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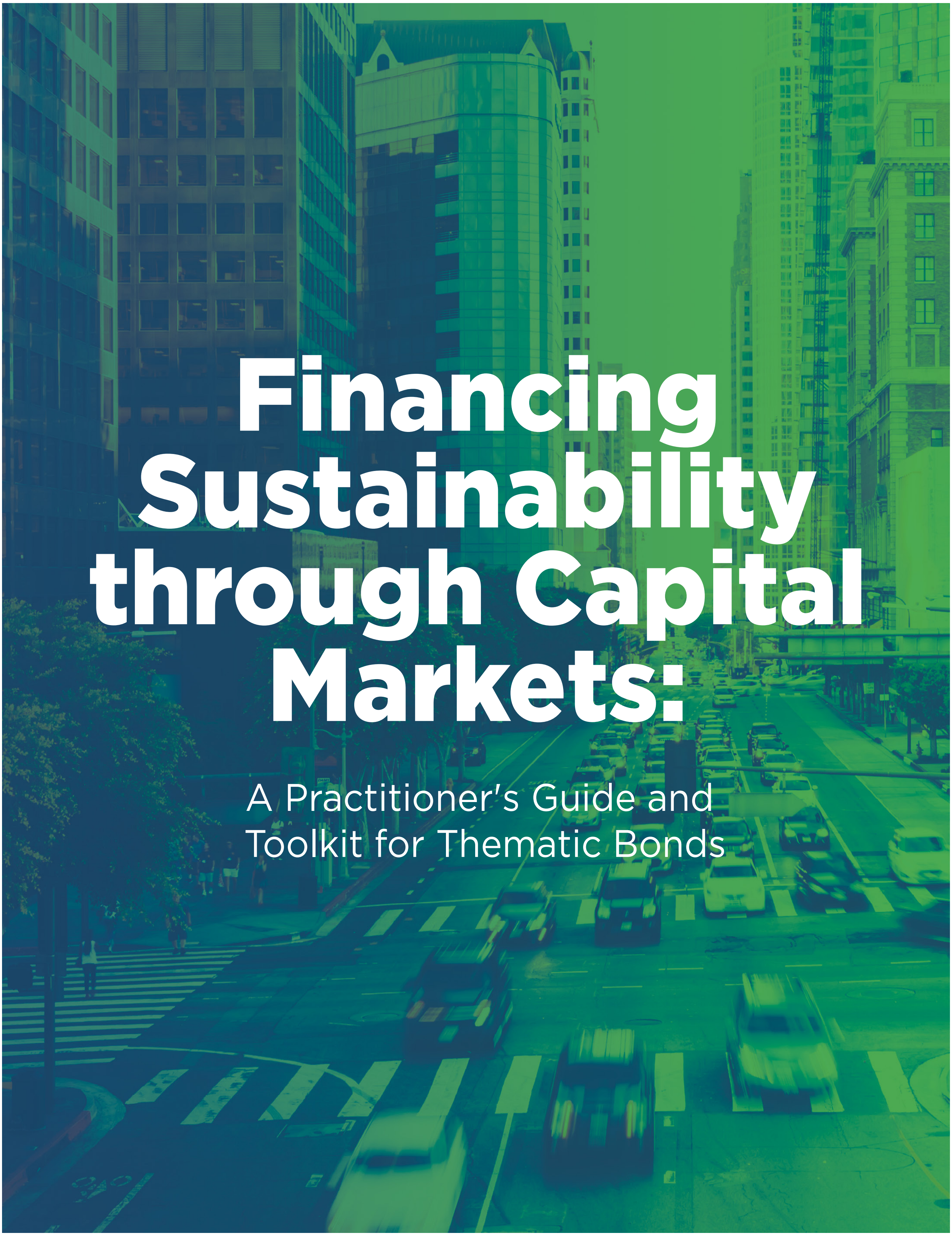

# Financing Sustainability through Capital Markets:

## A Practitioner's Guide and Toolkit for Thematic Bonds

# Acknowledgements

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# Acronyms

| | |
|---|---|
| **CBI** | Climate Bonds Initiative |
| **CG** | Corporate Governance |
| **CGDF** | Corporate Governance Development Framework |
| **DNSH** | Do No Significant Harm |
| **E&S** | Environmental and Social |
| **ESG** | Environmental, Social and Governance |
| **GBP** | Green Bond Principles |
| **GBTP** | Green Bond Transparency Platform |
| **ICMA** | International Capital Market Association |
| **IDB** | Inter-American Development Bank |
| **KPIs** | Key Performance Indicators |
| **LAC** | Latin America and the Caribbean |
| **NbS** | Nature-based Solutions |
| **SBG** | Sustainability Bond Guidelines |
| **SBP** | Social Bond Principles |
| **SDGs** | Sustainable Development Goals |
| **SLBP** | Sustainability-Linked Bond Principles |
| **SPO** | Second Party Opinion |
| **SPT** | Sustainability Performance Targets |
| **UNCTAD** | United Nations Conference on Trade and Development |
| **UNGC** | United Nations Global Compact |
| **UoP** | Use of Proceeds |

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# Foreword

### Building sustainable capital markets for a green and inclusive recovery

The world is facing an uncertain future: environmental and social risks, coupled with inadequate governance, threaten to destabilize economic growth[1] as we have known it. Climate action failure, biodiversity loss, involuntary migration, and infectious disease are but a few of the risks commonly cited by governments, society, and business as impediments to sustainable and inclusive long-term economic growth. Overcoming these hurdles requires mobilizing trillions of dollars in investments. In meeting the UN Sustainable Development Goals (SDG) alone, it is estimated that developing countries face a USD 2.5 trillion annual investment gap. This gap has likely deepened due to the COVID-19 pandemic, with private capital exiting developing economies and domestic spending diverted to emergency response.

Tapping into capital markets is critical for achieving a sustainable economic transition. We have the opportunity to apply a different perspective to confront the effects of this crisis and find sustainable solutions that benefit society and nature. Thematic bonds, which allocate proceeds to investments with positive environmental or social benefits, have demonstrated that they can help close this financing gap. They are effective investment vehicles, which can unlock investment flows by driving institutional and private capital towards sustainability.

As part of its mission, multilateral development banks have played a significant role in promoting the advancement of the thematic market by catalyzing institutional investments and enhancing private sector participation. IDB Invest has been a leader in Latin America and the Caribbean (LAC), supporting and structuring over 20 of these new instruments in nine countries to-date. In total, we supported roughly 30% of all social, sustainable, and green bonds issued by the private sector in LAC. IDB Invest further cemented its leadership in thematic bond markets in LAC with the publication, in January 2021, of its own Sustainable Debt Framework, the issuance of a USD 1 billion inaugural sustainable bond in February, and its first local gender bond issuance in Mexico in March 2021.

[1] See World Economic Forum, Global Risks Report, 2021, http://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2021.pdf

Our experience as a market leader in structuring these transactions and promoting further market development in the region highlighted the need to define practical guidance for thematic bond issuers and other market actors. With this publication, we aim to provide issuers with a guide on the factors that shape a successful thematic bond issuance.

This publication highlights current best practices in the market, while offering practical tools to help issuers assess their readiness to these best practices. The guide presents a holistic perspective to the concept of a thematic bond – describing how for issuers it provides an opportunity to diversity its investor base, while for investors a means to achieve non-financial impact alongside an investment return.

IDB Invest believes that adequate governance systems are crucial to the success of an issuance. IDB Invest works directly with clients, to help them adopt good corporate governance practices that meet internationally recognized standards. This publication provides tools that help issuers´ strengthen capacity to deliver on commitments, while also providing concepts to engage with their investor base through quality reporting.

The document also provides a practical roadmap for an issuance that emphasizes the key guidance steps for structuring. It details the specifics of each of the five stages that need to be addressed to give the bond its thematic flavor. Issuers can apply the Readiness and Proximity to Best Practices Assessment, which will help them to judge their preparedness and evaluate both their capacity as an organization and the foundation of the issuance itself.

The global thematic fixed income market has been steadily growing over the past years, reaching USD 700 billion in sustainable debt through 2020, nearly doubling the 2019 total of USD 358 billion. This is an evolving market, and we are committed to develop its full potential in our region. Our goal is to continue to be a market maker, catalyzing these investments through innovative instruments, our unique anchoring in the region, and by leveraging the power of being a member to the IDB Group.

With a regional recovery from the global pandemic close at hand, there is a great opportunity to further boost this nascent marketplace as a vehicle to shepherd the green and inclusive recovery that our region needs.

James Scriven, CEO of IDB Invest

# Introduction

The world faces serious environmental, social, and governance challenges that have long-term consequences and overcoming them requires mobilizing trillions of dollars in investments. Before the United Nations (UN) launched the Sustainable Development Goals (SDGs), the United Nations Conference on Trade and Development (UNCTAD) estimated that developing countries alone faced a USD 2.5 trillion annual investment gap to meet the SDGs.[1] This gap has likely deepened due to the COVID-19 pandemic, with private capital exiting developing economies and domestic spending diverted to crisis response.[2] Tapping into capital markets is critical for achieving a sustainable economic transition. Thematic bonds have demonstrated that they can be used as effective investment vehicles to help close this financing gap by driving institutional and private capital to prioritize the sustainability agenda.

Thematic bonds are valuable capital market instruments that have the ability to accelerate and unlock sustainable financial flows. They can attract mainstream institutional and impact investors, both local and international, and therefore have a positive influence on the issuer's ability to diversify sources of funding, while promoting investments with social and environmental benefits. The global thematic fixed income market has been steadily growing over recent years; reaching USD 700 billion in sustainable debt through 2020, nearly doubling the 2019 total of USD 358 billion.[3] Despite market expansion, thematic bonds still represent a small percentage of the global bond market.[4] Therefore, there is a great opportunity to further boost this market. This is particularly the case in Latin America and the Caribbean (LAC) which makes up only 2% of global thematic bond issuances.

