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Second Party Opinion

Flekkefjord Sparebank's Green Bond Framework

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Location: Norway **Sector:** Banking

Alignment With Principles

Aligned = ✔ Conceptually aligned = ○ Not aligned = ✖

✔ Green Bond Principles, ICMA, 2021

✔ Green Loan Principles, LMA/LSTA/APLMA, 2023

See Alignment Assessment for more detail.

Light green

Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term low-carbon climate resilient solutions.

Our Shades of Green Analytical Approach >

Strengths

Flekkefjord Sparebank has set quantitative decarbonization targets. In 2021, it launched its sustainability strategy in which it formalized its commitment to achieving carbon neutral operations and reduce emissions from its loan portfolio by 15% by 2030, compared to a yet-to-be established 2025 baseline.

Reporting commitments under the green bond framework are robust. The framework refers to established guidelines for reporting and includes a commitment to transparency on baselines and methodologies.

Weaknesses

Eligibility requirements for green buildings do not exceed the regulatory minimum, except for new construction. Buildings to be financed must be energy efficient compared to the stock of national buildings. However, the eligibility criteria fall short of representing significant steps toward a low carbon, climate resilient future.

Areas to watch

Flekkefjord Sparebank’s climate transition risk strategy is in its infancy. Exposure to physical climate risk is assessed for only half of the bank's corporate loans, representing a small share of the issuer's total loan portfolio as this risk is not considered for retail mortgage loans. Flooding is expected to be the main climate-related weather hazard its real estate portfolio is exposed to.

The ambition of and progress toward emission reduction targets are hard to assess due to insufficient disclosure. While we regard reporting under the framework as robust, Flekkefjord Sparebank does not yet report on Its own or financed emissions.

Eligible Green Projects Assessment Summary

Eligible projects under issuer's green bond framework are assessed based on their environmental benefits and risks, using the Shades of Green methodology.

Green buildings	**Light green**
New construction, existing buildings, and renovations	

Renewable energy	**Dark green**
Hydropower production facilities	

Pollution prevention and control	**Medium to Light green**
Recycling of waste and manufacturing of filter membranes for waste-water treatment	

See Analysis Of Eligible Projects for more detail.

Issuer Sustainability Context

This section provides an analysis of the issuer's sustainability management and the embeddedness of the financing framework within its overall strategy.

Company Description

Flekkefjord Sparebank is an independent savings bank (not part of any alliances) headquartered in Flekkefjord, in the Southwest of Norway. It provides online, mobile, in-person, and telephone banking services for personal and corporate clients, where retail banking is by far the largest segment (72% of loans). On the corporate side, the main sectors the bank has exposure to are real estate, diverse industry, and agriculture. All its revenue is generated in Norway. The bank also offers insurance products (about 2% of total income), as well as investment and pension services.

Material Sustainability Factors

Climate transition risk

Banks are highly exposed to climate transition risk through their financing of economic activities, which affect the environment. Banks' direct environmental impact is small compared to financed emissions and stems mainly from power consumption. Generally, policies and rules to reduce emissions could raise credit, legal, and reputational risks for banks. Positively, financing the climate transition offers a growth avenue for banks through lending and other capital market activities. In the European context, climate and environmental regulations are ambitious, and there is a strong push toward integrating sustainability considerations into the regulation of banks and financial markets.

Physical climate risk

Banks finance a wide array of business sectors that are exposed to physical climate risks. However, while climate change is a global issue, weather-related events are typically localized, so the magnitude of banks' exposure is linked to the geographic location of the activities and assets they finance. Similarly, banks' physical footprint (such as branches) may also be exposed to physical risks, which may disrupt their ability to service clients in the event of a natural catastrophe. Banks may help mitigate the effects of physical climate risks by financing adaptation projects and climate-resilient infrastructure, as well as by investing in solutions that support business continuity in exposed geographies. Key risks in Norway relate to an increase in extreme precipitation and flooding.

Biodiversity and resource use

Banks contribute to significant resource use and biodiversity impact through the activities they fund or invest in. For example, the real estate sector--which is a major recipient of bank financing--is a large consumer of raw materials for new construction, such as steel and cement. Similarly, bank-financed agricultural activities can have material biodiversity impacts.

