1. Introduction

Financial Institutions (FIs) play a pivotal role in mobilising capital for the investments that are required to transition towards a 'net zero' and climate-resilient development pathway. Global commitments to achieve the Sustainable Development Goals and the Paris Agreement on climate change provide a framework to identify investment opportunities. Sustainable infrastructure, clean sources of energy, water and sanitation, and climate-resilient agriculture are key areas towards which directing capital for building a sustainable future. According to the World Investment Report 2014, the estimated investment opportunity in developing countries in these sectors amounts to US$2.5 trillion.

The concept of 'green finance' has emerged to guide capital allocation towards climate change related opportunities and countries' priorities.

2. What is green finance?

Green finance refers to financial products and services that integrate environmental factors throughout the decision-making processes in order to promote investments that deliver climate benefits.

Green finance taxonomies have emerged to help identify eligible investments. Key ones include the "EU taxonomy for Sustainable Activities", the "Climate Bond Initiative Taxonomy", and the approach of "Multilateral Development Banks (MDBs) on Climate Mitigation & Adaptation Finance". Various countries have also taken steps to develop their own green finance strategies to support their transition into low carbon economies.

- Key sectors in which green finance plays a major role
    - Renewable energy (e.g. solar, wind)
    - Green infrastructure and buildings (e.g. buildings certified for their energy performance with international recognised approaches e.g. EDGE or LEED)
    - Sustainable transport (e.g. electric or hybrid vehicles)
    - Natural resources management e.g. water management
    - Biodiversity and habitat protection

  - Ecosystem services
  - Waste reduction and management
  - Pollution prevention and control
  - Sustainable tourism

- Portfolio approach to climate change

  Green finance is part of a broader portfolio-wide approach to climate change. As discussed in the Value-Add section on integrating climate change into governance and risk management frameworks, climate change can pose both financial risks and opportunities to an FI both in terms of lending activities and deposits.

  The recommendations of the Task Force on Climate-related Financial Disclosures' (TCFD) provide a framework for systematically integrating both risks and opportunities within an FI's decision making. It helps integrating climate change considerations at the transaction and portfolio level to ensure that developing and implementing a green finance strategy is part of a broader effort towards the decarbonisation and climate resilience of an FI's portfolio/balance sheet. An organisation-wide approach to climate change provides confidence on the genuine commitment of the FI to climate action and therefore can alleviate concerns of 'greenwashing'.

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- Identifying green finance opportunities

  To identify key green finance opportunities, an FI can start by assessing its portfolio with a climate risk lens to identify sectors/sub-sectors that are e.g. energy intensive, high in greenhouse gas emissions, or water intensive. Clients in these sectors, in fact, have to invest in energy efficiency, renewable energy and water efficient solutions to reduce their negative impact on climate or become more resilient to climate related

risks.

An FI can then assess the market and the regulatory environment for identifying the market potential of the opportunities identified as well as possible enablers or barriers.

The final step implies developing a dedicated product offering and establishing relevant partnerships with e.g. Energy Service Companies (ESCOs), technology manufacturers, and suppliers. These types of partners, in fact, can help an FI to build pipelines by bringing the technical expertise, market knowledge, and relationships.

- Developing a green finance strategy

The first step for an FI looking to develop and grow its green portfolio is to develop a green investment strategy and define a framework laying out the selection process and eligibility criteria for identifying projects that are aligned with the objectives of the Paris Agreement ('Paris-aligned'), support a just transition for workers, and communicates and strengthen adaptation and resilience to climate shocks and stressors. It then implies determining how to finance them most adequately. This framework also covers key components such as determining the appropriate sources of funding, how to structure deals and provide reporting to demonstrate how funding has been utilised and the expected impact of these projects (Table 1 provides more details).

"Green" projects, in fact, present specific characteristics that needs to be taken into account when developing a green finance strategy and related offering. Renewable energy projects, for instance, can have higher up-front costs than traditional sources of energy. Investments in energy efficiency can have longer payback times in context with low-energy prices due to counter-productive subsidies on fossil-fuels.