[1] United Nations Conference on Trade and Development (2014). World Investment Report. Available Online: https://unctad.org/system/files/official-document/wir2014_en.pdf

[2] OECD (2020). The impact of the coronavirus (COVID-10) crisis on development finance. Available Online: http://www.oecd.org/coronavirus/policy-responses/the-impact-of-the-coronavirus-covid-19-crisis-on-development-finance-9de00b3b/

[3] BloombergNEF (2021). Sustainable Debt Breaks Annual Record Despite Covid-19 Challenges. Available Online: https://www.climatebonds.net/resources/press-releases/2021/04/sustainable-debt-global-state-market-2020-scale-and-depth-17tn

[4] Estimated to be USD 128.3 trillion. ICMA (2020). Bond Market Size. Available Online: https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/bond-market-size/

Multilateral development banks have played a significant role in promoting thematic bond market advancement by attracting institutional investors and enhancing private sector participation. IDB Invest has been a leader in LAC by supporting, structuring, purchasing and issuing these new instruments. Through 2020, IDB Invest had supported twenty issuances in the region: six green bonds, four sustainable bonds, four social bonds, and four gender social bonds for financial institutions and corporations in Argentina, Brazil, Colombia, Costa Rica, Ecuador, Mexico, Panama, Peru, and Uruguay. Some of these transactions were firsts of a kind in their local market and globally, such as Davivienda's gender-linked bond, which expanded the bank's loan portfolio of woman-led SMEs, among other outcomes.[5] At the start of 2021, IDB Invest further demonstrated market leadership by publishing a **Sustainable Debt Framework** to issue green, social and sustainability bonds and other debt securities. IDB Invest's inaugural sustainability benchmark bond issued in February raised USD 1 billion in funding to support the bank's strategy to reignite growth in LAC.[6] Becoming a thematic bond issuer conveys IDB's commitment to sustainable development, increases transparency among the investor community of its environmental and social impact, and further strengthens IDB Invest's leadership position in the thematic bond market in LAC.[7]

With the support of HPL.LLC, IDB Invest developed this guide, **Financing Sustainability through Capital Markets,** to promote further market development in the region. The objective of this document is to provide issuers with a guide on the factors that shape successful thematic bond issuances, outlining the management capacity and internal systems that should be in place in the organization. It presents a holistic perspective, highlighting how to systematically incorporate ESG factors into the decision-making process with risk and opportunity in mind, while also ensuring performance is measured at the level of the issuance and the issuer.

First-time issuers can start at **Chapter 1 and 2**, which provide a definition of thematic bonds and describe the business case for issuing a thematic bond, outlining the benefits for issuers and investors. Those who already have the background knowledge can skip directly to **Chapters 3 and 4** which focus on the management capacity and implementation process of issuing a thematic bond. Chapter 3 describes how robust Corporate Governance practices help issuers enhance preparedness for issuing and minimize risk, while Chapter 4 provides a practical roadmap for issuance that emphasizes the key guidance steps for structuring. It includes an assessment framework to measure an issuer's overall readiness to issue a thematic bond. The document concludes with **Chapter 5**, which provides insights on current innovations and future market trends.

[5] IDB Invest (2020). IDB Invest structures the world's first gender-linked bond based on achieving outcomes, issued by Davivienda. Available online: https://www.idbinvest.org/en/news-media/idb-invest-structures-worlds-first-gender-linked-bond-based-achieving-outcomes-issued

[6] IDB Invest (2021). IDB Invest launches $1 billion inaugural sustainability benchmark bond. Available Online: https://www.idbinvest.org/en/news-media/idb-invest-launches-1-billion-inaugural-sustainability-benchmark-bond

[7] IDB Invest (2021). IDB Invest launches Sustainable Debt Framework to support the economic recovery in Latin America and the Caribbean.
Available Online: https://www.idbinvest.org/en/news-media/idb-invest-launches-sustainable-debt-framework-support-economic-recovery-latin-america-and

# 01.

# A BRIEF OVERVIEW OF THEMATIC BONDS

# 1.1 Defining Thematic Bonds

The transition towards a sustainable global economy requires scaling investments that provide positive ESG impacts. Thematic bonds are similar to their traditional debt counterparts except that their financing is allocated to investments with positive environmental and/or social benefits, thus contributing to the sustainability agenda. Thematic bonds can be issued by corporations, financial institutions, projects (project bonds), sovereigns, and sub-sovereigns to finance or refinance, in part or in full, new and/or existing assets or projects.

Green bonds were the first class of labeled instruments, inaugurating the market in 2007. The green bond market has grown exponentially in recent years, reaching a new milestone at the end of 2020, achieving USD 1 trillion in cumulative green issuance since market inception.[8] Beyond green bonds, an assortment of other labeled bonds has emerged, such as social, sustainability, blue, gender, SDG and transition, among others. While there is no universally accepted definition of thematic bonds, there have been various market guidelines and standards that have emerged in recent years. The International Capital Market Association (ICMA) principles are the most prevalent, as they provide voluntary guidelines for green, social and sustainability bond issuers. These principles have become the common denominator and building block for other labels and standards. The following table defines the common thematic labels in this market, along with an illustrative example of its respective key guidelines or standards.

[8] Climate Bonds Initiative (2020). $1 Trillion Mark Reached in Global Cumulative Green Issuance. Available Online: https://www.climatebonds.net/2020/12/1trillion-mark-reached-global-cumulative-green-issuance-climate-bonds-data-intelligence

### Table 1. The Thematic Bond Universe

| LABEL | DEFINITION | MAIN MARKET GUIDELINES/STANDARDS |
|---|---|---|
| Green | A fixed-income security raises capital earmarked for new or existing projects with environmental benefits. | ICMA Green Bond Principles (GBP)<br>EU Green Bond Standard (GBS)<br>Climate Bonds Standard Version 3.0 |
| Social | A fixed-income security raises capital earmarked for new or existing projects with social benefits. | ICMA Social Bond Principles (SBP) |
| Sustaina-bility | A fixed-income security raises capital earmarked for new or existing projects with a mix of environmental and social benefits. | ICMA Sustainability Bond Guidelines (SBG) |
| Transition | A fixed-income security raises capital earmarked for new or existing climate transition-related projects. These bonds are targeted at industries with high greenhouse gas (GHG) emissions that will allow them to secure funding with the goal of shifting to low-carbon business activities. | AXA IM Guidelines for Transition Bonds<br>IFC Definitions for Climate-Related Activities<br>CBI Financing Credible Transitions |
| Blue | A fixed-income security raises capital earmarked for new or existing marine and ocean-based projects that have positive environmental, economic and climate benefits. | UNGC Blue Bonds Reference Paper<br>EIB / European Commission / WWF / ISU Blue Economy Finance Principles<br>UNGC Sustainable Ocean Principles |
| Gender | A fixed-income security raises capital earmarked for new or existing projects that support the advancement, empowerment and equality of women. | ICMA SBP<br>UN Women's Empowerment Principles |
| SDG | A fixed-income security that raises capital earmarked for new or existing green, social or climate-related activities linked to the SDGs. | SDG Impact Standards for SDG Bonds |

# 1.2 Eligible Use of Proceeds

Green, social, and sustainability are the most common thematic labels in the market. In their simplest form, **green bonds** finance environmental projects, **social bonds** target projects with social benefits among a given population, and **sustainability bonds** address a combination of green and social issues for a target population. Therefore, the latter bond's use of proceeds (UoP) may comprise eligible categories from green and social bonds. The adjacent diagram summarizes the eligible categories according to ICMA

**Figure 1. Green, Social, and Sustainable Use of Proceeds**

**Sustainability Use of Proceeds (Green + Social)**

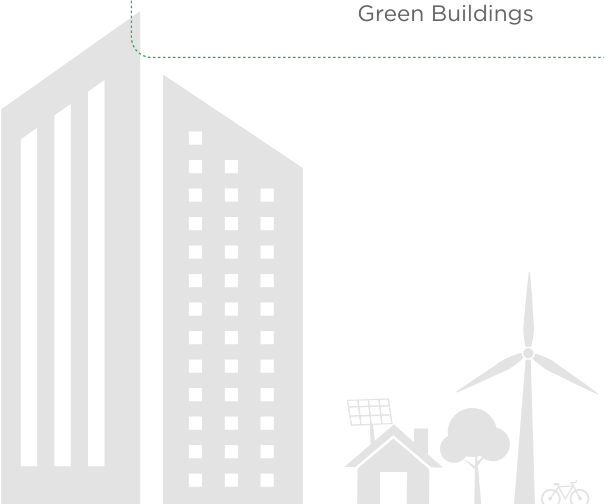
**Green Use of Proceeds (Elegible Categories)**

- Renewable Energy
- Pollution Prevention & Control
- Energy Efficiency
- Sustainable Water & Wastewater Management
- Eco-efficiency and/or Circular Economy
- Sustainable Management of Living Natural Resources and Land Use
- Terrestrial and Aquatic Biodiversity Conservation
- Clean Transportation
- Climate Change Adaptation
- Green Buildings

**Social Use of Proceeds (Eligible Categories & Target Population)**

- Affordable Basic Infraestructure
- Access to Essential Services
- Afforable Housing
- Employment Generation & Programs to Alleviate Unemployment from Socioeconomic Crises
- Food Security and Sustainable Food Systems
- Socieconomic Advancement and Empowerment

1. Living below poverty line
2. Excluded and/or marginalized populations
3. People with disabilities
4. Migrants and/or displaced persons
5. Undereducated
6. Underserved owing to a lack of quality access to essential goods & services
7. Unemployed
8. Women and/or sexual & gender minorities
9. Aging populations & vulnerable youth
10. Other vulnerable groups, including as a result of natural disasters



# 02.

# THE MARKET FOR THEMATIC BONDS

Thematic bonds offer benefits for both issuers and investors. From the issuer's point of view, thematic bonds can help them integrate sustainability into their overall strategy, positioning them as a more responsible company and attracting greater interest from customers and investors. For investors, thematic bonds can help connect them with investment opportunities and potentially deliver non-financial impact by addressing societal development needs. The list below presents further examples of the benefits to thematic bonds from issuer and investor perspectives:

**Table 2. Benefits for Issuers & Investors**

| | BENEFIT | DESCRIPTION |
|---|---|---|
| Issuers | Upgrade sustainability credentials | The process of issuing a thematic bond can be a catalyst to solidify sustainability in the DNA of the organization as it allows management to align their financial actions to their sustainability goals resulting in a more faithful investor base and more engaged workforce. |
| | Increase investor demand and diversification | Thematic bond issuers can attract new investors with sustainability mandates. |
| | Achieve higher levels of oversubscription | Anecdotally, demand for thematic bonds generally outstrips supply. Given the strong demand, some issuers claim to achieve a tighter yield at issuance, especially for bonds denominated in EUR or USD. |
| | Establish a loyal investor base | Impact investors tend to hold bonds to maturity, which can provide stability for thematic bond issuers. |
| | Enhance market and brand value | A thematic bond issuance allows management to promote the organization's sustainability practices, which is well received by key stakeholders like investors, employees, regulators, and consumers. |
| | Enhance reputation and visibility | Thematic issuers can brand themselves as forward thinking, innovative, and sustainable, which demonstrates their commitment to addressing climate and social issues. |
| | Promote intra-company collaboration | The process of issuing a thematic bond makes it possible to strengthen internal communication between the finance and sustainability teams |