Access and affordability

Banks' large impact on society stems from their role in enabling access to financial services to individuals and businesses, and in ensuring the correct functioning of payment systems. Ensuring affordable access to financial services, especially to the most vulnerable members of the population, remains a challenge for the banking industry. Structural issues such as poverty, informal economy, and lack of financial literacy partly limit access to financial services. However, banks have large opportunities to support economic development through financial inclusion, including by using new technologies.

Issuer And Context Analysis

All of the project categories included in the financing framework--green building, renewable energy, and pollution prevention and control--aim to address climate transition risk, which we consider to be a material sustainability factor for Flekkefjord Sparebank. The pollution prevention and control project category also seeks to contribute to reducing resource use, another material sustainability factor. In addition, physical climate risk is a relevant risk in the context of the framework, since some of the project categories--namely green buildings and renewable energy--are generally highly exposed to the impact of a changing climate.

Flekkefjord Sparebank's targets are a positive indication of its climate commitment but its climate transition risk strategy is in its infancy. In 2021, the bank launched its sustainability strategy in which it formalized its commitment to reducing operational and portfolio emissions. As a result, it has set the following targets:

- Become carbon neutral by 2025 (own operations),
- Increase the share of green loans in its corporate loan portfolio to 15% by 2025 and to 25% by 2030, and
- Assess the emissions related to its loan portfolio by 2025 and reduce said emissions by 15% by 2030 (with a 2025 baseline).

Nevertheless, insufficient disclosure constrains our ability to assess the bank's performance against these targets, as well as the targets' level of ambition. Flekkefjord Sparebank does not yet report on its own or financed emissions. It is in the process of attaining local environmental certification that is recognized by the European Commission, which we regard as positive. We note that the third target has a base year of 2025, which could mean an increase in emissions up to that year. We view as positive that the board of directors has some awareness about the effect of climate risks on the bank's operations and markets. We believe Flekkefjord Sparebank is implementing processes that will likely, in the coming years, contribute to addressing its climate transition risk. Of note, in 2022, the bank launched its ESG assessment as part of its credit risk evaluation for corporate customers exceeding Norwegian krone (NOK) 15 million of credit and its pledge to follow Norway's Road Map for Green Competitiveness in the Financial Industry. The bank currently applies its ESG assessment to about half of its corporate loans, representing only a small share of the total loan portfolio. The assessment aims to identify customers with high, medium, or low exposure to climate risks, and we note it focuses more on financial liability than on the potential for adverse impacts on climate.

Flekkefjord Sparebank has yet to develop a strategy to reduce its physical climate, biodiversity, and resource use risks. The bank has committed to reporting according to principles of the Task Force on Climate-Related Financial Disclosures (TCFD) as of 2023. Nevertheless, the targets it has set as part of its sustainability strategy do not address physical climate risks. For biodiversity issues, which may arise in relation to renewable energy projects, the bank relies on national regulations. In general, Norwegian environmental regulation is considered robust, but renewable energy and other development projects are sometimes the subject of controversies and civic engagement. We note that the bank's employees are required to become familiar with, and are annually updated on, its guidelines, which include the prevention of serious environmental damage. Additionally, the credit risk assessment of corporate borrowers, when the loan amount exceeds NOK15 million, includes questions on exposure to physical climate risks as well as on adverse environmental impacts.

Alignment Assessment

This section provides an analysis of the framework's alignment to Green Bond principles.

Alignment With Principles

Aligned = ✔ Conceptually aligned = ○ Not aligned = ✖

✔ Green Bond Principles, ICMA, June 2022 update

✔ Use of proceeds

All the framework's green project categories are shaded in green, and the issuer commits to allocate the net proceeds issued under the framework exclusively to eligible green projects. Please refer to Analysis of Eligible Projects section for more information on our analysis of the environmental benefits of the expected use of proceeds.

Flekkefjord Sparebank will allocate an amount equal to the net proceeds from instruments issued under its green bond framework to finance a loan portfolio aimed at promoting the transition to a low carbon economy. The project categories include loans to finance green buildings, renewable energy, and pollution prevention and control, with a focus on onshore ship recycling and water filter membranes for wastewater treatment. However, we observe that the framework does not reference a look-back period for refinanced eligible projects as is recommended by the Principles.

