Navigating the Sustainable Debt Market: Enhancing Credibility in an Evolving Market

AN INTRODUCTION TO THE TRENDS, CHALLENGES, OPPORTUNITIES, AND CURRENT PRACTICES RELATED TO SUSTAINABLE DEBT INSTRUMENTS

CPA CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

IFAC International Federation of Accountants

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Foreword

Sustainable finance has quickly become one of the biggest issues facing the financial community globally. Countries are searching for ways to shift flows of capital into activities that support the transition to a more sustainable, low-carbon economy.

The global sustainable debt market plays a foundational role in sustainable finance and is experiencing record growth. While green bonds are the most widely known, new types of innovative sustainable debt instruments are being introduced that raise capital for activities and projects aimed at advancing economic, environmental, and social objectives. The market has exploded in recent years, with total global sustainable debt issuances in 2021 approaching US$1 trillion.[1]

Further momentum is expected, driven by investor demand and pressure on organizations to integrate sustainability into their strategies and deliver on their environmental, social, and governance (ESG) commitments. However, this kind of growth does not come without risks and challenges. Our research identified several issues requiring attention for the benefit of all capital market participants. They include the lack of a single global standard governing sustainable debt issuances, the proliferation of voluntary, market-driven guidance from different bodies, the lack of a common understanding of what projects and activities qualify as “green” or “sustainable,” data limitations, along with inconsistent reporting, external reviews and assurance practices. These issues are exacerbated by a sustainable finance talent shortage.

We believe that professional accountants are well positioned to address these issues and meet the growing demands for transparency and accountability from investors and other stakeholders, something that is essential to minimizing the risk of greenwashing and supporting the integrity of this important market. Professional accountants can help ensure that capital market participants have access to and confidence in the information necessary to make their capital allocation decisions. This includes access to relevant and credible ESG information, which is becoming increasingly important as the sustainable debt market evolves with new types of debt instruments. The global accounting profession has long advocated for enhanced sustainability-related standards, reporting, and assurance practices that meet the information needs of investors.

We support the development of global sustainability disclosure standards through the IFRS Foundation's recently established International Sustainability Standards Board (ISSB). The Board will significantly improve the consistency and comparability of ESG disclosures over time and significantly contribute to the overall credibility of the ESG information ecosystem.

We hope this research will trigger meaningful dialogue among key players in this space to consider collective approaches. Together we can enhance investor protection, reduce complexity, and encourage the necessary growth and innovation to support a credible and robust global sustainable debt market.

Kevin Dancey
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Purpose of Study

This study specifically focuses on green, social and sustainable (GSS) use of proceeds bonds and sustainability-linked bonds (SLBs) and contains insights based on market data and literature, a review of a sample of recent sustainable debt issuances, and interviews with various market participants.

This study will be of interest to issuers, investors, regulators, underwriters, assurance providers, and policymakers, and highlights how professional accountants can enhance credibility in this growing market. It provides an understanding of the current state of the sustainable debt market, including:

- the different types of sustainable debt instruments
- global trends
- the typical process followed to issue a sustainable debt instrument
- principles and guidance currently available for the issuance of and reporting on such instruments
- external reviews, including third-party assurance
- challenges and opportunities
- considerations to enhance confidence in this growing market

Sustainability is moving mainstream and is being integrated into all business, investment and financing decisions. This report will equip readers with the necessary knowledge to navigate the rapidly evolving sustainable debt landscape, ask the right questions and consider how their role and actions can enhance the effectiveness, efficiency and integrity of the sustainable debt market.

We value your views and feedback. Comments about this paper should be addressed to:

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CPA Canada and IFAC engaged PwC Canada to conduct the research for this report. A special thank you to Sarah Marsh and Scott Morrison for leading the research activities and for their contributions to this report.

CPA Canada and IFAC would also like to thank the following individuals for sharing their perspectives on this research report:

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Key Takeaways

Sustainable debt issuances are on the rise and showing no signs of slowing down

- The sustainable debt market is growing at a rapid pace driven by strong demand from investors and rising expectations for governments and organizations to deliver on their ESG commitments.
- Europe is leading with the largest volume of issuances, and North America and Asia are showing momentum.
- While green bonds continue to dominate, new types of debt are being introduced with social and sustainability-linked debt issuances on the rise.

*Risk of **greenwashing** – a growing concern*

- There are increasing concerns about "greenwashing" or unsubstantiated or potentially misleading claims regarding sustainability practices or the sustainability-related features of the debt instrument.
- As a result, investors are demanding greater disclosure and transparency of comparable and reliable information.
- Standardized reporting and independent assurance play an important role in mitigating the risk of greenwashing, promoting market efficiency and enhancing investor protection.

A wide range of voluntary guidance and recommendations

- The current frameworks in the market provide issuers with guidance when issuing sustainable debt, including recommendations on disclosure, reporting and assurance practices.
- The increasing amount of voluntary guidance, recommendations and certifications that issuers are expected to comply with have resulted in market confusion and administrative burden.
- Alignment around sustainable debt principles and guidelines, including clarifying expectations for reporting and assurance, would enhance market efficiency, consistency and comparability.
- An important question to consider is whether greater regulatory oversight over sustainable debt issuances is needed.

Defining sustainable activities – still a challenge

- Lack of standardized definitions makes it difficult for issuers and their stakeholders to determine and assess which projects are eligible, especially with respect to use of proceeds bonds.

- This eligibility assessment is based on the issuer's judgement and what constitutes "green" or "social" can be interpreted quite differently.
- To address this issue, sustainable finance classification systems are emerging in various jurisdictions (e.g., European Union Taxonomy) providing guidance on specific activities that qualify as sustainable.

Barriers to high-quality impact reporting

- Regular and transparent reporting is a powerful tool allowing investors to assess the impact of their sustainable investments; however, the frequency and quality of the impact reporting varies.
- Sustainable debt impact reporting is subject to significant estimation and judgment; multiple voluntary sustainability reporting standards and frameworks and inadequate systems and controls to track proceeds and eligible project costs make it difficult to deliver consistent and accurate impact reports.
- Greater standardization and common definitions and measurement for ESG key performance indicators will enhance quality and comparability of impact reporting; the development of globally accepted sustainability disclosure standards through the IFRS Foundation's newly established ISSB will have a positive impact in this regard.

Assurance building trust and credibility, with practices varying widely

- Independent assurance lends credibility and reliability to reported information and enhances user confidence that the organization is delivering on its commitments, meeting their sustainability objectives/targets, and properly allocating proceeds to green and/or social initiatives.
- Service providers with different skills and qualifications are offering a wide range of assurance, external review and verification services; investors may not fully appreciate the scope of service being provided.
- More work should be done to understand the assurance needs of investors in this space, including clarity on the purpose and types of engagements performed and the level of assurance obtained.

