance instruments. The Scheme consists of the Climate Bonds Standard and the sector specific criteria.

Certified Debt Instrument: Any debt instrument certified by the Climate Bonds Standard Board Secretariat as meeting the requirements of the Climate Bonds Standard.

Climate Bonds Standard (CBS): A robust framework based on international best practice in green finance which defines the processes to be followed and sector eligibility criteria that must be met to achieve Climate Bonds Certification. The current version of the Climate Bonds Standard is published on the Climate Bonds website.

Pure-Play in green finance: an entity whose activities are substantially green.

Short-term Instruments: Debt Instruments with maturity at issuance of less than 365 days.

Issuer: An issuer (or borrower in the case of a loan) of a Certified Debt Instrument.

Verifier: An external reviewer who is authorised by the Climate Bonds Standard Board to issue a verification opinion in relation to a Certified Debt Instrument in accordance with the Climate Bonds Standard.

4. Scope and Purpose

The Steering Group was guided by the general principles that underlie any green financing arrangement in the spirit of the ICMA Green Bond Principles (GBP), the Climate Bonds Standard and the TEG Proposal for an EU Green Bond Standard issued in March 2020 and the legislated EU taxonomy. These principles and objectives are as follows:

- to support and facilitate the transition to a greener economy
- to encourage the transfer of capital to financing green projects
- alignment with the Climate Bonds Taxonomy and sector eligibility criteria
- establishment of a Green Finance Framework in which the Issuer explains its strategy and the purpose of the relevant green Use of Proceeds (UoP)
- application of the UoP principle
- traceability of the proceeds
- third-party verification at pre and post issuance.

The Steering Group has focused on the need to reconcile the use of short-term debt for financing longer-term projects and establish a link between short-term finance and sustainable activities.

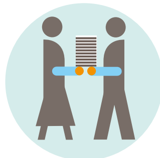
Recognising the important role played by financial institutions and green bond issuers in the short-term debt market, the Steering Group decided to engage in a consultation process with these stakeholders as part of its outreach.

5. Steering Group preliminary views

Investor interest

Green short-term debt instruments offer investors a lower risk investment (compared to longer dated debt) because of their short-term nature and reduced risk of government or central bank policy change. They also provide investors with greater flexibility to manage the maturity profile of their investment portfolio, while maintaining their exposure to climate finance.

Issuer interest



One reason an issuer may use short-term debt instruments is greater flexibility. An issuer can use short-term debt as a layer to its general funding policy, flowing into its longer-term capital structure, as green projects establish critical funding mass. They also offer the same level of transparency and contribute to positive environmental impacts like green bonds.

Differing prudential/liquidity treatments of various instruments will likely help drive issuer interest, while banks welcome a variety of tools at their disposal to diversify funding concentration (source, currency, product, tenor etc.). In addition, banks have client service models that seek to meet investor needs even if the bank doesn't necessarily gain funding advantage.

Relevance of term to maturity

The Steering Group debated whether establishing a link between the tenor of an instrument and the maturity of the financed assets is important for assessing the greenness of the instruments. The Steering Group concluded that short-term instruments do have an important role to play in the green finance market and the maturity of the instrument does not have to match the maturity of the assets financed by this instrument, so long as the underlying assets are aligned with the Climate Bonds' or EU Taxonomy and criteria. As a general principle, the maturity of the instrument can be shorter or equal, but not longer than the economic life of the assets, unless proceeds can be replenished with assets of similar green profiles (e.g., green receivables).

Some issuers of short-term paper implicitly use the refinancing argument and the notion of pre-financing to be replaced at some point in time by long-term bonds. It also facilitates the financing of the project build-up phase of green investments.

Market integrity

Some short-term instruments are by their nature more susceptible to greenwashing than other instruments. The Steering Group concluded that the overarching aim is to avoid greenwashing, so eligibility should be linked to the Climate Bonds' or EU Taxonomy and relevant sector eligibility criteria.

Short-term debt instruments can finance working capital linked to green projects or operating expenditures such as research and development (R&D), depollution works or repairs and maintenance of green projects.

All the principles used for green bonds remain valid: Green framework definition, UoP aligned with taxonomy, verification by duly authorised verifiers engaged at both pre and post issuance stage. However, there is a difference: the Steering Group considered that the traceability of funds is key for short-term green instruments.

