FINANCING SUSTAINABILITY THROUGH CAPITAL MARKETS:

A Practitioner's Guide and Toolkit for Thematic Bonds

Disclaimer

This report was prepared by HPL.LLC at the request of IDB Invest as a deliverable of the consultancy services rendered during the consultancy entitled “Update to the 2020 Thematic Bond Guide”. HPL has based its work on publicly available information, interviews with stakeholders and client calls.

Acknowledgements

This publication was made possible thanks to the generous contribution of the Korean Fund for Private Sector Development and Innovation.

This report was prepared by HPL.LLC and the IDB Invest Divisions of Environment, Social and Governance (SEG), Development Effectiveness (DVF), Advisory (ADV) and Investment (INO).

The project team authors and contributors included Yvonne Vogt (HPL), Daniela Canevaro (HPL), Sofia Saldívar (HPL), Kurt Vogt (HPL), Colin McKee (SEG), Marta Viegas (SEG), Bruno Sbardellini Cossi (SEG), Vanesa Rupérez (DVF), Paula Peláez (ADV), Marcela Betancourt (ADV), Carole Sanz Paris (INO) and Diana Sosa Carrillo (INO). Peer review was provided by Alexander Vasa and Valentina Márquez Cárdenas from the Inter American Development Bank (IDB) and Kohli Shrey, Federica Giacometti and Kelly Gregory at the London Stock Exchange Group.

Copyright

This publication is not a compliance document. Its contents are intended for general informational purposes only and should not be interpreted as compliance with IDB Invest’s policies nor market standards in the issuance of thematic bonds. As such, it should be taken only as a source of information, guidance, and analysis, to be applied and implemented by each user in its discretion in accordance with its own policies and applicable laws, which may or may not require all or any of the described practices to apply to its own activities.

Acronyms

BAU	business-as-usual
CBI	Climate Bonds Initiative
CGDF	Corporate Governance Development Framework
DFI	development finance institution
E&S	environmental and social
ESG	environmental, social and governance
GBP	Green Bond Principles
GBTP	Green Bond Transparency Platform
GSS	green, social and sustainability
GSS+	green, social, sustainability and sustainability-linked
ICMA	International Capital Market Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
KPI	key performance indicator
LAC	Latin America and the Caribbean
MDB	multilateral development bank
NbS	nature-based solutions
SBG	Sustainability Bond Guidelines
SBP	Social Bond Principles
SDGs	Sustainable Development Goals
SLB	sustainability-linked bond
SLBP	Sustainability-Linked Bond Principles
SPO	second party opinion
SPT	sustainability performance targets
UoP	use of proceeds

Table of contents

Disclaimer 2
Acknowledgments 2
Copyright 2
Acronyms 4
Foreword 7
Executive Summary 9
Introduction 10

01.

A Brief Overview of Thematic Bonds 13

1.1 Defining Thematic Bonds 14
1.2 Eligible Use of Proceeds 16
1.3 Sustainability Linked Bonds 19

02.

The Market for thematic bonds 20

2.1 The Business Case 21
2.2 IDB Invest's Value Proposition 22
2.3 Promoting Thematic Market Growth in Latin America and the Caribbean 26

03. Corporate Governance as the Foundation: Shaping Strategy and Risk Management 28

3.1 Why Corporate Governance Matters 29
3.2 Shaping Coherent Business Strategies 30
3.3 Shaping Strong Risk Management Systems 32
3.4 Enhancing Issuer's Preparedness 34

04. A Roadmap to Issuance 35

4.1 Readiness and Proximity to Best Practices Assessment 38
4.2 Design of a Use of Proceeds Bond 45
- **4.2.1** Use of Proceeds 46
- **4.2.2** The Process for Project Evaluation and Selection 47
- **4.2.3** Management of Proceeds 48
- **4.2.4** Reporting 48

4.3 Design of a Sustainability Linked Bond 50
- **4.2.1** Selection of Key Performance Indicators 50
- **4.2.2** Calibration of Sustainability Performance Targets 54
- **4.2.3** Bond Characteristics 56
- **4.2.4** Reporting 59
- **4.3.5** Verification 60

4.4 External Review 61
4.5 Bond Placement 63
4.6 Reporting and Continual Improvement 63

05. Market Innovations and IDB Invest's Role 65

Additonal Resources 68

Foreword

Addressing the world's sustainable and inclusive long-term economic growth is pressing. Latin America and the Caribbean (LAC) is prone to the negative effects of climate change; from extreme droughts to more frequent and severe hurricanes and tropical storms hitting the small island countries of the Caribbean, affecting country economies, people lives and ecosystems. The annual investment gap needed to mitigate and adapt to this new reality in the region, reaches US$4 trillion.

With the growth of Green, Social, Sustainable and Sustainability-Linked bonds– generally referred to as thematic bonds, debt capital markets instruments have become effective in meeting the targets outlined in the 2015 United Nations Sustainable Development Goals (SDGs) and the 2016 Paris Agreement on Climate Change, unlocking investment flows and driving institutional and private capital towards sustainability. According to the Climate Bonds Initiative, in 2023 thematic bonds recorded a cumulative volume of US$4.2 trillion.

At IDB Invest we believe in connecting private investors with the pressing challenges faced by the LAC region, and in the importance of generating practical knowledge. In 2021, IDB Invest published the Practitioner's Guide and Toolkit, a practical guide on the factors that shape a successful thematic bond issuance, for new thematic issuers. This publication Financing Sustainability through Capital Markets: A Practitioner's Guide and Toolkit for Thematic Bonds, is an update of the 2021 Toolkit, and reflects new insights, lessons learned, and challenges in the thematic bond market over recent years.

This Toolkit provides new guidance on how to prepare the use of proceeds, thematic bonds, and Sustainability-Linked bonds, outlining the management capacity and internal systems that an organization should have in place for a successful issuance. It presents a holistic perspective, highlighting how to systematically incorporate sustainability 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. This publication provides tools that help issuers engage with their investor base through quality reporting.

This toolkit emphasizes the key guiding steps for structuring a successful thematic bond. 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 judge their preparedness and evaluate both their capacity as an organization and the foundation of the issuance itself.

As an impact-oriented multilateral development bank, at IDB Invest we play a significant role in promoting the advancement of the thematic bonds market by attracting institutional investors and enhancing private sector participation. We are a leader in the region supporting and structuring 43 instruments until August 2024. In January 2021 we published our own Sustainability Framework. Since February 2021, IDB Invest has issued 6 sustainability bonds, 6 social bonds and 9 green bonds, with a total value of US$5.4 billion to finance or refinance green and social projects.

Institutional investors have vast amounts of capital that can support big strides in sustainable development and low-carbon transition. Bonds are among the most efficient debt instruments to scale up financing towards projects with positive social and environmental impact.

At IDB Invest we are committed to developing the full potential of thematic bonds and maximizing the participation of private investors. The global thematic bond market is expanding rapidly, and Latin America and the Caribbean currently represents a third of all debt securities issuance, three-times the global average. This trend is driven by a surge in investors seeking positive impacts in new markets and a region that is proving ripe for investment.

It is with instruments such as Thematic Bonds that we can move the needle on the SDGs and create an everlasting impact in a region that is in need of adapting and mitigating the challenges of climate change.

Marisela Alvarenga
Managing Director and Chief Investment Officer (a.i.)
IDB Invest

Luiz Gabriel Todt de Azevedo
Managing Director and Chief Strategy Officer (a.i.)
IDB Invest

Executive Summary

This document is an update of IDB Invest's Practitioner's Guide and Toolkit for Thematic Bonds, published in 2021. The new guide provides a practical roadmap for issuers by outlining the key steps for structuring and issuing **green, social, sustainability and sustainability-linked bonds,** reflecting new insights, lessons learned and challenges in the thematic bond market over recent years.

This document complements existing guidelines for thematic bonds and shares valuable insights and lessons drawn from IDB Invest's experience in structuring, advising and purchasing these instruments, as well as consultations with key stakeholders across 13 organizations, including development banks, second party opinion providers, issuers, investors and stock exchanges. The updated guidance provides issuers with a practical roadmap for thematic bond issuance and reflects on the evolution of the market, which has experienced significant growth in volume and number of issuers, as well as in sophistication with the emergence of sustainable finance taxonomies, and a greater scrutiny of the quality of thematic bond instruments.

The guide provides background context and the business case for both first time and seasoned issuers, all with the aim of helping attract thematic bond investors, a rapidly growing cohort looking to address environmental and social needs without sacrificing returns. The report provides new guidance on how to prepare use of proceeds thematic bonds and sustainability-linked bonds, outlining the management capacity and internal systems that should be in place in the organization for a successful issuance. The guide includes a maturity matrix for issuers to self assess their readiness to issue a thematic bond, addressing themes of corporate governance, environmental and social risk management, use of proceeds and key performance indicators, among other areas.

First time issuers can start at **Chapters 1 and 2,** which introduce the thematic bonds universe 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. **Chapter 3** describes how robust corporate governance practices help issuers enhance their strategy and manage risks, while **Chapter 4** provides a practical roadmap for issuance, including an assessment framework to measure an issuer's overall readiness to issue a use of proceeds or sustainability-linked bond. The guide concludes with **Chapter 5,** which provides insights on current innovations and future market trends.

Introduction

The green, social, sustainability and sustainability-linked (GSS+) bond market has grown exponentially in recent years, playing an important role in attracting capital toward a low carbon economy and closing social gaps. In Latin America and the Caribbean (LAC) in particular, at the end of 2023 the thematic bond market accounted for 28% of the region's debt (compared with a 12% share in global markets).[1]

Several factors contribute to this phenomenon. First, the region's acute vulnerability to climate change and social inequality underscores an urgent need for capital to fund projects in areas such as affordable housing, education and renewable energy, so thematic bonds are key instruments for mobilizing resources.

Second, there is a large participation of sovereign issuers in the market, which often leads to large scale transactions that significantly contribute to the market's size. For example, the Government of Chile alone has issued USD 48 billion in thematic bonds since 2019,[2] representing over a quarter of cumulative issuance volume in LAC.[3] It has been estimated that the impact of sovereign issuers tapping into the external environmental, social and governance (ESG) debt market leads to a 60% increase in the volume of corporate bond issuances and a 25% increase in the number of ESG corporate bond issuances after three years.[4]

The tide is now turning, with private sector issuers showing appetite for innovation and leveraging thematic bonds to gain traction and visibility on the international stage. The importance of thematic bonds in the LAC debt capital markets demonstrates the integral role that these instruments have played in driving institutional and private capital to prioritize the sustainability agenda in the region.

This guide is an update of the *Practitioner's Guide and Toolkit for Thematic Bonds* published in 2021, reflecting new insights and challenges in this emerging space. Since the first publication, the market has evolved substantially through market growth, clearer guidance in the form of sustainable finance taxonomies and greater scrutiny of the quality of thematic bond instruments.

As of the end of 2023, global issuance of thematic bonds reached a cumulative USD 4.2 trillion.[5] In LAC, the volume of thematic bond issuances has expanded to USD 176 billion, representing an 83% increase since 2021. The emergence of new instruments such as sustainability-linked bonds (SLBs) brought alternatives for sustainable finance in the market, which has grown to represent 23% of cumulative issuance volume in LAC.[6]

On the social side, LAC has become a leader in gender bonds, which now represent 17.6% of all fixed-income securities with a gender lens in the region;[7] on the environmental side, the region has been a pioneer in the blue bond space, with IDB Invest paving the way with the first blue bond issuance in LAC in 2021.[8]

[1] *S&P Global Ratings (2024). Sustainability Insights Research: Latin American Sustainable Bond Issuance To Rise In 2024. Available online* **here.**
[2] *Ministerio de Hacienda, Gobierno de Chile (2024). Chile emite nuevo bono social en dólares por US$1.700 millones. Available online* **here.**
[3] *HPL.LLC's proprietary database on thematic bonds in LAC (consulted in 2024).*
[4] *Cunha et. Al. (2023). Evidence of the knock-on effect of sovereign ESG bonds on corporate ESG bonds from Latin American and Caribbean (LAC) issuers. Available online* **here.**
[5] *Climate Bonds Initiative (2023). Sustainable Debt Market Summary Q3 2023. Available online* **here.**
[6] *HPL.LLC's proprietary database on thematic bonds in LAC (consulted in January 2024).*
[7] *Pro Mujer (2023). The Rise of Gender Bonds in Latin America. Available online* **here**.
[8] *IDB Invest (2021). IDB Invest Issues First Blue Bond in Latin America and the Caribbean. Available online* **here.**

International sustainable finance taxonomies such as the European Union's Sustainable Finance Taxonomy have played an important role in setting a high standard for thematic bond issuers. To acknowledge the local context, regional taxonomies are being developed. Colombia, Mexico and Panama have published their own national taxonomies, and others are on the way (Argentina, Brazil, Costa Rica, Chile, Dominican Republic and Peru). While alignment to taxonomies enhances comparability and disclosures, challenges lie in the interoperability and useability of taxonomies, as various initiatives are underway to develop taxonomies globally at different speeds (for further details, see **Chapter 1.2**).

Given the growth of the market and an increase in requirements, robust corporate governance, quality disclosure and impact measurement have come to center stage because there is greater scrutiny of the quality of thematic bond issuances from investors and other stakeholders. Investors are increasingly interested in sustainability performance, with a growing demand for more detailed impact reports (reporting not only on the output but also on the outcome and impact level) and greater transparency from issuers. While the principles of the International Capital Market Association (ICMA) provide good recommendations for the market on how to prepare reports on impact, there is still room for improvement in the quality and depth of thematic bond reporting. As this is still a nascent market, lack of transparency or limited disclosure could be detrimental to further growth. Promoting improved disclosure practices and deeper impact monitoring and reporting will help further the quality of the market. This guide seeks to orient issuers toward achieving best practices. For further details, see **Chapters 3 and 4.**

Multilateral development banks (MDBs) continue to play a significant role in promoting thematic bond market advancement by attracting institutional investors and enhancing private sector participation. MDBs are moving from playing a catalytic role in initiating market growth toward playing one in which they are upholding high standards, helping the market scale further and focusing on impactful frameworks that are truly responsive (in urgency, magnitude and effectiveness) to the current climate crisis and persisting inequalities in the region. This guide leverages IDB Invest's experience as a market leader in thematic bonds within the LAC region, arising from the institution's support in structuring, advising on and purchasing these market instruments (for further details see **Chapter 2.2 and 2.3**).

IDB Invest's objective is to ensure sustainable and inclusive growth for the LAC community. IDB Invest develops sustainability solutions for private sector clients to finance the private sector and catalyze sustainable financing to address the region's development challenges.