Sustainable finance skills demand outstripping supply

- The rise in sustainable debt, and sustainable finance more broadly, has triggered demand for professionals with a wide range of ESG skills and expertise.
- Education and subject matter expertise – on the part of issuers, investors and other key players across the capital markets – is key to maintaining and supporting the integrity and future growth of the sustainable debt market.

What Are Sustainable Debt Instruments?

A variety of fixed-income instruments raising funds to finance projects that advance economic, environmental and social objectives make up the sustainable debt market. Unlike traditional debt instruments, proceeds from sustainable debt issuances are intended to be used to finance operations and projects that deliver environmental benefits and positive social outcomes. These differences aside, sustainable debt instruments largely fall within the same regulatory framework as traditional debt.

Common Types of Sustainable Debt Instruments

The sustainable debt market today largely consists of two types of debt instruments: **(1) use of proceeds bonds and (2) sustainability-linked bonds**.

1. **Green, social and sustainable (GSS) use of proceeds bonds** – bonds or debt instruments where the proceeds are intended to be used exclusively to finance or refinance, in part or in full, new and/or existing eligible green, social or sustainable projects. They are commonly referred to as green, social or sustainable (GSS) bonds.

The green, social and sustainable projects and categories may be associated with one or more of the ***United Nations Sustainable Development Goals (UN SDGs)***.[2]

FIGURE 1: TYPES OF USE OF PROCEEDS BONDS

Green Bonds	Social Bonds	Sustainable Bonds
Raise funds for projects that deliver **environmental benefits**. "Green" can include renewable energy, sustainable resource use, conservation, clean transportation, adaptation to climate change, etc.	Raise funds for projects that deliver **positive social outcomes**. "Social" projects address specific issues or aim to achieve positive outcomes (e.g., access to healthcare and education).	Raise funds to deliver a **combination of environmental benefits and positive social outcomes** through a sustainable project. They have elements of both green and social bonds.

2. **Sustainability-linked bonds (SLBs) –** debt instruments with specific financial or structural characteristics (e.g., ***coupon rate***) tied to the issuer's sustainability objectives comprising key performance indicators (KPIs) and related sustainability performance targets (SPTs), as defined below:
   - KPI **–** a quantifiable measure of the company's sustainability objective (e.g., company-wide scope 1 and 2 ***Greenhouse Gas (GHG)*** emissions reductions).
   - SPTs **–** measurable improvements to the key performance indicator on which the issuer commits to a predefined timeline. Failure to meet the SPTs can result in an increase to borrowing costs (e.g., reduce absolute scope 1 and scope 2 GHG emissions by a specified date).

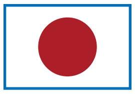
Unlike the GSS use of proceeds bonds, the proceeds of SLBs are intended to be used for general purpose and do not need to be used to finance green and/or social projects.

For other key terms used (and linked) throughout this paper, please refer to the glossary in *Appendix C*.

Examples

Here is a sample of use of proceeds and sustainability-linked bonds issued in various jurisdictions. The examples for GSS use of proceeds bonds outline the nature of the projects that the capital will be allocated to. For SLBs, the examples highlight the KPIs and SPTs associated with the debt.

Use of proceeds bonds:

Green bond[3]	Social bond[4]	Sustainable bond[5]
Proceeds will be used for: • Financing residential and commercial real estate projects that meet certain energy efficiency standards • Infrastructure financing for renewable energy	Proceeds will be applied to projects that relate to various social objectives such as: • Social and affordable housing • Access to clean drinking water • Access to essential services • Socioeconomic advancement	Proceeds will be used for: • Environmentally friendly "wellness building" • Securing skilled workers for construction industry and strengthening trust relationship with suppliers • Renewable energy business
NIBC Bank Banking and Capital Markets 	**City of Toronto** Municipality 	**Obayashi Corporation** Construction 

Sustainability-linked bonds

Sustainability-linked bond[6]	Sustainability-linked bond[7]
• KPI: Company-wide reduction in scope 1 and 2 GHG emissions • SPT: Reduce absolute scope 1 and 2 GHG emissions by 46% from 2019 levels by 2030 If the SPT is not reached, a premium payment amount or step-up margin amount, as applicable, will be specified in the relevant documentation of the specific bond transaction and will include specifics with respect to payment mechanisms and back-up mechanisms in case the SPT cannot be calculated or observed, or cannot be calculated or observed in a satisfactory manner.	• KPI: Absolute GHG emissions (scope 1 and 2, in tCO2e) • SPT: Reduce absolute scope 1 and scope 2 GHG emissions from operations by 63% by 2030 from 2015 baseline In the event that Woolworths Group does not achieve the SPT by the target date, a coupon adjustment, or a premium payment as the case may be, or other penalty mechanism will be applied to the SLB.
Telus Telecommunications 	**Woolworths Group** Retail and consumer groups 

Other Types of Sustainable Debt Instruments

The sustainable debt market is evolving, with new instruments and methods of financing becoming available. Other types of notable debt instruments include **transition bonds** and **sustainability-linked loans**.

Transition bonds	Sustainability-linked loans
Transition bonds are a relatively new class of bonds used to fund an organization's shift to more sustainable business practices. Unlike use of proceeds bonds, where the focus is on the direct use of the proceeds towards eligible green or social projects, transition bonds focus on an issuer's commitment to becoming more green. Transition bond proceeds are used to fund an organization's transition towards a reduced environmental impact or to reduce the organization's carbon emissions.[8] Example: Cadent transition bond	Sustainability-linked loans are loan products designed to reward a borrower with improved pricing for achieving predefined sustainability performance targets related to environmental, social and/or governance-related sustainability considerations.[9] A key characteristic of a sustainability-linked loan is that an economic outcome is linked to whether a selected predefined SPT is met. For example, the margin under the relevant loan agreement may be reduced where the borrower meets a predetermined SPT as measured by the predetermined KPI or vice versa.[10] Example: Maple Leaf Foods sustainability-linked loan

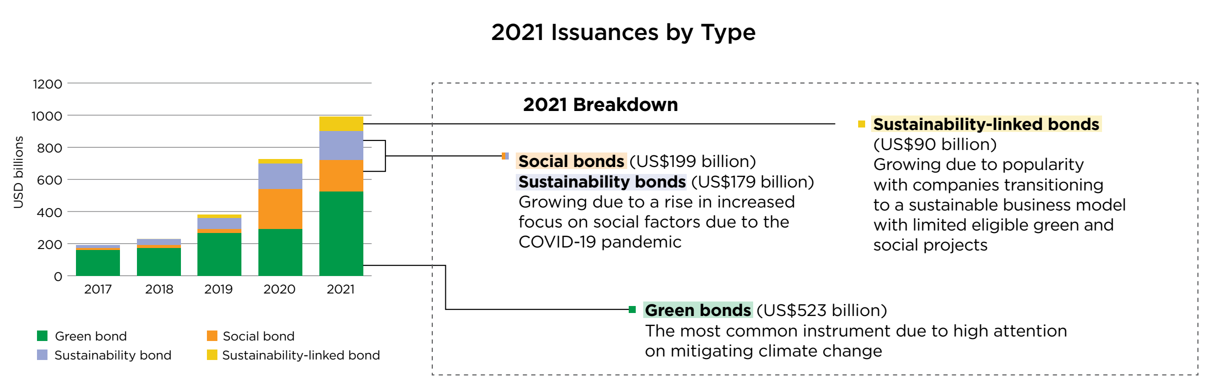
The remainder of this report will focus on GSS use of proceeds bonds and SLBs. Throughout the report, these instruments in combination are referred to as "sustainable debt instruments," and the market for these instruments is referred to as the "sustainable debt market."