Pure-play entities

The Steering Group concluded that a definition of a pure play, an entity with mostly green activities, would be crucial to the growth of this market, because short-term debt instruments are frequently used for general corporate funding. Qualifying entities could then label all their debt as green, regardless of tenor.

In line with Climate Bonds' definition of a climate-aligned entity, a pure play can be defined as an entity with activities that are at least 95% green.

The risk of double counting

Double counting and whether this should be of concern when assessing the eligibility of an instrument were considered. Leasing is a good example where one party borrows to buy a green asset. The lender gets the credit for the initial financing and the owner subsequently leases it to a third party who may also label the financing as green. The Steering Group concluded that to meet the primary goal of advancing a green agenda, double counting is inevitable, but it would be helpful to identify when double counting is significant.

Application of the Climate Bonds Standard to short-term debt Instruments

Term deposits and debt instruments with maturity of than one year have already been certified under the Climate Bonds Standard, as described in paragraph 6 below.

The issuer's Green Bond Framework should explicitly include reference to any certified short-term instruments and how they are used as part of the issuer's green financing program.

Furthermore, because of the short maturities of these instruments, post issuance verification is required at least on an annual basis and well before the 24-month deadline that the Climate Bonds Standard normally allows. For this reason, certified short-term instruments have only originated from Programmatic Issuers whose certified instruments are subject to annual post issuance verification by an external verifier approved by the Climate Bonds Initiative.

6. Short-Term instruments that may be certified under the CBS

Commercial Paper (CP) is unsecured, short-term debt commonly issued by companies or financial institutions to finance short-term liabilities. The proceeds mostly contribute to general corporate purposes and working capital financing. Maturities on most CP ranges from a few weeks to months, with an average of around 30 days. CP can be used as a layer of long-term funding if a certain amount of CP remains outstanding over time, often backstopped by an undrawn Green Revolving Credit Facility.

Examples include:

- **Hannon Armstrong** (2021).
- **SNCF** (2021) Green CP used to pre-finance projects later to be financed by green bonds.
- **Contact Energy** (New Zealand) certified their CP program in 2017 to finance renewable energy projects.

At present, UoP is the only way to achieve Certification since no definition of a pure play exists in the Climate Bonds Standard v3. Issuers would need to isolate and to trace the proceeds of the CP. These proceeds should be allocated to green projects or assets aligned with Climate Bonds Criteria. The proceeds could be used for pre-financing or for covering operating expenditures, such as depollution work, R&D, contracts with green electricity suppliers etc.

Pure plays could also issue certified CP in instances where UoP approach could not be used. This would require a Climate Bonds definition of a pure-play as noted above and once established, any instrument issued by the pure-play would be eligible for Certification.

Revolving Credit Facilities (RCF) are credit lines which may be drawn by the borrower and repaid on an ongoing basis with a term not exceeding one year, for consideration as a short-term debt instrument; clearly it is possible for tenors of RCF to exceed this maturity more broadly. The use of an RCF, even when it is of a five-year duration, is by nature short term, and is often used as a back stop to CP issuance. To establish green credentials, the parties to the loan must agree how the flow of funds will be evidenced using the UoP format.

RCF would be treated like CP: it would depend on the allocation of the proceeds and the related traceability. Once the pure-play definition is established, RCFs from such entities may then be eligible for certification.

Example:

- **Derwent RCF** from HSBC (2019).

Short-term bank loans are bilateral green loans and/ or syndicated term loans, that commercial, multilateral and development banks offer to their corporate and institutional customers to finance specific green projects with set criteria and reporting requirements. The loans may, or may not, be public and the terms vary considerably.

Where the UoP are aligned with Climate Bonds criteria, such loans may be certified.

In the case of a bridging loan to longer-term finance, the look back period for financing operating expenses should be limited to three years in line with *Article 4 of EU Regulation 2021/0191* in the proposed European Green Bond Standard.

Export Letters of Credit are issued by banks, guaranteeing future payment (upon receipt of goods) to the exporter. These instruments are usually short-term, generally used in trade with developing countries and/or importers of relatively weak credit quality.

Certification requires the verifier to confirm that the UoP of the importer is aligned with the Climate Bonds Criteria.