Table 2. Benefits for Issuers & Investors

| | BENEFIT | DESCRIPTION |
|---|---|---|
| Investors | Provide a long-term impact investment option for institutional investors | For asset managers, investment in thematic bonds provides a market return plus a measurable impact at the same time. For pension funds, investment in thematic bonds provides an opportunity to finance green and/or social infrastructure, which matches long term liabilities while also helping to build a sustainable society for pensioners to retire into. |
| | Generate investment opportunity in quality assets with transparent reporting | Thematic bonds are inherently more transparent because because their allocation and impact are reported annually, providing investors with a greater understanding of the impact of their investment for their own reporting purposes. |
| | Address environmental and social issues | Thematic bonds direct capital to activities that can generate positive environmental and social impact. They advance adoption of innovative new technologies, finance projects that provide green jobs, and promote economic opportunities, equal access to basic services and climate resiliency across regions. |
| | Enhance risk management | Issuers provide a solid due diligence for the selection of projects, which provides investors with a clear way to get both economic and environmental returns without significant additional risk. |
| | Meet sustainability objectives | Investing in thematic bonds can help investors meet their sustainability objectives (i.e., decarbonizing their portfolios). |

# 2.1 The Business Case

IDB Invest has been instrumental in shaping the thematic bond market in LAC. In scaling the market for thematic bonds, IDB Invest follows a holistic approach to promote participation by issuers and to foster investor confidence in thematic bonds. To facilitate private sector clients' access to thematic debt capital markets, IDB Invest offers financial and non-financial solutions related to: Financial Products; Advisory Services and ESG.

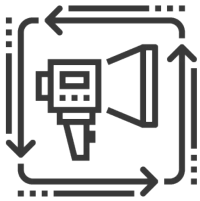
## Financial Products

IDB Invest has supported the effort of financial institutions and corporations to raise private funds at adequate maturities and terms in both local and international capital markets through the issuance of thematic bonds. These instruments attract institutional and thematic investors, diversifying sources of funding and promoting impact-driven investments.

IDB Invest can apply the following financial mechanisms to support thematic issuers: IDB Invest participates in private sector bond issuances either as a sole investor, anchor investor, credit guarantor, or by providing bridge financing to support our clients' future bond issuances.

**Fig 2 : Green, Social and Sustainable Bonds supported by IDB Invest**

## Bond Subscription:



IDB Invest can purchase a partial or total portion of the issuance of public or private debt securities, including asset backed securities. IDB Invest's participation as an anchor investor sends a strong signal to the market about the quality of the borrower and helps enhance the credibility of the bond, thus attracting local and/or international investors.

## Partial or Total Credit Guarantees:

A credit guarantee improves the risk profile of debt instruments. IDB invest can issue partial or total credit guarantees to cover bond issuances, leveraging their triple-A credit rating and crowding in institutional investors.

## Warehousing Lines:

IDB invest can grant revolving lines to acquire and accumulate assets for an exit in the capital markets via securitization (issuance of an Asset Backed Security [ABS] bond).

## B Bond:

IDB Invest can create alternative structures to mobilize institutional investors. The B Lender is a Special Purpose Vehicle (SPV) or trust that funds itself by selling notes to institutional investors as a private placement.

# Advisory Services and ESG Enhancement:

IDB Invest supports commercial financial institutions, private corporations and national development banks to prepare for their issuance of Green Social, and Sustainability Bonds. IDB's assistance to clients can be at various levels, and specifically might: (1) assess eligibility and capacity for a thematic bond issuance, including improving corporate governance prior to issuing; (2) support development of frameworks; or (3) support obtaining a third-party verification. Where necessary, IDB Invest defines an action plan with clients to strengthen the environmental, social or governance performance at the level of the issuance and the issuer.

# Advocacy:

IDB Invest works to develop the integrity and transparency ofthe asset class in order to foster issuer and investor confidence. As a part of IDB Invest's advocacy, the bank has published sustainability protocols, updated policies on Access to Information and Environmental and Social Sustainability, published sector guidelines and engaged in public-private sector dialogues, innovation labs, and other knowledge sharing platforms such as the Green Bond Transparency Platform to improve investment environments and promote the adoption of best practices for capital markets.

# Managing for Impact:

IDB Invest's mandate is to maximize development impact while maintaining financial sustainability, a two-sided objective shared with many impact and ESG investors. Therefore, IDB Invest developed its Impact Management Framework,[10] an end-to-end series of tools and practices that support the complete project lifecycle and integrate impact and financial considerations into portfolio management.

Its Impact Management Framework allows IDB Invest to build, measure, and manage a portfolio of financially sustainable investments that contribute to fulfillment of the SDGs. The framework is also fully aligned with common market practices, such as the Impact Management Project's five dimensions of impact and the Operating Principles for Impact Management.[11] IDB Invest applies its Impact Management Framework to thematic bond transactions to target high-impact sector opportunities and systematically assess the expected impact of each investment, as well as to enhance the dissemination of the results achieved.

[10] https://idbinvest.org/en/publications/idb-invests-impact-management-framework-managing-portfolio-impact
[11] IDB Invest's alignment with these Principles was independently verified in 2020. See: Disclosure Statement: Operating Principles for Impact Management and the Independent verifier's limited assurance report on the alignment of IDB Invest with the Operating Principles for Impact Management

## The Green Bond Transparency Platform


The Green Bond Transparency Platform (GBTP) is an initiative developed by the Inter-American Development Bank (IADB) to support harmonization and standardization of LAC green bond reporting and to promote greater transparency and comparability for investors. The platform supports secure, consistent, transparent and reliable reporting of impacts generated by all green bonds in the region. It allows tracking of impact at the use of proceeds level in line with existing and evolving standards and methodologies to build a track record on green bond use of proceeds and to generate confidence in the growing market in LAC.

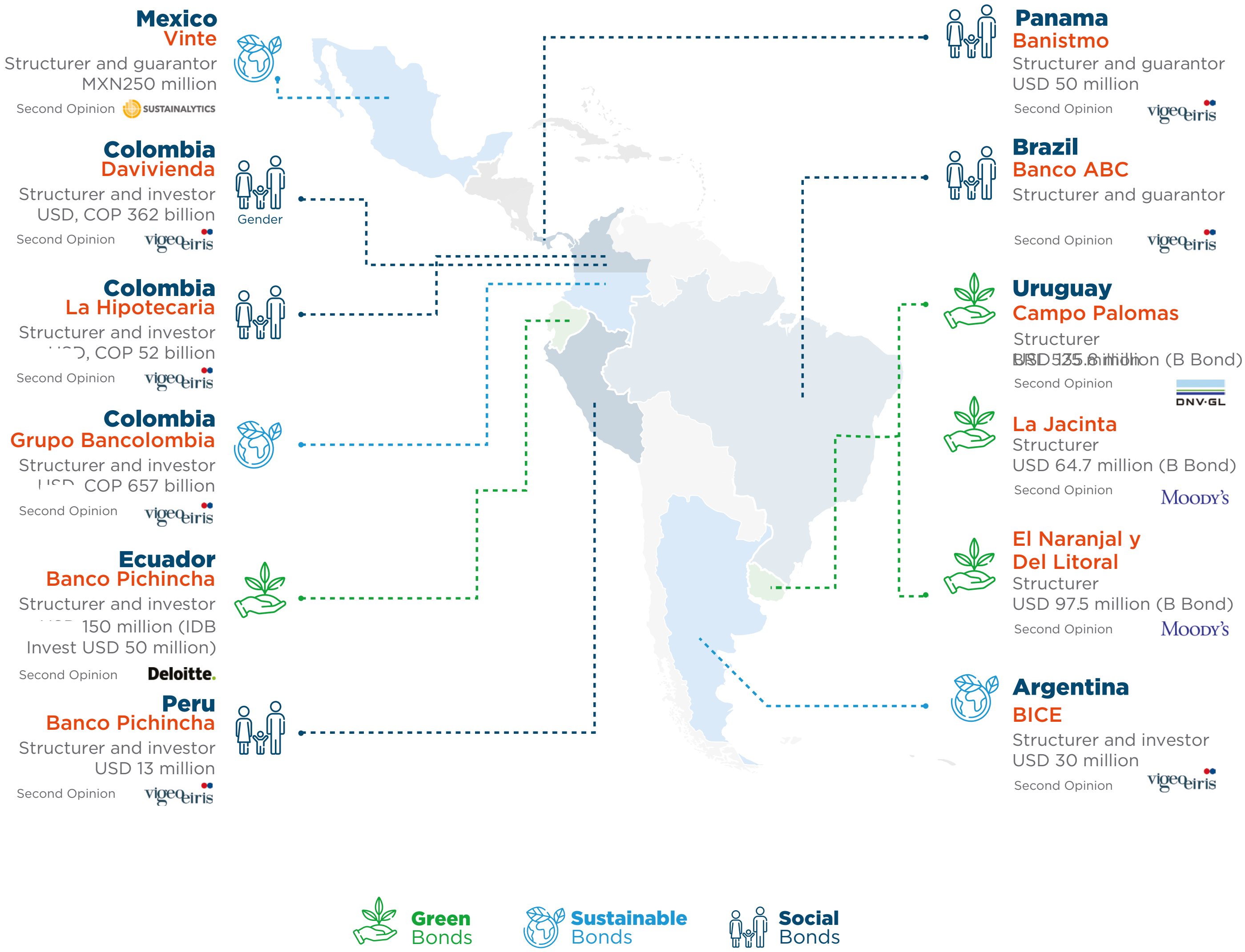
# 2.2 Promoting Thematic Market Growth in LAC

IDB Invest is successfully encouraging private sector participation in thematic bond issuance and attracting more investors to the asset class. Since 2017, IDB Invest has supported the issuance of 20 thematic bonds, valued at USD 1.3 billion, which includes mobilization of USD 500 million of private capital. This volume represents about 10% of the thematic bond market in LAC by volume or about half the number of all thematic bonds issued to date in the region.[12]

IDB Invest has supported many first-of-its-kind transactions including the first gender bond in Latin America, the first social bond in Brazil, or the world's first gender-linked bond based on achieving outcomes. Figure 2 highlights the diversity of thematic bonds supported by IDB Invest. The full list of transactions is available on https://www.idbinvest.org/en/solutions/capital-markets.

[12] According to ICMA sustainable finance database.

