

# The Treasury

## New Zealand Sovereign Green Bonds Programme Information Release

November 2022

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## Treasury Report: Labelled Bonds – Programme Approval and Announcement

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<b>Date:</b>	8 October 2021	<b>Report No:</b>	T2021/2425
		<b>File Number:</b>	DE-10-6

### Action sought

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	Action sought	Deadline
<b>Minister of Finance</b> Hon Grant Robertson	<b>Agree</b> to create a labelled bond programme  <b>Indicate</b> preferred timing for announcement of the programme	None

### Contact for telephone discussion (if required)

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Name	Position	Telephone	1st Contact
Karina Witty	Senior Funding and Engagement Strategist	[39]	[35]
Kim Martin	Head of Funding Strategy and Engagement	+64 489 07274 (wk)	
Alistair Birchall	Manager, Capital Markets Policy	[39]	✓

### Minister's Office actions (if required)

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**Return** the signed report to Treasury.

Note any feedback on the quality of the report

**Enclosure:** No

# Treasury Report: Labeled Bonds – Programme Approval and Announcement

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## Executive Summary

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This report seeks your agreement to create a labelled bond programme (LBP).

The report follows on from two recent pieces of advice provided to you ([T2021/2145] and [T2021/2352] refer). Those two pieces of advice set out the case for an LBP, including our assessment of benefits, risks, and challenges. The advice also noted how our thinking regarding an LBP has changed through time.

Should you agree to proceed, we recommend you announce that you are creating an LBP sooner rather than later. Given our consideration of an LBP is currently market sensitive, a public announcement will allow us to more fully engage with external stakeholders on the structure of the LBP.

Through discussions with your office, we understand you may be supportive of a November 2021 announcement, given alignment with either the 2021 Climate Change Conference (COP26), taking place from 31 October 2021 to 12 November 2021, or the APEC Minister's meetings taking place in the week commencing 8 November 2021. That timing is tight but achievable, given we recommend going to Cabinet before making an announcement. We anticipate providing you with a draft Cabinet paper on 14 October 2021 and allowing limited time for agency consultation (two days). It would then be open to you to either:

- Take a paper to DEV on 3 November 2021, and Cabinet on 8 November (requiring a shortened 1-week Ministerial consultation period), or
- Go straight to Cabinet on 8 November 2021 to allow for a full two-week Ministerial consultation.

As you consider whether to agree to the creation of an LBP, we have set out the proposed structure of the LBP and our proposed approach below.

### LBP Structure

We recommend you structure an LBP to reflect market best practice, including:

- Alignment with International Capital Market Association (ICMA) principles. These principles relate to the use of proceeds, the process for project evaluation and selection, management of proceeds, and reporting.
- Identification of how eligible expenditure is likely to contribute to the United Nations' Sustainable Development Goals (UN SDGs)
- Demonstrated coherence in eligible expenditure categories, and their expected impact outcomes, with broader government strategic sustainability priorities
- Application of only a limited portion of bond proceeds to historical expenditure.

### Proposed Approach

On its own, the creation of an LBP would not change existing or contemplated decision-making processes for funding projects (such as Budget or the Climate Emergency Response Fund). An LBP would create additional requirements for assessing project eligibility, reporting on the allocation of proceeds, and reporting on the expected and/or achieved impact of the projects. The data from that reporting will need to be collected centrally. The implication of these additional requirements is that:

- The Treasury would need to make system changes or build new processes to satisfy LBP requirements. For example, reporting and data collection currently takes place at an appropriation level, and does not provide a ready process for monitoring the allocation of proceeds
- An LBP would place higher expectations on government agencies. [34]

You have options regarding the level of integration between an LBP and the reporting and data collection requirements either in place (for Budget) or being contemplated (for example through CERF or Public Finance Modernisation). The work required to fully understand these options is yet to be completed and will be a focus of programme development. To support delivery, we recommend taking a more tactical approach in the early phase of an LBP while you address integration. In the short-term (for example the 2022/23 financial year), this means that development of the LBP will occur in parallel with the Budget.

Under the proposed tactical approach, we propose to set up an 'LBP Team' within the Capital Market Directorate. Our indicative view is that the development of an LBP under this tactical approach will come at a direct cost of approximately \$1 million. To the extent possible, we intend to meet establishment costs within the current funding profile of the Administration of Crown Borrowing, Derivatives Transactions and Investment Permanent Legislative Authority departmental PLA.