Since 2017, IDB Invest has supported the issuance of 43 thematic bonds in 13 countries, valued at 3.8 billion, which includes mobilization of USD 2.0 billion of private capital.[9] Some of these transactions have been innovations in the market, such as Bancolombia, the first bank to have issued an SLB in the region,[10,11] Banistmo, the first issuer of a gender bond in Latin America,[12,13] and Banco Bolivariano, the first blue bond with incentives linked to meeting objectives.[14]

[9] IDB Invest (n.d.). Thematic Bonds. Available online **here.**
[10] IDB Invest (2022). IDB Invest, Bancolombia Announce the Region's First Sustainability-Linked Bond Issued by a Bank. Available online **here.**
[11] Bancolombia (2023). Bancolombia Bonds. Available online **here.**
[12] IDB Invest (2022). Latin America, World Leader in Gender Bonds. Available online **here.**
[13] Banistmo (2023). Relación con inversionistas. Available online **here.**
[14] IDB Invest (2023). IDB Invest, Banco Bolivariano Announce the Issuance of the World's First Blue Bond with Targeted Incentives. Available online **here.**

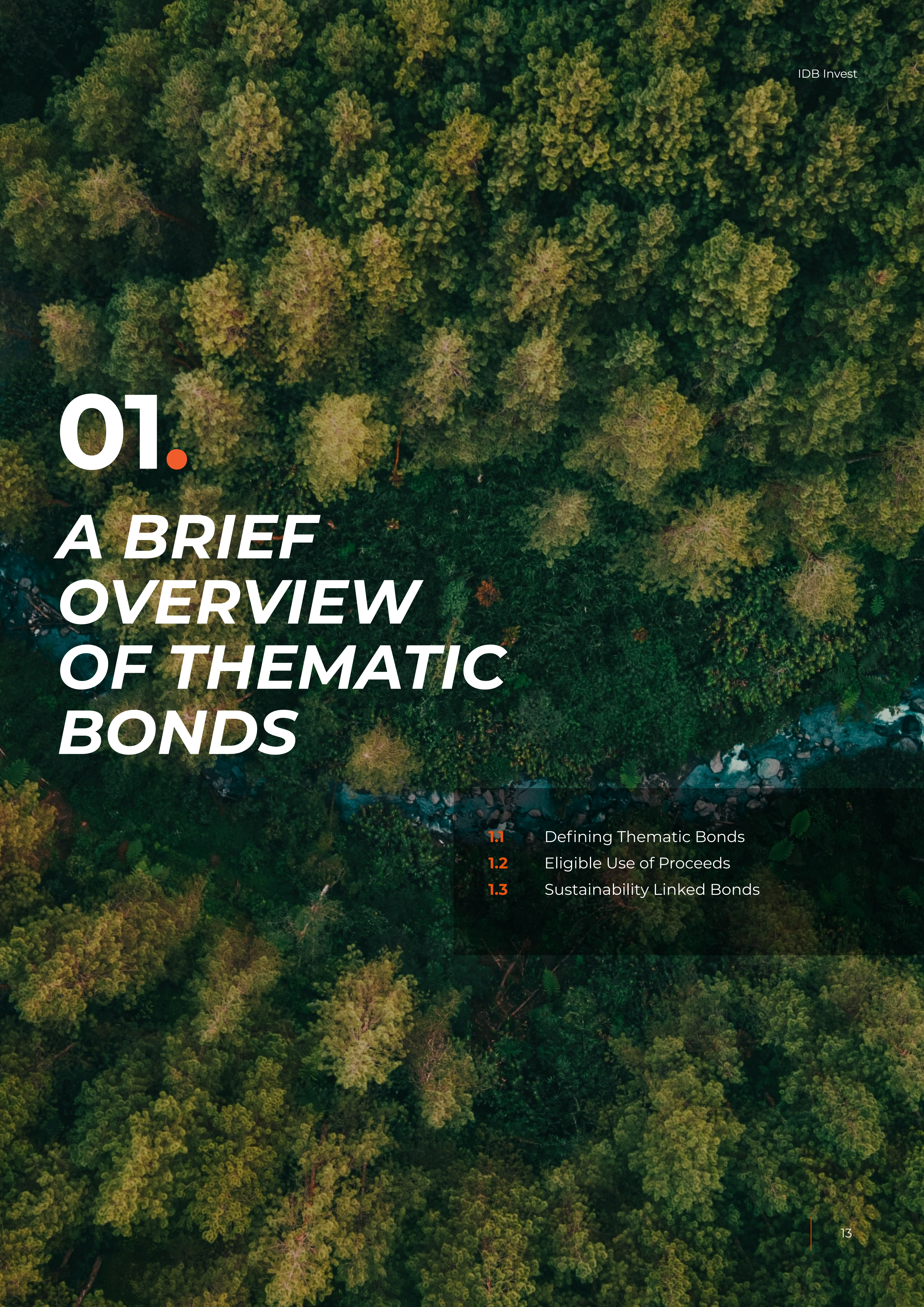
In 2021, IDB Invest launched its **Sustainable Debt Framework** as a key element of the funding strategy to enable the achievement of sustainability goals by issuing green, social and sustainability (GSS) debt in different formats, tenors, currencies and markets. The Sustainable Debt Framework is aligned with the Green Bond Principles (GBP), Social Bond Principles (SBP) and Sustainability Bond Guidelines (SBG) published by the ICMA and it was also awarded the highest second party opinion (SPO) score for its contribution to sustainability by Vigeo Eiris, a subsidiary of Moody's ESG solutions.

From when the framework was first established up until the end of 2022, IDB Invest issued thirteen bonds amounting to USD 3.7 billion in four different currencies (MXN, EUR, USD and AUD). Of the thirteen bonds issued: six were labeled as green bonds, including three blue bonds, one transition bond and one decarbonization bond; five were labeled as social bonds, one of which was a gender bond, one a silver economy bond and one a small and medium enterprise (SME) bond; and two were labeled as sustainability bonds.

Notable issuances included an inaugural USD 1 billion sustainability bond, the first social bond issued in the Australian market for AUD 400 million, the first gender bond issued by an MDB in Mexico for MXN 2.5 billion, and the first blue bond in LAC for AUD 50 million.[15]

With the support of HPL.LLC, IDB Invest developed this guide to provide issuers with a practical roadmap for thematic bond issuance that outlines key components for structuring. This guide was based on an in-depth literature review as well as consultations with key stakeholders across 13 organizations, including development banks, SPO providers, issuers, investors and stock exchanges. The report provides new guidance on how to prepare use of proceeds (UoP) thematic bonds and SLBs, outlining the management capacity and internal systems that should be in place in the organization for a successful issuance. It adopts a holistic perspective, highlighting how to systematically incorporate sustainability into the decision-making process with risk and opportunity in mind, while also ensuring that performance is measured at the level of the issuance and the issuer.

[15] *IDB Invest (2022). Sustainable Bond Program: Allocation and Impact Report. Available online* ***here.***



01.

A BRIEF OVERVIEW OF THEMATIC BONDS

1.1 Defining Thematic Bonds
1.2 Eligible Use of Proceeds
1.3 Sustainability Linked Bonds

1.1 Defining Thematic Bonds

Thematic bonds are valuable capital market instruments that corporations, financial institutions, projects (project bonds), sovereigns, sub-sovereigns and supra nationals can use to accelerate and unlock sustainable financial flows. Thematic bonds 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. Additionally, most investors now integrate sustainability issues into their investing mandate, which is supporting demand for GSS+ securities.

The thematic bond market has evolved to include various instruments, which have come in the form of two structures: (1) UoP thematic bonds, and (2) SLBs. The ICMA has published voluntary guidelines for thematic bond issuers, which define the key components for each instrument (**Figure 1**).

Figure 1. **Use of Proceeds Thematic Bonds vs Sustainability-Linked Bonds**

UoP thematic bonds are like 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. GSS bonds are the most common types of UoP thematic bonds, but additional labels have emerged, including blue, gender, Sustainable Development Goals (SDGs) and transition bonds (**Table 1**).

SLBs are performance-based fixed income instruments that raise capital for general corporate purposes to support the implementation of a sustainability strategy. Their financial or structural characteristics are adjusted according to the achievement of a predefined sustainability target. The advent of these instruments has opened a new door to sustainable financing by establishing a framework that enables investors to buy into an issuer's sustainability improvements.

While there is no universally accepted definition of thematic bonds, various market guidelines and standards have emerged in recent years. The ICMA principles are the most prevalent, as they provide voluntary guidelines for thematic bond issuers. These principles have become the common denominator and building block for other labels and standards. **Table 1** defines the common thematic labels in this market and offers an illustrative example of their respective key guidelines or standards.

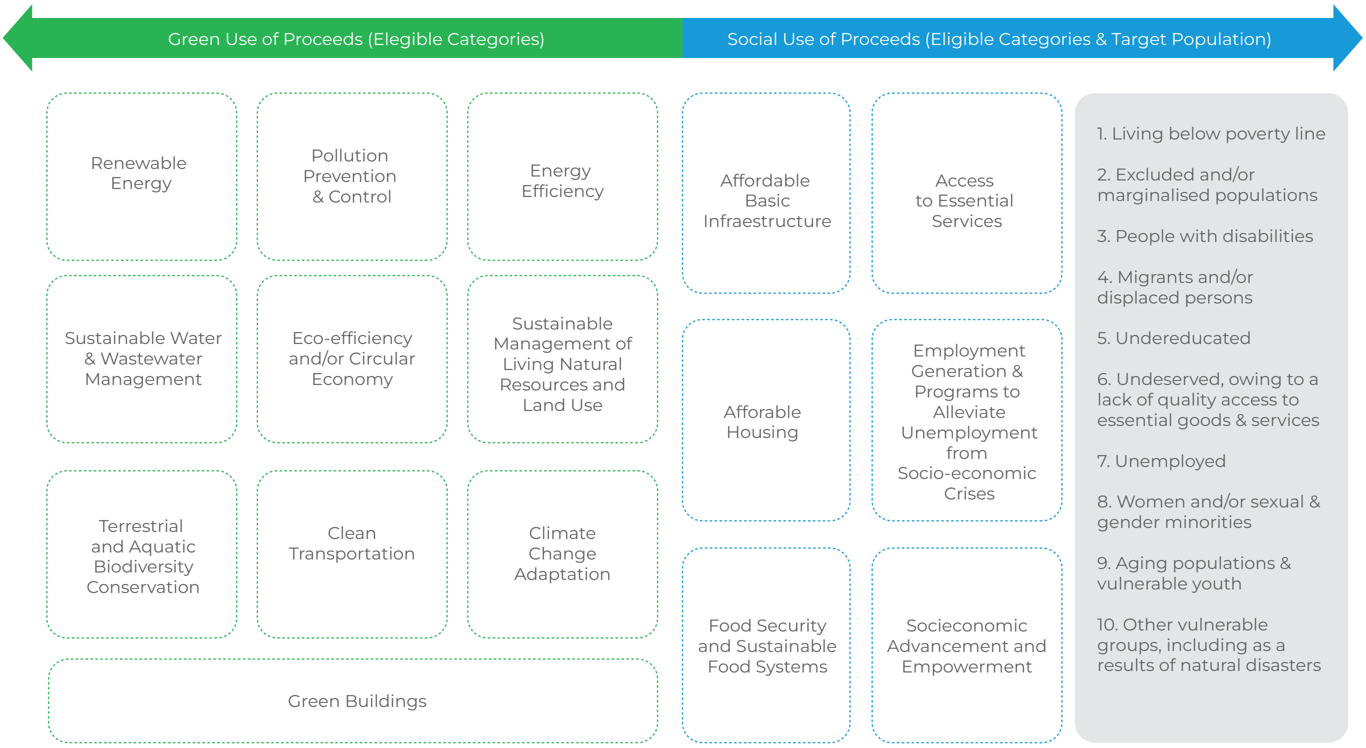
Table 1. The Thematic Bond Universe

LABEL	DEFINITION	MAIN MARKET GUIDELINES/STANDARDS
Green	A fixed income security that raises capital earmarked for new or existing projects with environmental benefits.	ICMA. *GBP* EU. *The European green bond standard – Supporting the transition* Climate Bonds Initiative (CBI). *The Climate Bonds Standard*
Social	A fixed income security that raises capital earmarked for new or existing projects with social benefits.	ICMA. *SBP*
Sustainability	A fixed income security that raises capital earmarked for new or existing projects with a mix of environmental and social benefits.	ICMA. *SBG*
Transition	A fixed income security that raises capital earmarked for new or existing projects related to climate transition. These bonds are targeted at industries with high GHG emissions that will allow them to secure funding with the goal of shifting to low carbon business activities.	ICMA. *Climate Transition Finance Handbook* CBI. *Principles for Transition*
Blue	A fixed income security that raises capital earmarked for new or existing marine and ocean-based projects that have positive environmental, economic and climate benefits.	ICMA. *New Guidance on Blue-Themed Bonds to Help Unlock Finance for a Sustainable Ocean Economy* United Nations Global Compact. *Blue Bonds Reference Paper*
Gender	A fixed income security that raises capital earmarked for new or existing projects that support the advancement, empowerment and equality of women.	ICMA. *Bonds to Bridge the Gender Gap: A Practitioner's Guide to Using Sustainable Debt for Gender Equality*
Sustainable Development Goals (SDGs)	A fixed income security that raises capital earmarked for new or existing green-, social- or climate-related activities and a link to the SDGs.	United Nations Development Programme. *SDG Impact Standards for Bond Issuers*
Climate resilience	A fixed income security that raises capital earmarked for new or existing climate-resilience–related activities.	CBI. *Climate Resilience Principles*
Sustainability linked	A fixed income security that raises capital for general corporate purposes, whose financial or structural characteristics are adjusted according to the achievement of a predefined sustainability target.	ICMA. *Sustainability-Linked Bond Principles (SLBP)*

1.2 Eligible Use of Proceeds

GSS bonds 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, UoP of the latter bonds may comprise eligible categories from green and social bonds. **Figure 2** summarizes the eligible categories according to the ICMA principles.

Figure 2. **Sustainability Use of Proceeds**



To further detail what is meant within each of the eligibility categories, international and national bodies have developed sustainable finance taxonomies. These are science based classification systems that provide guidance on how to identify projects, assets and activities that deliver key environmental, social and/or sustainability objectives.[16] By setting clear market guidance, sustainable finance taxonomies help avoid greenwashing or social washing, i.e. making false or misleading claims about the green or social credentials of GSS+ bonds.

[16] *United Nations Environment Programme (2023). Common Framework of Sustainable Finance Taxonomies for Latin America and the Caribbean. Available online* ***here.***

When appropriately designed, taxonomies can bring various benefits to issuers and investors, including the following:

- Provide clear definitions of what is "green" or "social".
- Promote greater confidence to investors on the quality of green and/or social assets.
- Facilitate tracking of sustainable finance flows.
- Allow for greater contextualization of sustainability objectives (in the case of local taxonomies).

Challenges lie in the interoperability and useability of taxonomies because various initiatives are underway to develop taxonomies globally at different speeds. There are a growing number of national and international taxonomies, as well as market based taxonomies that have been developed by industry players.[17] Within LAC, Colombia pioneered this movement by launching its own Green Taxonomy in 2022, which was developed by an inter institutional effort led by the Ministry of Finance.[18] In 2023, Mexico published its Sustainable Taxonomy, which was the first in the world to cover both environmental and social (E&S) issues, particularly with a gender focus.[19] Panama is the most recent country to have published its Sustainable Finance Taxonomy, in March 2024.[20] Other countries in the region, namely Argentina, Brazil, Costa Rica, Chile, Dominican Republic, Panama, and Peru, are in the process of developing their taxonomies (**Figure 3**). Additionally, the Central American Council of Superintendents of Banks is working on a sustainable finance taxonomy for Central America focused on the banking systems of Colombia, the Dominican Republic, Ecuador and Panama. Within this context, the United Nations Environment Programme has a Working Group on Sustainable Finance Taxonomies that developed a guidance document that can serve as a voluntary reference to orient LAC countries in the process of developing their taxonomies in a way that promotes harmonization and interoperability.[21] Eventually, there may be different requirements depending on the jurisdiction of issuance in terms of which taxonomy to align to.