**Figure 2. IDB Invest's Role in Promoting the Thematic Bond Market in LAC**




IDB Invest further cemented its leadership in thematic bond markets in LAC with the publication, in January 2021, of its own Sustainable Debt Framework. This is the first ICMA-aligned sustainability debt framework from a high-grade Multilateral Development Bank. IDB Invest launched a USD 1 billion inaugural sustainable bond in February to support the economic recovery in the region followed by its first local gender bond issuance in Mexico.

# 03.

# BUILDING THE FOUNDATION THROUGH CORPORATE GOVERNANCE (CG)

# 3.1 Why CG Matters

Improving the quality of Corporate Governance (CG) in LAC is essential to develop capital markets in general, and thematic bond markets in particular, bringing down risk levels and ensuring public trust in the region, which has historically been characterized by concentrated ownership structures and an “agency conflict” concerning the relationship between majority and minority shareholders and management. Because issuers’ compliance with thematic bond standards is voluntary and there are no built-in enforcement mechanisms, issuers with robust corporate governance and adequate management systems in place are better equipped to ensure that these assets contribute meaningfully to the sustainability transition.

**Issuers with robust CG and management systems in place are better equipped to issue a thematic bond**

Figure 3. Aspects of Corporate Governance

An adequate CG framework should aim at improving effectiveness of the board of directors, oversight and control systems, transparency, and accountability, minimizing information asymmetry and conflicts of interest. Sound CG makes institutions stronger, more efficient and accountable, and supports the implementation of good environmental and social practices. Well governed issuers will be better positioned to mitigate risks, safeguard against mismanagement and attract investment with a lower cost of capital. Businesses that operate more efficiently tend to allocate and manage resources more sustainably, while stronger stakeholder relationships help companies resolve environmental and social issues more effectively.[13]

## Advocating for Sustainable Corporate Governance

IDB Invest works directly with clients to help them adopt good corporate governance practices that meet internationally recognized standards. IDB Invest has developed a methodology in line with the Corporate Governance Development Framework (CGDF) to assess their client's corporate governance, which can be tailored to evaluate distinct ownership structures, business sectors and regulatory environments. The methodology helps determine whether prospective clients meet certain thresholds, as well as identify specific challenges and develop recommendations for improvement.

The recommendations for improvement made by IDB Invest in this context can significantly improve the quality of a thematic bond issuance, to the extent that it provides qualitative input as to the capacity of the issuer to adequately deliver on the issuance and engage with its investor base.

[13] Corporate Governance Development Framework (2015). The Business Case for Corporate Governance. Available Online: www.cgdevelopmentframework.com

# 3.2 Helping Issuers Minimize Risks

One of the biggest reputational risks associated with thematic bonds is for the market to perceive the issuance as 'green' or 'social' washing, meaning that the eligible assets financed have a far lower environmental or social benefit than originally claimed. Having adequate governance systems in place can help issuers ensure that there are no breaches to the environmental and social integrity of their issuance.

Thematic bond issuance risks relate mainly to governance structures and practices of the issuer, the interactions between the board, its committees and executive managers, and the issuer's operations, particularly regarding the management systems required for the thematic bond and whether the organization's strategy is aligned with achieving long-term sustainability. The risk management team may require having dedicated board and management committees, such as an audit committee, a risk committee (to monitor the performance and risk of financial investments and financial instruments as well as internal control risks), a financial investment committee (for investment policies and the corresponding oversight mechanisms), and/or a corporate finance committee (to design mechanisms and instruments).[14]

Because of the importance of robust corporate governance practices to the thematic bond market, some **external review providers** are including an evaluation of the issuer, not just the issuance. These review providers include an assessment of the sustainability or ESG performance of the organization in their methodologies, taking into account corporate governance practices and whether or not the issuer was involved in any controversies or controversial business activities. By obtaining an external verification, issuers are able to gain further credibility on not only the transaction, but the robustness of their internal management capacity to effectively select, evaluate, and monitor eligible UoP.

[14] United Nations (2015). Corporate Governance in Brazil, Chile, Colombia, Mexico and Peru. The determinants of risk in corporate debt issuance. Available at: https://www.cepal.org/en/publications/37721-corporate-governance-brazil-chile-colombia-mexico-and-peru-determinants-risk

# Enhancing Issuers' Preparedness

# 3.3

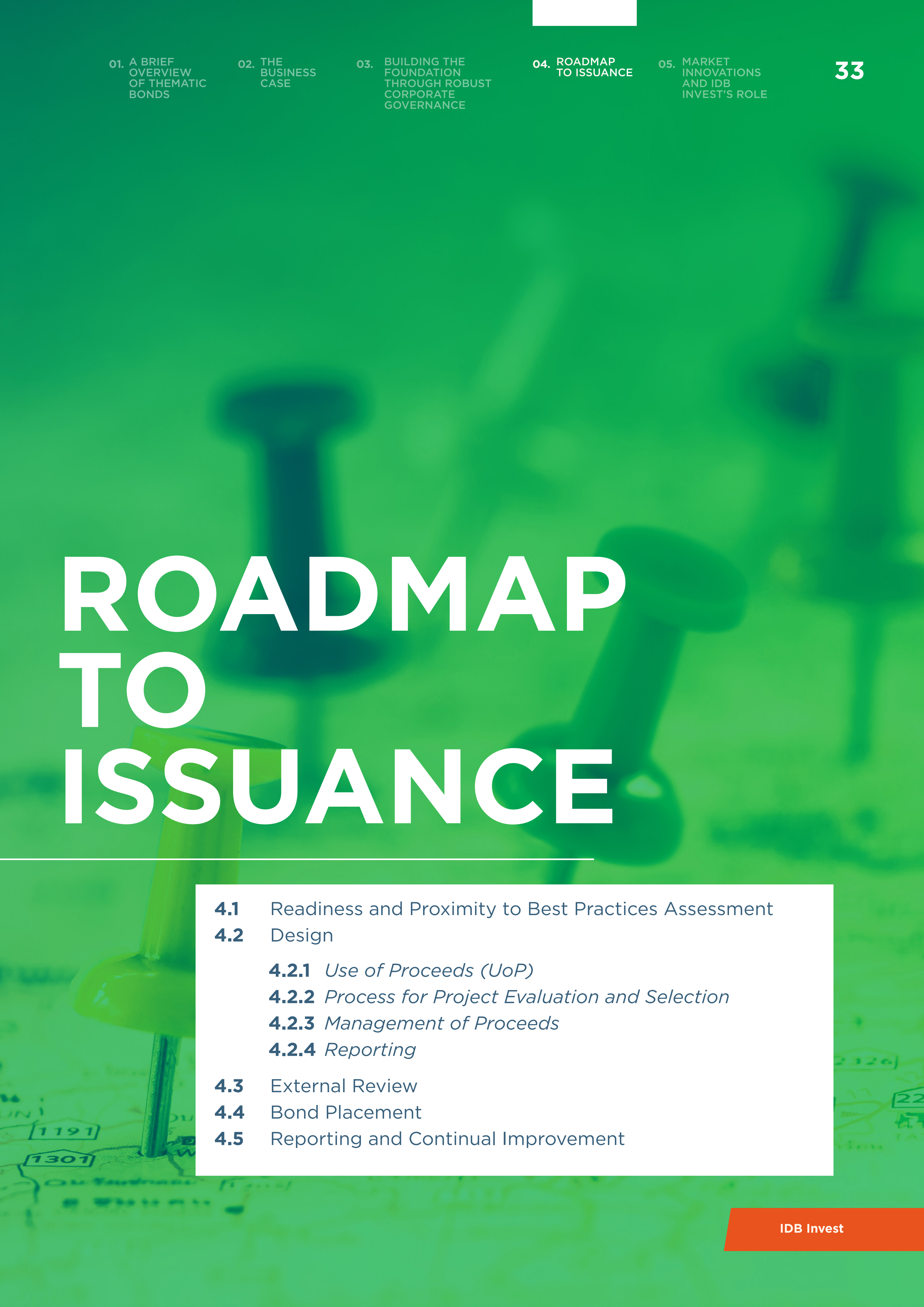
Thematic bonds can unlock capital market flows towards sustainability by financing assets with positive social and/or environmental impact. Having adequate governance systems in place can help issuers ensure that they have the capacity to deliver on their commitments and engage with their investor base through quality reporting. Issuers applying robust CG practices will be more prepared to answer to the demands of a thematic bond issuance.

One of the greatest differentiating factors between thematic bonds and their non-labelled counterparts is that the issuance of a labelled thematic bond implies **enhanced transparency** of information regarding the underlying assets financed by the instrument.

On one hand, issuers are expected to publish a **Framework** that details the internal processes involved in defining, selecting, evaluating, monitoring, and reporting on eligible assets. While they are not required by the standards to make this Framework public, there is a benefit in doing so because it provides credibility to the transaction. The Framework serves the issuer with a platform to outline their internal decision-making processes to further highlight for investors the robustness of their processes and why and how the issuance is aligned with their long-term sustainability strategy. On the other hand, while the bond is outstanding, issuers are required to provide **annual reports** on the allocation and impact of proceeds. This allows them to demonstrate their impact and alignment with their promises.

Issuers with better corporate governance are more prepared, and have a vested interest, to promote transparency. Therefore, those issuers with a strong foundation of corporate governance are better equipped to be successful thematic bond issuers.

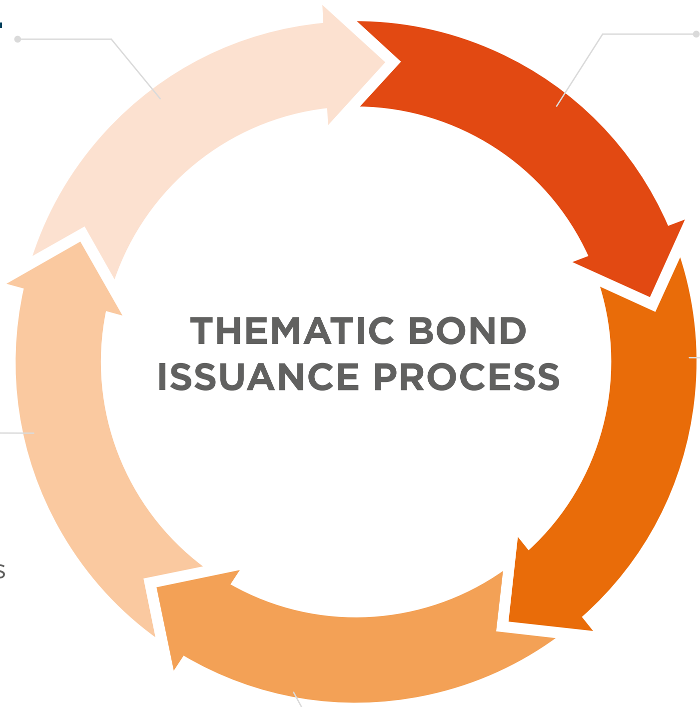
# 04.



