NORDIC INVESTMENT BANK

FINANCING THE FUTURE

NIB Environmental Bond Framework

Framework for the undertaking of NIB Environmental Bond issuance – the underlying rationale and methodology for loan selection, and the governance of bond issuance, proceeds management and reporting

September 2014

Table of Contents

1 Background for issuing NIB Environmental Bonds (NEB)

Socially Responsible Investments have become important in the debt capital markets. NIB's explicit environmental mandate positions the Bank ideally to issue "green bonds" and to allocate funds to projects that support its mandate.

NIB believes that such bond issues enhance NIB's "sustainable profile" with stakeholders both on the lending and investment side. Green bond issuance also allows reaching out to new investors, thus diversifying the Bank's investor base further.

Funding through NIB's Environmental Bond program (NEB) is part of the Bank's funding plan, so all policies regarding funding (Financial Policy and Liquidity Policy) apply.

This document lays the framework for the undertaking of NIB Environmental Bonds. The framework describes the underlying rationale and methodology for loan selection, and the governance of bond issuance, proceeds management and reporting.

2 Set-up illustration

NIB Environmental Bonds – NEB

NIB Environment Bonds are funding transactions the proceeds of which are used for selected environmental projects to be financed by NIB. Investors are offered a purpose defined investment; therefore the flow of proceeds from bond issuance to disbursement is separated from the common cash flows within NIB.

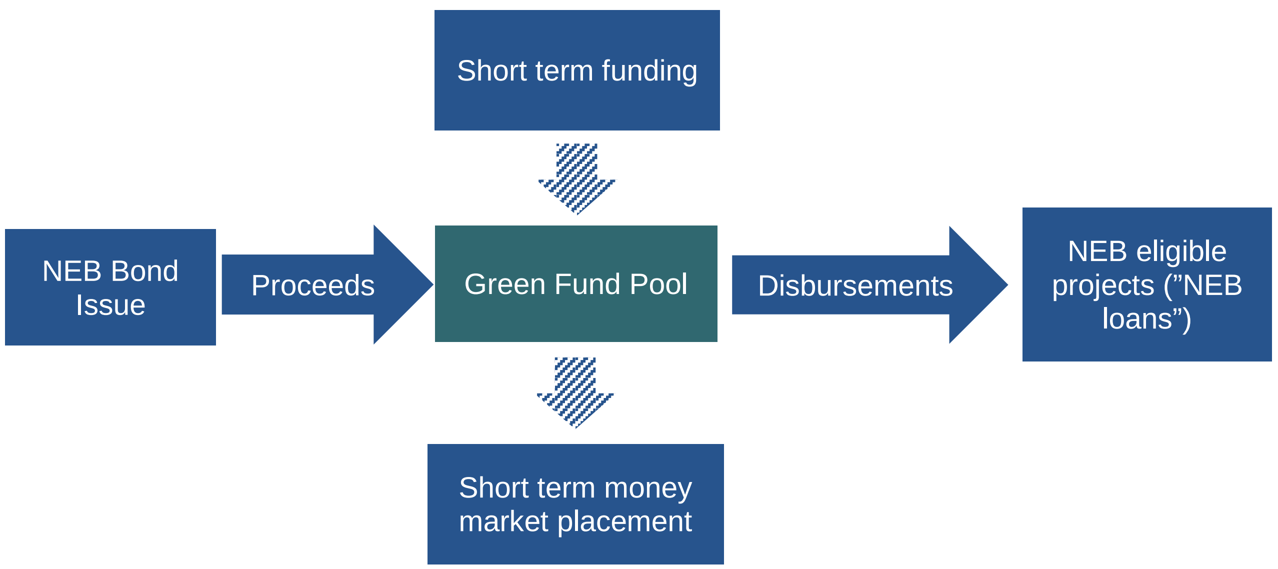
Two basic principles govern the NIB Environmental Bonds:

a) Financing of new projects

Proceeds of NEB issuance are only used for disbursement of loans to new environmental projects. NIB does not refinance existing projects with NEB proceeds.

b) Separation of funds

A central principle of “green bonds” is the separation of funds. Bond proceeds are allocated to a separate portfolio, the “Green Fund Pool”. Limited mismatches between the point of time of raising funds and disbursements are managed by money market instruments. Ultimately, however a straight link between proceeds and disbursements to loan for projects is established.



As per the above illustration, NIB issues NIB Environmental Bonds, and channels the proceeds to a separate Green Fund Pool until disbursements of loans to eligible projects.

Mismatches in the timeliness of funding and disbursements are managed within the Bank’s short term asset and liability management according to NIB’s liquidity policy.

The Green Fund Pool is managed by Treasury. In the following chapters, the underlying parameters for each part of the NEB Process - loan selection, bond issuance, warehousing and monitoring of the flows - is described.