Global Market Trends

2021 saw a record with almost US$1 trillion issuances of GSS use of proceeds and sustainability-linked bonds.[1]

Types of Sustainable Debt Issuances

FIGURE 2

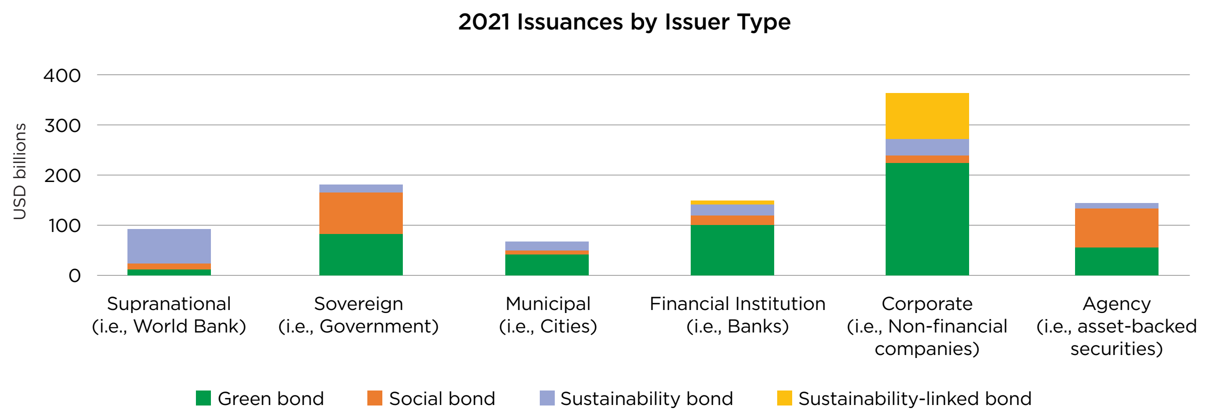


The information in this graph is based on data from [Moody's]() *and the* [Climate Bonds Initiative]().

Green bonds were first introduced to the market in 2007 and since then have been the most common type of sustainable debt instrument as private companies, public companies and governments continue to place increased focus on mitigating climate change. Recent years have seen a rise in social, sustainable and sustainability-linked bonds. This is largely a result of the COVID-19 pandemic, which increased the focus on social factors and the need for an economic recovery aligning with long-term climate, environmental and social objectives. The sustainability-linked bond market is still in its infancy; however, the number of issuances increased to US$90 billion as investors increase focus on the alignment of their sustainability objectives to issuers' bond objectives.[1]

Types of Sustainable Debt Issuers

FIGURE 3



The information in this graph is based on data from Moody's *and the* Climate Bonds Initiative.

In 2021, the corporate sector was the largest issuer of sustainable debt, totaling 37% of the market. An increasing number of private and public companies have been incorporating sustainability into their strategy and recognize the sustainable debt market as a method to fund this activity. Corporate issuers made up 95% of the SLB issuances in 2021. The emergence of SLBs has enabled companies in the early stages of transitioning to a more sustainable business model, with limited eligible green and social projects, to enter the sustainable debt market.[1]

Sovereigns follow with 18% of the market in 2021, largely driven by European issuers, such as the United Kingdom, France, Italy, and the European Union. In 2021, Sovereigns were the largest issuer of social bonds with a total of US$74 billion issuances.[1]

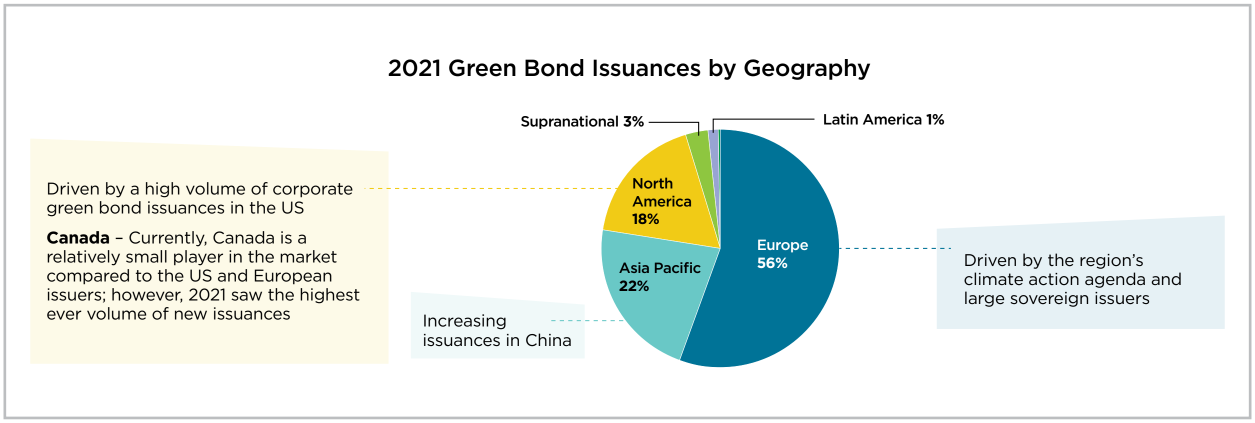
Government of Canada issues inaugural green bond

On March 23, 2022, the Government of Canada issued its inaugural 7.5-year, $5 billion green bond. The green bond will play an important role in financing investments in green infrastructure and other projects that will help fight climate change and protect the environment.

At the beginning of 2022, the Government of Canada published a Green Bond Framework. The Framework defines eligibility criteria and provides an example of expenditures aligned with the *International Capital Markets Association* Green Bond Principles.

Geographical Trends of Green Bond Issuances

FIGURE 4



The information in this graph is based on data from Moody's and the Climate Bonds Initiative.