# ROADMAP TO ISSUANCE

The financial structuring process of a thematic bond is similar to that of a regular bond; however, to give the bond its thematic flavor, there are a few additional steps issuers will have to take. The following steps are involved in the issuance of a thematic bond:

**Figure 4. Thematic Bond Issuance Process**[15]




[15] This roadmap is an evolution on a similar step-by-step process IDB applies. Notably, this roadmap includes a readiness assessment that an issuer can undertake as part of the process in defining the thematic label. For reference, see IDB's publication How to Issue Thematic Bonds, January 2021.

# 1. ASSESS

The issuer should conduct a self-evaluation to assess their preparedness to issue and how close they are to aligning to market best practices – evaluating both their capacity as an organization and the issuance itself. We have prepared a "Readiness and Proximity to Best Practice Assessment" where issuers can evaluate their preparedness for issuing - see Section 4.1 for further details.

# 2. DESIGN

The next step is to identify the qualifying eligible assets and design the framework in line with a credible global standard. This framework will define the internal decision-making processes involved in defining, selecting and evaluating, monitoring, and reporting on eligible assets - see Section 4.2 for further details.

# 3. REVIEW

It is important that the issuer obtain an external review of the transaction in order to verify its integrity. At the pre-issuance phase, an issuer can opt for a Second Party Opinion (SPO), Verification, Certification or Green/Social/Sustainability Bond Rating. This provides investors with assurance of the credibility of the thematic bond. At a post-issuance phase, an issuer can opt for a Verification or Certification to address the tracking of UoP, allocation of proceeds, environmental and/or social impact, or impact reporting - see Section 4.3 for further details.

# 4. ISSUE

The issuer will have to undergo the financial structuring and planing common to issuing a bond (regardless of the thematic flavor) together with underwriters - see Section 4.4 for further details.

# 5. REPORT

Responsibilities do not stop at the issuance, issuers are expected to provide annual reporting on the allocation and impact of proceeds at least until full allocation. This continuous monitoring, tracking and disclosure is essential for issuers because it helps them understand the impact of their operations and whether they are aligned with their overall long-term sustainability strategy. For investors, a close surveillance provides oversight on the impact of their investment - see Section 4.5 for further details.

# 4.1 Readiness and Proximity to Best Practices Assessment

Issuers can apply the Readiness and Proximity to Best Practices Assessment to judge their preparedness to issue, and to align to market best practices – evaluating both their capacity as an organization and the issuance itself.

## Organization's Capacity

Before evaluating the issuance itself, a potential issuer should assess its internal capacity to issue, evaluating its organizational capacity through its **Corporate Governance** and **Strategic Alignment.**

### Corporate Governance:

As discussed in Chapter 3, issuers with robust CG practices are better equipped to issue a thematic bond. The assessment of the issuer's CG can be based on the IFC CG Progression Matrix for Listed Companies,[16] which is organized by four levels of company maturity and complexity in line with the Corporate Governance Development Framework (CGDF) methodology. This Framework has been widely adopted by 35 Development Finance Institutions in the world.[17] While the fulfillment of the Progression Matrix is not necessarily a requirement to issue thematic bonds or to obtain financing with Development Finance Institutions (DFIs), the tool can help issuers assess the robustness of their governance practices or guide them in establishing a best practice roadmap.

[16] IFC (2021). IFC Corporate Governance Methodology. https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/investment+services/corporate+governance+tools

[17] CGDF (2015) Corporate Governance Development Framework. http://cgdevelopmentframework.com/

# IFC CG Progression Matrix

IFC has developed a Corporate Governance (CG) Methodology, which serves as an approach to evaluate and improve the corporate governance of a company. The IFC CG Methodology includes the assessment of six key CG parameters: (1) Commitment to Environmental, Social, and Governance (Leadership and Culture); (2) Structure and Functioning of the Board of Directors; (3) Control Environment; (4) Disclosure and Transparency; (5) Treatment of Minority Shareholders; and (6) Governance of Stakeholder Engagement.

| **Level 1** Basic Practices | **Level 2** Intermediate Practices | **Level 3** Good International Practices | **Level 4** Leadership |
|---|---|---|---|
| Companies that fulfill the requirements of national legislation | Companies that take extra steps to ensure good ESG practices | Companies that provide a major contribution towards improving ESG nationally and that comply with good international standards (e.g., IFC Performance Standards) | International best practices – companies that are publicly recognized as among national and global leaders on ESG; trailblazers |
| Companies fulfill Level 1 requirements | Companies fulfill Level 1 and 2 requirements | Companies fulfill Level 1, 2 and 3 requirements | Companies fulfill Level 1, 2, 3 and 4 requirements |

### Strategic Alignment:

The ICMA principles recommend that issuers position their eligible assets within the context of an overarching sustainability strategy. While this is not a requirement, it is very important for the issuer to be able to directly explain to their investors why this issuance fits into their strategy. The more an issuer can demonstrate the coherence of the issuance within their long-term vision, the more credible the transaction will be.

## Aligning an Issuance with Market Best Practices

Once the organizational foundation is addressed, issuers can then look at the components that make up a thematic bond, and evaluate their ability to meet, at least, minimum requirements and recommendations established by the ICMA in the following areas:

### Eligible Assets:

The most important differentiating factor between a thematic and a non-thematic bond is that eligible assets have a positive environmental or social impact aligned with a global standard. At a minimum, issuers should comply with the high-level eligible categories in the ICMA principles. Issuers that are able to provide ex-ante estimates of impact also provide deeper credibility to the transaction, because they can forecast on how impactful their investment projects will be. To align with best market practices, issuers can consider financing more future assets (as opposed to refinancing). Financing future projects is considered to provide more environmental or social additionality than refinancing old ones.

## Risk Management

ICMA principles recommend that issuers communicate at a minimum their processes and exclusion criteria to evaluate environmental and social (E&S) risks related to eligible assets. There is no requirement on the quality of the risk management system to be able to issue; however, issuers are encouraged to align to best market practices (e.g. international standards, such as the IFC Performance Standards) as they are evaluated on the rigor, scope, and track record of their risk management systems.

## Implementation Mechanisms:

Another key factor in issuing a thematic bond is the ability to monitor, track, and report on eligible assets. At a minimum, issuers must be able to properly identify and select eligible assets taking into account global standards. Issuers must have the capacity to monitor and track these assets for reporting purposes once they are selected and issued. This will ensure coherence with their outlined strategy and measurement of the impact of their operations. The market encourages high levels of transparency, so those issuers that obtain external verifications will be further aligned with best practices. Issuers must at least place net proceeds of the bond prior to allocation to eligible projects in investment grade securities. However, if issuers want to align with best market practices, they could implement policies to make these transitory investments in responsible investment grade securities.

## Reporting:

Issuers are required to report the allocation and impact specific to the use of proceeds. In order for an issuer to be prepared, they should have internal processes in place that will allow them to collect this information. The more formalized or familiar they are with these types of reporting processes, the easier it will be. To align with best market practices, issuers can opt for an external verification of their allocation and/or impact indicators.

Issues can score themselves between 0 and 3 in each of the themes mentioned above. If the issuer receives a 0 in one or more of the areas evaluated, they should consider implementing internal improvements prior to issuance. Meanwhile, those who score a 1 can consider that they meet minimum requirements to issue, and the higher the rating between 2 and 3 the more aligned they are with current best market practices. The range of scores and description of the Readiness and Proximity to Best Practice Assessment is presented below:

**Table 3. Readiness and Proximity to Best Practices**

| SCORE | READINESS |
|---|---|
| 0 | Recommended that issuer improve internal capacity before issuing a thematic bond |
| 1 | Issuer demonstrates basic corporate governance practices (Level 1 IFC CG Progression Matrix) and strategic alignment, and the issuance complies with minimum standards established by the ICMA principles |
| 2 | Issuer demonstrates intermediate corporate governance practices (Level 2 IFC CG Progression Matrix) and strategic alignment, and the issuance meets above average market practices |
| 3 | Issuer demonstrates good international or leadership corporate governance practices (Level 3 or 4 IFC CG Progression Matrix) and strategic alignment, and the issuance meets best market practices |

## Table 4. Assessment Matrix

| | ORGANIZATION'S CAPACITY | | ISSUANCE'S ALIGNMENT WITH MARKET BEST PRACTICES | | | |
|---|---|---|---|---|---|---|
| | CORPORATE GOVERNANCE [18] | STRATEGIC ALIGNMENT | ELIGIBLE ASSETS | RISK MANAGEMENT | IMPLEMENTATION MECHANISMS | REPORTING |
| 0 | Does not fulfill Level 1 requirements of the IFC CG Progression Matrix for Listed Companies | Does not have a sustainability strategy | Does not have identified eligible assets in line with international standards | Does not have a system to identify or manage material E&S risks associated with eligible assets | Does not have internal systems to select, evaluate, monitor, or track eligible assets | Does not have reporting or monitoring systems in place |
| 1 | Fulfills Level 1 requirements of the IFC CG Progression Matrix for Listed Companies | Eligible assets positioned within the context of issuer's sustainability strategy | Eligible assets clearly defined and in line with ICMA green and/or social categories | Internal processes to manage material E&S risks associated only with eligible assets and applies a basic exclusion list | Has internal capacity and procedures in place to select, evaluate, monitor, and track eligible assets | Issuer can apply internal processes or systems to facilitate impact and allocation reporting |
| 2 | Fulfills Level 2 requirements of the IFC CG Progression Matrix for Listed Companies | Issuer sets strategic impact goals for issuance aligned to sustainability strategy | Meets previous criteria and ex-ante estimations of impact are provided | E&S policies and exclusion list aligned with international standards (i.e., IFC Performance Standards) and applied across the Issuer's activities | Meets previous criteria and establishes a formal body with rules of governance to manage these processes | Meets previous criteria and commits to an external review of either allocation or impact reporting |
| 3 | Fulfills Level 3 or Level 4 requirements of the IFC CG Progression Matrix for Listed Companies | Recurring issuer that builds on strategic impact goals set in previous transactions | Meets previous criteria and more than 50% of eligible assets pertain to financing future assets (as opposed to refinancing).[19] | Meets level 2 criteria and requires alignment of contractors, suppliers and/or clients to Issuer's E&S risk processes and procedures (considered best in class) | Meets previous criteria and funds not yet allocated are invested in responsible investment grade securities | Meets previous criteria and commits to external review of both allocation and impact reporting |

