Green and Transition Financing Tools for the Alberta Power Transition

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Eligible Power Transition for Green Financing Tools

Companies / entities and Projects reducing GHG emissions, including:

- Retirement of coal facilities
- Coal to gas conversions
- Gas generation with CCUS
- Build of renewables generation- wind, solar, geothermal, transmission
- Energy Storage
- Bioenergy from forest waste
- Hydropower generation
- Renewable natural gas
- Technologies to mitigate emissions – e.g. CCUS
- Hydrogen retrofitting
- Technologies to enable the above
- Government financing of incentives

Environmental / ESG Finance Tools

- Green Bonds*
- Transition Bonds*
- Sustainability Bonds
- Sustainability-Linked Bonds

Green Bonds / Transition Bonds - why?

- Project green credentials into capital market
- Attract new investors- growing class of ESG investors
- Differentiate capital market product - potentially defensive
- Pricing advantage? - primary and secondary markets - increasing evidence
- Germany's recent "paired bond" framework - "greenium"

Emerging Pricing Advantage to Issuers

- Green Bonds showing larger book cover and greater spread compression than non-labelled equivalents, on average
- Approximately 55% of green bonds allocated to investors who describe themselves as green
- Access to additional source of capital market support
- Green bonds seen as facilitating greater engagement with investors than non-labelled bonds

Emerging Pricing Advantage to Issuers

- Recent study showed 11 of 21 green bonds priced on or inside the issuer’s yield curve
- Green bonds tend to show more price tightening in the immediate secondary market than non-labelled equivalents
- Issuers that recently have claimed a pricing advantage based on yield curve – City of Toronto, Province of Ontario, CIBC, FortisBC

Green Bonds – what? – a label

- A label applied to a financing
- “Green Bond” standards developed in the market - consensus
- Green Bond Principles (GBP) - voluntary process guidelines prepared by ICMA
- Dentons first Canadian law firm member of GBP (2014)
- Climate Bond Initiative
  - Certification standards
  - Deal commentary

Green Bond Principles - 4 core components (+ one recommendation)

- **Use of Proceeds** - utilization of the bond proceeds for Green Projects - renewable energy, energy efficiency, pollution prevention, clean transportation, green buildings, sustainable water management, others. (generally not for general corporate purposes)
- **Process for Project Evaluation and Selection** - clear communication to investors how project satisfies "Green Project" criteria
- **Management of Proceeds** - net proceeds of the bond issue need to be tracked somehow to specified use of proceeds
- **Reporting** - annual reporting of use of proceeds, and qualitative or where feasible quantitative reporting on impact of the Green Project
- **Fifth recommended component** - external review

Green Bond Examples

- In the last year over 70 power-related green bond financings globally
- 12 of these deals done by Canadian issuers
- Wind, solar, small hydro, geothermal, biomass, transmission and distribution projects (<100 gCO_2/ kWh carbon intensity)

Green Bond Examples

- Numerous Canadian examples of green bonds issued to finance wind and solar projects – Brookfield Renewable, Algonquin Power, OPG, CPPIB, Cdn. Banks

- Southern Power (Georgia), with mixed generation fleet (coal, wind, solar) has issued green bonds to finance or invest in solar and wind generation facilities

EU Taxonomy – legal force in EU

- A regulatory classification system under which companies are allowed to define their activities as sustainable
- Mandatory reporting around sustainable activities for “large public interest entities”
- Activity must substantially contribute to an environmental objective – climate change mitigation, climate change adaptation, sustainable water use, transition to a circular economy, pollution prevention and control and protection of biodiversity
- Activity must do no significant harm to other environmental objectives (as defined in the taxonomy)
- Comply with governance safeguards – OECD and UN re human rights
- Activity must adhere to technical screening criteria – i.e. specifications to be met

Transition Bonds - a new tool

- Green bonds not for issuers in fossil fuel industries or limited "green" use of proceeds
- "Greenwashing" concerns for use of green bonds by these issuers
- A new tool required to help those companies finance their transition to lower emissions- market recognizes critical role
- Demand is growing/evolving for bonds in this space - ESG investors
- Companies looking to tell their transition story to capital markets- broader story than "use of proceeds"

Early Transition Bond examples

- UK natural gas distribution network operator issued transition bonds to retrofit natural gas pipelines to reduce methane leaks and to transport hydrogen, develop natural gas plants and build hydrogen fueling infrastructure, plus renewable energy and clean transportation
- Hong Kong power company issued transition bonds to finance the construction of a large natural gas powered generation plant (in a market dominated by coal generation)
- A few other similar examples re retrofit of gas pipelines for transport of hydrogen and methane leakage reduction
- Waiting for a Canadian example