Future Expected Growth

The sustainable debt market shows no signs of slowing down. Sustainable debt issuances are projected to reach US$1.35 trillion in 2022 as a result of a variety of factors:[1]

- increased climate mitigation and adaptation efforts in advance of net-zero commitments
- broader focus on societal concerns in addition to environmental issues
- growth in the number of emerging markets issuances
- continued investor demand for instruments tied to sustainability performance

What Is Driving Growth in the Sustainable Debt Market?

Growing demand from investors and increased focus on ESG issues in the private and public sector have fueled growth in the sustainable debt market. GSS use of proceeds bonds and SLBs allow investors to provide capital to sustainable products and initiatives without taking on the additional risks associated with other investments due to their fixed income asset class.

Investors and issuers are drawn to these instruments due to the variety of benefits they offer. Some benefits for issuers include:

- increased availability of market capital and access to a wider pool of investors
- market incentives
- reputation enhancement

Increased Availability of Market Capital and Access to a Wider Pool of Investors

Investors and issuers are increasingly focused on sustainability-related projects that can require extensive capital. Sustainable debt instruments provide much-needed capital to issuers while allowing investors to align investments with their sustainability strategies.

> *"Issuance of these types of instruments is met with high demand from investors, especially in the European markets."*
>
> **Tessa Dann**
> **Director of Sustainable Finance**
> **Australia New Zealand (ANZ) Bank**

Sustainable debt instruments can provide opportunities to highlight sustainability ambitions and attract a wider and diverse pool of investors globally. The significant demand for sustainable debt from investors is evidenced by the increased likelihood of ***oversubscription***. A recent study confirmed that of a sample of issuances, all were significantly oversubscribed. In the United States, average oversubscription was 4.7x for green bonds compared to 2.5x for traditional bonds.[11]

Large institutional investors, such as BlackRock and Goldman Sachs, have committed to increase the amount of capital deployed to sustainable investments.[12,13]

Market Incentives

Sustainable debt issuances may experience favourable pricing advantages. The term "***greenium***" is often used to refer to green bonds that are issued at a higher price and therefore offer a lower yield compared to outstanding debt. Although the pricing advantages can vary, they may result in lower costs to fund the debt instrument compared to traditional debt.

> *"When issuing our first social bond, we were able to take advantage of favourable pricing. This is one of the key attributes for any issuer, meaning it costs less to fund strategic social capital projects compared to using conventional debt."*
>
> **Randy LeClair**
> **Director, Capital Markets**
> **at the City of Toronto**

> *"Our sustainability-linked bond was met with record demand compared to other types of debt we have issued in the past. There is a clear demand for these types of instruments in the investment community."*
>
> **Sheldon Bueckert**
> **Director, Treasury at Enbridge**

Reputation Enhancement

Stakeholders are demanding that companies incorporate sustainability factors into their strategy and identify ways to improve their performance on these factors. By establishing sustainable projects for GSS use of proceeds bonds or tying sustainability objectives to borrowing costs with SLBs, issuers can demonstrate an organizational commitment to improving their sustainability performance.

The Issuance Process

The issuance of a green, social or sustainable (GSS) use-of-proceeds bond or sustainability-linked bonds (SLBs) is similar to that of a traditional bond. However, there are important differences as a result of the specific sustainability claims of these bonds.

The following diagram presents the typical steps and activities at various stages in the issuance process. The process is generally consistent among different jurisdictions.

△ Challenge ☆ Best Practice

Pre-issuance phase

Step 1:
Perform preliminary analysis

- Determine the sustainability themes and projects (GSS use of proceeds bonds).
- Establish appropriate key performance indicators and sustainability performance targets (SLBs).
- Ensure those charged with governance are involved in discussions, and engage the finance and sustainability departments.
- Finalize the $ value of the issuance and the related bond characteristics.
- Consider the various voluntary guidance, process frameworks and principles (i.e., ***International Capital Markets Association Principles***), certifications (i.e., ***Climate Bonds Initiative***) and types of external reviews and ratings, which may be applicable.

Step 2:
Draft bond framework

Draft and approve a framework, which could include:

- An overview of the debt and explanation of sustainability strategy
- Explanation of eligible projects, the company's process for evaluating projects, and managing proceeds (GSS use of proceeds bonds)
- Selection of KPIs, SPTs, bond characteristics (SLBs)
- The company's planned approach for reporting and verification, including which ***impact metrics*** should be reported

☆ *Involve advisors and third-party assurance providers in discussions throughout the process.*

Pre-issuance phase

Step 3:
Finalize framework and obtain second-party opinion

- Select a ***second-party opinion*** provider and provide them with the draft bond framework.
- Make necessary adjustments and finalize the bond framework.
- Obtain and review second-party opinion report.

Step 4:
Complete the issuance

- Finalize the ***prospectus*** and stakeholder communication plan.
- Complete the bond issuance with the bank.
- Draft and finalize press release.

Post-issuance phase

Step 5:
Monitor bond performance

- Prepare a methodology document and design and implement controls over data.
- Collect data relevant to the bond (e.g., issuance proceeds, eligible project spending, performance on KPIs and SPTs).
- Complete key calculations (i.e., SPT performance).

△ ***Data management***

☆ *Involve finance, internal audit and third-party consultants where appropriate*

Step 6:
Obtain third-party assurance

- Select an independent third-party assurance (or external review) provider.
- Provide the documentation support required for the specific type of engagement (i.e., use of proceeds, KPIs and SPTs, impact measurement).
- Respond to assurance comments and requests.
- Obtain and review third-party assurance report.

△ ***External review challenges***
Data management

☆ *Consider **readiness assessment***

Post-issuance phase

Step 7: Publish bond report	A bond report could include the following: • A list of the projects that the proceeds have been allocated to (GSS use of proceeds bonds) • A description of the projects • The amounts allocated to each project • The expected impact of the projects • Third-party assurance report Bond reports may also include impact reporting, which goes beyond the allocation of proceeds and incorporates specific impact metrics that pertain to the outcomes of the projects related to the bond. The bond reports should be made available to the public. Investors are the primary users of the second-party opinion, the third-party assurance, and the bond reports (outputs from steps 3, 6 and 7).
Continuous: Process of monitoring and reporting	• Continue step 5 and step 7 to monitor the ongoing performance of the debt instrument. • Consider obtaining assurance over annual impact metrics. • Reporting on performance usually occurs annually. △ *Impact measurement* ☆ *Consider assurance over impact metrics*

