Frequently Asked Questions: Green Evaluations And Transaction Alignment With The Green Bond Principles 2018

July 24, 2018

This article was reviewed and republished July 24, 2018. In April 2018, we first published this article answering frequently asked questions about transaction alignment with the Green Bond Principles. We are updating this report after reviewing the latest edition of the Green Bond Principles 2018 (GBP 2018) published June 14, 2018.

The 2018 edition of the Green Bond Principles *remains framed by the same four core components (Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds and Reporting).* We have updated GBP 2017 to reflect GBP 2018 in the article. However, the conditions within our Green Evaluation framework that we examine to determine GBP alignment have not changed.

S&P Global Ratings has received many questions from market participants about its Green Evaluation’s alignment with the Green Bond Principles. We can apply our Green Evaluation approach to many different types of financing transactions, including bonds. Several transactions we have evaluated have been issuer self-labeled as green bonds, while others have not carried a green label. We have received similar questions about alignment from issuers and investors. Below are some of the most frequently asked questions on the topic.

**Frequently Asked Questions**

**What is a Green Evaluation?**

S&P Global Ratings' Green Evaluation is a point-in-time assessment of the relative environmental impact of a financing transaction or portfolio (for more information, see "Green Evaluation Analytical Approach," published April 26, 2017, on RatingsDirect). The evaluation of a transaction involves the assessment of Transparency, Governance, and relative net environmental impact or Mitigation on a scale of 0 to 100. It then combines these three elements to provide a final Green Evaluation score both on a scale from 0 to 100 and from E1 to E4. For transactions funding resilience projects, instead of Mitigation we assess the resilience benefit and provide an Adaptation score on a scale of 0 to 100 and R1 to R4. A higher number, or E1 or R1 score, indicates a higher relative net environmental impact or resilience benefit, respectively, over the funded assets’ life (see chart).

S&P Global Ratings does not limit Green Evaluations to issuer self-labeled green bonds. We can also evaluate unlabeled bonds, equity transactions, bank loans, private placements, project...
finance debt, hybrids, portfolios, asset-backed securities, and other financial transaction types. Informing our evaluation are the cash flow management processes and environmental measures in the offering documents or other reports, committed to by the issuer.

As a point-in-time assessment, a Green Evaluation is in part based on an estimate of the expected lifetime net environmental impact of a project should it perform to industry average. S&P Global Ratings does not maintain ongoing surveillance on a Green Evaluation. A Green Evaluation is not a credit rating.

**Green Evaluation Analytical Approach**

The **Green Bond Principles** are:

The International Capital Markets Association, which acts as the secretariat to the Green Bond Principles and Social Bond Principles Executive Committee, describes the principles as "voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the Green Bond market by clarifying the approach for issuance of a Green Bond." (Green Bond Principles, June 2018.)

The four core components of the GBP 2018 are:

- Use of proceeds
- Process for project evaluation and selection
- Management of proceeds
- Reporting

**What is a Green Bond?**

In the context of this FAQ and our discussion on alignment with GBP 2018, we are using the term green bond to refer to a bond that an issuer has self-labeled green, based on its view that it has voluntarily complied with the GBP's recommended four components. In cases where an issuer labels a bond as green using a rationale or taxonomy other than the GBP, we would not offer a GBP
Does S&P Global Ratings' Green Evaluation of an issuer self-labeled Green Bond constitute an external review under the GBP 2018?

We believe an opinion on alignment from an independent party such as S&P Global Ratings provides a second opinion, which is referred to as a form of external review under the GBP 2018. We note, however, that S&P Global Ratings' Green Evaluations are not verifications, certifications, audits, or credit ratings.

Do all elements of the Green Evaluation analytical approach contribute to S&P Global Ratings' alignment opinion?

No. We base our alignment opinion on our assessment of Transparency and Governance. Our Mitigation and Adaptation scores do not contribute to our alignment opinion.

In what way is S&P Global Ratings' Transparency and Governance assessment aligned with the GBP 2018?

In our assessment of Transparency and Governance scores on a transaction for the purpose of Green Evaluation, we consider whether:

- The net proceeds have been or are expected to be committed to eligible green projects
- The issuer has used and disclosed or is expected to use and disclose clear criteria in allocating funds to select environmentally beneficial projects
- The proceeds have or are expected to be tracked (potentially with the use of subaccounts) and if the issuer will seek verification of their proceeds allocation by either an auditor or an independent third party
- The issuer has or is expected, and how often it expects, to report on the funded projects' environmental impact and the use of proceed

In our view, these categories align with the GBP 2018.