[17] *International Capital Market Association (2021). Overview and Recommendations for Sustainable Finance Taxonomies. Available online* ***here.***
[18] *Government of Colombia (n.d.). Taxonomia Verde. Available online* ***here.***
[19] *Government of Mexico (2023). Taxonomía Sostenible de México. Available online* ***here.***
[20] *United Nations Environment Programme (2024). La Taxonomía de Finanzas Sostenibles de Panamá. Available online* ***here.***
[21] *United Nations Environment Programme (2023). Common Framework of Sustainable Finance Taxonomies for Latin America and the Caribbean. Available online* ***here.***

Figure 3. **Taxonomy Implementation in Latin America and the Caribbean**

Implemented

Colombia: ***Green Taxonomy***, published March 2022

Mexico: ***Sustainable Taxonomy***, published March 2023

Panama: ***Sustainable Finance Taxonomy***, published March 2024

In development

Argentina: ***Roadmap*** presented with UNDP, May 2021

Brazil: ***Roadmap*** developed by the Ministry of Finance, September 2023

Costa Rica: Launched ***initiative*** with UNDP, April 2023

Chile: ***Roadmap*** presented with CBI and IDB, August 2022

Dominican Republic: ***Green Taxonomy*** developed by SIMV and IFC, under public consultation, October 2023

Peru: Launched ***initiative*** with GIZ, October 2022

Aligning to sustainable finance taxonomies helps UoP thematic bond issuers define more clearly the environmental and/or social objectives of the assets they are financing. Some investors are starting to evaluate whether issuances are aligned to screening criteria set by taxonomies. SPO providers are organizations that offer assurance regarding the alignment of a bond framework with accepted market principles and also use taxonomies to evaluate alignment with best practices. Some SPOs provide an additional assessment to see whether a bond is EU taxonomy–aligned. While local taxonomies are beneficial for issuers and local investors by providing greater local context, there is a limited benefit from the perspective of international investors, who may be more inclined to use international taxonomies. The intention around taxonomies is to make the market more transparent by establishing guardrails and making reporting, assessment and alignment easier. But as more taxonomies emerge, it will be important for market players to promote harmonization and interoperability between them.

1.3 Sustainability Linked Bonds

SLBs are fixed income instruments for which the financial characteristics of the issuance may vary depending on whether the issuer achieves previously defined sustainability objectives. These objectives are measured through key performance indicators (KPIs) and assessed according to set sustainability performance targets (SPTs). Issuers are therefore committing to achieving future improvements in sustainability outcomes. ICMA's Sustainability Linked Bond Principles (SLBP) define five key components for SLBs **(Figure 4).**

Figure 4. **The Five Key Components of Sustainability-Linked Bonds**

Selection of KPIs	Calibration of SPTs	Bond Characteristics	Reporting	Verification
Relevant, core and material	Ambitious and able to be benchmarked	Financial/ structural penalty or reward	Published at least annually	Independent and external
Measurable	Alignment to strategy		Performance of KPI (including baseline)	At least once a year*
Externally verifiable	Predefined timeline		Verification assurance report on the SPT	*or when assessment can lead to potential financial/ structural adjustment
Able to be benchmarked	Implementation		Information to monitor ambition	

As opposed to UoP thematic bonds, SLBs do not need to be tied to a specific project or asset; rather, the financing can be applied to general corporate purposes aligned with a sustainability strategy, which opens the door to more potential issuers joining the sustainable fixed income market. As such, the SLB market in LAC is dominated by non financial corporates, which represent 68% of SLB issuance volume.[22] This gives greater flexibility to issuers who want to come to the market but may not have the green or social capital expenditures to back up a GSS issuance. For SLBs to be credible, issuers must have suitable monitoring systems in place to report quality and material KPIs and set ambitious targets. As the SLB market is still nascent, it should be considered an evolving market because issuers and investors continue to gather more experience with these instruments. For instance, the CBI estimated that only 17% of the outstanding amount of SLB issued globally is currently aligned with international climate goals, but they observed that this proportion is growing rapidly.[23]

[22] *HPL.LLC's proprietary database on thematic bonds in LAC (January 2024).*
[23] *Climate Bonds Initiative (2024). Sustainability-Linked Bonds: Building a High-Quality Market. Available online* ***here.***

02.

THE MARKET FOR THEMATIC BONDS

2.1 The Business Case

2.2 IDB Invest's Value Proposition

2.3 Promoting Thematic Market Growth in Latin America and the Caribbean

2.1 The Business Case

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

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

	BENEFIT	DESCRIPTION
Issuers	Align funding strategy with sustainability credentials	The process of issuing a thematic bond can be a catalyst to solidify sustainability in the DNA of the organization because it allows management to align their financial actions to their sustainability goals, resulting in a more faithful investor base and a more engaged workforce.
	Broaden access to a diversified pool of investors	Thematic bond issuers can attract new investors with sustainability mandates.
	Achieve 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 large size 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 such as investors, employees, regulators and consumers.
	Promote intra company collaboration	The process of issuing a thematic bond makes it possible to strengthen collaboration across relevant teams. In addition to the finance and sustainability teams, sourcing, operations and other teams are often the ones that deliver on KPIs.
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 the allocation of eligible criteria and performance of SPTs are reported annually, providing investors with a greater understanding of the impact of their investment for their own information purposes.
	Address E&S issues	UOP thematic bonds direct capital to activities that can generate positive E&S 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. SLBs enable investors to buy into the issuer's sustainability improvements.
	Enhance risk management	Issuers provide a solid due diligence for selecting of UOP projects and SLBs' KPIs, which provides investors with a clear way to get economic, E&S returns without significant additional risk.
	Meet sustainability objectives	Investing in thematic bonds can help investors meet their sustainability objectives (i.e. decarbonize their portfolios).

2.2 IDB Invest's Value Proposition

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 promoting participation by issuers and fostering 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 standards.

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: it participates in private sector bond issuances as a sole investor, anchor investor or credit guarantor; it provides bridge financing to support clients' future bond issuances; or it structures alternative solutions such as a B Bond (repackaging of a B loan) to mobilize institutional investors (**Table 3**).

Table 3. **Financial Mechanisms to Support Thematic Issuers**

Bond Subscription:	**Partial or Total Credit Guarantees:**
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.	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:	**B Bond:**
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).	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 Environmental, Social and Governance Enhancement

IDB Invest supports commercial financial institutions, private corporations and national development banks to prepare for their issuance of thematic bonds. IDB Invest'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 thematic 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 of the asset class to foster issuer and investor confidence. As a part of its advocacy, IDB Invest joins forces with the Inter-American Development Bank (IDB) to publish sustainability protocols, update policies on *Access to Information* and *Environmental and Social Sustainability,* publish sector guidelines, and engage in public–private sector dialogues, innovation labs and other knowledge sharing platforms. For example, in April 2021 IDB and IDB Invest launched the Green Bond Transparency Platform (GBTP) to improve investment environments and promote the adoption of best practices for capital markets.

Managing for Impact:

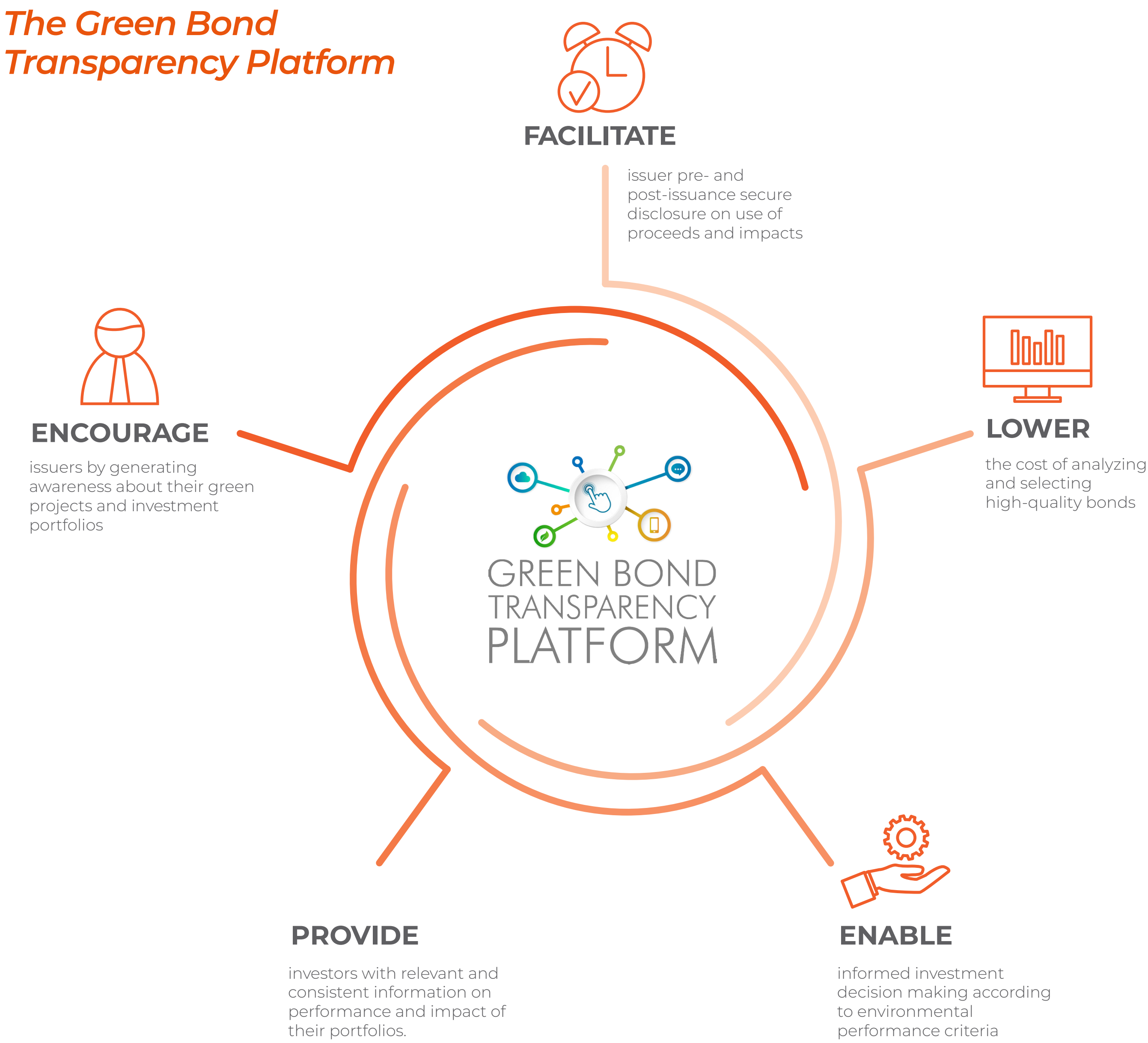
IDB Invest's mandate is to maximize development impact while maintaining financial sustainability, a two sided objective shared with many impact and ESG investors. Therefore, IDB Invest developed its *Impact Management Framework*,[24] an end to end series of tools and practices that support the complete project lifecycle and integrate impact and financial considerations into portfolio management. IDB Invest also supports clients in building or strengthening their impact monitoring and reporting capabilities (e.g. design of indicators and instruments for data collection, integration of monitoring platforms in bank systems and design of impact dashboards to facilitate reporting).

The Impact Management Framework allows IDB Invest to build, measure and manage a portfolio of financially sustainable investments that contribute to the 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.[25] 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.

[24] *IDB Invest (2020). IDB Invest's Impact Management Framework: Managing a Portfolio for Impact. Available online* ***here.***

[25] *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.*

Figure 5. **The Green Bond Transparency Platform**



The GBTP is a public platform developed by IDB to promote transparency in the green bond market in LAC. It supports the harmonization and standardization of green and sustainability bond reporting, facilitating first hand granular, credible and comparable data for investors' evidence based decisions. The platform supports secure, consistent, transparent and reliable reporting of impacts generated by all green bonds in the region. It allows impact to be tracked at the UoP level in line with existing and evolving standards and methodologies in order to build a track record on green bond UoP and generate confidence in the growing market in LAC.

The GBTP's planned globalization was announced in September 2023, to be accomplished through a collaboration with other development finance institutions (DFIs) looking to enhance accountability and transparency of green and sustainable bonds in emerging markets.[26]

[26] *AECID, EIB, KFW, AFD, IDB (2023). Joint Declaration by the Multilateral and Bilateral Development Institutions for the Global Enhancement of Accountability and Transparency in the Green and Sustainable Bond Market. Available online* ***here.***

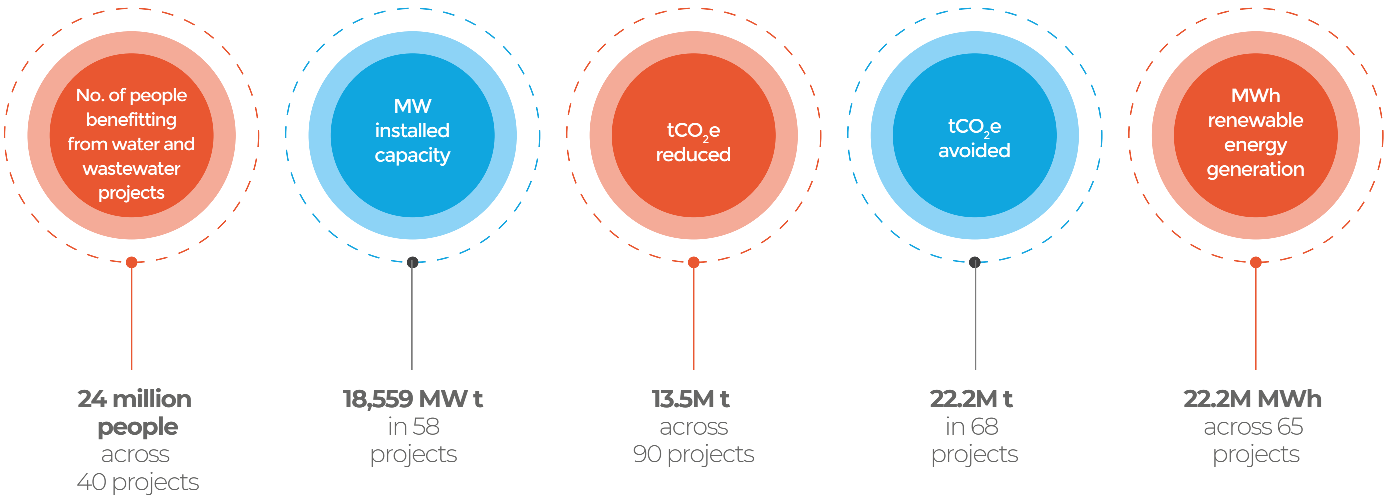
Thematic Bond Issuer Impact/Output Metrics on the Green Bond Transparency Platform

As of March 2024, the GBTP presents information on 240 bonds in 18 countries, representing USD 43.7 billion in issuance volume and USD 19 billion in total disbursement. The GBTP provides first hand data from thematic bond issuers, ensuring that no interpretation or calculation of an individual bond's data is applied by the platform system. This approach aims to motivate issuers to be fully responsible for their reporting.[27] The inclusion of external reviewers as qualified users provides further credibility because a tag reflecting an external review only appears after the confirmation of the external reviewer.

The GBTP provides access to post issuance standardized reporting data of UoP and impacts of the bonds in one place. All data can be exported at no cost, allowing investors and the public to perform analyses to evaluate the impacts and outputs of the overall green bond issuance in the region covered in the platform.