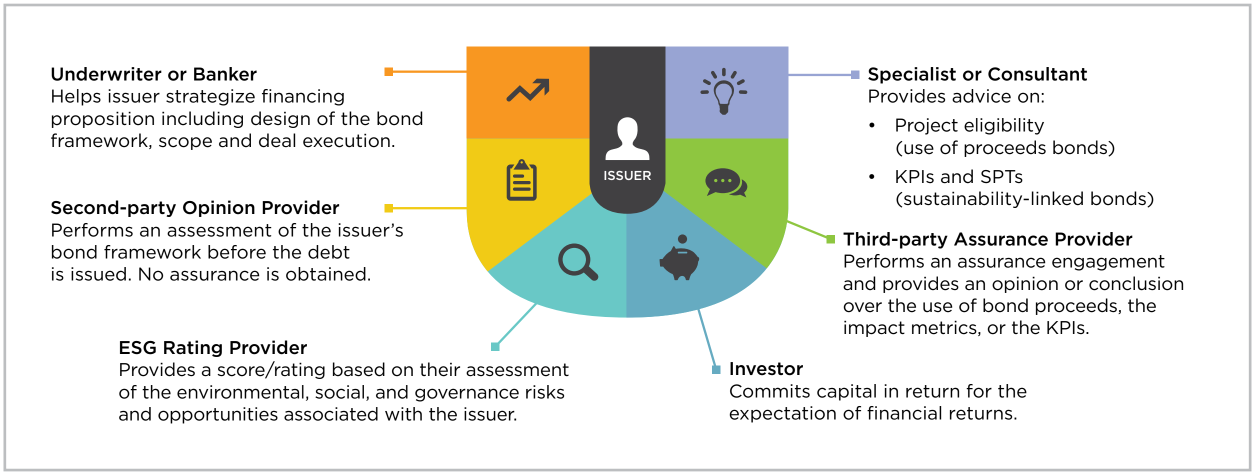
WHAT IF THE ISSUER DOES NOT DELIVER ON THEIR PROMISES?

If issuers fail to demonstrate alignment of projects to the eligible categories (GSS use of proceeds bonds) or fail to reach SPTs for KPIs (SLBs) by targeted dates, this could have implications on reputation, investor confidence, access to capital, and debt service costs.

The Key Players

Various stakeholders play a role within the sustainable debt issuance process. Currently, there is variability among issuances in terms of what role these stakeholders play. The image below explains, at a high level, the main role of each of the key stakeholders.

FIGURE 5



Sustainable Debt Principles and Guidance

Principles and Guidance

In recent years, various principles and guidance have emerged, which aim to assist in mobilizing capital towards sustainability objectives.

Sets of voluntary principles (the principles) specific to various types of sustainable debt instruments published by the International Capital Market Association (ICMA) have emerged as the most widely used guidance that issuers use to develop their bond frameworks. The Climate Bonds Initiative (CBI) has developed a standard aligned to the ICMA's Green Bond Principles and certification scheme available for assets and projects that meet the requirements of CBI's Climate Bonds Standard. While the use of the Principles and criteria are not currently mandatory, they have contributed to the goal of enhancing standardization when issuing sustainable debt instruments. These principles and guidance established by the ICMA and CBI are summarized below.

	International Capital Market Association (ICMA) Framework	Climate Bonds Initiative (CBI) certification
About the organization	ICMA is a not-for-profit membership association committed to serving the needs of its wide range of member firms active in the international debt capital markets.	The Climate Bonds Initiative is an investor-focused not-for-profit that promotes investment in projects and assets necessary for a rapid transition to a low-carbon and climate-resilient economy.
What is the scope?	Establishes voluntary principles and guidelines for the following debt instruments: • green bonds • social bonds • sustainability bonds • sustainability-linked bonds	The Climate Bonds Standard and certification are specific to green and *climate bonds*.

	International Capital Market Association (ICMA) Framework	Climate Bonds Initiative (CBI) certification
What areas are covered?	The Principles for GSS use of proceeds bonds provide guidance on the following: • the way to determine eligible projects • project evaluation and selection • management of proceeds • reporting • verification The Principles for SLBs provide guidance on the following: • selection of KPIs • determination of SPTs • bond characteristics • reporting • verification	The standard is a tool for labelling green investments and provides sector-specific eligibility criteria for assets and projects that can be used for *climate bonds* and green bonds. Certification* is available for bonds and projects that meet the requirements of the standard: • Fully aligned with the green bond principles • Using best practice for internal controls, tracking, reporting and verification • Financing assets consistent with achieving the goals of the *Paris Agreement*
Is an *external review* required?	Pre- and post-issuance external reviews recommended	Pre- and post-issuance external reviews required for bond certification

Proposed European Union Green Bond Standard (EU GBS)

In July 2021, the European Commission published a proposal for an EU GBS. It will be a voluntary standard and be open to any issuer of green bonds, including companies, public authorities and issuers located outside of the EU.

There are four key requirements under the proposed framework: (1) alignment with the *EU Taxonomy*, (2) full transparency on the allocation of bond proceeds, (3) external review, and (4) supervision by the *European Securities Markets Authority* among others.

Sustainable Finance Taxonomies

Sustainable finance taxonomies exist in various regions – such as the EU taxonomy for sustainable activities and China's green bond catalogues – to provide definitions on what constitutes a "green" or "sustainable investment."[15]

* As of December 31, 2021, there have been US$210 billion cumulative bonds that are CBI certified.[14]

Market-based taxonomies – such as the Climate Bonds Taxonomy from CBI – were developed to guide climate-aligned assets and projects.[16] The International Organization for Standardization (ISO) is also in the process of developing a green taxonomy to describe what is required to determine the eligibility and credibility of green debt instruments.[17]

> *"We see sustainable finance standards evolving at a rapid pace. This is a welcome evolution, as without more clear guidance, issuers are challenged on what to report, and investors are challenged on how to interpret these disclosures."*
>
> **Global Institutional Investor**

The development of ***sustainable finance taxonomies*** and standards is expected to progress into 2022 as an increasing number of countries (including Canada) finalize their own taxonomies.[8] The formulation of these taxonomies will increasingly play a role in the flow of capital to sustainable activities; however, the increasing number of taxonomies and their evolving nature pose a risk for potential fragmentation as different definitions of what constitutes a "green" or "sustainable" investment by region emerge.[1]

The IFRS Foundation's Sustainability-related Reporting Project

There is a movement for global standardization of sustainability standards used to measure companies' performance on different sustainability factors. The IFRS Foundation has created a new standard-setting board to deliver a comprehensive global baseline of sustainability-related disclosure standards to provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities. These standards will be relevant to the sustainable debt market, as the sustainability information disclosed could provide information on projects related to use of proceeds bonds and key metrics for evaluating performance on key performance indicators.

External Reviews,** Including Third-party Assurance

Investors and other stakeholders are concerned about "greenwashing" – the process of conveying a false impression or providing misleading information about how a company's product or activities are more environmentally sound/sustainable than they are.[18] Companies can mitigate these concerns by obtaining external verification or reviews[19] from an external service provider on specific aspects of their sustainable debt issuance, pre- and/or post-issuance.