Basic Principles - but no prescribed framework…yet

- Evolving in the market
- Use of proceeds - transition use of proceeds (doesn’t need to be “green”)
- Project evaluation and selection
- Management of proceeds
- Reporting
- AND… need a demonstrated longer term commitment and pathway for transition

Emerging Frameworks - Sustainalytics (August 2020)

- Report – "The Role of Natural Gas in the Energy Transition"
- Switching from coal to gas powered generation – significant emissions reduction
- Longer term climate benefits (Paris targets) of switching from coal to gas require:
  - emissions abatement (carbon capture and utilization systems),
  - limited methane leaks in supply chain, and/or
  - use of lower carbon gases
- Longer term, especially as seasonal reliability support for renewables

Emerging Frameworks - Climate Bond Initiative (September 2020)

- Investments that will make a substantial contribution to reaching net zero emissions by 2050 and halving global emissions by 2030 but have no role to play after 2050 (activities inconsistent with Paris climate targets)
- Investments that will have a role to play after 2050 (achievement of Paris climate targets) but currently the transition pathway to net zero goals is unclear
- Technological viability trumps economic competitiveness to determine whether an activity can be on the transition pathway to meet the Paris climate goals
- Goals and pathways based on science
- Offsets don’t count

Emerging Frameworks- Climate Bond Initiative (September 2020) continued

Examples of investments:

- Wind farms, solar
- Early decommissioning of a coal generation plant
- Gas power generation with CCUS (based on assumed asset life of 15-20 years) and mitigating any gas leakage (interim activity)
- Waste to energy from landfill (interim activity)
- Energy from bioenergy
- Production of blue hydrogen
- Enabling activities – CCUS technologies, energy storage

- Does not require entity level transition plan

Canada taking a Leading Role in developing the framework

- 2019 Report of the Expert Panel on Sustainable Finance commissioned by the Government of Canada
- Recommendation #9 - expand Canada’s green fixed income market, and set a global standard for transition-oriented financing.
- CSA Technical Committee on Transition and Sustainable Finance is leading the creation of a Transition Finance Taxonomy as a voluntary industry-led initiative with committee member including banks, asset owners, investment managers, service providers and industry.
- Dentons is represented on the Technical Committee

International Capital Market Association – Climate Transition Finance Handbook Guidance for Issuers December 2020

- Concept of climate transition focuses principally on the credibility of an issuer's climate change-related commitments and practices
- Commitments and practices to purposefully and explicitly seek to meet the goals of the Paris Agreement on Climate Change to keep global temperature rise this century well below 2 degrees C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees C
- Handbook seeks to provide guidance and common expectations to capital market participants on the practices, actions and disclosures to be made available when raising funds in the debt capital markets for climate transition-related purposes, using instruments aligned to the green and social bond principles or sustainability bond guidelines, or to the sustainability-linked bond principles

Climate Transition Finance Handbook Guidance

- There are four key elements to the handbook's recommendations:
  - Issuer's climate transition strategy and governance;
  - Business model environmental materiality;
  - Climate transition strategy to be 'science-based' including targets and pathways; and,
  - Implementation transparency.
- External review, assurance and verification suggested for each of these

Issuer’s climate transition strategy and governance

Corporate strategy to address climate-change related risks is a prerequisite to issuing a transition-labelled instrument, with the following suggested items:

a) Long term target to align with the goals of the Paris Agreement,

b) relevant interim goals on a trajectory to meeting the long-term goals,

c) the issuer’s levers towards decarbonization and strategic planning toward the long term goals,

d) clear oversight and governance of the transition strategy, and

e) evidence of a broader sustainability strategy to mitigate broader environmental and social externalities.

Business Model Environmental Materiality

- Climate transition financing should be for the funding needed in the strategic change over time to the issuer’s core business activities that are the main drivers of its current and future environmental impact
- The climate change trajectory should be a material factor to the future success of the business model

Climate Change Strategy Should Reference Science-Based Targets and Transition Pathways

- Greenhouse gas reduction targets – cover all scopes
- Formulate targets both in absolute and intensity terms
- Baseline
- Scenarios and methodologies

Implementation transparency

- Disclosure of the underlying investment program including capital and operational expenditures
- How does the program support the implementation of the transition strategy
  a) Details of divestments, governance and process changes
  b) Considerations of a just transition
  c) % of assets/revenues/expenditures/divestments aligned to the various levers to decarbonization
  d) Capex roll out plan aligned to the strategy
  e) Qualitative and quantitative reporting on the climate-related outcomes and impacts the expenditures are intended to result in

Where are we today?

- Green bonds have been used in power industry to finance many of the transition activities we’re seeing in Alberta

- Transition bonds provide a new opportunity for power industry moving away from fossil fuel emissions

Thank you

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