What is an eligible green project?

Green taxonomies vary around the globe. In China, for instance, efficiency upgrades to coal-fired power stations are considered green. Although the GBP 2018 do not exclude issuer self-labeled green bonds from funding fossil-fuel-related projects, some issuers (or investors) might believe that anything fossil-fuel-related should be excluded from consideration as a green investment of any shade of green.

In the context of performing a Green Evaluation, we refer to the issuer's definition of what constitutes a green use of proceeds, as long as we believe the project (or a discrete component thereof) falls within the scope of our published approach. Pursuant to our Transparency and Governance scoring, we consider (among other things) the strategies, criteria, policies and financing covenants in place that provide comfort that the proceeds have been, or will be, applied to eligible green projects (as defined by the issuer).
We plan to provide second opinions on GBP alignment only when requested by the issuer and when some if not all the projects financed by the transaction fall within the scope of our green evaluation approach (see tables 1 and 2).

Table 1

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<th>Technologies In Scope -- Carbon Hierarchy</th>
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<tr>
<td><strong>Green energy</strong></td>
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<td>Photovoltaic solar power generation</td>
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<tr>
<td>Concentrated photovoltaic solar power generation</td>
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<td>Solar thermal</td>
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<td>Small hydropower generation (&lt;30 MW)</td>
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<td>Large hydropower generation (&gt;30 MW)</td>
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<td>Onshore wind power generation</td>
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<td>Offshore wind power generation</td>
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<td>Geothermal power generation</td>
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<td>Biomass power generation</td>
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Table 2

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<tr>
<th>Technologies In Scope -- Water Sector Hierarchy</th>
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<tr>
<td>Conservation measures (residential, commercial and industrial)</td>
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<td>Smart metering (residential)</td>
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Our Carbon Hierarchy

In establishing this new global benchmark to compare the relative environmental impact of various financing transactions, we include within our scale of 0 to 100 (E4 to E1) projects that contribute to carbon emission reduction, including improvements to fossil-fuel-related processes. Our final scoring recognizes that not all projects labeled as green contribute to systemic decarbonization but can result in the life extension of fossil-fuel-based assets. Based on our carbon hierarchy, these projects score at the low end of our scale.

How does S&P Global Ratings’ Transparency and Governance scoring differ from the GBP 2018?

The GBP provide a framework of recommended processes and measures that an issuer may use as the basis for self-labeling its bond green.

Our Green Evaluation is a second opinion about the relative environmental impact of a financing based on our analytical approach, which is aligned with the GBP. The evaluation includes both a Transparency and a Governance score, both on a scale of 0 to 100. We determine these scores based on a set of questions we have developed, a subset of which covers the four components the GBP recommends.

The weightings we apply to derive our Transparency and Governance scores on a scale of 0 to 100 are our own. Some of the factors we consider in our scoring that we believe advance governance objectives and enhance overall transparency relative to current market standards include:

- Disclosure of the methodology used to calculate estimated or actual environmental impact. We believe disclosing each metric’s methodology enables investors to better understand and have confidence in the environmental impact that a financing will have;

- Intention to follow local environmental regulations. We believe that this is important in achieving impact and avoiding adverse consequences;

- The depth of the environmental metrics to be reported on. We believe it is appropriate to rank issuers that provide more in-depth environmental metrics higher than those who provide less detailed information; and

- Intention to meet established standards such as LEED or the Building Research Establishment Environmental Assessment Method, known as BREAM. We believe attaining such a certification
with established standards provides additional comfort with respect to the environmental impact.

What does it take to be aligned with the GBP 2018 as measured by a Green Evaluation?

A transaction must meet several conditions within the Green Evaluation framework for S&P Global Ratings to consider a green bond aligned with the GBP 2018.

First, all net proceeds must be allocated to eligible green projects as described above.

Second, the bond must meet the basics of the four components of the GBP 2018, indicating a commitment to:

- Use the net bond proceeds for eligible green projects
- Use clear criteria in selecting projects for funding
- Manage and track proceeds
- Commit to regular reporting of environmental impact and use of proceeds

Third, under our approach to assessing alignment, we believe that a bond must receive a Governance score of 58 or more, and a minimum Transparency score of 42 or more.

If all three conditions are satisfied, S&P Global Ratings might view an issuer self-labelled green bond as being aligned with the GBP 2018.