Steps	Key Tasks

Developing a green asset strategy and selection process	- Developing a strategy document in collaboration with key stakeholders and teams across the FI (Sustainability Team, Credit Risk, E&S, Business Development, etc.). This should reflect national priorities and integrate international best practice such as Green Loan Principles, MDB Methodology on Climate Finance and local context such as emerging government policies, NDCs, etc. - Define eligibility criteria for projects and create process to identify a diligence process that can be easily integrated into existing frameworks in the bank. - Set up structures and mechanisms to track and report on the green loans post-disbursement.
Determine appropriate product offering	- Ascertain the most suitable ways to obtain the required funding to finance these projects. These can be through direct investments such as equity and debt, or indirect such as funds targeted at green growth, venture capital, etc.
Transaction structure	- Consider need for partnerships to co-finance or access to expertise based on different factors such as asset characteristics and macroeconomic factors. - Where possible, seek support from other finance services that provide credit enhancement mechanisms such as guarantees and risk-sharing products to improve the risk-return profile of the transaction and ensure that it is within the overall risk appetite of the FI. - Prepare all necessary documents as the FI would do in other transactions taking into consideration project risks, cashflow, E&S DD alongside other streams required to ensure that the structure meets all the FI's typical requirements.
Monitoring and reporting	- Where possible, reporting should cover the following: allocation reporting, eligibility reporting, and impact reporting (further detail below). - Upon disbursement, publish a report to stakeholders on proceeds allocation and management of unallocated share. - Report should be disclosed using a set of qualitative and quantitative metrics which have been developed during the strategy creation stage and agreed with other investors. The report should capture the impact of the projects and any other material developments.

Adapted from: ASEAN Green Financials Instruments Guide

Putting these structures in place, alongside transparency and public disclosure, limits

the potential of the FI falling into the risk of greenwashing, a situation where projects are portrayed to seem more environmentally friendly than they are, with the aim to capitalise on the demand for environmentally sustainable products. It is also best practice for the FI to engage an external reviewer to evaluate the green credentials as well as transparency and clarity of the framework which provides additional comfort to the investors. Furthermore, aligning with overarching methodologies such as the Green Loan Principles and MDB Methodologies on Climate Finance boost credibility of their program.

3. The Green Loan Principles

As stated above, the risk of greenwashing is an emerging theme and FIs interested in tapping into the growing available funding and opportunities in the green finance space are required to develop an approach that aligns with best practice. The International Capital Market Association's Green Loan Principles (GLP) provide guidance on how FIs can grow its green portfolio flexibly but within a standard framework. The four core principles provide a framework for what an FI needs to put in place and demonstrate to originate, select, and administer a green loan from the relevant funding source which is then on-lend to underlying green projects and borrowers:

- Use of Proceeds

  The fundamental determinant of a green loan is the utilisation of the loan proceeds for green projects which should be appropriately described by the FI in the finance documents and, if applicable, marketing materials. All green loans should provide clear objectives which will be assessed and, where feasible, quantified, measured, and reported.

  While the definition of green may vary depending on sector and geography, the objective should revolve around addressing areas on environmental concern such as climate change mitigation and adaptation, natural resource depletion, loss of biodiversity, and air, water, and soil pollution and examples of this are covered in methodologies such as the "Climate Bond Initiative Taxonomy", "EU taxonomy on sustainable activities", and "MDB on Climate Mitigation & Adaptation Finance". Where funds are to be used, in whole or part, for refinancing, it is recommended the FI

provide an estimate of the share of financing versus refinancing. Where appropriate, they should also clarify which investments or project portfolios may be refinanced, and, to the extent relevant, the expected look-back period for refinanced green projects.

- Process for Project Evaluation and Selection

  The FI deploying a green loan should clearly communicate to its funding source:

  - Its climate and environmental sustainability objectives positioning this information within the context of their overarching objectives, strategy, policy, and/or processes relating to environmental sustainability and climate change (see section on portfolio approach to climate change);
  - The process by which the borrower determines how projects fit within the eligible categories set out in Principle 1 and;
  - The related eligibility criteria, including, if applicable, exclusion criteria or any other process applied to identify and manage potentially material environmental risks associated with the proposed projects (see section on E&S and green finance).