3 Loan selection

3.1 Selection process

The Sustainability & Mandate function within Lending assesses the mandate fulfillment of new projects. The assessment is restricted to evaluating how well a project contributes to strengthening the member countries' competitiveness and enhancing the environment. Mandate makes a qualitative and quantitative analysis of the projects' direct and indirect effects.

The Sustainability & Mandate Unit identifies projects meeting NEB eligibility criteria during the above mentioned assessment of mandate fulfilment of potential loans, and is therefore responsible for pre-selecting the loans suitable for NEB proceeds disbursement. All loan proposals are as part of the regular credit process taken to the Credit Preparatory Meeting (CPM) and thereafter to the Credit Committee, which decides whether a loan will be financed by NEB proceeds.

3.2 Selection criteria

NEB Loans will be identified through the following selection criteria:

- That the project is located in a **member or EU country.**

- That the Sustainability review has **not identified any potentially threatening risk elements** to the project. Risk elements that could potentially jeopardise the project implementation are (not an exhaustive list):
    - Lack of or pending environmental permits
    - Failure to comply with Best Available Techniques (BAT) as defined by the European Union.
    - Reputational risks associated with project location or certain sectors (coal, oil, peat, bio-fuels based on raw material feed from food, large or even medium sized hydro power and similar)
    - Client lack of a transparent reporting system to its relevant stakeholders for environmental aspects

- That the project has a high likelihood of achieving the targeted environmental benefits

- That the **project belongs to one or more of the following themes**:
    - **Energy efficiency:** The implementation of energy efficiency projects leading to a reduction in electric energy use of at least 30%. These primarily relate to industrial projects such as improvements in compressed air systems, the replacement of light fittings, the recovery of waste heat, the installation of heat exchangers in ventilation systems, making drying processes more efficient (including kilns), making cooling/heating more efficient.
      Note: Efficiency projects involving fossil fuelled power or heat generation are not eligible.

    - **Renewable energy:** Increased electricity generation from existing hydroelectric power plants or small scale greenfield hydropower, increased electricity generation from wind turbines, increased electricity generation from photovoltaic panels, increased generation from tidal and wave, increased electricity or heat generation from geothermal installations, increased electricity or heat generation from solid biofuels, or investments in infrastructure for the production or processing of solid / liquid biofuels. Note: Peat is not considered to be a biofuel, increased electricity or heat generation from biogas, or investment in infrastructure for the production of biogas.

Note: Only biogas generated from organic waste qualifies, liquid biofuels will be assessed from a life-cycle perspective.

- o **Public transport solutions:** mainly based on electricity or bio fuels (improvement of general transport logistics to increase energy efficiency of infrastructure and transport, e.g. reduction of empty running, railway transport ensuring a modal shift of freight and/or passenger transport from road to rail (improvement of existing lines or construction of new lines), waterways transport ensuring a modal shift of freight and/or passenger transport from road to waterways (improvement of existing infrastructure or construction of new infrastructure).

- o **Transmission and distribution systems:** transmission upgrades to allow for more renewable energy connected to the grid

- o **Waste management systems:** with an aim to reducing emissions to air, mainly CO_{2eq}, SO_x, NO_x, Dust, Heavy metals and dioxins and reduce pollution discharges to water.

- o **Waste water treatment:** with an aim to reducing discharges to water (mainly P, N, BOD, COD and Heavy metals)

- o **Green buildings: t**he construction of commercial and multi-family buildings certified, or to be certified according to LEED Platinum or BREEAM Excellent, and that fulfil EU Green Building requirements. Site selection is part of the overall assessment and due consideration will be taken to minimise re-bound effects when selecting projects

- The general principle for greenfield activities is that they prevent a long-term lock-in in high-carbon infrastructure (urban, transport and power sector infrastructure).

3.3 Compliance

Proceeds raised through NEB finance projects which benefit the environment. Evaluation of the compliance of the projects with the criteria before disbursement is of great importance in order to reduce reputational risks. Therefore NIB will request insight into available reporting from authorities and will only consider projects that have an acceptable follow-up reporting on the performance with regards to above criteria.

3.4 Project monitoring

The need for monitoring is assessed as part of NIB's environmental and social review. The Bank expects the clients to be in compliance with the Sustainability Policy and Guidelines throughout the project and provisions entitling the Bank to monitor projects are incorporated in the loan agreement.

After NIB's financing is committed in legal documents and disbursed, the Bank carries out monitoring of projects with major environmental and social risks and impacts in accordance with the environmental review or when deemed necessary by NIB due to unexpected events.