Generally, the types of external reviews that issuers obtain related to their sustainable debt issuances are grouped into the following types:

- **Second-party opinions:** An issuer can obtain an assessment of the alignment of their sustainable debt issuance/framework/program with the relevant principles at the pre-issuance phase, typically performed by an institution with sustainability expertise.
- **Verification (also known as third-party assurance):** An issuer can obtain third-party verification, where the underlying subject matter (pertaining to environmental/social/sustainability tracking and allocation of funds or KPI performance and sustainability targets for SLBs) is evaluated against a specific set of *criteria*. The outcome of this evaluation is the subject matter information. These engagements are typically performed by independent professional accountants in public practice.
- **Certification:** An issuer can have its sustainable debt certified by external bodies against a recognized external green/social/sustainability standard or label. E.g., certification under CBI's Climate Bonds Standard

"Because of the significant reputational risk (greenwashing) associated with green, social or sustainability-linked financial instruments, we will only work with service providers that have a certain pedigree and reputation. Preserving the integrity of the market is very important to us at National Bank."

Jason Taylor
Managing Director, Sustainability Advisory & Finance at National Bank of Canada

** While the terms "review" and "opinion" have different meanings in the *CPA Canada Handbook – Assurance*, these terms are used in this report, based on the terminology used and understood by key players in the sustainable debt market, including by the ICMA. No assurance opinion is provided for second-party opinions akin to the assurance opinion or conclusion provided when performing an attestation or direct engagement using standards in the *CPA Canada Handbook – Assurance*.

- **Bond scoring/rating:** An issuer can have its sustainable debt or a key feature such as use of proceeds, selection of KPIs, calibration of the level of ambitiousness of SPTs evaluated or assessed by third parties, such as specialized research providers or rating agencies, according to an established scoring/rating methodology.[19]

External reviews can vary in their scope and may address a green, social, sustainability and sustainability-linked bond framework; an individual green, social, sustainability, and sustainability-linked bond issue; and/or the underlying assets (in the case of specific use of proceeds bonds) and/or procedures.[19] There are currently a variety of external review and third-party assurance providers with differing qualifications in the market, including professional accountants in public practice and service providers at ESG consulting firms.

The remainder of this section will focus on ***second-party opinions*** obtained prior to the bond issuance and ***third-party assurance*** obtained following the bond issuance.

As stipulated in *section 5*, both a pre-issuance SPO and post-issuance third-party assurance are recommended by the ICMA framework; however, given that these principles are voluntary, so too are the SPOs and third-party assurance recommended within this framework. Pre- and post-issuance assurance is required by CBI in order for green and climate bond certification.

Second-party Opinions and Third-party Assurance

	Pre-issuance review: Second-party opinion (SPO)	Post-issuance review: Third-party assurance
What is covered as part of the engagement?	An SPO entails a review of the issuer's bond framework such as the following: **GSS use of proceeds bonds** • Is the organization's bond framework aligned to the accepted market standard (i.e., ICMA's Green Bond Principles)? • Are the proceeds of the bond aligned to market practices and expectations of the investment community? **SLBs** • Are the KPIs adequate? • Are the SPTs ambitious and impactful?	In an assurance engagement, the practitioner designs and performs procedures to obtain sufficient appropriate evidence to express a conclusion or opinion about the subject matter information. Common example engagements are included below. **GSS use of proceeds bonds** *Assurance opinion over the use of proceeds* An assurance engagement over the allocation of funds from green and/or social projects *Assurance opinion over the impact metrics* An assurance engagement over the expected impacts of the sustainable debt instrument reported by the issuer on an annual basis **SLBs** *Assurance opinion over KPIs* An assurance engagement over the performance level against each SPT for each KPI. This engagement typically occurs at least once a year.
Is a universal standard applied?	SPO providers do not perform the engagement using internationally accepted auditing and assurance standards. Without the application of a consistent international standard, it is difficult to compare statements made between different providers.	Third-party assurance engagements are performed in accordance with recognized auditing and assurance standards, i.e., *International Standard on Assurance Engagements (ISAE) 3000 (Revised)*.***

*** The Canadian equivalent of ISAE 3000 is Canadian Standard on Assurance Engagements (CSAE) 3000. The Canadian Auditing and Assurance Standards Board has developed non-authoritative guidance on applying CSAE 3000 to sustainability and other extended external reporting assurance engagements.

	Pre-issuance review: Second-party opinion (SPO)	Post-issuance review: Third-party assurance
Who performs these engagements?	Consultants at sustainability service providers (such as Sustainalytics, Cicero, ISS ESG, Vigeo Eiris) perform a majority of engagements.****	Engagements are usually performed by professional accountants in public practice, but they may be performed by others, including sustainability service providers.
Are the service providers subject to professional standards and ethical requirements?	The service providers who most commonly perform SPOs are typically not subject to strict independence requirements from their clients or any regular external quality review by an independent body.	Professional accountants in public practice, who most commonly perform post-issuance assurance engagements, are subject to professional standards and regulatory frameworks, including requirements for quality management, and the independence, ethics and competence of the assurance practitioner.
Is a level of assurance obtained?	Currently, no assurance is obtained. Market expectations for assurance at the pre-issuance phase may evolve in the future.	One of two distinct levels of assurance is obtained: *Reasonable assurance*: This is a high, but not absolute, level of assurance. The practitioner's report includes a positive conclusion regarding, for example, whether the subject matter information is prepared, in all material respects, in accordance with the applicable criteria. *Limited assurance*: This is lower than in a reasonable assurance engagement, but a level of assurance that still enhances the intended users' confidence about the subject matter being reported. The practitioner's report includes a negative form of assurance, for example, that no matter(s) have come to the practitioner's attention that cause them to believe the subject matter information is not prepared, in all material respects, in accordance with the applicable criteria.

**** In some jurisdictions, professional accountants in public practice perform pre-issuance reviews; however, at the time of this research, this is not common. The professional accountant's role in the pre-issuance phase may evolve in the future.

	Pre-issuance review: Second-party opinion (SPO)	Post-issuance review: Third-party assurance
Is a report provided?	A private report is provided by the SPO provider and may be made publicly available only at the discretion of the issuer.	The practitioner provides a report that includes an informative summary of the work performed as the basis for the practitioner's conclusion, without detailing all the procedures performed. The report includes the practitioner's conclusion or opinion by way of standard wording. The independent report may be put in the public domain at the discretion of the issuer.

As illustrated in the table above, there is currently inconsistency in the market with respect to reporting and levels of assurance obtained, impacting investor understandability and comparability of the engagement. There is also a variety of service providers providing these services subject to varying ethical and quality management requirements.

Third-party Assurance Challenges

Given the important role professional accountants in public practice play in adding credibility to information and protecting the public interest, this section specifically highlights challenges for third-party assurance providers.