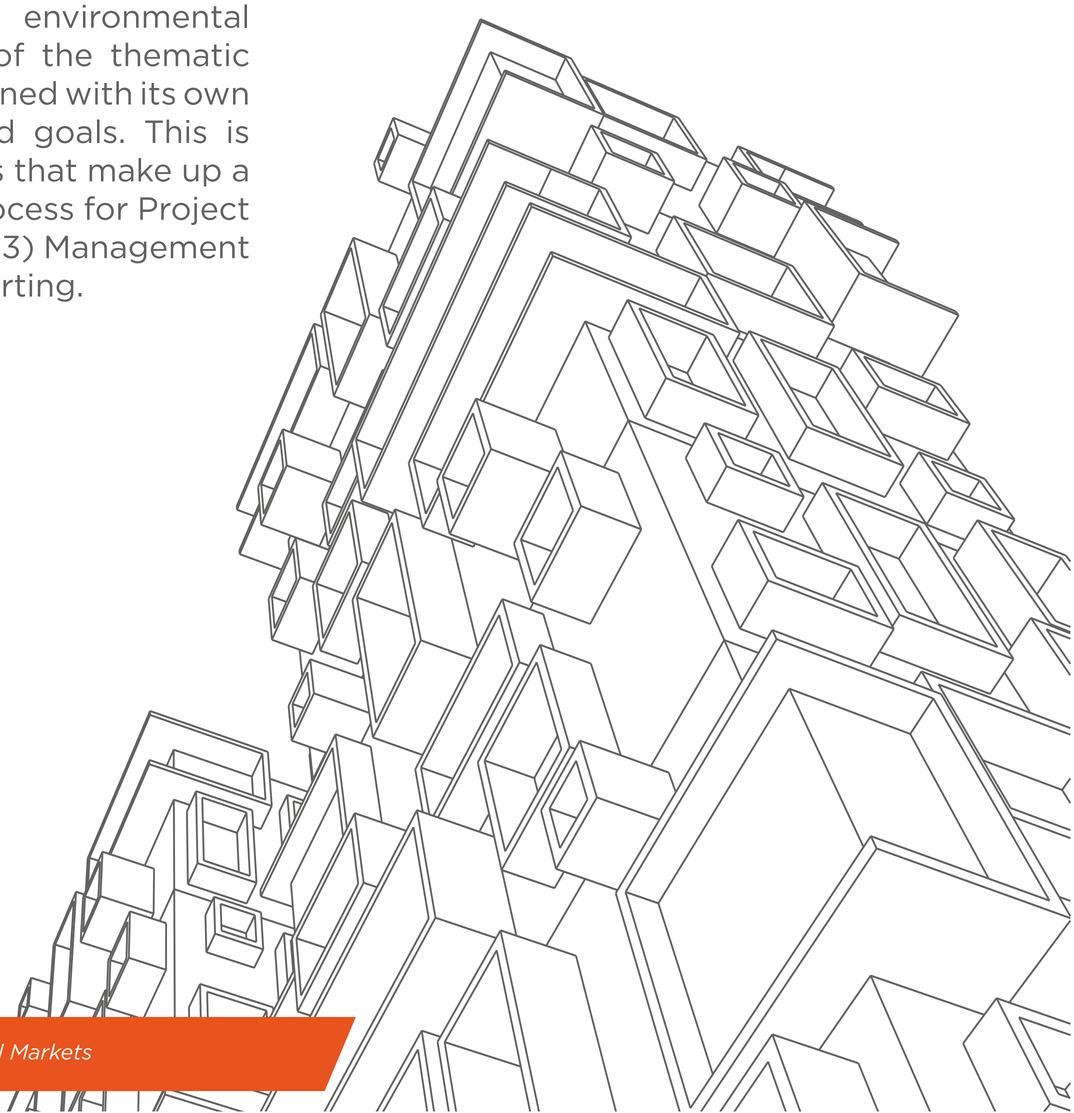
[18] Corporate Governance evaluation is based on the IFC Corporate Governance Methodology for the IFC Corporate Governance Progression Matrix. An explanation of the levels are provided here and the Matrix for Listed Companies can be downloaded in this page.

[19] Financing future projects is considered to provide more environmental or social additionality than refinancing old ones.

# 4.2 Design

Once the issuer has assessed the reputational risks, and assessed their readiness, the issuer should establish a **Framework** that will define the internal decision-making processes involved in defining, selecting and evaluating, monitoring, and reporting on eligible assets. Issuers can base their framework on international standards, such as the ICMA principles, EU Green Bond Standards, or other internationally recognized standards.

The Framework should begin with an introduction or overview of the issuer, which can include a statement reflecting the issuer's strategic alignment with the issuance, presenting the environmental and/or social objectives of the thematic bond and how they are aligned with its own sustainability strategy and goals. This is followed by the four pillars that make up a framework: (1) UoP, (2) Process for Project Evaluation and Selection, (3) Management of Proceeds, and (4) Reporting.



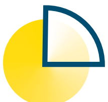
## Table 5. Thematic Bond Framework Components

| COMPONENT | DESCRIPTION |
|---|---|
| Use of Proceeds | • Define eligibility criteria for use of proceeds that present clear environmental and/or social benefits<br>• Recommended that issuers provide an estimate of share of financing vs. refinancing (clarifying the expected lookback period)<br>• Eligible project categories include the high-level categories for green and social projects referred in Section 1.2 |
| Project Evaluation and Selection | • Issuer must clearly communicate to investors:<br>– Environmental and/or Social objectives<br>– Process to determine how UoP fit within the eligible categories defined in the Use of Proceeds<br>– The related eligibility criteria, including, if applicable, exclusion criteria and other processes applied to identify and manage potentially material environmental and social risks<br>• In addition, Issuers are also encouraged to position information within the context of their strategy and to obtain external review of evaluation and selection process |
| Management of Proceeds | • Net proceeds should be credited to a sub-account sub-portfolio, or otherwise tracked and attested to in a formal internal process linked to lending and investment operations<br>• Balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible projects<br>• Issuer should communicate to investors the intended types of temporary placement for the balance of unallocated net proceeds<br>• Recommended that management of proceeds be subject to an external review |
| Reporting | • Annual report on use of proceeds until full allocation including allocation and impact reporting<br>• Recommend use of qualitative performance indicators and where feasible quantitative performance measures and disclosure of key underlying methodologies<br>• Issuers that can monitor impacts achieved are encouraged to include them<br>• Recommended to include a summary reflecting the main characteristics of the thematic bond program and its alignment to the principles |

# 4.2.1 Use of Proceeds (UoP)

The key difference between a thematic and a non-thematic bond is that the UoP are designated to eligible assets with a positive environmental and/or social impact. In the Framework, it is important to clearly identify and define the eligible assets based on a global standard or taxonomy (as described in Section 1.2). Issuers should meet the minimum requirements, as established by the ICMA principles. Issuers may also apply other taxonomies, such as those described in the EU Sustainable Finance Taxonomy or the Sector Criteria of the Climate Bonds Standard.

The table below provides some examples of Green and Social UoP that could be potentially eligible in the sectors where IDB Invest works.[20]

| | GREEN | SOCIAL |
|---|---|---|
|  Agribusiness | • Conservation or protection of natural resources<br>• Certified practices under sustainable forestry management<br>• Water efficient technologies for irrigation | • Expenditures for the promotion of local entrepreneurship programs for rural farmers |
|  Energy | • Renewable energy projects<br>• Smart grids<br>• Smart charging | • Financing mini grids that provide access to affordable clean renewable energy |
|  Financial Institutions | • Green mortgages | • MSME loans with the purpose of job creation<br>• COVID-19 support and recovery measures<br>• Social housing for low-income groups |

[20] The green and social use of proceeds showcased in this table are just examples that do not necessarily imply that similar or the same use of proceeds would automatically be eligible.

| | GREEN | SOCIAL |
|---|---|---|
| **Manufacturing** | • Environmentally sustainable consumer products<br>• Green manufacturing buildings<br>• Circular economy transformation | • Vaccines, affordable medicine |
| **Social Infrastructure** | • Energy efficiency improvements in social infrastructure (Green Affordable Housing) | • Construction of public schools or hospitals, |
| **Transport** | • Electric mobility assets and infrastructure | • Access to affordable public transport to low-income groups |
| **Tourism** | • Energy efficiency improvements in hotels<br>• Investments in adaptation measures (flood defenses, sea walls, etc.) | • Emergency COVID-19 relief for micro and small companies in the tourism sector |
| **Water & Sanitation** | • Water use reduction or water-saving technologies<br>• Sustainable wastewater management | • Access to clean drinking water to vulnerable areas or areas that have experienced large demographic growth |
| **Telecommunications, Media and Technology** | • Energy efficient data centers<br>• Network modernization | • Fiber optics and cable networks to areas with low connectivity<br>• Digitalization and accessibility initiatives to low-income or vulnerable groups |