Based on the data disclosed in the GBTP, it is noted that 58% of the issued bonds include reporting on the UoP, while 52% incorporate reporting on their impacts. This underscores a potential opportunity for issuers to enhance their use of open, transparent tools, thereby highlighting their adherence to best practices and showcasing the projects funded by participating in this platform.

Based on the reported data, it is observed that four out of the top five impact metrics used are associated with renewable energy projects, with the remaining one focusing on water projects.[28]



[27] *Vasa et al. (2022). A novel database for green bonds to support investment analysis and decision making, research and regulatory decisions: The Green Bond Transparency Platform. Available online* ***here.***
[28] *Green Bond Transparency Platform (2024). Available online* ***here.***

2.3 Promoting Thematic Market Growth in Latin America and the Caribbean

IDB Invest is successfully encouraging private sector participation in thematic bond issuance and attracting more investors to the asset class. Since 2017 and up until August 2024,, IDB Invest has supported the issuance of 43 thematic bonds in 13 countries, valued at USD 3.8 billion, which includes mobilization of USD 2.0 billion of private capital.

IDB Invest has supported many first of its kind transactions, including the first gender bond in Latin America (*Banistmo*, 2019), the first social bond in Brazil (*Banco ABC*, 2020), the world's first gender linked bond based on achieving outcomes (*Davivienda*, 2020) and the first SLB issued by a financial institution in the LAC region and in Colombia (*Bancolombia*, 2022).

Figure 7 highlights the diversity of thematic bonds supported by IDB Invest. The full list of transactions is available *here.*

Figure 7. IDB Invest's Role in Promoting the Thematic Bond Market in Latin America and the Caribbean

Thematic Bonds

Green Bond · Blue Bond · Sustainable Bond · Social Bond · Gender Bond · Sustainability-linked Bond

Argentina

Bice
US$30 million

Bolivia

Banco Sol
BOB$206 million

Brazil

BDMG
US$50 million

Banco ABC
R$525 million

Sicredi
US$100 million

Natura
R$1,326 million

Costa Rica

Banco Promerica
US$30 million

Banco Nacional
US$45 million

Liberty
US$450 million (B Bond)

Banco Nacional
US$50 million

Colombia

Grupo Bancolombia
COP$657 billion

Compañía de Empaques
COP$50 billion

Davivienda
COP$362 billion

La Hipotecaria
COP$52 billion

Banco W
COP$150 billion

Mibanco
COP$76,5 billion

Autopista de Peaje-RumichacaPasto
COP$530 billion

Unión Vial Rio Pamplonita
US$401 million

Bancolombia
COP$640 billion

Banco de Bogotá
US$230 million

Ecuador

Banco Pichincha
US$50 million

Banco Guayaquil
US$20 million

Jardín Azuayo
US$20 million

Banco Bolivariano
US$80 million

Banco Solidario
US$30 million

Banco Pichincha
US$50 million

Produbanco S.A
US$50 million

El Salvador

Banco Promerica
US$20 millones

Fedecredito
US$80 million

Guatemala

Banco Promerica
US$50 millones

Mexico

Cadu
MXN502 million

Vinte 18x
MXN250 million

Vinte 23x
MXN1500 million

Panama

Banistmo
US$50 million

Peru

Caja Arequipa
PEN$57,64 million

Banco Pichincha
US$13 million

Los Portales
US$35 million

Trinidad and Tobago

Home Mortgage Bank
US$44,4 million

Uruguay

Natelu and Yarnel
US$25,3 million

Campo Palomas
US$135,8 million
(B Bond)

La Jacinta
US$64,7 million
(B Bond)

El Naranjal y Del Litoral
US$97,5 million
(B Bond)

BBVA UY
US$15 million

IDB Invest further cemented its leadership in thematic bond markets in LAC with the publication of its own Sustainable Debt Framework in January 2021. This is the first ICMA aligned sustainability debt framework from a high grade MDB. 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 and private placements for three green bonds.[29]

[29] *IDB Invest (2022). Sustainable Bond Program: Allocation and Impact Report. Available online* here.

03.

CORPORATE GOVERNANCE AS THE FOUNDATION: SHAPING STRATEGY AND RISK MANAGEMENT

3.1 Why Corporate Governance Matters
3.2 Shaping Coherent Business Strategies
3.3 Shaping Strong Risk Management Systems
3.4 Enhancing Issuer's Preparedness

3.1 Why Corporate Governance Matters

Improving the quality of Corporate Governance in LAC is critical to the development of local capital markets, particularly thematic bond markets. Robust corporate governance practices play a crucial role in mitigating risk and cultivating public trust in a region characterized by historically underdeveloped capital markets, heightened volatility, inadequate regulatory frameworks, concentrated ownership structures, and limited investor participation and engagement. Companies that adhere to strong corporate governance principles and maintain effective management systems are better positioned to attract investment, nurture positive investor relations and ensure that thematic bonds make a significant contribution to sustainability.

Figure 3. **Aspects of Corporate Governance**

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

An effective corporate governance framework serves several fundamental purposes. First, it establishes mechanisms to hold decision makers within a company accountable for their actions and decisions, thereby mitigating the risks of misconduct and conflicts of interest. Second, it promotes transparency by mandating the disclosure of pertinent information to shareholders, stakeholders and the public, fostering trust and informed decision making. Third, it ensures fairness by advocating for equitable treatment of all stakeholders, including shareholders, employees, customers and communities. Additionally, it emphasizes responsible stewardship of corporate resources and the consideration of ESG factors in decision making processes.

It encompasses robust risk management practices to identify, assess and mitigate risks, safeguarding the company's financial performance and reputation. And it ensures that companies comply with applicable laws, regulations and industry standards. Corporate governance encourages companies to focus on creating sustainable long term value for shareholders and stakeholders rather than prioritizing short term gains.

Avocating 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)[30] 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.

3.2 *Shaping Coherent Business Strategies*

Companies that have established strong governance are better positioned to issue thematic bonds because they can effectively align the issuance with their overall business strategy and sustainability goals. Robust corporate governance practices play a pivotal role in shaping business strategy, rendering issuers more resilient, efficient, transparent, accountable and sustainable. Integral to this accountability is the implementation of robust reporting mechanisms, effective impact management, avoidance of "green" or "social" washing, meticulous risk management and a clear articulation of the company's vision, mission and purpose.

This solid foundation instills greater credibility and trust among investors, further solidifying the issuer's position in the market (**Figure 9**).

[30] *Corporate Governance Development Framework (2021). Collaboration on Corporate Governance. Available online* ***here***

Figure 9. **A Robust Corporate Governance Shaping Strategy**

The board of directors is responsible for driving business strategy and promoting greater sustainability within the organization, which requires three basic pillars:

1. Composition and diversity:

Boards that include independent directors and/or directors with sustainability expertise can bring additional perspectives on sustainability outcomes. When a board is diverse (gender, race, age and experience), it is more likely to represent the interests of all stakeholders, which can lead to increased trust in the company. Balancing board continuity with introducing new members can bring fresh perspectives on sustainability. This can be further complemented with continuous education and training for all board members on sustainability issues and thematic bond markets.

2. Integrating sustainability in business strategy:

Boards that are involved in defining sustainability goals and policies are better prepared to align sustainability with corporate strategy and purpose, as well as to promote innovation and the pursuit of sustainability opportunities within operations.

3. Risk oversight:

Boards that ensure that risk management processes are robust and effective in identifying, assessing and mitigating risks tend to be more successful in achieving strategic objectives and sustainability goals. By providing oversight of the risk management framework, the board helps safeguard the organization's long term sustainability and resilience in the face of uncertainty.

Coherence between the business strategy and the thematic bond issuance is key. For UoP thematic bonds, it is important that the financed assets are aligned within the context of the issuer's overarching objectives related to sustainability. For SLBs, it is important to acknowledge that KPIs are material to the core sustainability strategy and should cover the full spectrum of ESG risk and opportunity – which in turn will allow for sound ambition, leading to more credible transactions and creating more trust with investors.

3.3 Shaping Strong Risk Management Systems

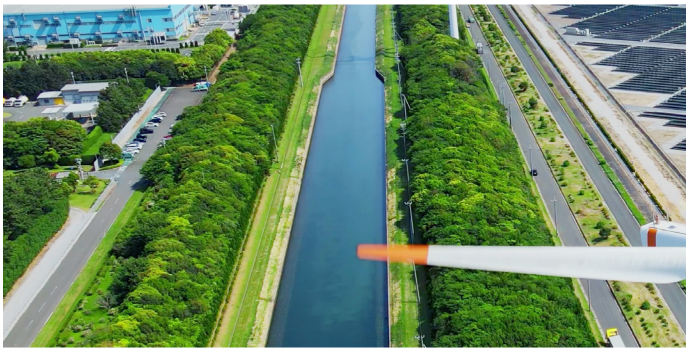
Thematic bond issuers have come under greater scrutiny from the market. One of the biggest reputational risks associated with thematic bonds is for the market to perceive the issuance as "green" or "social" washing. For UoP thematic bond issuers, this could happen if the eligible assets financed have a far lower environmental or social benefit than originally claimed, if there is no clear demonstration of how the proceeds are used to generate positive sustainability outcomes, or if the issuer lacks capacity to report on those outcomes. For SLB issuers, this could happen if the KPIs are not considered material for the business and the SPTs are not considered ambitious compared with peers, business as usual (BAU) or other science based targets. Having adequate governance systems in place can help issuers ensure that there are no breaches to the E&S 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 a thematic bond committee (see **Chapter 4.2.2** for more details), 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).[31] Additionally, it is important that organizations have a strong and practical crisis management governance model to address problems if they arise, which creates a more resilient organization.

For UoP thematic bond issuers, the updated ICMA principles provide guidance on ESG risk management, detailing that issuers should have a process in place to identify, manage and report on material sustainability risks. ICMA encourages issuers to have a process in place to identify mitigants to known material risks of negative social and/or environmental impacts of financed projects. This can include a description of the relevant trade off analysis that has been done as well as the monitoring undertaken by the issuer to ensure that these risks are addressed in a meaningful way.[32] This aligns closely with what DFIs promote through their respective

[31] *United Nations (2015). Corporate governance in Brazil, Chile, Colombia, Mexico, and Peru: The determinants of risk in corporate debt issuance. Available online **here.***

[32] *International Capital Market Association (2021). Green Bond Principles. Available online **here.***




sustainability policies and in conditioning lending to deliver a certain E&S performance. Similarly, thematic bond sponsors should ensure that the E&S risks are properly identified, managed and monitored. For example, a green bond that finances the construction of a hydropower dam should safeguard that any related biodiversity loss or negative community impacts are adequately understood and appropriately managed. DFIs such as IDB Invest often refer to best practice sector guidelines[33] in working with project sponsors to design for good management practices. SPO providers include an assessment of the sustainability or ESG performance of issuers in their methodologies, considering corporate governance practices, E&S policies and procedures, and whether the issuer was involved in any controversial business activities (this will be covered in further detail in **Chapter 4.4**). By obtaining an external verification, issuers can gain further credibility on not only the transaction but also the robustness of their internal management capacity to effectively select, evaluate and monitor eligible UoP.

For SLB issuers, it is important to acknowledge that the core sustainability strategy should cover the full spectrum of ESG risk and opportunity, which in the end is what allows for sound ambition. While there are no specific assets that are being financed through an SLB issuance, SPO providers evaluate the coherence between the issuer's business and sustainability strategies, its ability to identify, manage and mitigate E&S risks, and its ability to achieve the defined KPIs and SPTs.

Environment, Social and Governance Performance Indicators for Capital Markets

Robust corporate governance practices help shape strong management systems, which help issuers mitigate risks. A good tool for issuers to use to evaluate their corporate governance and risk management processes is *IFC's ESG Performance Indicators for Capital Markets,* which provide a sustainability data framework based on the Performance Standards on Environmental and Social Sustainability and Corporate Governance Methodology of the International Finance Corporation (IFC), indicating the types of metrics that are important for corporates and financial institutions to incorporate.

[33] The IFC's Environmental, Health and Safety Guidelines and Industry Sector Guidelines are commonly considered a benchmark in identifying and managing common E&S risks. They can be found ***here.***

3.4 Enhancing Issuer's Preparedness

Thematic bonds can unlock capital market flows toward sustainability by financing assets with a positive social and/or environmental impact or an issuer's sustainability objectives. 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 corporate governance practices will be better prepared to answer to the demands of a thematic bond issuance.

One of the greatest differentiating factors between thematic bonds and their non labeled counterparts is that the issuance of a labeled thematic bond implies **enhanced transparency** of information regarding the underlying assets financed by the instrument or its progress on SPTs.

First, 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, the best practices indicate that this information should be available in a readily accessible format to investors since it provides credibility to the transaction. The framework serves the issuers 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.

Second, while the bond is outstanding, issuers are required to provide annual reports on the allocation and impact of proceeds (for UoP thematic bonds) and on the performance regarding the SPTs (for SLBs). 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, issuers with a strong foundation of corporate governance are better equipped to be successful thematic bond issuers.

04.

A ROADMAP TO ISSUANCE

4.1 Readiness and Proximity to Best Practices Assessment

4.2 Design of a Use of Proceeds Bond

4.3 Design of a Sustainability Linked Bond

4.4 External Review

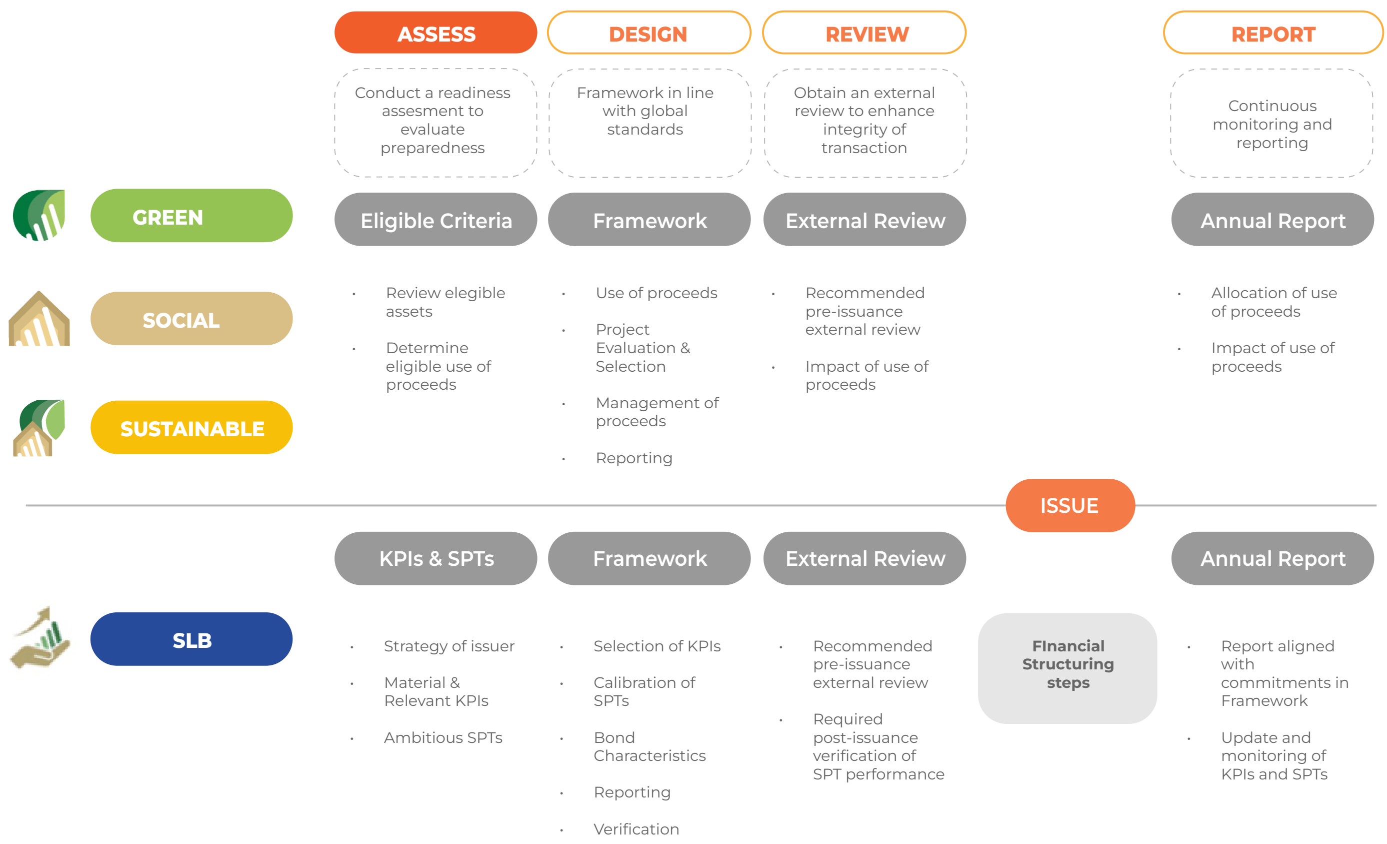
4.5 Bond Placement

4.6 Reporting and Continual Improvement

The financial structuring process of a thematic bond is like that of a regular bond, but to give the bond its thematic flavor, issuers will have to take a few additional steps.