A transaction could conceivably score adequately from a numeric standpoint on our scale from 0 to 100 but not meet the basics of the four components of the GBP 2018. In this case, the green bond would not be aligned with the GBP 2018, in our view.

If a transaction scores E1 on S&P Global Ratings' Green Evaluation scale, can I assume it is aligned with the GBP 2018?

Not necessarily, for several reasons.

Under our analytical approach, we derive the final Green Evaluation on a scale of 0 to 100 by weighting the Transparency score by 15%, the Governance score by 25%, and the Mitigation score by 60%. With an excellent Mitigation score of 90 to 100, a bond could achieve an E1 (an overall score of 75 to 100) yet have a weak Transparency score (below 40) and an average Governance (below 60) score that did not align with the four pillars of the GBP.

Under our analytical approach, a portion of a financing transaction could score E1, although allocating some of the funds to ineligible (nongreen) projects would negatively affect our scores. To be aligned with the GBP, all transaction proceeds must be disbursed to eligible green projects.

Could an E4 bond be aligned with the GBP 2018?

Yes. Under our approach, despite excellent Transparency and Governance scores, the Mitigation score or net environmental impact of the technology could limit the final Green Evaluation to the lower quartile, or E4. Our Mitigation scores caps the final Green Evaluation, no matter how good the Transparency and Governance. As an example, a fossil-fuel plant efficiency upgrade could
have Transparency and Governance scores well above the minimum levels for GBP 2018 alignment, but our environmental impact assessment would limit the final Green Evaluation score. The GBP 2018 do not preclude an issuer from a self-labeling transaction funding a fossil-fuel plant efficiency upgrade as green.

**Can a transaction be viewed as aligned with GBP 2018 if the Green Evaluation Mitigation or Adaptation assessment covers less than the entire green bond?**

Yes, a Green Evaluation could apply to only a portion of an issuer’s self-labeled green bond, and the transaction could still be eligible for an alignment opinion if the entire transaction’s Transparency and Governance meets our conditions for alignment outlined above.

An issuer might have communicated their intention to allocate all proceeds to green projects (as defined by the issuer) but we might not be in a position to provide a Green Evaluation for the entire transaction if some of the green projects do not fall within the scope of our analytical approach.

Our Green Evaluation reports identify the proportion of the financing that we can evaluate using our methodology. The related reports also clearly state the proportion of a financing the issuer has allocated or intends to allocate to green projects. For example, an issuer intends to allocate proceeds of a $150 million bond as follows: $100 million of proceeds to a wind energy project (covered by our methodology) and $50 million to a sustainable agriculture project (not yet covered by our analytical approach). In our report, we would note that the Green Evaluation applies to 66% of the $150 million transaction in the report, and that all proceeds are funding green projects (thus meeting our first condition for alignment).

**Does an S&P Global Ratings’ Green Evaluation constitute verification or certification of a self-labeled green bond under the GBP?**

No. Our Green Evaluation does not constitute a verification, certification, audit or rating. Our Green Evaluation provides an independent second opinion of a particular financing transaction, at a point in time, based on our analytical approach. The report might or might not provide a second opinion on alignment.

**Can a Green Evaluation of a refinancing be considered aligned with the GBP?**

The GBP 2018 provides that "Green bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects ... and which are aligned with the four core components of the GBP."

Based on this, we believe that a refinancing may be eligible for an alignment opinion with the GBP 2018 if it meets the three conditions outlined above.

**Will S&P Global Ratings be publishing its alignment opinions?**

If requested by the issuer, we might include an alignment opinion in our green evaluation reports. Green Evaluation reports are point-in-time evaluations and become public only at the issuer’s request.
Does an S&P Global Ratings' Green Evaluation satisfy the Climate Bond Initiative (CBI) certification standard?

No. There are several reasons for this:

- Some green projects might be considered green under the GBP 2018 and fall within the scope of our green evaluation approach but are excluded from CBI certification standards, such as nuclear and fossil-fuel projects.

- S&P Global Ratings' Green Evaluations and alignment opinions are not certifications.

- CBI certification requires reporting until all proceeds of the transaction are disbursed. S&P Global Ratings' Green Evaluation is a point-in-time evaluation of a transaction based on actual or expected allocation of proceeds.

Related Research

- Green Evaluation Analytical Approach, April 26, 2017
- How Do Labeled Green Bonds Measure Up?, Nov 8, 2017

This report does not constitute a rating action.