# The role of regulations in defining local green finance framework

## Ukrainian experience

# Expected investment needs relevant for green bonds: Ukraine

**Mitigation related investments that can be financed by green financial instruments, 2022 – 2030 (EUR bn)**

| **Sector (pre-war assessment)** | lower bound | upper bound |
|---|---|---|
| Electricity sector | 16.5 | |
| Residential buildings | 3.6 | 6.4 |
| Public buildings | 2.0 | 3.7 |
| Industry | 3.2 | 6.9 |
| Transport sector | 2.1 | 6.1 |
| Total mitigation related investments | **27.4** | **39.6** |

- **Electricity**: installation of 12 GW of RES by 2030 that replaces coal in the electricity mix
- **Building:** annual thermal retrofitting of 0.8% of the residential and 1.5% of the public building stock
- **Industry**: investment in low-carbon equipment in steel sector (52% of total industrial energy consumption), mining and food industry
- **Transport:** public city transport and rail transport can significantly contribute to reducing CO2 emissions

Green reconstruction of Ukraine to restore its damaged infrastructure and fixed assets in a sustainable way (damages estimated by KSE at USD 84.4 bn as of 18/04/2022)

# First green bond issues in Ukraine

- **DTEK Renewables** (part of DTEK group of companies with previous experience of bond issuances on international capital markets) issued a green bond in 2019
  - EUR 325 million, 5 year maturity, for wind and solar power generation facilities (refinancing of bridge finance) allocated in 2019 and 2021
  - Assessed by Sustainalytics
  - Impact reports issued in 2020 and 2021
  - Initially highly oversubscribed by investors (mainly from UK and EU) but became illiquid due to problems with feed-in tariff support scheme for RES in Ukraine
- **Ukrenergo** (Ukrainian transmission system operator) issued a green (and sustainability-linked) bond in 2021 using state guarantees
  - USD 825 million, 5 year maturity, for repayment of debt arising from contracts for the sale of electricity for fixed feed-in tariffs by RE generation facilities
  - Assessed by Sustainalytics
  - Highly oversubscribed by investors, with EBRD acting as anchor investor by taking up a USD 75 million tranche

# Defining local green finance framework in Ukraine

- As of July 2021, green bonds are recognized as a specific class of debt instruments in accordance with Article 18 of the Law of Ukraine “On capital markets”
- A procedure for selection and support of green projects financed from the state and local budgets is currently being drafted by the Ministry of Environmental Protection and Natural Resources (the procedure will include a taxonomy and technical criteria for green projects)
- The NSSMC has recently adopted non-binding recommendations for issuance of green bonds prepared with technical assistance from IFC
- The NSSMC is expected to adopt additional requirements to the issuers of green bonds related to the transparent use of proceeds and impact monitoring
- Standards applied in the local asset management industry do not include the recognition of climate risks in asset management, and the disclosure of climate impact to end-investors
- The private sector ‘ecosystem’ consisting of supporting service providers for external review of green bonds has not yet been established
- Wider enabling environment is also constraining - no preferential tax treatment (e.g. tax relief or abolition of the state duty for the issuance of green bonds) and no subsidies for covering additional costs related to green bonds (e.g. verification costs) are available or being considered

# Barriers to bond market development

- history of macroeconomic **instability and defaults**; high level of dollarization
- **uneven approach to taxation** - income from government bonds is exempted from taxation, whereas income from corporate bonds is taxable
- high yield on risk-free government bonds and **insufficient premium** for risk on corporate bonds
- **restricted access of foreign investors** to the local corporate bonds due to lack of clearing and settlement procedures, and other requirements
- **lack of institutional investors** - a pension reform has not been implemented and private pension funds have not yet emerged; insurance business is underdeveloped and insurance companies have limited capacity to invest in securities

Some barriers for development of the local bond market lie beyond the capital market:

- ongoing governance problems and uncertainty over the path of key economic reforms
- poor investment climate which makes companies reluctant to expand businesses
- the government had to retroactively reconsider its support scheme for renewables damaging trust of existing and potential investors in the sector
- war-time risks