3.5 NEB loan approval from loan customer

Before NEB proceeds are disbursed the Bank will seek consent from the customer to publish the project on the Bank's webpage as a receiver of NEB proceeds. This involves no further requirements or privileges for the customer.

3.6 Reporting on web/external marketing

All NIB Environmental Bonds and projects, which have either been partially or wholly financed by NEB proceeds, are published on the Bank's webpage. The bank will report regularly on the impact of financed projects in terms of $CO_{2\ eq}$.

The NIB Environmental Bond webpage used for reporting:
http://www.nib.int/capital_markets/environmental_bonds is subject to continuous update. The page briefly outlines the objective and purpose of the NIB Environmental Bond program and lists all issued NEBs (issue date, amount, currency, maturity) as well as projects, which have received proceeds from NEBs (disbursement date, amount, share of total loan, maturity, name of loan receiver with a link to a full description of the loan)

3.7 Second opinion, credit rating and rank of bonds

For the framework of NIB Environmental Bonds NIB has acquired a second opinion from the research institute CICERO.

NIB Environmental Bonds do not reference to the credit risk of the projects which receive the proceeds. Therefore the bonds carry the same credit ratings and rank pari passu with all other outstanding bonds issued by NIB.

4 Bond issuance

4.1 Funding profile

Ideally the size and maturity of a NIB Environmental Bond closely matches those of the projects receiving the proceeds; mismatches are however expected to occur and are managed by Treasury.

NIB will try to reduce mismatches between proceeds and their use; however loans to eligible projects will often have a longer maturity than NEBs. Funding and disbursements can be in different currencies and the currency risk will be handled by using the derivative markets.

4.2 Tail-financing

Should the NEB have a shorter maturity than the associated eligible loans, NIB has the possibility to either again assign funds from the Green Fund Pool or refinance the loans out of the Bank's general liquidity pool.

4.3 Increases and buy-backs

NIB Environmental Bonds can be increased, as long as proceeds are used for financing eligible projects.

Partial or whole buy-backs of NIB Environmental Bonds are possible to support NIB's funding program. Buybacks can either be financed from funds in the Green Fund Pool or from the Bank's general liquidity.

4.4 Coupon payments

Coupon payments of NEBs are not directly linked to any associated NEB loan interest payments, as the interest payment periods, cash flow distribution and maturities may not be matching. Thus coupons are paid out of the general liquidity pool at NIB's sole discretion

4.5 Redemption

Since there can be mismatches in timeliness between financed projects and NEB and there is no direct credit link between bond and project, the final redemption payment of a NEB is not necessarily sourced from cash flows out of the projects, but can be financed out of NIB's general liquidity pool.

4.6 Legal

NIB Environmental Bonds can be issued under any of NIB's debt issuance programs or as stand-alone issues.
In order to reflect the targeted use of proceeds of the borrowing, offering materials for previous issuances of NEB have indicated that the proceeds are to be used for financing selected loans to projects which are considered to enhance the environment in NIB's member countries, that NIB has established a framework that allows for funds raised through issuances of NEB to be directed to its environmental lending and that lending projects qualify as eligible under the framework if they satisfy strict internal environmental sustainability criteria and are aimed at (but not limited to) reducing emissions to air by promoting energy efficiency, renewable energy, public transport solutions and recycling; and reducing discharges to water by improving wastewater treatment.
Payment of principal of and interest on the Notes is made solely on the credit standing of NIB as a single institution and is not directly linked to the performance of environmental lending projects

5 Monitoring the flows

5.1 Monitoring of use of proceeds and cash flows

Separation of flow of funds and use of proceeds from NIB's general funding is a fundamental principle for the NEB program. Therefore monitoring and documentation of flow of funds from bond issuance to disbursement is important.

NIB monitors and documents nominal amounts, calculated in EUR, when accounting for NEB proceeds and disbursements..

Interest paid or received under bonds, loans and warehousing will be excluded from the calculation and monitoring for the reasons mentioned under 4.5 above.

5.2 Liquidity warehousing

The NEB proceeds in the Green Fund Pool are invested in accordance with NIB's liquidity policy. Warehousing currencies can be EUR, USD and the Nordic currencies.

5.3 NEB loan pre-payment

The maturity (defined as the first possibility for termination) of loans are likely to be longer than the associated NIB Environmental Bond.

However, if a loan is repaid early and ahead of the associated bond maturity, the proceeds will either go back into the Green Fund Pool so it can be reused for loans to new eligible projects or become part of the Bank's general liquidity pool.

5.4 If a NEB loan ceases to exist

According to NIB's general loan agreements, a loan will have to be paid back if the project does not comply with or if it substantially deviates from the original purpose. This also applies to NEB loans, however the NIB Environmental Bond financing such a loan remains outstanding with its' full amount. Payments under the loan will be treated the same as in 5.3