Certificate of Agribusiness Receivables (CAR) is a title backed by agribusiness credit, created by the Brazilian government to encourage the financing of the chain of production in the agricultural sector. These instruments are issued by securitisation vehicles and sold to investors in capital markets to finance the purchase of the feedstock.

The same rules as for CPs apply, including alignment with the Climate Bonds Agriculture/Bioenergy criteria; existing examples of certifications already exist. Adaptation and resilience criteria also require that the agricultural production units do not harm the resilience of the system they operate in.

Example:
- **FS Bioenergia**, Certified CRAs (2021).

Export Financing in Brazil

- Advance on Export Exchange Contracts (ACC): The supplier sells goods to an international buyer and a bank finances supplier´s working capital needed to produce the goods. The supplier repays the bank on maturity. ACCs offer tax benefits provided by the Brazilian Government to promote exports.

- Advance on Export Shipping Document (ACE): Similar to ACC, but this is a post-shipment financing. The supplier provides a longer payment tenor to international buyers and a bank finances its working capital needs derived from the goods commercialization.

Certification requires the verifier to confirm that the UoP of the exporter is aligned with the Climate Bonds Criteria.

Green Deposits usually have a maturity of up to 1-year and are accepted by financial institutions. Depositors are often institutional investors. Non-banks (e.g. securitisation vehicles) may also issue green units or notes.

Often demand can be driven by format, e.g., not all investors can buy securities, so they opt for deposits instead. Deposits can also be tailored for size, currency, and maturity.

Eligibility for certification of instruments offered by the deposit provider (the bank) is under the UoP principle. As the volume of these liabilities fluctuates, Climate Bonds requires an annual external review. Existing examples of certifications already exist, such as **Westpac, National Australia Bank, Commonwealth Bank of Australia** variations of Certified Green Deposits. For these banks, green segregated balance sheets and liquidity profiles are done at a total portfolio level. In the absence of green liabilities, green assets get funded from a pool of non-green funds.

Other examples:
- **Standard Chartered's Sustainable Account for UK and UAE** (2021).
- **Nedbank's Green Term Deposits offering** (2015).

Floating Rate Notes have a variable interest rate tied to a benchmark rate. Interest is usually paid quarterly and the term is several months/years. FRNs are popular with US corporates with quarterly re-issuance.

Eligibility for certification is under the UoP principle, as for CP.

Example:
- **OCBC Bank** Singapore (3-year notes).

Eligibility for certification is under the UoP principle.

Example:
- Certified **Barclays** Green Structured Notes (2021), note pay-off based on a green index.

Green Repurchase Agreements (Repos) enable short-term borrowing by banks or corporates, usually in government or investment grade securities governed by a GRMA agreement. The difference in price is the implicit overnight interest rate. Repos are typically used to raise short-term capital (overnight or with maturity < 12 months).

UoP principle must be applied to avoid greenwashing. Traceability of the cash leg is important.

Green Repos are considered as Climate Bonds eligible under the UoP principle. For such instruments the green label is not determined by the collateral. As the volume of these liabilities fluctuates, Climate Bonds requires annual external review. An existing example of a certification is the **Commonwealth Australia Bank Green Repo** (2021).

Other green repo examples:
- **Agricultural Bank of China with BNP Paribas** (2021).
- **EDF with BNP Paribas** (2021).
- **Standard Chartered Bank with Saudi National Bank** (2021).

Green Leases are bilateral contracts whereby the owner of the asset (the lessor) grants to another party (the lessee) the exclusive right to use the asset for an agreed period, for an agreed amount payable on a periodical basis (lease rentals) over the specified lease period.

A green lease agreement which is intended to ensure that the leased assets are used and managed in a manner which fosters sustainability. It may relate to land and buildings, but also to electric vehicles or other green assets.

If the Lessee recognises the asset in its Balance Sheet under IFRS16 and the asset is aligned with the Sector Criteria, it is eligible for Certification. An example of a green lease certification is **California Public Works Board** (2021).

Trade Finance / Receivables Financing / Factoring - A third-party lender buys outstanding accounts receivable at a discount. The trader's/exporter's accounts receivables effectively act as collateral. The key is to understand what the receivables, creditors or stocks relate to. Are they related to green assets or green revenues? For illustration, if creditors are solar panel providers for an electric company, this can satisfy this requirement. The idea is relatively straightforward for pure-plays. Requirement to track and report otherwise.