Figure 10 shows the steps involved in the issuance of a thematic bond.

Figure 10. **The Thematic Bond Issuance Process**[34]



1. Assess

The issuer should conduct a self evaluation to assess its preparedness to issue and how close it is to aligning to market best practices, evaluating both its capacity as an organization and the issuance itself. This guide offers a **Readiness and Proximity to Best Practices** assessment in which issuers can evaluate their preparedness for issuing (see **Chapter 4.1** for further details).

2. Design

The next step is to identify the qualifying eligible assets or material KPIs and ambitious SPTs and to design the framework in line with a credible global standard. This framework will establish the internal decision making processes involved in defining and selecting eligible assets or material KPIs and ambitious SPTs, in addition to evaluating, monitoring and reporting on them. The design of these processes will help issuers with the implementation of these processes moving forward (see **Chapter 4.2 and 4.3** for further details).

[34] This roadmap is a development of a similar step-by-step process applied by IDB. 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).

3. Review

It is important for the issuer to obtain an external review of the transaction to verify its integrity. At the pre issuance phase, a UoP and SLB issuer can opt for an SPO, a verification, certification or a GSS bond rating. This provides investors with assurance of the credibility of the thematic bond. At a post issuance phase, a UoP issuer can also opt for a verification to address the tracking of UoP, allocation of proceeds, environmental and/or social impact, or impact reporting, while SLB issuers are required to obtain a verification of their performance against each SPT for each KPI (see **Chapter 4.4** for further details).

4. Issue

The issuer will have to undergo the financial structuring and planning common to issuing a bond (regardless of the thematic flavor) together with underwriters (see **Chapter 4.5** 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 or SPT performance at least until full allocation (with best practice being that the issuer reports until the maturity of the instrument). In the case of SLBs, this is one of the five core components of the SLBP. 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 **Chapter 4.6** 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 a UoP thematic bond or an SLB and to align with market best practices, evaluating both their capacity as an organization and the issuance itself.

The 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 corporate governance practices are better equipped to issue a thematic bond. The assessment of the issuer's corporate governance can be based on the IFC CG Progression Matrix for Listed Companies,[35] which is organized by four levels of company maturity and complexity in line with the CGDF methodology. This framework has been widely adopted by 35 DFIs in the world.[36] While the fulfillment of the Progression Matrix is not necessarily a requirement to issue thematic bonds or to obtain financing with DFIs , the tool can help issuers assess the robustness of their governance practices or guide them in establishing a best practice roadmap.

The IFC Corporate Governance Progression Matrix

IFC has developed a *Corporate Governance 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 corporate governance parameters:

1. Commitment to E&S matters and governance (leadership and culture);
2. Structure and functioning of the board of directors;
3. The control environment;
4. Disclosure and transparency;
5. Treatment of minority shareholders; and
6. Governance of stakeholder engagement.

[35] *International Finance Corporation (n.d.). IFC Corporate Governance Methodology and Tools. Available online* ***here.***
[36] *Corporate Governance Development Framework (2021). Corporate Governance Development Framework. Available online* ***here.***

***Figure 11.* The IFC Corporate Governance Progression Matrix**

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:

For UoP thematic bond issuers, 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 its investors why this issuance fits into its strategy. The more an issuer can demonstrate the coherence of the issuance within its long term vision, the more credible the transaction will be.

For SLB issuers, the ICMA principles highlight that the KPIs should be material to the issuer's core sustainability and business strategy and address relevant sustainability objectives. A key determinant for materiality is that the KPIs are coherent with the overall strategy. Additionally, the SPTs should also be consistent with the issuer's overall sustainability strategy and business strategy. It is important to acknowledge that the core sustainability strategy should cover the full spectrum of ESG risk and opportunity.

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 the minimum requirements and recommendations established by ICMA.

Aligning a Use of Proceeds Issuance with Market Best Practices

Eligible Assets:

The most important differentiating factor between a UoP thematic bond 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 can align with international taxonomies also provide deeper credibility to the transaction because they are financing best in class green or social assets.

Risk Management

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

Implementation Mechanisms:

Another key factor in issuing a UoP 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 in view of global standards. Issuers must at least place net proceeds of the bond prior to allocation to eligible projects in investment grade securities. 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 issuers that obtain external verifications will be further aligned with best practices.

Reporting and Verification:

Issuers are required to report the allocation of the UoP until they reach full allocation, and the impact metrics specific to the UoP during the life of the bond until it reaches maturity. Additionally, issuers must disclose any material developments related to the UoP on a timely basis. For an issuer to be prepared, they should have internal processes in place that will allow them to collect this information. Issuers can opt to produce a stand alone report for thematic bonds or to incorporate it in their sustainability report. 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.

Aligning a Sustainability-Linked Bond Issuance with Market Best Practices

Relevant and material KPIs:

For SLB issuers, having KPIs that are core to the organizations' business strategies and sustainability goals is key to a successful issuance. At a minimum, issuers should choose KPIs that are core, relevant and material. Providing historical data is not just a best practice but a fundamental requirement. Issuers who go further by offering transparent information on the calculation and verification of those KPIs demonstrate best in class practices.

Ambitious SPTs:

Key to an SLB issuance is having ambitious targets. At a minimum, issuers should set targets that are ambitious compared with BAU, peers or references to science. The more ambitious the SPTs the better: issuers that can disclose mid term and long term goals with the SPTs and who are able to demonstrate that their targets are significantly more ambitious than BAU, peers or science demonstrate best practices in the market.

Bond characteristics:

At a minimum, SLB issuers must set a financial or structural impact associated with meeting (or not meeting) SPTs. The larger the incentive or penalty, the better.

Reporting and Verification:

For SLBs, issuers are required to report on the performance of SPTs annually and provide an independent third party verification of this performance. Issuers that can provide verifications of both historical and future performance are better aligned with market best practices.

Scoring:

Issues can score themselves between 0 and 2 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 issuers who score a 2 are more closely aligned with current market best practices. Best practices in the market continuously evolve, so issuers are encouraged to continue to evaluate changes in the market to keep improving internal practices. The range of scores and description of the **Readiness and Proximity to Best Practices** assessment is presented below. This table is meant to guide issuers and should not be considered as a precise measure of readiness.

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

Table 5. **Assessment Matrix – Use of Proceeds Thematic Bonds**

ORGANIZATION'S CAPACITY			ISSUANCE'S ALIGNMENT WITH MARKET BEST PRACTICES			
SCORE	CORPORATE GOVERNANCE	STRATEGIC ALIGNMENT	ELIGIBLE ASSETS	RISK MANAGEMENT	IMPLEMENTATION MECHANISMS	REPORTING
0	Does not fulfill Level 1 requirements of the IFC Corporate Governance 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 risks associated with eligible assets.	Does not have internal systems or processes 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 Corporate Governance Progression Matrix for Listed Companies.	Eligible assets positioned within the context of the issuer's sustainability strategy.	Eligible assets clearly defined in line with ICMA green and/or social categories.	Has internal systems 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 3 or 4 requirements of the IFC Corporate Governance Progression Matrix for Listed Companies.	Issuer sets strategic impact goals for issuance aligned to sustainability strategy.	Fulfills Level 1 requirements and eligible assets are aligned to an international or local sustainable finance taxonomy.	E&S policies and exclusion list aligned with international standards (e.g. IFC Performance Standards) and applied across the issuer's activities.	Fulfills Level 1 requirements and has a specific process for the selection of the bond proceeds, dedicated staff, (e.g. approval/ oversight committee)	Fulfills Level 1 requirements and commits to an external review of both allocation and impact reporting.

Table 6. Assessment Matrix – Sustainability-Linked

ORGANIZATION'S CAPACITY			ISSUANCE'S ALIGNMENT WITH MARKET BEST PRACTICES			
SCORE	**CORPORATE GOVERNANCE**	**STRATEGIC ALIGNMENT**	**RELEVANT & MATERIAL KEY PERFORMANCE INDICATORS (KPIS)**	**AMBITIOUS SUSTAINABILITY PERFORMANCE TARGETS (SPTS)**	**BOND CHARACTERISTICS**	**REPORTING AND VERIFICATION**
0	Does not fulfill Level 1 requirements of the IFC Corporate Governance Progression Matrix for Listed Companies.	Does not have a sustainability strategy.	Does not have material or relevant KPIs.	Does not have set ambitious SPTs.	Does not have set financial or structural characteristics linked to the achievement of sustainability objectives.	Does not have reporting or monitoring systems in place.
1	Fulfills Level 1 requirements of the IFC Corporate Governance Progression Matrix for Listed Companies.	Has E&S policies and exclusion list aligned with international standards (e.g. IFC Performance Standards) and applied across the issuer's activities. Has a basic sustainability strategy in place.	Identifies KPIs that are core, material and relevant to the organization.	Calibrates SPTs that are ambitious compared with BAU.	Has set financial or structural characteristics linked to the achievement of sustainability objectives.	Measures and publishes reports on SPT performance for any date/period relevant for assessing it. Completes a pre-issuance verification of baseline and trajectory.
2	Fulfills Level 3 or 4 requirements of the IFC Corporate Governance Progression Matrix for Listed Companies.	Fulfills Level 1 and has a robust sustainability strategy in place with set and public long-term sustainability goals.	Fulfills Level 1 requirements, and historical KPIs are externally verified.	Fulfills Level 1 requirements, and the SPTs are significantly more ambitious than BAU, peers or references to science.	Fulfills Level 1 requirements and has set significant financial or structural characteristic linked to the achievement of sustainability objectives.	Fulfills Level 1 requirements, undertakes and discloses the post-issuance verification of SPT performance. Impact performance informs the business sustainability strategy.

Lessons Learned on Preparedness

The preparation process for issuing thematic UoP bonds or SLBs is essential for the success of the issuance. Conducting a readiness assessment helps issuers identify the institutional capacity changes that must be made for a successful issuance and areas of opportunity. Through this self reflection, companies may realize that they are missing key foundations that will impact the quality of the issuance.

Based on experience supporting issuers in their preparation process, IDB Invest has identified a few common pitfalls for thematic bond issuers:

Use of Proceeds Thematic Bonds

- Difficulty in understanding the identification and segmentation of eligible UoP: Issuers must undergo a process to segment and identify eligible UoP in alignment with the regional or international recognized taxonomy to be financed within their framework. By undergoing this process, issuers are better able to identify what can be financed for a thematic bond issuance.

- Lack of an E&S risk management process: Issuers that are unable to identify, manage and mitigate E&S risks related to the projects/assets to be financed can be faced with large risks associated with the implementation of these projects in the future, which may jeopardize the deployment of funds for their intended use.

- Reporting challenges: Some issuers lack a proper methodology for measuring the output, outcome and/or impacts of the financed projects. Others may have the methodology set but do not have the proper data needed to measure impact, which limits the disclosure of results and the transparency of the instruments, and therefore the capacity to attract investors.

Sustainability Linked Bonds

- Lack of strategy: SLB issuers must have sustainability clearly integrated in their business strategy, informed by a materiality assessment, in order to facilitate the selection of material, coherent, relevant and ambitious KPIs. Additionally, issuers who have not yet undergone a materiality assessment will have more difficulty in identifying material and relevant KPIs.

- Lack of historical performance: Issuers who do not have historical data will face difficulty in calibrating SPTs because they will not be able to demonstrate their BAU and define a credible baseline and trajectory for the SPTs.

- Lack of external benchmarks: Having a point of comparison is key to being able to demonstrate ambition. Issuers who do not have a point of comparison may have a harder time calibrating targets and showing meaningful goals.

4.2 Design

Once it has assessed the reputational risks and its readiness, the issuer should establish a **framework** that will define the internal decision making processes involved in defining and selecting eligible assets, in addition to evaluating, monitoring and reporting on them. 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) the process for project evaluation and selection, (3) management of proceeds, and (4) reporting.

Table 7. **Thematic Bond Framework Components**

COMPONENT	DESCRIPTION
Use of Proceeds	• Define eligibility criteria for use of proceeds that present clear environmental and/or social benefits • Recommended that issuers provide an estimate of share of financing vs refinancing (clarifying the expected lookback period) • 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: – Environmental and/or Social objectives – Process to determine how UoP fit within the eligible categories defined in the Use of Proceeds – The related eligibility criteria, including, if applicable, exclusion criteria and other processes applied to identify and manage potentially material environmental and social risks • 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 • Balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible projects • Issuer should communicate to investors the intended types of temporary placement for the balance of unallocated net proceeds • 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 • Recommend use of qualitative performance indicators and where feasible quantitative performance measures and disclosure of key underlying methodologies • Issuers that can monitor impacts achieved are encouraged to include them • 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 UoPs 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 **Chapter 1.2**). Issuers should meet the minimum requirements, as established by the ICMA principles. Issuers may also align with local or international taxonomies, such as country specific taxonomies or those described in the EU Sustainable Finance Taxonomy and the Sector Criteria of the Climate Bonds Standard.