✔ Process for project evaluation and selection

The process for project evaluation and selection is described in the framework. Flekkefjord Sparebank has established a Green Bond Committee (GBC) comprising members of its top management, who are responsible for selecting eligible projects. If a project no longer meets the eligibility criteria, the GBC will remove it from the portfolio. Each lending activity undergoes a credit approval process, which includes the requirements that borrowers comply with environmental and social regulation. These requirements are specified in the bank's internal procedures and are not publicly disclosed. Although this somewhat constrains our ability to assess the validity of its internal procedures, we view as positive that the bank has committed to improving transparency by aligning its reporting to TCFD requirements. For activities related to corporate customers with loans exceeding NOK15 million, the bank conducts an ESG assessment. In addition, the framework outlines a project exclusion list, which includes, for example, fossil fuel generation and/or extraction and resource extraction with negative environmental impacts.

✔ Management of proceeds

The bank commits to allocating the proceeds from instruments issued under its green bond framework to assets in its green portfolio. The allocation of net proceeds will be tracked to ensure that they support only the financing of eligible projects. Moreover, under the framework, the bank will ensure that the value of the green loan portfolio exceeds, at all times, the value of outstanding instruments. If projects no longer meet the eligibility criteria, the issuer, through the GBC, will remove and replace them from the green loan portfolio. Unallocated proceeds will be managed in line with the bank's regular liquidity management policy. That said, we note the framework does not make reference to a deadline for when the issuer intends to allocate all proceeds after issuance, which we view as a weaker practice. We also consider the wording of the bank's commitment to apply its project exclusion list (that is, fossil fuel energy, weapons, tobacco) for temporary holdings to be ambiguous.

✔ Reporting

The bank commits to publishing annually an allocation report on its website until full allocation of proceeds. This report will include a description of the projects at the category level, the amount of debt outstanding, the share of green loans financed by green bonds, and the amount of net proceeds. In addition, the issuer will report the actual environmental impact of projects until full allocation. We view as positive that the issuer will align its impact reporting with ICMA's Harmonised Framework for Impact Reporting and that the allocation report will provide transparency on assumptions and calculation methods.

Analysis Of Eligible Projects

This section provides details of our analysis of eligible projects, based on their environmental benefits and risks, using the Shades of Green methodology.

For the three years following issuance of the financing under the framework, Flekkefjord Sparebank expects to allocate approximately 88% of the proceeds from its first bond under the framework to green buildings, 4% to renewable energy, and the remaining 8% to pollution prevention and control. The issuer expects primarily refinancing of existing loans.

The eligible assets will include assets for which borrowers have commenced operations or placed-in-service prior to the applicable green financing, unless otherwise noted in the respective financing documents.

The framework excludes the financing of loans to customers linked to fossil energy extraction and/or generation, production of or research and development within weapons and defense systems, potentially environmentally negative resource extraction, gambling, pornography, or tobacco.

Light green

Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term low-carbon climate resilient solutions.

Our Shades of Green Analytical Approach >

Overall Shades of Green assessment

Based on the project categories detailed below, the expected allocation of proceeds, and consideration of environmental ambitions reflected in the Green Bond Framework, we assess the framework as Light green.

Green project categories

Green Buildings

Assessment	Description
Light green	Loans provided to the issuer's customers to finance their acquisition, ownership, construction, or renovation of residential, commercial, and public buildings which meets either of the criteria set out below: 1. Buildings built in 2021 or later: • Primary energy demand (PED) is 10% lower than the threshold set for the nearly zero-energy building (NZEB) requirements in national measures (veiledning-om-beregning-av-primarenergibehov-og-nesten-nullenergibygg.pdf (regjeringen.no)). PED refers to the amount of energy needed to meet the energy demand associated with the typical uses of a building expressed in kilowatt hours per square meter (kWh/m^2) per year, based on the relevant national calculation methodology and displayed on the energy performance certificate (EPC). • For commercial buildings, a BREEAM-NOR or BREEAM In-Use certificate notation as “Excellent” or better. 2. Buildings built before 2021: • Energy Performance Certificate A, or alternatively, buildings within the top 15% of the national stock in terms of primary energy demand, defined as; – buildings built according to Norwegian building codes of 2010 (TEK10; to ensure TEK10 alignment, the issuer will use a conservative two-year time lag and include buildings built from 2012 onward) or 2017 (TEK17). Using TEK10 and TEK17 will be replaced with a

new national definition of "top 15%" if this is developed); or Energy Performance Certificate B for buildings built prior to 2012.