Most notable is the potential lack of suitable criteria, which is a pre-requisite before a practitioner can accept an assurance engagement. Bond frameworks established by the issuer may not meet the characteristics of suitable criteria, resulting in several potential outcomes:

- Practitioners unable to perform engagements at the pre-issuance phase
- For post-issuance assurance engagements:
  - The framework may have characteristics that need to be refined, clarified or even excluded as part of developing suitable criteria.
  - There may be variability in reporting (including impact reporting), potentially due to a lack of reliability[*****] in the reporting criteria. For example, some issuers may:

***** Reliability is defined as allowing the reasonably consistent measurement, evaluation of the underlying subject matter, including, where relevant, the presentation and disclosure.

- disclose more detailed information with respect to how proceeds were spent, whereas others disclose more broadly that the proceeds were spent in accordance with the framework.
- use different terminology in its reporting, which can be misunderstood by users. For instance, some entities refer to "use" of proceeds, and others refer to "allocation" of proceeds.

A number of challenges for investors and issuers highlighted throughout this report also result in challenges for third-party assurance providers, including the defining of sustainable activities, barriers to high-quality impact reporting, and issues related to data management. Wherever possible, issuers should involve third-party assurance providers earlier and throughout the issuance process to better set engagements up for success.

Results of Research Findings

To better understand the external review landscape over global sustainable debt issuances, a desktop review of a sample of 25 issuances was conducted, as outlined in *Appendix A*.

Pre-issuance

- **Of the issuances sampled, 96% obtained an SPO during the pre-issuance phase.**
- **Of those with SPOs, 100% were provided by sustainability service providers.**
- **Sustainalytics was the most common service provider, providing 50% of the SPOs.**

Post-issuance

- **Of the issuances sampled, 88% received post-issuance external verification.**
- **Of those with external verification, 86% were from an audit firm, and 14% were from a sustainability service provider.**
- **With respect to the level of assurance, 36% obtained reasonable assurance, 57% obtained limited assurance and 7% obtained no assurance.**

"Proper due diligence through third-party assurance is essential to building confidence and wide-spread adoption in the green, social and sustainable financing arena. Although there are incremental costs associated with third-party assurance, these costs are considered a moot point, as they are now a part of doing business in the sustainable world we live in. Plus they are miniscule in light of the magnitude of these transactions."

Sean St-John
Executive Vice-President, Managing Director at NBC

Challenges and Considerations in an Evolving Market

Key challenges and risks that emerged from the study:

Greenwashing

Greenwashing is a risk within the market.

For the sustainable debt market, the risks include that proceeds are allocated to projects with inaccurate or misleading claims that they classify as green and/or social, or the KPIs and SPTs for SLBs are not ambitious enough.

Impact measurement

There are differing approaches to measuring the impact of sustainable debt instruments. Data limitations, such as inadequate tracking of proceeds and eligible project costs, can result in inaccurate impact reporting.

Inaccurate impact reporting creates a risk for investors, because it could misrepresent the actual performance of the instrument.

Sustainable finance skills gap

There is a growing gap between the current availability of sustainable finance skills and what will be required to support growth in fields such as the sustainable debt market.

There are difficulties in recruiting staff experienced in sustainability, and more training programs in this field are needed.

Different types of guidelines and standards

A variety of non-authoritative guidance with broad definitions in the market makes it difficult for issuers and their stakeholders to determine and assess which projects are eligible for use of proceeds bonds.

Evolving ***sustainable finance taxonomies*** and regional differences can create confusion and uncertainty in the market.

Data management

Systems, data and processes to develop post-issuance reports highlighting the performance of sustainable debt instruments for investors may be inadequate in light of being a relatively new area of reporting.

Relevant data may reside outside of financial reporting systems and may not be subject to established governance and internal control protocols required over financial information.

Variability in external reviews, including third-party assurance

There is currently a variety of practitioners/consultants performing external reviews, subject to varying ethical and quality management requirements.

Inconsistent reporting and levels of assurance obtained impact investor understandability and comparability of engagements.

There are also challenges with bond frameworks meeting suitable criteria.

The challenges faced by issuers, related to defining sustainable activities, impact reporting and data management, also result in difficulty for assurance providers.

Looking to the Future – Considerations for Stakeholders

It is important to consider how these instruments can achieve their purpose of advancing sustainability objectives while reducing risks and enhancing investor protection.

We invite readers of this report to consider the following questions:

Investors

- How can we work with issuers of sustainable debt to determine the appropriate eligible projects and appropriate KPIs and SPTs to align with both parties' sustainability objectives?
- What levels and types of external verification and assurance engagements provide us with sufficient confidence in sustainable debt issuances?
- Does the bond report include useful impact metrics that help us effectively evaluate the instrument's performance?

Issuers

- How can we mitigate making claims that could be viewed as greenwashing the performance of our sustainable debt instrument?
- Do we have sufficient data management processes and controls in place that will (1) track issuances and result in sufficient and appropriate information for our bond reports and (2) support external verification/assurance engagements? Can we involve third-party assurance providers earlier and throughout the issuance process to better set engagements up for success?
- Are we consistently and accurately reporting the impact of our instrument on a timely basis for stakeholders?
- Have we clearly defined eligible projects, KPIs and SPTs with appropriate level of detail?

External reviewers/assurance providers

- Can we engage with issuers and other key players, where appropriate, earlier in the issuance process to better set external reviews, including third-party assurance engagements, up for success?
- Have we clearly communicated the type of engagement (including level of assurance obtained) to issuers and investors?
- How could assurance services evolve to continue to meet the needs of issuers and investors in this growing market?

Regulators

- Is greater regulatory oversight over sustainable debt issuances needed? Should there be a regulatory position on what qualifies as a "sustainable debt issuance"?
- What are the assurance needs of investors, and should mandatory assurance be considered?
- What role do we have in promoting greater transparency and consistency in the market, and is further regulation required to address risks that have been identified in the sustainable debt market?

Providers of principles and guidance for bond frameworks

- How can we encourage further convergence and alignment among reporting practices for green and other sustainable debt instruments?
- Do current guidelines apply to emerging instruments in the market (e.g., transition bonds)?
- Do current guidelines address the evolving needs of the sustainable debt market and its investors?

Assurance standard setters

- Are we helping to ensure that assurance standards remain fit for purpose as this market continues to evolve?

What is the role of the accounting profession?