Eligibility for certification is under the UoP principle.

- Example: **Standard Chartered** set up its first green trade finance facility in 2021 for **Amplus Energy Solutions**.

Supply Chain Financing - A buyer purchases goods from a supplier; the buyer may extend the trade terms of the supplier. A Supply Chain Finance bank provides discounted early payment to the supplier. At invoice maturity, the buyer pays the invoice to the bank. The bank implicitly relies on the buyer credit and provides credit to supplier at an attractive cost. This works economically when the buyer has a better credit rating than the supplier and can thus access capital at a lower cost.

Eligibility for certification is as for CP, under the UoP principle.

Stock / Inventory Financing is credit obtained by businesses to pay for products that aren't intended for immediate sale. It allows businesses to free up working capital that is otherwise tied up, by borrowing against the value of the stock, both finished goods and raw materials.

Eligibility for certification is as for CP, under the UoP principle.

Bank Guarantees are issued by a bank to a corporate to undertake the settlement of a liability if the corporate fails to deliver on its obligations to a third party. Typically used in large infrastructure projects. The risk of double counting should be monitored and eliminated when the contingent liability materialises.

Eligibility for certification is as for CP, under the UoP principle.

Example:

- **Crédit Agricole** CIB Spain signed an agreement with **Siemens Gamesa Renewable Energy S.A.** for an Uncommitted Global Green Guarantee Facility (2020).

Note that this would be relatively straightforward for pure plays. Climate Bonds will confirm the definitions of an eligible pure play in the coming months. Requirement to track and report otherwise.

Sustainability Linked Commercial Paper is essentially the same as for CP, but with pricing linked to an ESG rating objective or general environment company objective.

These would, at a minimum, be aligned with the Sustainability Linked Loan/Bond Principles, rather than using the UoP principle. Verifiers assess performance against Sustainability Performance Targets as measured by stated Key Performance Indicators.

Sustainability-Linked Instruments cannot yet be Certified under the Climate Bonds Standard. The development of criteria for several transition sectors and for certifying entities transitioning to net zero will allow such instruments to be certified under the Climate Bonds Standard.

Examples:

- **Enel SpA l SDG 7 - Euro Commercial Paper Program.**
- **LafargeHolcim Sustainable Cp** (2021).

7. Recommendations

Short-term debt is deemed to be consistent with the goal of financing Climate Bonds eligible projects, assets, and expenditures, because of the important role it plays in effective treasury management and as bridge capital.Short-term debt should be labelled as green to enable its identification and preferencing by investors, and it should be included in thematic investment strategies.

The Steering Group concluded that having a specific and practical definition for a pure-play entity is critical for the future success and development of the green working capital market. Climate Bonds will develop definitions of eligible pure-play entities and develop criteria for certifying entities in the coming months.

8. Conclusions

This paper seeks to confirm the eligibility of short-term debt under the Climate Bonds Certification Scheme. Short-term debt instruments have an important role to play in effective treasury management and as bridge capital mechanisms. As such, short-term debt instruments are deemed to be consistent with the goal of financing green projects and assets.

Until recently, green CP and other short-term instruments have attracted little attention in the sustainable finance market. To support climate-related capital flows at the required speed and scale, this market must be equipped to support the transition to net zero.

To fully mobilise capital for climate solutions, attention needs to be paid to all capital markets, each with their own important role in the complex flow of capital the global economy depends on. The whole spectrum of the capital markets needs to transition to green to enable the delivery of net zero by 2050.

Double counting is the inevitable consequence of having two parties to every green financing transaction and cannot be eliminated, but may need to be monitored.

Finally, the rapid growth of global investor appetite for green-themed paper, including some initial CP issuance, suggests that conditions are favourable for a rapid growth of Green CP and other short-term instruments.

For Certification under the Climate Bonds Standard, issuers must incorporate their short-term debt financing instruments in their Green Bond Frameworks and follow a programmatic Certification approach which requires post issuance external verification at least on an annual basis.

Climate Bonds INITIATIVE

www.climatebonds.net

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