  GLP requires FIs to develop a process on how projects are selected and evaluated into its green finance process. This system should clearly communicate the FI's sustainability objectives and the process by which it determines how projects fit within the eligible categories. This process should also, where possible, be integrated into the FI's existing policies and processes such as Credit Guide, ESMS, SOPs, etc. to ensure that they are mainstreamed and all key stakeholders across the institution are aware they exist and integrated in the various stages of the transaction cycle.

- Management of proceeds

  The GLP state the use of proceeds of a green loan should be credited to a dedicated account or otherwise tracked by the borrower in an appropriate manner, so as to

maintain transparency and promote the integrity of the product. Where a climate loan takes the form of one or more tranches of a loan facility, each green tranches must be clearly designated, with proceeds of the climate tranche(s) credited to a separate account or tracked by the borrower in an appropriate manner.' Given the way in which most FIs manage their Treasury function, the use of segregated accounts might not be feasible. In order to ensure that proceeds are instead "tracked in an appropriate manner", monitoring of use of proceeds should be organised in one of the following ways:

(i) Reporting on a portfolio basis specifically focused on the green or climate sub-book; or

(ii) Reporting on a list basis (i.e. on a Sub-loan-by-Sub-loan basis) in cases where a smaller number of larger loans are involved.

The process for managing unallocated proceeds should be presented where possible. This is not a requirement of the GLP, but may be helpful to provide information to funding providers on the extent there of risk that unallocated proceeds are held in temporary investment instruments (cash or cash equivalent instruments) that include greenhouse gas intensive projects inconsistent with the objectives of the GLP.

To efficiently track, monitor, and report on the green portfolio, the FI should develop and integrate processes on how the proceeds are managed.

- Reporting

  The FI should keep readily available information on the use of proceeds until fully drawn. This should include projects for which the proceeds have been partly or fully allocated, a brief description, allocated amount, and impact expected. Due to factors such as confidentiality agreements, competitive considerations, and other complexities around data disclosure, FIs may be unable to provide full details publicly. However, it may be presented in a generic way but should be available to investors funding the projects.

  Where possible, reporting should cover the following areas:

  - **Allocation reporting**: The list of projects and assets to which net proceeds have

been allocated, the amounts allocated, and an estimate share of the net proceeds used for financing and refinancing. Generally, in YTD data on an annual basis. This should include growth of the book relative to growth of total lending.

- **Eligibility reporting**: This should include confirmation that the projects meet the eligibility standards and any relevant information on environmental performance.

- **Impact reporting**: For example, energy capacity, electricity generation, greenhouse gas emissions reduced/avoided, etc.

When appropriate, the GLP recommend an external review. An external review may be partial, covering only certain aspects of a borrower's green loan or associated green loan framework or full, assessing alignment with all four core components of the GLP. Alternatively, the GLP recognised that given that the loan market is traditionally a relationship-driven market and therefore lenders are likely to have a broad working knowledge of the borrower and its activities, self-certification by a borrower, which has demonstrated or developed the internal expertise to confirm alignment of the climate loan with the key features of the GLP, may be sufficient. Nonetheless, FIs are recommended to thoroughly document such expertise, including the related internal processes and expertise of their staff.

Such guidance and external review might include the following:

- **Consultant review**: An FI can seek advice from consultants and/or institutions with recognised expertise in environmental sustainability or other aspects of the administration of a climate loan. "Second party opinions" may also fall into this category.

- **Verification**: An FI can have its green loan, associated green loan framework, or underlying assets independently verified by qualified parties, such as auditors or independent ESG rating providers. In contrast to certification, verification may focus on alignment with internal standards or claims made by the borrower.

For FIs more advanced in their climate activities and wishing to make public their engagement, other measures can be beneficial such as the following:

- **Certification**: An FI may have its green loan or associated green loan framework certified against an external green assessment standard. An assessment standard defines criteria, and alignment with such criteria is tested by qualified third parties/certifiers.

- **Rating:** An FI can have its green loan or associate green loan framework rated by qualified third parties, such as specialised research providers or rating agencies.