- For commercial buildings, a BREEAM-NOR or BREEAM In-use certificate notation as "Excellent" or better.

3. Renovated buildings:
    - Major renovations leading to a reduction in primary energy demand of at least 30%.
    - The initial primary energy demand and the estimated improvement is based on an energy audit conducted by an independent expert. The 30 % improvement results from an actual reduction in primary energy demand, and be achieved through a succession of measures within a maximum of three years.
    - For the full building to qualify after renovation, it should be expected to meet the criteria under #1 or #2 above.
4. Exclusions:
    - Residential buildings used for leisure (cabins).
    - Commercial buildings purposely built to support activities explicitly excluded (see exclusion list above**).**

Analytical considerations

- For existing buildings, high energy performance is important to the transition to a low carbon economy. In new construction, improving energy performance and reducing emissions associated with building materials are, in our view, key topics to address from a low carbon perspective. For all buildings, mitigating exposure to physical climate risk is crucial to improving climate resilience.
- The criteria for existing buildings should ensure that some of the most efficient buildings in Norway are financed. However, this includes mostly buildings only in line with regulations applicable at the time of construction (2012 to 2020). Note that, in Norway, the top 15% of the building stock are not yet officially determined, and the framework's definition relies on a report by a consultancy. There is uncertainty as to how robust this definition of the top 15% is, although this is the best information currently available.
- For new residential buildings, the framework lacks criteria to address emissions related to building materials, which in the Nordic context typically contribute to half of a building's lifecycle emissions.
- Buildings with fossil fuel heating will not be financed. It is positive that cabins are excluded, since energy building requirements do not apply to most of these, as are buildings purposely built to support fossil energy generation and other activities excluded under the framework.
- For new commercial buildings, the additional criterion to have an "Excellent" BREEAM-NOR in the design phase contributes to incorporating sustainability in the design phase of a building while the BREEAM In-Use certification should contribute to better energy-use management. However, the point-based system of such certification does not guarantee a low climate-impact building.
- There are no specific criteria related to mitigation of physical climate risks of the financed assets, nor screening for highly exposed assets. In general, buildings are highly exposed to physical climate risks, and while building regulations currently consider such risks in Norway, this is no guarantee that such risks are properly addressed. An increase in precipitation and flooding are key risks in the Norwegian context.

Renewable Energy	
Assessment	**Description**
Dark green	Loans provided to the issuer's customers to finance their acquisition, ownership, construction, upgrade or maintenance of hydropower production facilities in Norway, as well as related required infrastructure, which meets either of the criteria set out below: • The power density is above 5 watts per m2 or life-cycle emissions are below 100 grams of carbon dioxide equivalent per kWh. • Run-of-river hydropower plants without artificial reservoirs.

Analytical considerations

- Renewable energy, including hydropower, is a key element in a low carbon energy sector, as long as impacts on local biodiversity are carefully managed.
- Hydropower can entail significant emissions from construction and from water reservoirs. It is therefore positive that a threshold for life-cycle emissions or power density is included for plants that are not run-of-river (without reservoirs). The criteria in the framework are the EU Taxonomy's significant contribution to climate change mitigation criteria. The issuer expects to finance only small existing hydropower assets, which are regulated by the national energy authorities.
- Given the ongoing and future impacts of a changing climate, which in the bank's region likely include flooding, the resilience of hydropower assets is crucial. Such aspects are covered in the licensing process and regulation of such assets in Norway, while the bank also considers physical climate risk in its credit assessment.
- Hydropower can have adverse impacts on biodiversity and ecosystems, for example water flows and fish migration. In Norway, these issues are dealt with in the licensing process with the relevant authorities, including through environmental impact assessments for any new plants, and through regulation of the waterways. Specific local impacts will vary, and plants with older licenses may not always have in place best practices for ecosystem preservation, for example measures to facilitate fish migration. Run-of-river plants without artificial reservoirs, which are also included in the framework, typically have a lower impact on surrounding biodiversity. Overall, we consider the adverse impacts on biodiversity to be sufficiently managed.