The accounting profession has a crucial role to play in enhancing confidence that sustainable debt is, in fact, being used to shift capital towards more sustainable activities and outcomes. In addition to the important role that professional accountants play in providing third-party assurance and enhancing credibility of reported information, professional accountants within organizations can take the lead in the following areas:

- **Identifying the appropriate sustainable debt financing arrangement and ensuring alignment with organizational sustainability objectives and corporate strategy**
- **Identifying the advisors and service providers to work with**
- **Developing the debt framework, defining appropriate criteria and establishing processes for selecting and evaluating eligible projects and activities**
- **Implementing effective processes, internal controls and systems to track relevant information necessary to evaluate performance of the instrument, including selecting appropriate KPIs and methods to measure impact**
- **Regular reporting for internal and external purposes, including on allocation of proceeds, eligibility of projects and impact**

In a rapidly growing market, independent third-party assurance is critical to minimizing the risk of greenwashing and enhancing investor protection. As the sustainable debt market continues to evolve, professional accountants must remain cognizant of changes and potential impacts on investors, clients, and the organizations they serve.

We believe it is an opportune time to review the infrastructure for sustainable debt issuances and consider the changes that may be necessary to enhance investor confidence, reduce unnecessary complexity and promote market growth. We *see opportunities* to:

- *enhance the quality and consistency of reporting*
- *simplify the landscape of voluntary principles and guidance*
- *standardize definitions/measurement of ESG KPIs for impact reporting*
- *better understand the assurance needs of users, including the value of increasing standardization of external review/assurance services provided in this space*
- *enhance education for stakeholders across the sustainable finance ecosystem*

Appendices

Appendix A: External Review and Assurance Highlights from Desktop Review

To better understand the external review landscape over global sustainable debt issuances, a desktop review including a sample of 20 GSS use of proceeds bonds and 5 SLBs was conducted. The following insights were gleaned:

Pre-issuance review

	Yes	No
Was there a second-party opinion provided?	24	1

	CiCERO Shades of Green	ISS ESG	Rating and Investment Information Inc.	Sustainalytics	Vigeo Eiris
Who were the second-party opinion providers?	1	5	1	12	5

Post-issuance review

Our post-issuance review reflected only 16 issuances because of the timing of the issuance.

	Yes	No
Was there an external review on post-issuance reporting?	14	2

	Audit firm	Other
Who provided the external review?	12	2

	Reasonable assurance	Limited assurance	No assurance
Level of assurance	5	8	1******

****** Obayashi had a second-party opinion provider give an opinion on post-issuance that did not provide any level of assurance. (https://www.obayashi.co.jp/en/sustainability/upload/img/DNV_GL_Periodic_Review_en_202106_2.pdf)

Appendix B: Interview Participants

CPA Canada, IFAC and PwC Canada would like to thank the participants from the following organizations, listed in alphabetical order, who generously offered their time and expertise to support the development of this paper:

- Alimentation Couche-Tard
- ANZ Institutional (Dean Spicer, Head of Sustainable Finance; Tessa Dann, Director in Sustainable Finance)
- Climate Bond Initiative (Krista Tukiainen, Head of Market Intelligence)
- Enbridge (Sheldon Bueckert, Director, Treasury)
- McGill University (Dror Etzion, Professor of Management and Sustainability)
- National Grid (Kylee Dickie, Group Head of Financial Reporting)
- OMERS
- Sustainalytics (Heather Lang, Executive Director, Sustainable Finance Solutions)
- The City of Toronto (Randy LeClair, Director, Capital Markets)
- UNDP (Belissa Rojas, Impact Measurement and Management Lead)
- National Bank of Canada (Jason Taylor, Managing Director, Investment Banking Group; Sean St-John, Executive Vice-President, Managing Director Co-Head Fixed Income, Currencies & Commodities)

Appendix C: Glossary

Climate bonds Fixed-income financial instruments linked to climate change solutions.

Coupon rate The amount of annual interest income paid to a bondholder, based on the face value of the bond.

Criteria The benchmarks used to evaluate or measure the subject matter, including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal or less formal. There can be different criteria for the same subject matter. **Suitable criteria** are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

European Securities Markets Authority (ESMA) An independent European Union (EU) Authority that contributes to safeguarding the stability of the EU's financial system by enhancing the protection of investors and promoting stable and orderly financial markets.

European Union (EU) taxonomy A classification system that establishes a list of environmentally sustainable economic activities.

Greenhouse gas (GHG) emissions Produced when hydrocarbons, such as natural gas and oil, are burned. GHGs include carbon dioxide (CO2), methane, nitrous oxide and ozone – all of which contribute to climate change.

Greenium When a green bond is issued at a higher price and therefore offers a lower yield compared to outstanding debt.

Greenwashing the process of conveying a false impression or providing misleading information about how a company's product or activities are more environmentally sound/sustainable than they are.

Impact metrics Metrics used to report the impact of the sustainable debt instrument.

International Standard on Assurance Engagements (ISAE) 3000 (Revised) A standard that applies to assurance engagements other than audits or reviews of historical financial information.

Oversubscription When the demand for the sustainable debt instrument is greater than the amount available.

Paris Agreement A legally binding international treaty on climate change, which aims to limit global warming to well below 2°C, preferably to 1.5°C, compared to industrial levels.

Prospectus A formal document that includes specific detailed disclosures about a company, its business and the securities being offered.

Readiness assessment An assessment that allows the entity to obtain a third-party view as to whether they are ready for an assurance engagement over their sustainability information.

Second-party opinion An institution with environmental/social/sustainability expertise that is independent from the issuer may provide a second-party opinion (either required or recommended pre-issuance as described in the respective Principles). The institution should be independent from the issuer's adviser for its green, social sustainability and sustainability-linked bond framework, or appropriate procedures such as information barriers will have been implemented within the institution to ensure the independence of the second-party opinion. Any concerns on the institution's independence should be disclosed to investors.

Stakeholder capitalism A form of capitalism in which companies seek long-term value creation by taking into account the needs of all their stakeholders and society at large.

Suitable criteria Before a practitioner can accept an assurance engagement, they must be satisfied that the criteria (such as the requirements in a subject matter standard) applied to the information reported by the entity exhibits the characteristics of suitable criteria. "Suitable criteria" must exhibit the following characteristics: relevance, completeness, reliability, neutrality and understandability.

Sustainable finance Refers to the process of incorporating environmental, social and governance factors into financial decision-making.

Sustainable finance taxonomies Official definitions of sustainable finance and comprehensive classification systems.

Third-party assurance Where the underlying subject matter (pertaining to environmental/social/sustainability tracking and allocation of funds or KPI performance and sustainability targets for the SLBs) is evaluated against a specific set of **criteria**. The outcome of this evaluation is the subject matter information. These engagements are typically performed by independent professional accountants in public practice.

United Nations Sustainable Development Goals (UN SDGs) A collection of 17 interlinked global goals designed to be a blueprint to achieve a better and more sustainable future for all. The UN SDGs were set up in 2015 by the United Nations General Assembly and are intended to be achieved by the year 2030.

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