The table below provides some examples of green and social UoPs that could be potentially eligible in the sectors where IDB Invest works.[37]

Table 8. **Examples of Green and Social Uses of Proceeds**

	GREEN	SOCIAL
Agribusiness	• Conservation or protection of natural resources • Certified practices under sustainable forestry management • Water efficient technologies for irrigation	• Expenditures for the promotion of local entrepreneurship programs for rural farmers
Energy	• Renewable energy projects • Smart grids • 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 • Social housing for low income groups • MSME loans for women led businesses
Manufacturing	• Environmentally sustainable consumer products • Green manufacturing buildings • Circular economy transformation	• Vaccines, affordable medicine
Social	• 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 • Investments in adaptation measures (flood defenses, sea walls, etc.) • Licensed certified sustainable tourism	• Employment generation in sustainable tourism for indigenous groups
Water & Sanitation	• Water use reduction or water-saving technologies • 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 • Network modernization	• Fiber optics and cable networks to areas with low connectivity • Digitalization and accessibility initiatives to low-income or vulnerable groups

[37] *The green and social UoPs showcased in this table are just examples that do not necessarily imply that these or similar uses would automatically be eligible.*

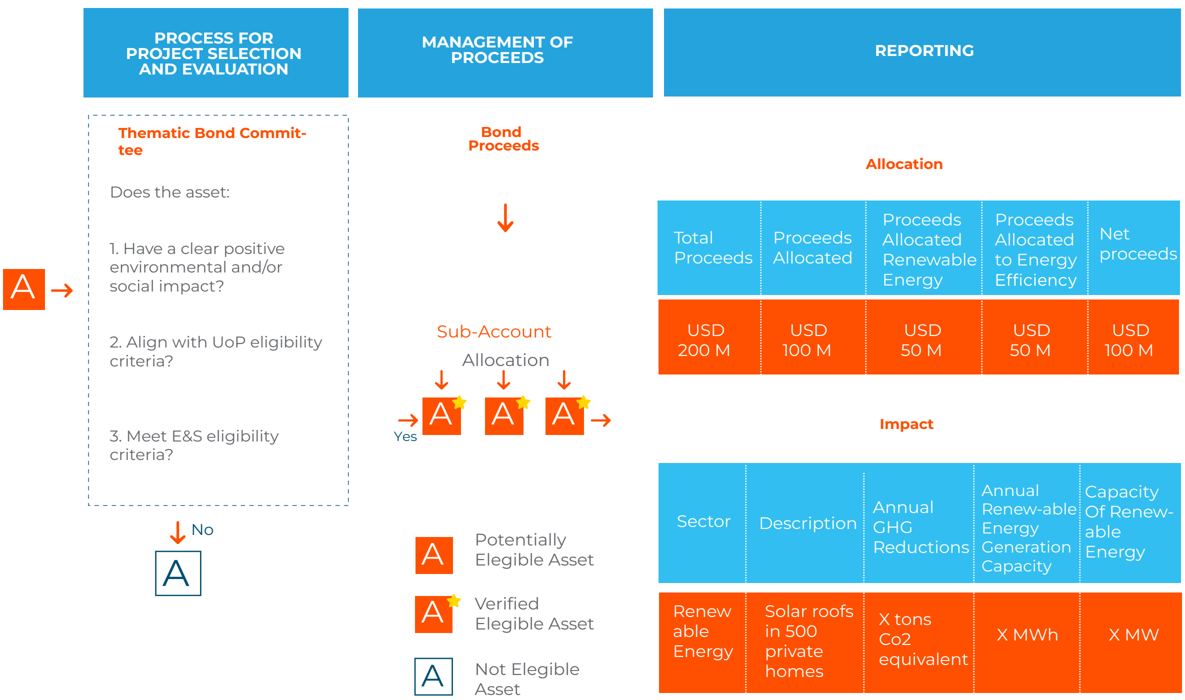
4.2.2 Process for Project Evaluation and Selection

Issuers should establish a transparent and robust internal process to select and evaluate eligible assets. Many issuers opt to establish a **thematic bond committee** made up of people in relevant senior management roles (e.g. risk, sustainability and finance). It is important to highlight the roles and function of the people involved in the committee, as well as to describe the governance of the committee (e.g. how the selection process works, frequency of meetings and minutes taken). In the framework, it is useful to provide a diagram visualizing the process adopted 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 E&S eligibility criteria.

It is also important to describe the risk management systems that the issuer has in place to evaluate material E&S 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 guidelines 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 the policies and/or actions that they have in place 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 and oil and gas. External review providers view positively the fact 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 12. **Internal Processes for a Use of Proceeds Thematic Bond**



4.2.3 Management of Proceeds

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

Issuers can choose a few options 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 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 these 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 the impact of thematic assets. The issuer is required to provide at least annual reports on the allocation and impact of proceeds during the life of the bond. To facilitate communication and enhance transparency, issuers are encouraged to publish their bond framework and annual report on their website in alignment with best practices.

Allocation Reporting:

The allocation reporting should include the following information:

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

In case of divestments or controversies that arise 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, established ex ante, and 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 an organization's activities and should be measurable, readily determined and verifiable.

Outcomes
Benefits, learnings or other effects that are likely to occur as a result of the output.

Impacts:
Attribution of an organization's activities to broader and longer term outcomes that may take years to become evident.

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

4.3 Design of a Sustainability Linked Bond

As opposed to UoP thematic bonds, SLBs can be used for general corporate purposes aligned with a sustainable strategy. The distinguishing factor of this instrument is that its financial attributes are intricately linked to the issuer's success (or not) in reaching predefined sustainability or ESG goals within a set timeline. These goals are measured by specific, predefined KPIs and SPTs that shape their functionality and impact.

The design of these instruments requires a robust sustainability strategy, precise delineation of KPIs that accurately capture the issuer's involvement in sustainability initiatives, and the establishment of ambitious SPTs that go beyond the issuer's standard operational practices. Additionally, it is essential to establish financial or structural characteristics that reflect incentives or penalties contingent upon the attainment of these objectives and that guarantee the transparency and efficacy of these instruments. Moreover, regular reporting on indicator progress and target fulfillment, subject to external evaluation, is required.

The instrument's design will be defined within the **framework,** which begins with an introduction or overview of the issuer and its business and sustainability strategy, as well as its rationale for issuing an SLB. This is followed by a description of the following five pillars: (1) selection of KPIs, (2) calibration of SPTs, (3) bond characteristics, (4) reporting and (5) verification. This framework should align with international best practices, particularly the SLBP established by ICMA.[38]

4.3.1 Selection of Key Performance Indicators

An SLB's distinctive feature is related to the linkage of the bond's financial or structural characteristics to the issuer's performance in designated sustainability areas. Therefore, measuring, monitoring and evaluating this performance is foundational in the design of the SLB framework. Selecting material and relevant KPIs plays a crucial role in ensuring both accountability and transparency. Moreover, they form the essential basis for tying the financial characteristics of the bond to the issuer's sustainability achievements (see **Chapter 4.3.3** for further details).

The following considerations can help issuers design effective KPIs that can accurately reflect and drive sustainability performance (**Figure 13**):

[38] *International Capital Market Association (2023). Sustainability-Linked Bond Principles. Voluntary Process Guidelines. Available* ***here.***

Figure 13. **Designing Robust Key Performance Indicators**

SELECTION OF KPIs

KPIs should be material to the issuer's core sustainabiluty / business strategy and address relevant E, S, or G challenges of the industry sector and be under management's control.

1. **Relevance & Materiality**
2. **Measurable**
3. **Externally verifiable**
4. **Benchmarkable**

ICMA's Illustrative KPIs examples:

KPI 1 - DIVERSITY % of women at Management / Executive level (and/or engineer)	**KPI 2 - CLIMATE CHANGE** Scope 1, 2 and 3 GHG emissions (absolute in CO2e)	**KPI 3- AIR QUALITY** Emissions for NOx, SOx and/or other pollutants (incl. PM) (absolute or intesity
KPI 4 - WASTE Total weight of waste generated (t/year)	**KPI 5- BIODIVERSITY** Forest under management for protection, conservation, restoration, and/or sustainable use (ha)	**KPI 6- WATER** Volume of fresh water withdrawn / consumed.

1. Relevance and materiality:

The KPI should be relevant, core and material to the issuer's overall business and directly reflect the issuer's performance and strategy on an important environmental or social challenge or gap, beyond BAU practices. Therefore, this indicator should be linked to the issuer's core sustainability strategy and be commensurate with the challenges the issuer faces in its current or future operations. It is also important that it is a direct measure of the issuer's performance, something over which the issuer has control.

2. Measurable:

The indicator should be quantitatively evaluated and have a clear and consistent methodology for its calculation.

3. Externally Verifiable:

KPIs must be designed in a way that their achievement can be independently verified by a quality third party reviewer.

4. Benchmarkable:

The indicator must be comparable with the issuer's context, peers and references to science (i.e. standards and national/international data). This facilitates an understanding of the issuer's performance and ambition in the context of broader sustainability goals or sectoral benchmarks. Comparisons can be made between local and international peers and sector standards to obtain a more holistic view. Social KPIs require a greater focus on regional comparisons because local context is important.

In addition to the above points, issuers should:

- **Choose KPIs that have been previously measured:** The robustness and reliability of an indicator are further enhanced by its traceable history, meaning that, if possible, the indicator should have been previously established and made publicly accessible. This transparency allows investors and other stakeholders to assess the indicator's performance over time. In instances in which these indicators lack a publicly available history, issuers should provide externally verified KPI values for the past three years. These historical data provide a deeper context, enabling a more comprehensive evaluation of the issuer's long term performance trends and the level of ambition of the SLB in driving meaningful sustainability progress.

- **Communicate the rationale and process for selecting the KPI:** Coherence between business objectives and the KPI is essential to determining whether a KPI is relevant, core and material to the issuer and of high strategic importance.

- **Establish a clear definition for the KPI:** This includes the scope and calculation methodology. Furthermore, establishing a baseline for each indicator is essential. This baseline should reflect the indicator's value in the year preceding the bond's issuance, serving as a reference point for subsequent tracking. Where feasible, KPIs that can be aligned to science based references are preferable.

To help identify KPIs that align with these requirements, ICMA has developed an ***Illustrative KPIs Registry,*** an excel matrix that maps potential indicators against key sustainability themes, distinguishing between primary and secondary KPIs and setting global benchmarks.[39] Issuers must set at least one primary or core KPI for the SLB issuance.

[39] *International Capital Market Association (2022). Illustrative KPIs Registry. Available online* ***here.***

Trends in Sustainability-Linked Bond Key Performance Indicators

Market observations reveal that 61% of issuers typically establish one KPI, and the most common KPIs used are related to GHG emission reductions.[40] **Figure 14** shows the results of a recent study on the trends and characteristics of the SLB market conducted by Luxembourg Stock Exchange, which reviewed the total number of issuers and bonds on the LGX DataHub as of December 31, 2021. It was found that environmental KPIs made up 90% of the those used by SLB issuers at this time, followed by social (6%), governance (2%), mixed (1%) and ESG rating (1%) KPIs.[41]

Figure 14. **Sustainability-Linked Bond Market Characteristics**

	% of KPIs	Examples
Environment	90%	• GHG emissions intensity • Carbon footprint • Renewable energy • Water consumption • Recycled water/materials
Social	6%	• Gender equality • Access to basic water infraestructure • Reducing work accident frequency • Women on board directors
Governance	2%	• ESG-related indices • Women in leadership positions
Mixed	1%	• Sustainability education • Creation of diversity index
ESG Rating	1%	• External ESG rating

[40] *Environmental Finance (2022). Sustainability-Linked Bonds and Loans – Key Performance Indicators. Available online* ***here.***
[41] *Luxembourg Stock Exchange (2024). Trends and characteristics of the sustainability-linked bond (SLB) market. Available online* ***here.***

4.3.2 Calibration of Sustainability Performance Targets

SPTs are specific, measurable goals that an issuer commits to achieving within a set timeframe. The significance and careful design of SPTs are fundamental to the credibility and success of an SLB, ensuring that the financial instrument genuinely promotes an ambitious progress within the organization's sustainability commitments.

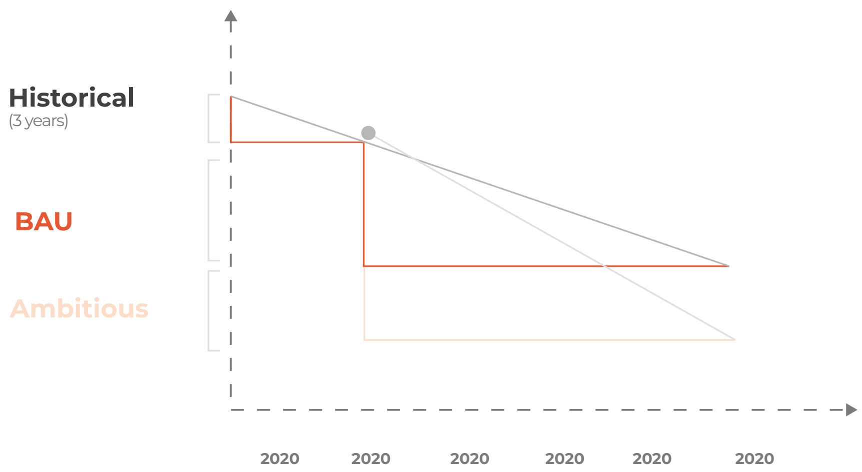
Issuers may set one or more SPTs for each KPI. To create meaningful and realistic SPTs that reflect the issuer's level of ambition, four primary criteria are considered (**Figure 15**):

Figure 15. **Designing Ambitious Sustainability Performance Targets**

Calibration of SPTs

1. **Ambition**
2. **Alignment**
3. **Predefined timeline**
4. **Implementation**

Expresses the goal that the issuer sets for the KPI. SPTs should be ambitious (beyond BAU and benchmarkable to an external reference) and be within the direct control of the issuer



1. Ambition

SPTs should represent material improvements that go beyond BAU practices, are ambitious compared with peers and references to science and require significant effort or innovation to achieve. To ensure that SPTs are genuinely ambitious, it is important to **benchmark** performance against:

a. Own historical results. SLB issuers need to have strong internal reporting capacity to track performance, which will help them establish a baseline or reference scenario for the SPT and evaluate whether the target goes beyond the BAU trajectory. This is why, when selecting KPIs, it is recommended that issuers disclose historical performance for at least three years.

b. Industry peers. The SPTs should be ambitious against other issuers in the same industry (for the case of corporates) or other countries (for the case of sovereigns).

c. Scientific methodologies or best practices: Where possible, targets should also be compared with an external reference (i.e. science based targets) or align with official international objectives (i.e. nationally determined contributions).

2. Alignment:

A critical aspect throughout the design process of SLBs is ensuring that both KPIs and SPTs are in harmony with the issuer's wider ESG aims, sustainability strategies and – for corporate entities – their business objectives.

3. Predefined timeline

Establishing a clear and justified timeline for achieving the SPTs is crucial and should include the target observation date(s)/period(s) of the trigger event(s) and the frequency of the SPTs. This involves not only setting a deadline but also explaining the rationale behind the chosen timeframe, ensuring that it is as ambitious and practical as the objective itself. Also, it is recommended that issuers include targets that are appropriate for the financial instrument selection. In general, it is recommended to include an intermediate observation date (e.g. if it is a 10 year bond, establish targets in year 5).

4. Implementation:

Detailing the specific measures that the issuer intends to undertake to meet the SPTs is essential. While it is important for SPTs to be ambitious, they must also be feasible for the issuer. This should include a plan outlining the necessary actions, along with an assessment of potential external challenges that could impede progress and are beyond the issuer's control. By acknowledging these potential obstacles, the issuer can prepare more robust strategies for achieving the SPTs. Some issuers stress the importance of assessing whether the objective is achievable through the means at hand and in the external context. Additionally, disclosing the financial plans required to achieve the SPTs helps demonstrate the feasibility and ambition of the SPTs.

Some additional structural considerations should be kept in mind.

- **Verified baselines:** It is important for issuers to set an externally verified baseline or reference point for the SPT as well as the rationale for choosing that baseline.

- **Call options:** Ideally, issuers do not set call options for the bond prior to the trigger event. This ensures accountability and incentivizes meeting the targets. If issuers must include call options prior to the trigger date or early call options make it impractical to assess SPT achievement, the call price should reflect the assumption of unmet targets, encouraging careful scheduling of observation or penalty payment dates.