4. Green Financing Mechanisms

As FIs develop the approach to Green Financing and seek to align it with best practice, it is noteworthy to mention that a growing bouquet of financial products and services has been rolled out and receiving uptake in the sector. This section provides a non-exhaustive list of some of these financial products currently being adopted by FIs to finance green assets to underlying borrowers.

- Examples of green instruments and description

Instrument	Description
Green bonds	Proceeds are allocated to nominated green projects/assets. Part of the project's risk is transferred from the issuer to investors.
Private placement	Green bonds placed directly with investors and the issuer is expected to disclose details on the nominated projects and assets to be financed.
Green loans	These are provided to encourage market development in climate-aligned sectors in line with the Climate Bonds Taxonomy and green loan principles.
Venture capital	Funds are allocated to innovative pilot-scale green projects for qualified green infrastructure. This aids developers to secure a funding stream for green projects that may fall outside FIs risk appetite.

Guarantees/first loss provisions	Covers investors from the loss of capital if there is financial loss. This provides protection to debt providers who are liable to pay compensation to investors irrespective of the cause of the loss.

Adapted from: ASEAN Green Financials Instruments Guide.

The mechanism utilised will depend on various factors such as the project type, payback profile, and the profile of a given borrower/investee. This would have to be examined on a case by case basis to determine which product best suits a project's risk adjusted/return profile.

- E&S and Green Finance

To properly identify opportunities for green financing and properly finance them, an FI still needs to have developed and apply its E&S requirements as stated in its ESMS. The FI shall screen the client/project against its exclusion list, categorise the E&S risk profile accordingly and conduct the necessary E&S DD, develop an ESAP where necessary, include covenants in legal documents and continue monitoring as per usual.

For example, a green finance project such as a Solar Power Plant will still be subject to a rigorous E&S DD process which, depending on its size, will include the Performance Standards compliance and cover topics such as involuntary resettlements, impact on biodiversity, etc. as the FI would have treated in another similar Power Plant if not 'green'.

The FI shall not conflate both E&S and green financing requirements but seek ways to integrate them in the holistic project appraisal process. Managing E&S risks in the project remains paramount and is a key priority for the FI even when financing green projects. It is a prerequisite to systematically identify opportunities and have in place a sound approach for the financing of green projects.

Further guidance on ESMS development and implementation and relevant sector information is covered in various sections of the toolkit.

- Conclusion

  There is an increased momentum around green finance, and this is attributed around the need for the world to address global challenges around sustainable development and transition into a low carbon and climate resilient economy. This provides opportunities for FIs to tap into new opportunities such as access to funding and enhanced brand reputation. However, this has also given rise to cases of greenwashing. For institutions to avert this risk, having strategies in place that fuse best practice with local context facilitate confidence in various stakeholders whilst remaining forerunners in this emerging space.

  Green finance should be considered a part of developing a broader portfolio-wide approach to climate change, complementing climate risk management, and systematic integration into existing business and governance processes. The Task Force on Climate-related Financial Disclosures (TCFD) is the most commonly accepted global framework to enable this process. It is supported and promoted by financial regulators, investors, and civil society.

  It is also imperative to note that as FIs seek to define strategies and processes pertaining to green finance, this is not conflated with E&S requirements covered extensively in the toolkit and may not be considered as a substitute. The aspirations are that adoption of the green finance framework covered in this guide is done in concurrence with the project meeting all the mainstreamed processes which includes Credit, E&S and BI requirements.

5. Further Resources

- Chartered Banker Institute: The Green Qualifications Workbook
- The Global Green Finance Index
- Clifford Chance: A Guide to Some of the Key Initiatives in Green Finance
- Climate Bonds Initiative: Quarterly Green Bonds Market Summary
- ICMA’s Green Bond Principles

- ICMA's Green Loan Principles
- ICMA's Green Bond impact reporting – see Green Sector specific documents
- ICMA's Climate change adaptation – Suggested Impact Reporting Metrics for Climate Change Adaptation Projects
- Linklaters: Sustainable Finance – The rise of green loans and sustainability linked lending
- London Stock Exchange – Guide-to-Navigating the green-finance landscape