As outlined in earlier advice, we see improvement in project identification, evaluation, and reporting disciplines as one of the key benefits of an LBP, helping to ensure high value projects are undertaken and well-executed. We consider there will be areas where there are benefits from integrating the LBP into our broader reporting and data collection processes, and areas where the LBP may need its own bespoke processes, such as external reviews. Integration will have resourcing implications for Treasury that will need to be worked through. These implications will be considered both as part of the Treasury's upcoming Budget bid and as the LBP programme is developed.

## Recommended Action

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We recommend that you:

- a **direct** officials to prepare a draft Cabinet paper seeking Cabinet agreement to the creation of a labelled bond programme, and to provide this to you for your consideration on Thursday 14 October 2021

*Yes/no*

- b **agree** to take the paper in recommendation a above:

- i) to the Economic Development Committee on 3 November 2021, requiring a shortened one-week Ministerial consultation period

*Agree/disagree/discuss*

OR

- ii) direct to Cabinet on 8 November 2021, enabling two weeks of Ministerial consultation

*Agree/disagree/discuss*

- c **agree**, subject to Cabinet agreement, to announce the labelled programme in November 2021

*Agree/disagree/discuss*

- d **note** that a labelled bond programme will require the Treasury and government agencies to manage additional data collection and reporting requirements

- e **note** that we recommend taking a more tactical approach in the early phase of an LBP to manage delivery risk

- f **note** that an LBP will have resourcing implications for the Treasury that will be considered both through the Treasury's upcoming Budget bid and as the LBP programme is developed

- g **refer** this report to the Minister of Climate Change

*Refer/not referred.*

Alistair Birchall  
**Manager, Capital Markets Policy**

Hon Grant Robertson  
**Minister of Finance**

# Treasury Report: Labelled Bonds – Programme Approval and Announcement

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## Purpose of Report

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1. This report seeks your approval to create a labelled bond programme (LBP). In seeking your approval, the report:
  - Describes the structure of an LBP
  - Notes that you have options regarding the level of integration between an LBP and the reporting and data collection requirements either in place (for Budget) or being contemplated (for example through CERF or Public Finance Modernisation)
  - Set out expected programme challenges, and indicative resourcing and cost for establishment of the LBP, and
  - Outlines an indicative timeline to both the announcement of a programme and first issuance. Based on feedback provided to us through your office, we understand you have a preference to make an announcement in early November 2021.
2. The report follows on from two recent pieces of advice provided to you ([T2021/2145] and [T2021/2352] refer). Those two pieces of advice set out the case for an LBP, including our assessment of benefits, risks, and challenges. Our advice also noted how our thinking regarding an LBP has changed through time.

## Structure of an LBP

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### **Features**

3. The term 'labelled bond' captures three broad types of bond: 'Green', 'Social' and 'Sustainable'.<sup>1</sup> Although there are no formal standards with which these bonds need to comply, the following features have evolved that are considered to reflect best practice. These features have helped to support increased investor confidence in labelled bonds:
  - Alignment with International Capital Market Association (ICMA) principles. ICMA have prepared different principles for the three types of bond (for example 'Green Bond Principles for Green Bonds')
  - Identification of how eligible expenditure is likely to contribute to the United Nations' Sustainable Development Goals (UN SDGs)
  - Demonstrated coherence in eligible expenditure categories, and their expected impact outcomes, with broader government strategic sustainability priorities
  - Application of only a limited portion of bond proceeds to historical expenditure. Such application is commonly referred to as a 'look-back'.
4. To provide confidence around the integrity of the LBP, issuers will typically commission an independent report that reviews the structure and commitments contained in the programme. This report is known as a 'Second Party Opinion' (SPO).

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<sup>1</sup> Sustainable Bonds are those that finance a combination of green and social projects.

5. Labelled bonds provide ‘financing’ for projects. An LBP is likely to be weighted towards capital expenditure but could also capture larger operating spend projects. An LBP does not provide a new source of ‘funding’ and would not provide any additional fiscal headroom relative to the current approach of issuing New Zealand government bonds. As happens now, the size of your borrowing programme would be set with reference to your fiscal strategy. Assuming equivalent bond pricing and tenor, the fiscal impacts of an LBP would be identical in all respects to equivalent NZGBs – including how they affect core Crown net debt and OBEGAL.