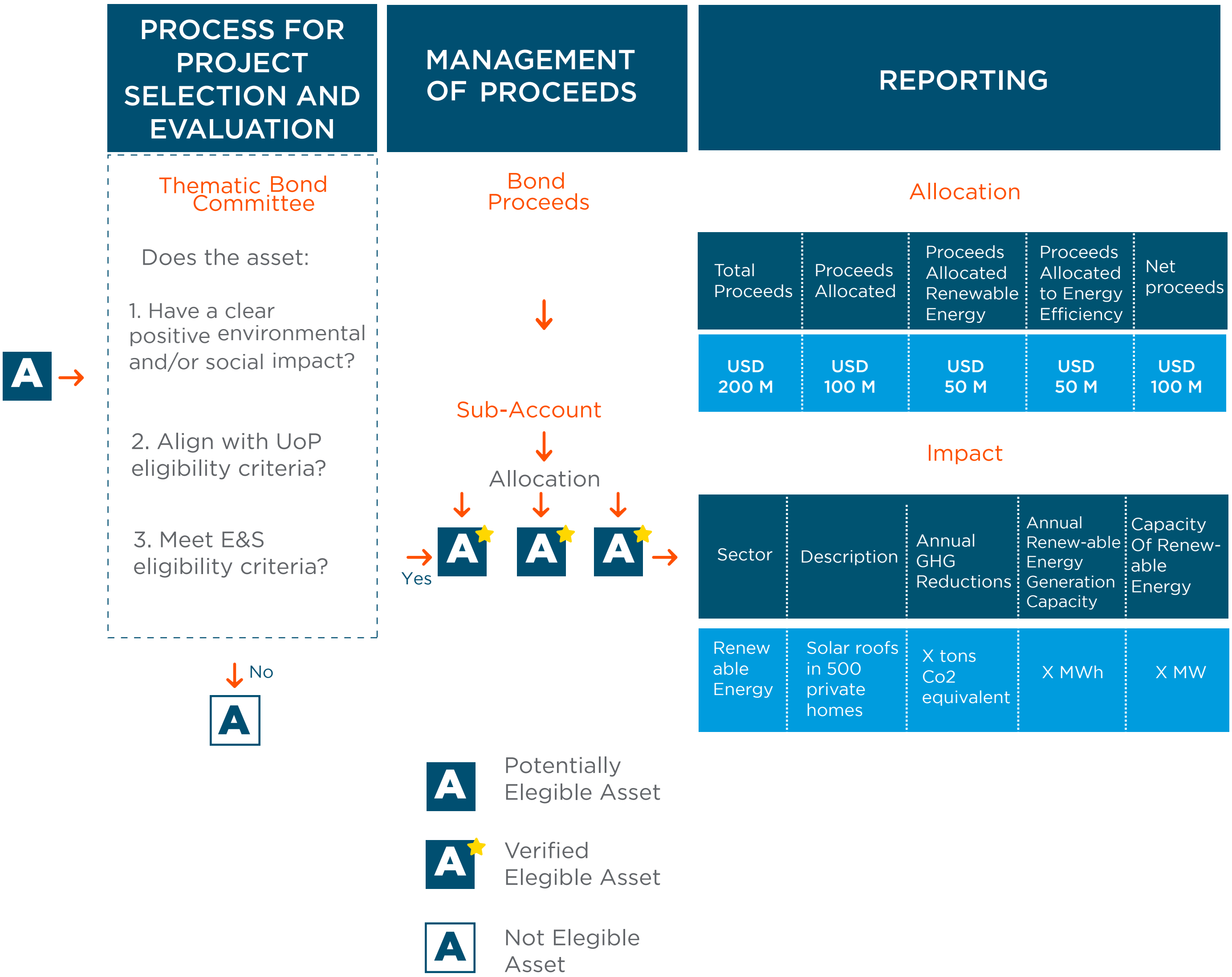
# 4.2.2 Process for Project Evaluation and Selection

Issuers should establish an internal process in order to select and evaluate eligible assets, which is transparent and robust. Many issuers opt to establish a **Thematic Bond committee** made up of people in relevant senior management roles (e.g. Risk, Sustainability, Finance, etc.). It is important to highlight the roles of the people involved in the committee and their function, as well as describe the governance of said committee (e.g. how the selection process works, frequency of meetings, minutes taken, etc.). In the Framework, it is useful to provide a diagram visualizing the process adapted by the Committee - detailing how the committee established that the asset: 1) demonstrates positive environmental and/or social impact, 2) aligns with eligibility criteria, and 3) meets material environmental and social eligibility criteria.

It is also important to describe the issuer's risk management systems in place to evaluate material environmental and social risks related to eligible projects. At a minimum, issuers should be able to adequately describe in their framework how E&S risk management applies to the bond's eligible assets. Issuers should try to align with international standards and sectoral guideline relevant to the industry and country(s) in which they operate. It is ideal if issuers can provide links to, or reference to, additional documentation that describes their policies and/or actions in place in order to mitigate E&S risks in their frameworks.

Additionally, issuers should describe the exclusion criteria detailing the types of business practices or activities that would not be financed under the thematic bond. These exclusions often target controversial sectors, such as nuclear power, oil & gas, etc. External review providers view positively that exclusion lists are implemented to ensure that financing is not granted to activities with high levels of environmental or social risks. Best practice is to formalize the issuer's commitment to policy issues and/or exclusions in a policy document and make it publicly available on the issuer's website.

**Figure 5. Internal Processes for a Thematic Bond**



# 4.2.3 Management of Proceeds

Issuers should implement mechanisms to track the UoP, this is done in order to ensure transparency in how the funds of the bonds are being allocated to eligible assets.

There are a few options issuers can choose to manage funds:

**Separate Account**
for thematic assets in order to deposit bank proceeds.

**Sub-Account**
where the issuer sets aside a sub-account to transfer funds to eligible assets when required.

**Virtual Thematic Account**
proceeds are transferred to a general account and the eligible assets are tracked virtually through a tracking system.

If not all of the funds are allocated at issuance, it is recommended that the net proceeds be allocated to a sub-account and invested in liquid, highly rated, short term securities or investments. Some issuers have chosen to allocate those funds to responsible investment securities or funds, which is considered best practice.

# 4.2.4 Reporting

The reporting process is essential to provide full transparency of both the UoP and impact of thematic assets. The issuer is required to provide at least annual reports on the allocation and impact of proceeds. To facilitate communication and enhance transparency, issuers can publish their annual report on their website.

## Allocation Reporting

The allocation reporting should include the following information:

- List of eligible assets financed by the bond, including a description and amounts allocated
- Bond proceeds allocated per eligible category
- The remaining balance of unallocated proceeds at reporting period end.

In case of divestments, or controversies that arose with the eligible assets, it is recommended that issuers provide information about how these assets were replaced by ones that were eligible and/or how the controversies were dealt with. The allocation report may also include additional statistical information, if possible (e.g. regional distribution of eligible assets if investments were in different countries).

# Impact Reporting

Impact reporting should describe the expected impact of eligible assets, defined ex ante. Issuers are encouraged to update their reporting ex post with actual impacts. Issuers should also provide both qualitative and quantitative indicators along with the disclosure of the key underlying methodology and assumptions used to determine the performance results.

ICMA has developed guidance reports for determining impact indicators of green and social bonds. The **Harmonized Framework for Impact Reporting for Green Bonds** provides core indicators and other sustainability indicators for the following green eligible categories: renewable energy, energy efficiency, sustainable water and wastewater management, waste management and resource efficiency, clean transportation, green buildings, and terrestrial and aquatic biodiversity conservation. ICMA has not yet developed recommendations for the remaining categories: environmentally sustainable management of living natural resources and land use, climate change adaptation, and eco-efficient and/or circular economy adapted products, production technologies and processes. ICMA recommends that issuers aim to report on at least the core indicators for relevant projects to facilitate comparison of project results. The **Harmonized Framework for Impact Reporting for Social Bonds** describes non-exhaustive illustrative lists of indicators for each eligible category organized as:

**Output:**
practices, products and services that result from the project, which are relevant to the achievement of the outcomes

**Outcomes**
benefits that are likely to occur as a result of the output

**Impacts:**
The long-lasting results and ultimate objectives of the outcomes

These two references also include helpful reporting templates that can be used by issuers to present their reports.

# External Review 4.3

In recent years, having an external review has become a more common practice in the thematic bond market. In 2019, 86% of green bond issuance had some form of external review.[21] There are various ways in which issuers can obtain a third-party evaluation of their issuance. ICMA describes four main types of external reviews: SPOs, Verifications, Certifications, and Green/Social/Sustainability Bond Ratings.

At the **pre-issuance** phase, an issuer can opt for a SPO, Verification, Certification or Green/Social/Sustainability Bond Rating. This provides investors with assurance of the credibility of the thematic bond. At a **post-issuance** phase, an issuer can opt for a verification or certification to address the tracking of UoP, allocation of proceeds, environmental and/or social impact, or impact reporting.

[21] https://www.climatebonds.net/system/tdf/reports/cbi_sotm_2019_vol1_04d.pdf?file=1&type=node&id=47577&force=0

Table 7. Types of External Reviews[22]

| TYPE | SUB - TYPE | TIMELINE | WHAT IT ENTAILS |
|---|---|---|---|
| **SPO** | | Pre-Issuance | Evaluation of Framework's alignment with ICMA principles, assessment of issuer's strategy / policy / objectives, and an evaluation of green / social / sustainable features in the bond's UoP. |
| **Verification** | **Limited[23] or Reasonable Assurance[24] Engagement** | Pre-Issuance | Independent verification that can do one, or more of the following: 1) verify against a designated set of criteria (i.e. business processes and/or environmental / social / sustainability criteria); 2) focus on alignment with internal or external standards or claims made by the issuer; or 3) evaluate environmentally or socially sustainable features of underlying assets. |
| | | Post-Issuance | An independent verification at the post-issuance stage can address the internal tracking of UoP, allocation of proceeds, statement of environmental and/or social impact, or alignment of reporting of UoP. Some providers offer an Annual Review of these aspects (another form of Limited Assurance). |
| **Certification** | **Climate Bonds Standards Certification** | Pre-Issuance Verification | Confirms that the bonds use of proceeds adhere to the Climate Bonds Standard as well as sector specific criteria. |
| | | Post-Issuance Verification | Assures adherence to the Climate Bonds Standard, including the allocation of proceeds to eligible green projects and types of green projects |
| **Green/Social/ Sustainability Bond Rating** | | Pre-Issuance | A rating can be on the Green / Social / Sustainability Bond, its framework, or key features of the bond (i.e. UoP). The output may include a focus on environmental and/or social performance data, the process relative to the ICMA principles, or another benchmark. |

[22]It is worth noting that the only parties able to provide Climate Bonds Standards Verification are CBI approved verifiers. Data compiled from ICMA, the Climate Bonds Initiative (CBI) and The Global Green Bond Partnership
[23]Limited Assurance Engagements offer a lower level of scrutiny over the subject matter compared to Reasonable Assurance Engagements. With limited assurance, the Verifier can only conclude whether, based on the procedures performed and evidence obtained, any matters have come to their attention that would make them believe the subject matter is materially misstated
[24]Reasonable Assurance Engagements offer a high level of scrutiny over the subject matter and allow the Verifier to be able to positively conclude whether, based on the procedures performed and evidence obtained, the subject matter, in all material respects, meets the criteria of the engagement.

The most popular form of external review is the SPO, which evaluates a bond framework's alignment with ICMA's GBP, SBP, or SBG or other relevant international standards. Conducted before the issuance itself, an SPO assesses the quality of the issuance by way of the categories listed out in its UoP. SPO providers are increasingly including an ESG evaluation of the issuer as a part of their methodology.

The SPO process generally lasts between 3 to 4 weeks, depending on the type of issuer being evaluated. After an initial kick-off session, issuers will be required to provide information to the SPO provider (e.g. the Framework, documentation describing internal processes, etc.), and the provider with analyze the information provided, and in some cases, request additional interviews with the issuer. A draft opinion will be provided for feedback prior to the final opinion presented.

The methodologies used to evaluate issuers vary depending on the provider, but generally, the providers will evaluate the issuer's alignment with the four components of the ICMA principles: UoP, project selection and evaluation, management of proceeds, and reporting.