- **Cases of recalculations:** In the case of a material impact on the baseline, KPI or SPT, issuers are recommended to provide a valid justification for the recalculation and define their own quantitative threshold for recalculation as well as a corrective action plan in case of deviation. It is crucial that these changes are made in good faith, properly communicated to investors and verified by an external entity to ensure they retain their original relevance and ambition. The documentation should include clear and detailed clauses that allow for these adjustments in a transparent and justified manner. When there is a change in the baseline or in an SPT, a new SPO is suggested.

Issuers that set ambitious and credible SPTs can differentiate themselves in the financial market, attracting investors who are increasingly focusing on sustainability considerations in their investment decisions.

4.3.3 Bond Characteristics

The bond characteristics refer to the structural and/or financial impact resulting from the issuer meeting (or not meeting) predetermined targets. These characteristics are pivotal to the bond's structure, ensuring that KPIs and SPTs are tied to incentives or penalties aimed at advancing the ESG goals.

As illustrated in **Figure 16,** a study conducted by the IFC delineated six distinct types of bond characteristics that have been observed in the global SLB market. While these are not the only structures that can be utilized, they represent the mechanisms that are most applied, with the most frequent on the top of the list and the least on the bottom.

Figure 16. **Types of Bond Characteristics**[42]

Characteristic	Type of Incentive or Penalty:
Coupon Step-Up	If the issuer does not meet targets, subsequent interest payments will be increased by a predetermined penalty amount (usually quoted in basis points).
Redemption Premium	If the issuer does not meet targets, they will have to pay a predetermined premium on its redemption price at the time of redemption (usually quoted in percentage).
Coupon Step-Down	If the issuer meets targets, subsequent interest payments will be decreased by a predetermined amount (usually quoted in basis points).
Donation	If the issuer does not meet targets, an amount equal to a predetermined percentage of the bond's issuance will be donated to a foundation or organization of the issuer's choice.
Purchase Carbon Credits	If the issuer does not meet targets, they will purchase carbon offsets for an amount equivalent to a predetermined percentage of the aggregate principal amount of the bonds.
Early Redemption	If the issuer does not meet targets, the bond will be redeemed early at a predetermined redemption price.

Research by the IFC indicates that the coupon step up mechanism is the bond characteristic most used in the global SLB market.[43] This trend is mirrored in the LAC region, where approximately 70% of SLBs incorporate a coupon step up. This approach penalizes issuers by elevating the interest rate, typically by 25 basis points, if the SPTs are not met within the agreed time frame. The redemption premium at maturity ranks second in global popularity but is observed less frequently in the LAC region. On the other hand, the coupon step down feature, which rewards issuers by lowering the interest rate for exceeding SPTs, is the second most used characteristic in the LAC SLB market.[44]

[42] *Own elaboration based on International Finance Corporation (2022). Structural Loopholes in Sustainability-Linked Bonds. Available online **here.***
[43] *International Finance Corporation (2022). Structural Loopholes in Sustainability-Linked Bonds. Available online **here.***
[44] *HPL.LLC's proprietary database on thematic bonds (consulted in 2024).*

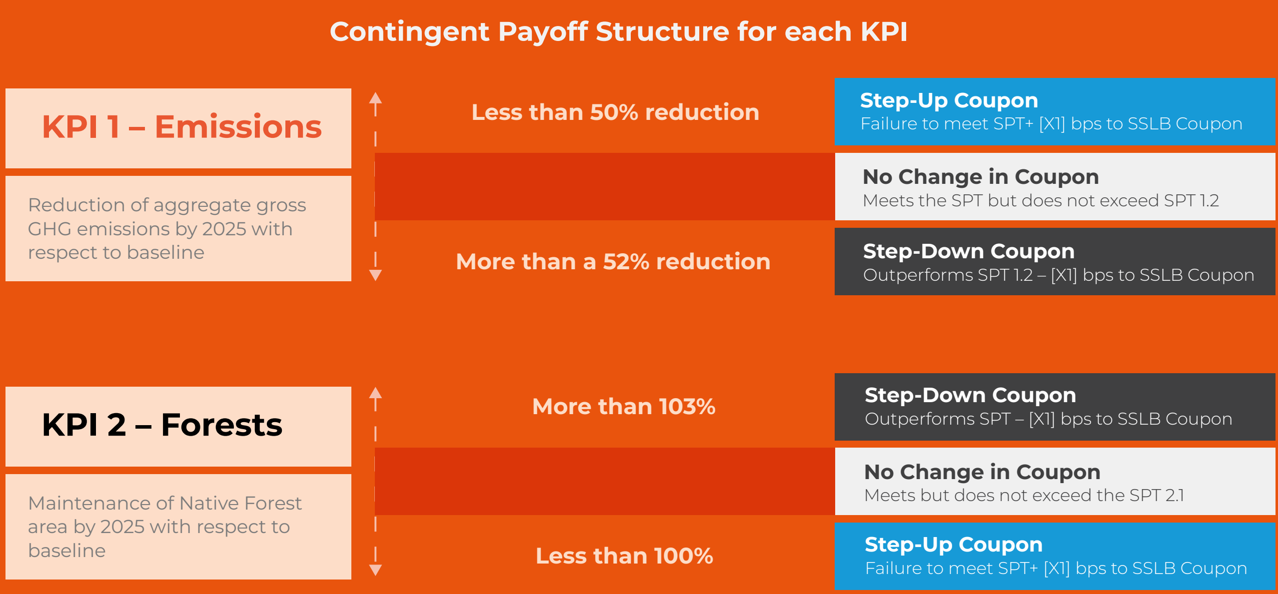
While there is a greater trend toward coupon step up, investors do not have a specific preference for one structure over another. However, some consider that the stronger the penalty, the more credible the instrument becomes. ICMA specifies that the variation of the bond characteristics should be commensurate and meaningful relative to the issuer's original bond financial characteristics but does not provide specific guidance as to the magnitude of the financial and/or structural impact.

It is important to note that while SPO providers assess the transparency of bond characteristics, most do not evaluate the magnitude of incentives or penalties. This is partially because the specificities of the bond characteristics are only outlined in the framework but are detailed more granularly in the prospectus, as they are closely linked with other financial terms and conditions. Therefore, at the time of the SPO (pre issuance), this information may not be available.

Republic of Uruguay's Sustainability-Linked Bond

The SLB market showcases various examples of how to design robust bond characteristics, including innovative approaches such as that of Uruguay. This country has implemented a novel strategy by designing multiple penalties around a single objective, offering a model that both rewards and penalizes issuers according to their achievement of goals. For instance, one of the SPTs aims to reduce GHG emissions by 2025: a failure to achieve at least a 50% reduction results in an interest rate increase. No action is taken for reductions between 50% and 52%, while reductions exceeding 52% trigger a rate decrease as a reward. Uruguay's approach not only presents an innovative model but also sets ambitious and robust sustainability goals.

Figure 17. **Uruguay's Sustainability-Linked Bond Structure**



The Impact of Not Meeting Targets

There are a few examples in the market of issuers that have not reached (or may not reach) their targets. The energy crisis has proven challenging for companies committed to decarbonization targets. This is the case of the Italian utility Enel SpA, for which investors are pricing that the issuer will have missed its 2023 target of reaching 148 gCO2e/kWh[45] after changes to European energy policy resulted in the delayed phaseout of coal plants. The failure to meet this target would lead to an estimated USD 27 million of additional annual interest costs for the company.[46] The SLB of the Greek Electricity Firm Public Power Corporation (PPC) triggered a step up when their emissions had risen because the firm had to increase coal powered generation following the Ukraine War.[47] The polish oil and gas company PKN Orlen had a coupon step up applied to its two SLBs after the firm's ESG rating was downgraded to BBB from A in December 2021.[48]

Failing to meet targets does not negatively impact the development of the SLB market. It demonstrates that issuers set themselves ambitious targets instead of objectives they can easily reach. The examples of Enel and PPC highlight that meeting targets is also dependent on external factors outside of issuers' control such as geopolitical situations or policy changes. It is therefore crucial for issuers to set robust assumptions and run sensitivity scenarios when estimating SPTs and defining their level of ambition. Also, investors expect issuers to explain reasons behind failed targets and to share their plan to implement corrective actions and timelines to recover the path to achieve their sustainability goals. Issuers' communication is paramount to maintaining credibility in the SLB instrument.

Figure 18. **The Enel case: The Impact of Not Meeting Targets**

The Impact of Not Meeting Targets

Enel Case

Year Issued: 2019 **Issuance Value:** USD 31 billion **Step-Up:** 25 bps

- Highly probable it will not achieve 148 gCO2e/kWh by 2023
- 10 bonds face a 25 bps step-up if the target is not met
- Potential annual increase in interest cost of USD 27 million

PKN Orlen Case

Year Issued: 2020 **Issuance Value:** USD 220 million **Step-Up:** 10 bps

- The coupon for the transactions was tied to the MSCI ESG score
- Step-ups were applied to two SLBs after a 'BBB' rating downgrade
- The step-ups will result in an annual interest increase of USD 329 million

Public Power Corporation Case

Year Issued: 2021 **Issuance Value:** USD 775 million **Step-Up:** 50 bps

- First issuer to announce a 'trigger' event on an index-eligible SLB
- Step-up if the target of 40% reduction in Scope 1 CO2e is not met by 2023
- The failure to meet the target has been confirmed by the company in 2023

[45] *Environmental Finance (2023). Enel SLB target miss to cost it $27m. Available online* ***here.***
[46] *Energy Connects (2023). Top Issuer in $250 Billion ESG Bond Market Risks Trigger Event. Available online* ***here.***
[47] *Fitch Ratings (2023). Impact of PPC's Failure to Meet Sustainability-Linked Bond Targets Limited. Available online* ***here.***
[48] *Fitch Ratings (2023). Impact of PPC's Failure to Meet Sustainability-Linked Bond Targets Limited. Available online* ***here***

4.3.4 Reporting

The reporting component of an SLB framework is pivotal in ensuring transparency and accountability regarding the progress of selected KPIs and the achievement (or not) of set targets. This visibility of compliance or non compliance with the SPTs is pivotal for all stakeholders involved, as it demonstrates the credibility of the instrument and its effectiveness as a tool for achieving sustainability objectives. Through meticulous reporting, issuers ensure that investors and the broader community are well informed about the bond's impact on sustainability objectives. Additionally, it directly influences the financial adjustments that may be applied to the bond according to its sustainability performance.

Within the context of the SLB framework, the reporting mechanism must encompass the following elements:

1. Frequency:

The framework must specify the regularity with which updates on the performance indicators and progress toward targets will be disclosed. ICMA indicates that they should be published at least annually and at any relevant date or period that allows the performance of the SPT to be evaluated if it is necessary to adjust the financial characteristics of the instrument.

2. Methodology:

It is essential for issuers to delineate the methodology employed in calculating the performance indicators and the consistency throughout the analysis. Any change in methodology would require a revision of the baseline and targets to ensure comparability and must be notified This transparency in methodology ensures that all stakeholders have a clear understanding of how performance is measured and interpreted, providing a solid foundation for evaluating the issuer's progress toward sustainability objectives.

3. Disclosure Channels:

According to best practices, the framework, SPO and verification report should be accessible not only to the investors but also to the broader public. This approach underlines the importance of transparency and the role of public accountability in sustainability efforts. The framework should therefore detail the channels through which these reports will be made available (e.g. the issuer's website), ensuring ease of access and wide dissemination of information regarding the issuer's sustainability performance.

Furthermore, these reports should include any additional information that enables investors and other stakeholders to effectively monitor the progress of the SPTs. This could encompass details such as shifts in the issuer's sustainability strategy, changes in governance structures or any other relevant updates. Also, it might include whether there have been any re assessments of the KPIs and/or restatements of the SPTs and/or pro forma adjustments of the baselines or KPI scope. The commitment to provide such comprehensive reporting should be clearly articulated within the framework beforehand, underscoring the issuer's proactive stance on communication and transparency.

This component is crucial for fostering trust between issuers of SLBs and their investors, as well as for helping develop the market and facilitating standard setting and the creation of benchmarks. Reporting not only reflects compliance or deviation from the targets associated with these indicators but also reinforces the bond's value proposition in driving sustainability outcomes.

4.3.5 Verification

Whereas post issuance verification is a best practice for GSS bonds, it is a mandatory component for SLBs. This critical process involves a thorough examination by an external, independent and qualified verifier who confirms the performance of the KPIs against the SPTs. This verification must be carried out annually or for any date for which assessment of SPT performance may lead to an adjustment of the financial characteristics of the SLB bond.

The verification report must be publicly disclosed and designed for easy access. It should detail the progress of the indicators relative to the SPTs and announce their impact on the bond's financial characteristics, ensuring transparency and accountability.

Moreover, issuers are strongly encouraged to undertake an external pre issuance review in the form of an SPO (see **Chapter 4.4** for details). Although this step is not mandatory, it is strongly recommended as a best practice within the market. This pre issuance review offers an additional layer of credibility and reassurance to investors regarding the issuer's commitment to sustainability objectives. Furthermore, it is key to ensuring the accuracy of the baseline and the soundness and methodology of the target setting. This process can help mitigate risks during implementation because improvements can be integrated before issuance.

4.4 External Review

In recent years, having an external review has become a more common practice in the thematic bond market. According to the CBI, 89% of LAC green bonds by volume adopt an external review, with SPOs being the most common, covering 77% of volume at the end of 2022.[49] Additionally, external reviews are seen positively by investors because they provide greater credibility for transactions. Some stock exchanges are requiring issuers to provide their external review as a requisite to list bonds in a dedicated thematic bond listing platform.

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 GSS bond ratings (see **Table 9**).

Table 9. **Types of External Reviews[50]**

TYPE	SUB - TYPE	TIMELINE	WHAT IT ENTAILS
SPO		Pre-Issuance	Evaluation of framework's alignment with ICMA principles, assessment of issuer's strategy, policy and objectives, and an evaluation of green, social, sustainable and sustainability-linked features in the bond.
Verification	Limited[51] or Reasonable Assurance[52] 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 GSS+ criteria); 2) focus on alignment with internal or external standards or claims made by the issuer; or 3) evaluate environmentally, socially or sustainability linked features of underlying assets.
		Post-Issuance	An independent verification at the post issuance stage, which can also be done by SPO providers, can address the internal tracking of the 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). For SLBs this independent verification is a requirement, and the verification is focused on assessing the performance of the SPTs.
Certification	Climate Bonds Standards Certification	Pre-Issuance Verification	Confirms that the bond's UoP and KPIs 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 KPIs.
Green/Social/ Sustainability Bond Rating		Pre-Issuance	A rating can be on the GSS+ bond, its framework or key features of the bond (i.e. UoP, KPIs and SPTs). The output may include a focus on environmental and/or social performance data, the process relative to the ICMA principles, or another benchmark.

49 Climate Bonds Initiative (2023). Latin America and the Caribbean Sustainable Debt State of the Market 2022. Available online ***here.***
50 It is worth noting that the only parties able to provide climate bonds standard verification are CBI-approved verifiers.
Data compiled from ICMA, the CBI and the Global Green Bond Partnership.

51 Limited assurance engagements offer a lower level of scrutiny over the subject matter compared with 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.
52 Reasonable assurance engagements offer a high level of scrutiny of 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 meets the criteria of the engagement in all material respects.

