



Recommendations and Guidelines for the issuance of Green Bonds in Colombia

Considering that financial markets play a fundamental role in the management of environmental, social, and governance risks, as well as in the leverage of opportunities associated with the mobilization of resources towards projects with positive impacts on the environment, the Colombian Financial Superintendence ("CFS") recently published the Green Bond Guide (the "Guide") and issued External Circular Letter 028 of 2020 (the "Circular Letter 028") to give instructions related to the information to be provided in the issuance, placement, and information reports of green bonds in Colombia.

Likewise, it is important to highlight that green bonds are financial instruments or debt securities issued by public or private entities that seek to obtain, in the capital markets, resources specifically aimed to financing or refinancing of all or part of "green" projects (the "Green Bonds"). Thus, the only difference between Green Bonds and ordinary bonds or internal public debt bonds is the abovementioned specific destination of the resources. This destination must be detailed in the issuance prospectus.

Green projects are those new or existing investment plans, research and development activities, and/or use of resources that aim to: (i) mitigate negative impacts on the environment and climate change; or (ii) generate positive effects on the environment, such as mitigation and adaptation to climate change, conservation of natural resources and biodiversity, and prevention and control of pollution and soil contamination (the "Green Projects").

The first Green Bond was issued by the World Bank in 2007 after the Intergovernmental Panel for Climate Change (IPCC) published a report relating the impact of human activity on global warming. This report raised

awareness of the challenges of climate change and showed the investors possibilities to support solutions to address climate change through secure investments without sacrificing financial returns.

On the other hand, according to the Guide, the term "green bond" applies to those bonds that are organized and documented according to the Green Bond Principles ("GBP"). The GBP are guidelines developed by the International Capital Market Association (ICMA), which were initially published in 2014 and subsequently updated in 2018. These principles were created to contribute to the development of the Green Bond market with integrity, and to promote transparency and information disclosure.

The GBP is comprised of four core components: (i) Use of proceeds; (ii) Procedures for Project Evaluation and Selection; (iii) Management of Proceeds; and (iv) Reporting.

In addition to these guidelines, the GBP also recommend an independent external review to confirm the alignment of the Green Bonds (or Green Bond program) with the above-mentioned GBP components. External advice can be of different types, whether it is on all four components of the GBP, or certain aspects of the Green Bonds, the underlying assets, or the procedures.

According to the Guide, the Green Bond market in Colombia has been developed under the best international practices and in line with what has been established by the GBP, and in that sense, CFS issued the Guide to give recommendations on the application of these good practices and the specific obligations provided in Circular Letter 028.

It should be mentioned that the authorization processes before CFS and other general rules applicable to ordinary bonds will also apply to Green Bonds. However, to obtain the authorization of registration of Green Bonds in the National Registry of Securities and Issuers (NRSI) and the respective public offering, the issuer must additionally comply with certain obligations that must be reflected in the prospectus and complementary documents of the issuance, under the guidelines of Circular Letter 028.

In line with the aforementioned, the recommendations of the Guide on good practices for the issuance of Green Bonds in Colombia and the provisions of Circular Letter 028 are framed within the four main components of the GBP mentioned above, as follows:

1. Use of proceeds

Green Bonds must provide the following information regarding the use of the proceeds: (i) the policies that will govern the use of the proceeds, providing that such proceeds will be used to fund Green Projects. The information on the policies of the use of the proceeds must be updated in case there is an upcoming event; and (ii) the classification system or taxonomy on which the Green Projects, investment plans, or use of the proceeds, and recipients of the proceeds of the issue will be identified.

In this regard, the Guide recommends: (i) that nationally or internationally recognized classification systems and/or taxonomies such as those of the CBI, the European or Colombian Commission, the GBP, and IFC definitions for climate-related activities, be used to determine the use of the proceeds; and (ii) if some or all of the proceeds are used (or may be used) for refinancing, it is recommended that the issuer informs investors about the estimated ratio between those with financing objectives and those with refinancing objectives and indicate, to the maximum extent possible, which investments or Green Project portfolio can be refinanced.

2. Procedure for Project Evaluation and Selection

Green Bonds must provide the following information related to the process for project evaluation and selection: (i) the environmental sustainability objectives pursued by the issuance, the eligibility or exclusion criteria for the Projects, and the policies and procedures regarding social and environmental risks of the Projects; and (ii) specify whether the denomination of the Green Bonds will result in the execution of Green Projects, investment plans or use of proceeds, and inform others of the list of these Projects and their estimated amount with their appropriate taxonomy, the main financial, technical and legal elements, and the evaluation and monitoring mechanisms.

Consequently, the Guide recommends: (i) to have a list of pre-selected Projects equivalent to at least 50% of the proceeds, for the authorization of the CFS; (ii) to have sustainability management systems or frameworks, such as sets of policies and procedures for the identification, evaluation, and monitoring of environmental and social risks, and to include in the prospectus their most relevant aspects; and (iii) in case a third party selects and evaluates the eligible Green Projects, to prove its identity and suitability.

3. Management of Proceeds

The Green Bonds must provide the transparency policies for the management of the proceeds, foreseeing management mechanisms, traceability, report, and information mechanisms of the use of non-assigned net balances, as well as the conditions for the reallocation of resources by the issuer to other Projects.

In this regard, the Guide recommends: (i) to mention in the prospectus the procedure for collecting, managing and assigning the resources for the Green Projects (the maximum time for the assignment of proceeds should be up to 24 months); (ii) to designate specific accounts and other reliable mechanisms for the management of proceeds; (iii) to include in the prospectus that in case of having unassigned resources, the assembly of bond holders should be summoned for: (a) request the prepayment of the Bonds; or (b) continue with the credit in the initial conditions.

4. Reporting

Green Bonds must provide the following information regarding disclosure policies: (i) designate in the prospectus one or more independent third parties to report on (a) the ability of the issuer to comply with the prospectus concerning the principles of use of proceeds and the criteria and references used for the selection of Projects; and (b) the use of proceeds after the end of the period for which they are to be used and the current or expected results on the environmental sustainability objectives of the issue; (ii) report on the circumstances in which Green Bonds quality is lost due to supervening circumstances; and (iii) the possibility that the issuer will present the other reports it considers, stating all the conditions of these in the prospectus.

Thus, the Guide recommends: (i) to include information about the use of the proceeds to inform investors about the impact of the Green Bonds, and that such information is validated by an independent third party; (ii) to have an independent third party's concept about the management of the proceeds in green activities; and (iii) in the event of loss of the "green" designation, call a bondholder meeting for: (a) continuing with the credit in the initial conditions or, (b) pre-pay the issuance.

With this regulation that formally incorporates the taxonomy of Green Bonds, Colombia is the first country in Latin America that has a specific regulatory framework for this type of thematic bonds. Thus, without a doubt, this will contribute not only to financing all types of projects that have a positive impact on the environment, to ensuring that investments are made sustainably, and to combating climate change, but also to the financial

system acting as a transformer and generator of additional benefits for society.

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