**Figure 9. General SPO Process**

1. **Kick-Off**
   The virtual kick-off is led by the SPO provider with the objective to present the scope of assessment and identify relevant documentation needed.

2. **Information Request**
   The SPO provider will request documentation from the issuer, and in some cases, will schedule specific interviews.

3. **Analysis**
   SPO provider will analyze information provided by issuer, evaluating alignment with the ICM principles, and in some cases, will conduct an ESG assessment of the issuer.

4. **Feedback**
   SPO provider will provide a draft of their opinion for the issuer to review and provide feedback.

5. **Final Documents**
   SPO provider will present the final opinion of the issuer.

# 4.4 Bond Placement

Alongside the non-financial steps involved in issuing a thematic bond, issuers will have to take all of the usual steps to issuing any bond. As a part of their role in the market, IDB Invest is helping to mobilize private capital by purchasing part of the bond issuance or providing guarantees. An illustrative example is presented below of a publicly distributed securities issuance to investors.

**Figure 10. Bond Placement Process**

| 2-4 Weeks | 5-6 Weeks | 2 Weeks | 1 Week |
|---|---|---|---|
| **Preparation for Issuance** | **Due Diligence, Credit Rating and Documentation** | **Marketing/ Execution** | **Closing** |
| • Choose Underwriting Bank<br>• Prepare internal team for issuance<br>• Register with local regulator | • Due diligence<br>• Credit Rating process<br>• Prepare Prospectus | • Roadshow presentation<br>• Press release<br>• Distribution of prospectus | • Final documentation<br>• Pricing of bond<br>• Settlement |

# Reporting and Continual Improvement 4.5

As referred to in Section 4.2.4, the process to issue a thematic bond does not end at the issuance but is a continual process that ultimately accounts for shifts in market dynamics, investor demands, changing standards and corporate updates of sustainability programs and management systems.

Issuers have the responsibility to provide ongoing reporting on proceeds impact and allocation. Post-issuance reporting provides transparency and helps to ensure accountability and credibility of the issuance. The overall goal of the thematic bond market is to help drive institutional and private capital towards the sustainability agenda. By providing greater transparency in their reporting, issuers are better equipped to align their operations to their overall sustainability strategy and are helping investors understand the impact of their investments.

# Top 5 Tips for a Successful Thematic Bond Issuance

Here are a few tips for first time issuers embarking on a thematic bond issuance:

## 1.

### Project Management:

Assign one leader to manage the preparation process to issue the thematic bond and build a cross-functional team to support the project. Ideally have someone from senior management closely collaborating with the finance and sustainability departments.

## 2.

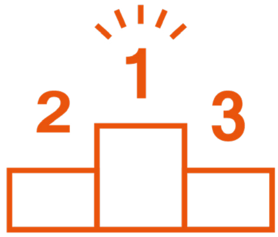
### Selecting Elegible Assets:

Identify eligible assets in the pipeline and the right KPIs that are in line with the overall strategy of the organization. A focus on quality of data and data-systems helps organize the collection of impact indicators.

# 3.

## Assess your Peers:

Look at the market in your industry to understand best practices. Evaluate how other issuers have structured their green or social bond frameworks, and assess other principles beyond ICMA alone.




# 4.

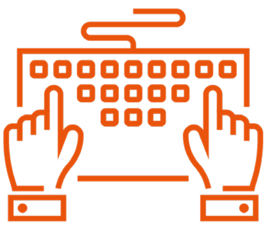
## Internal Capacity Building Benefits:

While the process may be more hands-on than issuing a regular bond, issuers can improve on their internal capacity by implementing the selection, monitoring, tracking, and disclosure processes inherent in a thematic bond.


# 5.

## Use External Resources:

There are many publicly available documents that help describe the process. See Additional resources on page 62 for further details.



# 05.

# MARKET INNOVATIONS AND IDB INVEST'S ROLE

While this guidance is focused on the most common thematic bonds, the thematic bond market is constantly evolving and growing. Green, social and sustainability bonds make up the majority of sustainable debt issuances today, but market innovations arerampant, leading to new developments in the standards, greater sophistication in the issuances, and increasing scrutiny from investors.

In order to achieve international climate goals, carbon-intensive sectors in particular need to achieve significant reductions in their greenhouse gas emissions. Transition bonds are a new asset class targeted at these industries in particular, with the objective to finance expenditures to facilitate a shift of business activities along a transition pathway in line with decarbonization targets. The transition bond market is evolving quickly: in 2019 ICMA established a Climate Transition Finance Working Group to provide guidance for potential future issuances by carbon-intensive industries and in 2020 they published a Climate Transition Finance Handbook, which provides additional guidance for issuers seeking to raise funds for climate-transition related purposes.[25] Other guidance documents have been published by market participants, such as AXA Investment Managers' Guidelines for Transition Bonds and the Climate Bonds Initiative in partnership with Credit Suisse's Financing Credible Transitions.[26, 27]

There has been an increased focus on financing biodiversity, conservation, and nature-based solutions (NbS) as integral opportunities for meeting sustainable development goals. Impact bonds have emerged as effective instruments to incorporate a results based framework allowing private investors to fund social or environmental interventions and earn a return based on the achievement, of certain outcomes linked to the intervention, such as the USD 50 million Rhino Impact Bond issued in 2019.[28] Blue bonds are another new instrument that seeks to ensure a healthy ocean and provide opportunities for business and global economic growth. IDB Invest has collaborated with the UN Global Compact (UNGC) and other private sector working group members to develop a Blue Bonds Reference Paper for Sustainable Ocean Investments that provides insights and guidance for the public good on how to identify opportunities for issuing blue bonds in ocean-related projects and companies that make a significant contribution to the SDGs. The paper used UNGC's Sustainable Ocean Principles as a baseline and 5 Tipping Points for a Healthy and Productive Ocean by 2030 as a framework for setting clear KPIs to deliver on the SDGs.[29]

[25] ICMA (2020). Climate Transition Finance Handbook 2020.

Available Online: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/climate-transition-finance-handbook/

[26] AXA (2019). Financing brown to green: Guidelines for Transition Bonds.

Available Online: https://realassets.axa-im.com/content/-/asset_publisher/x7LvZDsY05WX/content/financing-brown-to-green-guidelines-for-transition-bonds/23818

[27] CBI (2020). Financing Credible Transitions – A Climate Bonds/Credit Suisse Project.

Available Online: https://www.climatebonds.net/transition-finance/fin-credible-transitions

[28] ZSL (2019). Rhino Impact Investment Project.

Available Online: https://www.zsl.org/conservation/our-priorities/wildlife-back-from-the-brink/animals-on-the-edge/rhino-impact-investment

[29] UNGC (2020). Blue Bonds Reference Paper. Available Online: https://unglobalcompact.org/library/5741

The majority of thematic bonds issued in the market so far have been UoP bonds. Because of their structuring, most UoP thematic bonds are applied to financing capital expenditures (CAPEX). Sustainability-Linked Bonds (SLB) are a new performance-based fixed-income security that raises capital for general corporate purposes and whose financial or structural characteristics are adjusted based on the achievement of a predefined sustainability target. These bonds could be SDG-linked bonds, ESG-linked bonds, blue-linked bonds, transition-linked bonds, or any other label mentioned before. The Sustainability Linked Bond Principles published by ICMA outlines voluntary process guidelines for SLB issuers.[30] The advent of these principles has opened a new door to sustainable financing by establishing a framework that enables investors to buy into a company's sustainability or ESG improvements. As opposed to the traditional use of proceeds bonds, sustainability or other performance linked instruments do not need to be tied to a specific project or asset, rather the financing can be applied to general corporate purposes which opens the door to more potential issuers to joining the sustainable fixed income market.

As the regional market leader in structuring, advising and investing on thematic bond issuances, IDB Invest is fully invested in strengthening the depth and sophistication of this marketplace. As a financial instrument, thematic bonds have demonstrated their ability to address development priorities ranging from the UN's Sustainable Development Goals to gender inclusion and empowerment, with clear investor interest in their dual purpose delivering both financial and non-financial returns. IDB's Sustainable Debt Framework further illustrates our belief in and commitment to the power of financial markets as a means to channel additional investment resources in support of a broad development finance mission.

Addressing the challenges of biodiversity loss, climate change, gender and diversity, and the economic recovery from the coronavirus pandemic remain at the heart of IDB's work in Latin America and the Caribbean. This guide seeks to broaden the understanding of the practical steps that can be taken in issuing thematic bonds. The intended audience is broad, from capital market exchanges to first-time thematic bond issuers. We invite you to join us on this sustainable financing journey and help respond to pressing societal challenges while simultaneously developing the power of markets to affect positive change.

[30] ICMA (2020). Sustainability Linked Bond Principles (SLBP).
Available Online: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/

# Additional Resources

Table 8. Key Guidelines/Standards for Thematic Bonds

| ORGANIZATION | GUIDELINE |
|---|---|
| AXA IM | Guidelines for Transition Bonds |
| EIB et al. | Sustainable Blue Economy Finance Principles |
| EU | EU Green Bond Standard |
| ICMA | Climate Transition Finance Handbook |
| | Green Bond Principles |
| | Green Bond Principles Green Project Mapping |
| | Green, Social and Sustainability Bonds Resource Center |
| | Social Bond Principles |
| | Sustainability Bond Guidelines |
| | Sustainability-Linked Bond Principles |
| UNGC | Blue Bonds Reference Paper |
| | Sustainable Ocean Principles |
| UN WOMEN | Empowerment Principles |

Table 9. Additional Sources for Thematic Bonds

| TOPIC | ORGANIZATION | GUIDELINE |
|---|---|---|
| Corporate Governance | IFC | IFC Corporate Governance Methodology Tools |
| General Guidance/ Frequently Asked Questions | ICMA | Guidance Handbook |
| | | Q&A for Social Bonds Related to Covid-19 |
| External Review | CBI | Guidance for Verifies Version 2.0 |
| | ICMA | Guidelines for External Reviews |
| Risk Management Frameworks | EP Association | Equator Principles |
| | IFC | Corporate Governance Development Framework |
| | | IFC Performance Standards |
| | IDB Invest | DB Invest Sustainability Policy |
| Reporting | CBI | Post-Issuance Reporting |
| | ICMA | Harmonized Framework For Impact Reporting for Green Bonds |
| | | Harmonized Framework for Impact Reporting for Social Bonds |
| | Nordic Issuers | Position Papel on Green Bonds Impact Reporting |
| | World Bank | Green Bond Proceeds Management & Reporting |

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