### **Core Components**

6. The ICMA principles have four core components. These components are:
  - Use of Proceeds
  - Process for Project Evaluation and Selection
  - Management of Proceeds, and
  - Reporting.
7. Use of Proceeds requirements depend on the nature of the bonds. For Green Bonds, issuers are expected to describe clear environmental benefits.<sup>2</sup> These benefits will be assessed and, where feasible, quantified by the issuer. ICMA provide a list of project categories that are likely to be supported by the Green Bond market. The categories are broadly followed by most Green Bond issuers, and include energy efficiency, environmentally sustainable management of living natural resources and land use, clean transportation and climate change adaptation.
8. Processes for Project Evaluation and Selection suggest issuers should clearly communicate to investors (i) the environmental and/or social objectives of the eligible projects (ii) the process by which the issuer will determine how projects fit within eligible project categories and (iii) how the issuer identifies and manages perceived environmental and/or social risks associated with the relevant projects.
9. Management of Proceeds. Bond proceeds should be tracked so they can be distinguished from other government funding and financing. Ideally this means they will be allocated to a separate account until spent. It is considered acceptable for proceeds to be managed on a portfolio basis, where multiple labelled bond issues can be aggregated for application to multiple projects. A high level of transparency is recommended in relation to this component. An external auditor or other third party could be engaged to verify the internal tracking method and the allocation of funds from bond proceeds.
10. Reporting is generally split into two types of reporting, reporting on the allocation of proceeds and reporting on the expected and/or achieved impact of the projects financed by the proceeds. Reporting can also be supported by third party review.
11. Additional guidance is available for issuers that wish to finance projects towards implementing a net zero emissions strategy aligned with the goals of the Paris Agreement and for mapping UN SGDs to the ICMA principles.

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<sup>2</sup> For Social Bonds, projects should directly aim to address or mitigate a specific social issue and/or seek to achieve positive social outcomes especially but not exclusively for a target population. Recommended social project categories include affordable housing, employment generation programmes, food security and sustainable food systems, socioeconomic advancement and empowerment.

## **Operation of the LBP**

12. At a high level, we expect the labelled bond programme would work as follows:
- The Treasury, in consultation with external advice, will recommend the framework for the labelled bond programme, including defining eligible project categories (Use of Proceeds). We indicatively favour either a Green Bond programme, or a Sustainable Bond programme that includes Green Bond issuance.
  - Agencies will identify large scale projects that have environmental and/or social benefits.
  - The programmes or projects identified will be evaluated by a governance committee, using clearly defined project evaluation criteria to determine whether they would be eligible to be included in the labelled bond programme (Process for Project Evaluation and Selection). Those projects that are eligible will be 'tagged' as eligible for the LBP. The committee would comprise officials and potentially independent experts, rather than Ministers.
  - When projects are considered for funding, the 'tag' of eligibility will be visible to decision-makers (for example Ministers in the case of the Budget).
  - As labelled bonds are issued, projects with expenditure expected to occur in a defined time period, known as an 'expenditure window', will be selected from the eligible project pool as projects that will be financed by the bond issuance. There are options around how this selection is governed, with our indicative preference being for that selection to be made by the governance committee. Based on market best practice, it is likely a small proportion will relate to programmes or projects completed in the year prior to issuance (the 'look-back' period), while the balance will be spent in the four year after issuance
  - Proceeds raised from labelled bonds will be earmarked as labelled bond proceeds. Money spent on projects in the eligible project pool will be tracked. (Management of Proceeds).
  - Regular meetings, possibly semi-annually, will be held by a governance or oversight committee. This committee will ensure the programme is running effectively, approve projects to be added to the eligible pool of projects and review reporting information prior to publication. Reporting is expected to involve reporting on allocation of proceeds and reporting on the expected and/or achieved impact of the projects. Frequency of reporting is yet to be determined but is likely to be annual or biennial. This reporting will be externally assured. (Reporting).
  - The Treasury will be responsible for portfolio strategy, issuance, risk and operational aspects of the programme (through New Zealand Debt Management). We will monitor investor feedback, government strategies and market developments, adjusting the programme as required to ensure it remains supported by stakeholders.
13. Beyond the processes outlined above, we intend to investigate how we can incorporate unique characteristics to our labelled bond offering, for example a Te Ao Māori perspective.