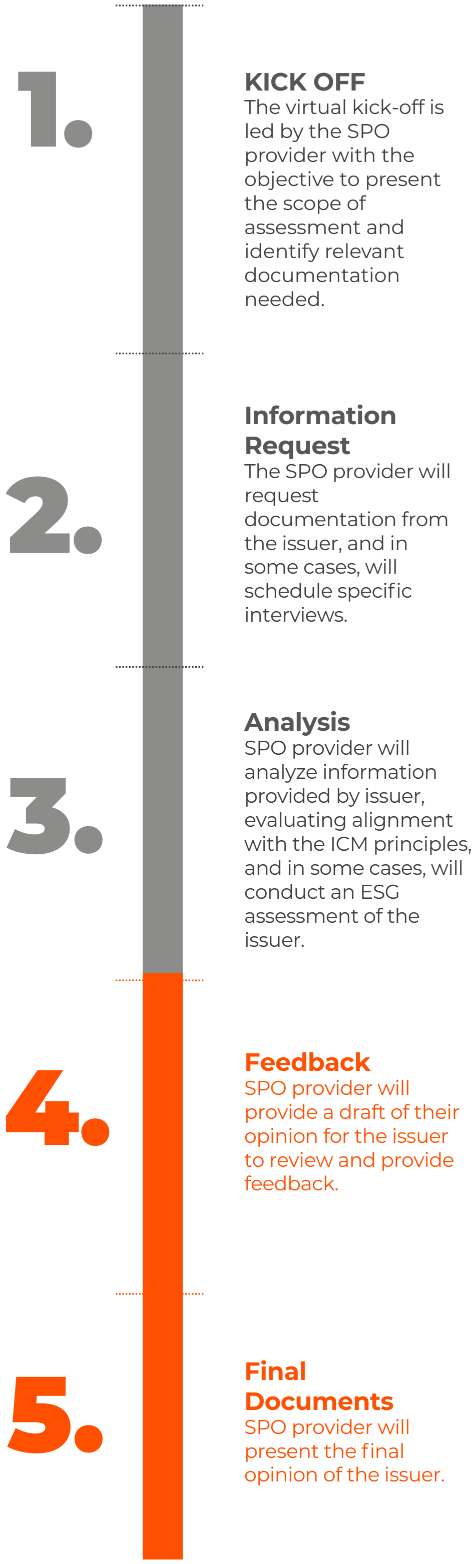
In the pre issuance stage, a UoP and SLB issuer can opt for an SPO, verification, certification or SLB/GSS bond rating. This provides investors with assurance of the credibility of the thematic bond. In the post issuance stage, SLB issuers are required to do the verification, while UoP issuers are recommended to seek a verification to address the tracking of UoP, allocation of proceeds, environmental and/or social impact, or impact reporting.

The most popular form of external review is the SPO, which evaluates a bond framework's alignment with ICMA's GBP, SBP, SBG or SLBP or other relevant international standards. Conducted before the issuance itself, for UoP bonds an SPO assesses the quality of the issuance by way of the categories listed in its UoP. For SLBs, the SPO assesses the quality of the issuance by the ambition, materiality and relevance of its KPIs and SPTs.

The SPO process generally lasts between three and four 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 and documentation describing internal processes). The provider will 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 core components of the ICMA principles and evaluate the issuer's overall sustainability strategy.

Figure 19. **The General Second Party Opinion Process**



4.5 Bond Placement

Alongside the non financial steps involved in issuing a thematic bond, issuers will have to take all the usual steps for issuing any bond. An illustrative example of a publicly distributed securities issuance to investors is presented below.

Figure 20. **The 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 • Prepare internal team for issuance • Register with local regulator	• Due diligence • Credit Rating process • Prepare Prospectus	• Roadshow presentation • Press release • Distribution of prospectus	• Final documentation • Pricing of bond • Settlement

4.6 Reporting and continual Improvement

As referred to in **Chapter 4.2.4** and **4.3.4**, the process for issuing 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.

UOP thematic bond issuers have the responsibility to provide ongoing reporting on proceeds impact and allocation. SLB issuers should publish up to date information and verification assurance reports relative to the performance of the SPT(s) and information to monitor their level of ambition. Post issuance reporting provides transparency and helps ensure the accountability and credibility of the issuance. The overall goal of the thematic bond market is to help drive institutional and private capital toward the sustainability agenda. By providing greater transparency in their reporting, issuers are better equipped to align their operations with their overall sustainability strategy and are helping investors understand the impact of their investments.

Top Five 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 for issuing 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 Eligible Assets or Material Key Performance Indicators

Depending on whether issuance is a UoP or an SLB, the issuer should focus on the basic capacity to issue and on what the impact of its operations on the SDGs are in order to determine material metrics, including the quality of data and the capabilities to organize information on 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. For SLBs, it is necessary to benchmark KPIs and SPTs to assess their ambition.

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 integrating capacities such as implementing the selection, calibration, monitoring, tracking, verification and disclosure processes inherent in a thematic bond in their internal processes.

5. Use External Resources

There is an overabundance of publicly available documents that describe and guide the structuring of thematic bonds. To determine the most appropriate material for each issuer's circumstances, IDB Invest recommends prioritizing material that accounts for such local circumstances when and where it is published by local capital market authorities. Examples of these additional resources are further detailed in this guide's Annex.

05.

MARKET INNOVATIONS AND IDB INVEST'S ROLE

This guide explores a variety of technical aspects and lessons learned within the thematic bond market, which is in a state of continuous evolution and growth. To conclude, it is important to emphasize a few key developments that have been noted:

1. Shift in investment approaches: Traditionally, the market predominantly favored financing the "best in class": entities with significant environmental or social impacts were prime targets for capital flows. Recently, however, there's been a paradigm shift toward transforming sectors faced with substantial environmental challenges, also known as "hard to abate" sectors. This pivotal shift recognizes that achieving the most substantial environmental impact involves not only investments in green industries but also support for carbon intensive sectors that are crucial to the global economy and are transitioning toward sustainable practices. Consequently, instruments designed for transition and decarbonization are gaining increased prominence in the bond market, signifying an urgent move to transition from high carbon activities. This development widens the bond market to issuers from industries previously marginalized within the thematic bond market, demonstrating an expansion in focus and a more inclusive approach to achieving sustainability goals.

2. Local taxonomies: The adoption of local taxonomies has emerged as a vital strategy for directing investments toward sustainable initiatives, drawing inspiration from the success of the European Union's Sustainable Finance Taxonomy in concept standardization, which helped streamline capital flows toward investments that align with sustainability. With three countries in the region already implementing their taxonomies and seven more in the process, these classification systems adapt specific criteria to the local context. They ensure that sustainable activities align with each region's development goals, providing investors with clear guidance on aligning their investments with national priorities. This approach not only fosters transparency but also promotes projects with positive E&S impacts, strengthening the region's commitment to sustainable development.

3. Innovative financial instruments: The market has seen an increase in issuers introducing innovative financing strategies for thematic bonds. Among the notable instruments developed recently are the following:

a. Hybrid instruments: Some issuers in the region now offer bonds that merge UoP and SLBs within a single issuance, such as the Chilean paper company CMPC's green and sustainability-linked bond of 2023.[53] This innovation ties the bond's returns to specific sustainability performance indicators while financing specific projects, enhancing accountability and commitment.

b. Green bonds and carbon credits: This inventive pairing combines the advantages of green bonds with the supplementary benefits of carbon credit offsets, thereby amplifying the environmental impact of these investments. For example, in 2023 the World Bank issued an emissions reduction green bond for which investors will earn a return linked to the issuance of a carbon credit project.[54]

[53] *CMPC (2023). Hecho Esencial. Available online **here.***
[54] *World Bank (2023). Emission Reduction-Linked Bond – Achieving Wide Ranging Development Outcomes by Enabling the Private Sector. Available online **here.***

c. Nature performance bonds: These bonds establish a direct link between financial returns and specific environmental milestones such as the conservation of biodiversity or ecosystem restoration, paving the way for investments that have a tangible positive impact on the environment. The United Nations Development Programme is currently offering training for the market on these innovative instruments.[55]

4. Reporting quality: The introduction of new instruments in the thematic bond market has not only diversified investment options but also increased scrutiny of reporting standards and the tangible impact of these investments. Worldwide, investors believe that the market's evolution in terms of reporting has been positive, moving from rudimentary frameworks five years ago to the current state, in which there is a high recognition of the importance of detailed and quantitative reports. This change is largely due to initiatives such as ICMA's guidelines for impact and allocation reporting, which have played a pivotal role in improving the quality and granularity of reports. Such advancements underscore the critical importance of the methodology.

Throughout the evolution of the bond market, two critical factors have emerged as fundamental: credibility and additionality.

Credibility focuses on verifying whether the bond issuance effectively supports the company's sustainable strategy, assessing the essence of each project or KPI in its contribution to achieving that strategy via methodologies, reporting, SPO and verification. It is therefore important to highlight that while reporting quality has improved over time, ongoing efforts to enhance report scrutiny and transparency remain crucial for market growth. It is essential to emphasize the methodological rigor (for both UoP and SLBs) of issuers selecting impact indicators pre issuance. Additionally, disclosures should cover not just outcomes but also progress, challenges and any deviations post issuance.

Additionality delves even deeper, questioning whether investments are creating unprecedented paths toward sustainability, that is, whether they are truly investing in green or transforming the brown. The goal goes beyond mere innovation for the sake of novelty: it aims to ensure that each investment fosters a genuine shift toward sustainable practices.

As the regional market leader in structuring, advising and investing in thematic bond issuances, IDB Invest is fully committed to strengthening the depth and sophistication of this marketplace. As a financial instrument, thematic bonds can help address development priorities ranging from the UN's SDGs 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 its belief in and commitment to the power of financial markets to channel additional investment resources in support of a broad development finance mission.

Addressing the challenges of sustainability (such as biodiversity loss, climate change, gender and diversity) remains at the heart of IDB's work in LAC. 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. IDB Invest invites you to join us on this sustainable financing journey and to help respond to pressing societal challenges while simultaneously developing the power of markets to affect positive change.

[55] *United Nations Development Programme (2024). UNDP offers training for Nature Performance Bonds. Available online* ***here.***

Additional Resources

Below is a non exhaustive list of additional resources that can be used for a thematic bond issuance.

Table 10. **Additional Guidelines for Thematic Bonds**

TOPIC	ORGANIZATION	RESOURCE	SUMMARY
Corporate governance and risk management frameworks	EP Association	*The Equator Principles*	Provides a financial industry benchmark for determining, assessing and managing E&S risks in projects.
	IDB Invest	*IDB Invest Environmental and Social Sustainability Policy*	The policy seeks to enhance the E&S sustainability of investment projects financed by IDB Invest.
	IFC	*IFC CGDF*	Provides a common approach to corporate governance due diligence.
		IFC Corporate Governance Methodology Tools	Provides a progression matrix that assesses how a company performs in six governance parameters.
		IFC's ESG Performance Indicators for Capital Markets	Provides a sustainability data framework aimed at reducing the ESG data reporting burden and enhancing sustainability reporting in emerging capital markets.
		IFC's Performance Standards on Environmental and Social Sustainability	Designed to help avoid, mitigate and manage risks and impacts as a way of doing business in a sustainable way.

TOPIC	ORGANIZATION	RESOURCE	SUMMARY
External review	CBI	*Guidance for Verifiers*	Guidance for verifiers looking to be third party verifiers approved by CBI.
	ICMA	*Guidelines for External Reviews*	Voluntary guidance related to professional and ethical standards for external reviewers.
General guidance	ICMA	*Climate Transition Finance Handbook*	Additional guidance for issuers seeking to utilize thematic bonds toward the achievement of their climate transition strategy.
		Bond Index Service Mapping	Harmonizes index data requirements and disclosure policies for GSS issuers.
		Guidance Handbook and Q&A	Additional information for market participants on how to interpret ICMA guidance documents.
		Mapping to the Sustainable Development Goals	Provides a broad frame of reference on how market participants can evaluate the objectives of GSS bonds against the SDGs.
		Research and Learning	Provides a hub of public learning resources related to thematic bonds.
		Sustainability Standards and Labels	Provides an overview to assess the relevance of different sustainability standards and labels.
		Taxonomies and Nomenclatures	Provides guidance on various nomenclatures and taxonomies used to assess green eligibility.

TOPIC	ORGANIZATION	RESOURCE	SUMMARY
Market Data	BIVA	GSS Bonds in Mexico	A free and public database of listed GSS bonds in the Mexican Stock Exchange (BIVA).
	BOLSA DE SANTIAGO	GSS Bonds in Chile	A free and public database of listed GSS bonds in the Santiago Stock Exchange.
	BOLSA NACIONAL DE VALORES	GSS Bonds in Costa Rica	A free and public database of listed GSS bonds in the Costa Rican Stock Exchange (BNV).
	BOLSA DE VALORES DE COLOMBIA	GSS Bonds in Colombia	A free and public database of listed GSS bonds in the Colombian Stock Exchange (BVC).
	BYMA	GSS Bonds in Argentina	A free and public database of listed GSS bonds in the Argentinian Stock Exchange (BYMA).
	CBI	Interactive Data Platform	A free and public sustainable debt data tool based on CBI reports.
	ERM NINT	ESG Database of Sustainable Debt in Brazil	A free and public database on Brazilian thematic bond issuances.
	IDB	Green Bond Transparency Platform	A free and public integrated dataset of LAC thematic bonds.

TOPIC	ORGANIZATION	RESOURCE	SUMMARY
Sustainable finance taxonomies	CBI	CBI Taxonomy	A guide to climate-aligned assets and projects.
	EU COMMISSION	EU Sustainable Finance Taxonomy	An EU-wide classification system for sustainable activities.
	COLOMBIAN GOVERNMENT	Colombia Green Taxonomy	A classification system for economic activities and assets that contribute to achieving Colombia's environmental objectives and commitments.
	MEXICAN GOVERNMENT	Mexican Sustainable Taxonomy	A classification system for economic activities and assets that contribute to achieving Mexico's E&S objectives and commitments.
Thematic bond standards	CBI	Climate Bonds Standard	A labeling scheme for issuers that ensures that certified investments in climate mitigation are consistent with the 1.5!C warming limit in the Paris Agreement.
		Climate Resilience Principles	Describes the potential range of climate resilience investments.
		Principles for an Ambitious Transition	Describes a robust framework of principles that signal the credibility of transition.
	EU COMMISSION	EU Green Bond Standard	A voluntary standard that relies on the detailed criteria from the EU taxonomy to define green economic activities.

TOPIC	ORGANIZATION	RESOURCE	SUMMARY
Thematic bond standards	ICMA	Bonds to Finance the Sustainable Blue Economy	A practitioner's guide for bonds to finance the sustainable blue economy.
		Bonds to Bridge the Gender Gap	A practitioner's guide for bonds to bridge the gender gap.
		GBP	Voluntary guidelines that describe the four key components for green bond issuances.
		SDG Impact Standards for SDG Bonds	An internal decision-making framework to help this group develop and implement an impact strategy to contribute positively to sustainable development in line with the SDGs.
		SBP	Voluntary guidelines that describe the four key components for social bond issuances.
		SBG	Voluntary guidelines that describe the four key components for sustainability bond issuances.
		SLBP	Voluntary guidelines that describe the five key components for SLB issuances.

FOR MORE INFORMATION:

Web: www.idbinvest.org

Bloomberg: IDBINV <GO>

LinkedIn: www.idbinvest.org/linkedin

Twitter: www.idbinvest.org/twitter

Facebook: www.idbinvest.org/facebook

Blog: www.idbinvest.org/blog