## How might an LBP be integrated into existing decision-making and reporting processes?

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14. On its own, the creation of an LBP would not change existing or contemplated decision-making processes for funding projects, such as the Budget or the Climate Emergency Response Fund (CERF). An LBP would create additional requirements for assessing project eligibility, reporting on the allocation of proceeds, and reporting on the expected and/or achieved impact of the projects. The data from that reporting will need to be collected centrally. The implication of these additional requirements is that:
  - The Treasury would need to make system changes or build new processes to satisfy these requirements. For example, reporting and data collection currently takes place at an appropriation level, and does not provide a ready process for monitoring the allocation of proceeds.
  - An LBP would place higher expectations on government agencies. [34]
  
15. Should you decide to proceed, you have options regarding the level of integration between an LBP and reporting and data collection requirements either in place (for Budget) or being contemplated (for example for CERF or through work on Public Finance Modernisation). The work required to fully understand these options is yet to be completed and will be a focus of programme development. This ambiguity presents some risk to LBP resourcing and coordination. To help manage this risk, and support delivery, we would recommend taking a more tactical approach in the early phase of an LBP.

### ***Short term tactical implementation***

16. In the short-term (for example the 2022/23 financial year), development of the LBP will occur in parallel with the Budget. This means criteria for LBP inclusion will be determined after agencies have developed Budget bids, and possibly after Budget decisions have been made.
17. As a result, project identification, evaluation, and selection will occur outside of the Budget process. This could involve the Treasury identifying a small number of large-scale projects for inclusion in the LBP. Inclusion of these projects would be considered by delivery agencies and Ministers (yourself and delivery Ministers plus others as deemed desirable). After agreement for inclusion, the Treasury would work with agreed delivery agencies to develop reporting processes.
18. This approach would manage several risks:
  - *Budget delivery*: the approach would limit resourcing pressures on the Treasury and allow the process to be delivered by an 'LBP Team' (subject to appropriate coordination)
  - *Reporting capability*: risk around capability would be reduced by limiting the number of projects within the programme and selecting only projects where we had a high degree of confidence that delivery agencies were willing and able to commit to reporting requirements.

## Longer term integration

19. While a tactical approach will help reduce risk for 2022/23, using this approach for an extended period may generate reputational risk for the Crown (for example through perceptions of 'greenwashing'). For an LBP to be credible, we consider a more structured and systematised approach to project identification, evaluation, and reporting will be required. As outlined in earlier advice, we see improvement in these discipline as one of the key benefits of an LBP, helping to ensure high value projects are undertaken and well-executed.
20. Over the longer-term, we also see benefits from integrating an LBP with existing decision-making and reporting processes, as well as those being contemplated or developed, such as the CERF. Areas where integration may be possible include bid preparation by agencies, identification of eligible projects to support decision-making (for example at Budget), and integration of reporting with the existing and contemplated requirements placed on agencies.
21. Within the Treasury, integration may allow for greater use of our broader processes and reporting infrastructure, such as the Capital Panel and the Treasury's Vote network. A shift from the LBP Team towards these processes and systems will have resourcing implications for Treasury that will need to be worked through.
22. Further work is required to determine exactly how integration might be achieved (including resourcing implications), but would include consideration of the following:
  - *Capacity:* an increase in system capacity may be required, both within the Treasury and agencies. Investment options could range from making the improvements necessary solely for the LBP to broader cross government system improvements which would result in improved transparency and tracking of projects and expenditure across government. We consider there will be areas whether there are benefits from integration, and areas where the LBP may need its own bespoke processes, such as external reviews and SPOs.
  - *Coordination:* coordination and cooperation across agencies will be imperative to ensure projects are able to be identified and their expected impacts are well understood and monitored.
  - *Incentives:* the inclusion of a project in the LBP will place a reporting requirement on the agency responsible. Ministerial support may be required to ensure agencies are incentivised and resourced to develop projects that may be eligible for inclusion in the programme.

## Expected programme challenges

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23. Beyond the risks and investment identified around reporting processes, officials consider we will also need to manage the following risks in establishing an LBP:
  - Scale of near-term projects. A viable LBP programme will require sufficient volume of issuance to support secondary market trading and investor confidence in the longevity of the programme. We have confidence that there are sufficient large-scale projects to provide this scale over time but note there is heightened risk in the short-term.
  - Timing risk around first issuance. Clearly defined government targets, as well as strategies to meet those targets, support development of use of proceeds categories. They also support assessment through SPOs. With the Government's first Emissions Reduction Plan not expected to be finalised until May 2022, it may be challenging to align government strategies and use of proceed categories ahead of this time. This could raise risks to a timeline anticipating first issuance in September 2022.

- Alignment with broader climate advice. While we have advised that the case for an LBP is not contingent on other climate decisions, such as those relating to the CERF, ETS hypothecation, or the ERP, there will nonetheless be benefits in aligning our approach. This is particularly true of work considering ‘tools’ to monitor and report on climate transition spending, including through the CERF. These tools will have similar requirements to the LBP, and it will therefore be beneficial for our approach to avoid unnecessary complexity and duplication.

## Project resourcing and cost

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24. Should you wish to proceed, we will stand-up an establishment team. This will come with a cost. Our indicative view is that the development of an LBP and the processes to support the first issue of an LBP will come at direct cost of approximately \$1 million. This number is subject to uncertainty, primarily relating to the cost of structuring advice. Our estimate assumes we take the tactical approach noted above and excludes the cost of reporting and longer-term integration for project selection, monitoring and reporting. To the extent possible, we intend to meet establishment costs within the current funding profile of the Administration of Crown Borrowing, Derivatives Transactions and Investment Permanent Legislative Authority departmental PLA.
25. Establishing a labelled bond programme is expected to require the following resourcing:
  - Two to three full-time FTE within the Treasury’s Capital Markets Directorate (housing the LBP Team) over the next 12 months
  - Time commitments and advice from various teams within the Treasury, as well as government agencies. Many of these agencies are under pressure, and will need support
  - Engagement with Iwi partners
  - External legal advice
  - Engaging banks to assist in programme structuring, and
  - External support in creating programme related materials for public distribution and SPO engagement.
26. Development of the systems necessary to integrate the LBP into the Budget and reporting processes set out in this advice will take time and require additional resourcing. Should you proceed, we will also begin to consider integration needs as part of the Treasury’s upcoming Budget bid.

## Next steps

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27. From the perspective of New Zealand Debt Management, it is desirable to announce that you are creating an LBP sooner rather than later. Given our consideration of an LBP is currently market sensitive, a public announcement will allow us to more fully engage with external stakeholders on the structure of the LBP.
28. Through your office we understand that you have interest in an announcement in November 2021 to align with either the 2021 Climate Change Conference (COP26), taking place from 31 October 2021 to 12 November 2021, or the APEC Minister’s meetings taking place in the week commencing 8 November 2021.

- 29. The creation of LBP is a substantive policy decision that has fiscal implications. We recommend going to Cabinet before making an announcement. The primary focus of the Cabinet paper would be to socialise the proposed LBP with your colleagues, (including highlighting links to the Budget process and project evaluation, reporting and data collection requirements, as well as to the Climate Funding & Financing report back taking place in November 2021). We would recommend a second Cabinet paper in April 2022 following finalisation of the structure for the LBP and further work on integration.
- 30. You could either take the paper to DEV on 3 November, and Cabinet on 8 November (requiring a shortened 1-week Ministerial consultation), or straight to Cabinet to allow for full two-week Ministerial consultation. Given abbreviated timeframes, we anticipate providing you with a draft paper on 14 October 2021 and allowing limited time (two days) for agency consultation.
- 31. The timeline provides for shorter consultation periods than we would recommend and provides almost no scope for delay. However, we consider that the two-stage policy development approach, and the nature of decisions we recommend seeking now, mitigates the risk of agency/Ministerial issues with the proposal.
- 32. It would be possible for you to undertake fuller consultation should you prefer to announce the LBP later in 2021, for example alongside the Budget Policy Statement, however it should be noted that this later announcement date may make it more challenging to issue labelled bonds in calendar year 2022.

**Timeline to first issuance**

- 33. At this stage of the project it is difficult to determine all milestones and when those milestones will need to be completed. At a high level, we are nonetheless working to a timeline that incorporates the following key targets:

Date	Action
<i>November 2021</i>	Cabinet paper, followed by public announcement that the Crown is developing an LBP
<i>December 2021</i>	Appoint banks as structuring advisors to programme establishment
<i>March 2022</i>	Use of proceeds categories, criteria for project selection, monitoring and reporting processes established
<i>April 2022</i>	LBP framework taken to Cabinet
<i>May 2022</i>	Documentation, including the labelled bond framework, Second Party Opinion and an investor presentation presented for approval
<i>June 2022</i>	Public release of documentation
<i>August 2022</i>	Public announcement of details of inaugural labelled bond
[37]	