Pollution Prevention and Control	
Assessment	**Description**
Medium to Light green	Loans provided to the issuer's customers to finance their acquisition, ownership, construction, upgrade or renovation of operating facilities and/or equipment, as well as related infrastructure and professional services, which meets either of the criteria set out below: 1. Recycling of waste, including but not limited to onshore ship recycling at approved recycling facilities, in accordance with the highest available recycling standards 2. Manufacturing of filter membrane for waste-water treatment in facilities (not associated with fossil energy extraction) which purifies water and/or enhances the reuse of waste substances and nutrients

Analytical considerations

- Increasing waste recycling and reducing resource use are important in the transition to a low carbon future, since the extraction and processing of new resources cause significant emissions and environmental impacts. However, these activities are not necessarily fully aligned with a low carbon future; for example, recycling may entail significant emissions recycling, while the environmental benefits of filter membranes will vary depending on the different technologies and applications.
- The eligible projects seek to increase material recycling and the reuse of waste and nutrients in a potentially wide range of sectors. Eligible recycling technologies may use both fossil fuels and renewable power, while overall contributing to lower emissions through material recovery. In the framework, Green Yard, a recycler of ships, is given as an example of a customer

likely to be eligible. Enhanced reuse of waste streams and nutrients are environmental benefits from the use of filter membranes for wastewater treatment, but the framework does not set quantitative criteria for these benefits and it is not clear whether the financed technology has environmental benefits beyond standard technologies.

- Filter membranes are typically made of fossil fuels, while their overall environmental benefits and risks will depend on the context in which they are implemented. The issuer has stated that the membranes will be used, for example, within aquaculture and shipping, where we consider these to have environmental benefits. The exclusion of activities within fossil energy extraction ensures that financed activities will not facilitate oil and gas extraction.
- All physical assets are exposed to physical climate risks, while better filter membrane technologies may, in some contexts, have adaptation benefits.
- Emissions of pollutants to air, soil, and water, which may occur at recycling facilities, are generally strictly regulated in Norway, including through environmental permits, which we consider to sufficiently manage the risks of harmful local pollution.

S&P Global Ratings' Shades of Green

Assessments	**Dark green**	**Medium green**	**Light green**	**Yellow**	**Orange**	**Red**
Description	Activities that correspond to the long-term vision of an LCCR future.	Activities that represent significant steps toward an LCCR future but will require further improvements to be long-term LCCR solutions.	Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term LCCR solutions.	Activities that do not have a material impact on the transition to an LCCR future, or, Activities that have some potential inconsistency with the transition to an LCCR future, albeit tempered by existing transition measures.	Activities that are not currently consistent with the transition to an LCCR future. These include activities with moderate potential for emissions lock-in and risk of stranded assets.	Activities that are inconsistent with, and likely to impede, the transition required to achieve the long-term LCCR future. These activities have the highest emissions intensity, with the most potential for emissions lock-in and risk of stranded assets.
Example projects	Solar power plants	Energy efficient buildings	Hybrid road vehicles	Health care services	Conventional steel production	New oil exploration

Note: For us to consider use of proceeds aligned with ICMA Principles for a green project, we require project categories directly funded by the financing to be assigned one of the three green Shades.

LCCR--Low-carbon climate resilient. An LCCR future is a future aligned with the Paris Agreement; where the global average temperature increase is held below 2 degrees Celsius (2 C), with efforts to limit it to 1.5 C, above pre-industrial levels, while building resilience to the adverse impact of climate change and achieving sustainable outcomes across both climate and non-climate environmental objectives. Long term and near term--For the purpose of this analysis, we consider the long term to be beyond the middle of the 21st century and the near term to be within the next decade. Emissions lock-in--Where an activity delays or prevents the transition to low-carbon alternatives by perpetuating assets or processes (often fossil fuel use and its corresponding greenhouse gas emissions) that are not aligned with, or cannot adapt to, an LCCR future. Stranded assets--Assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities (as defined by the University of Oxford).

Related Research

- Analytical Approach: Second Party Opinions: Use of Proceeds, July 27, 2023
- FAQ: Applying Our Integrated Analytical Approach for Use-of-Proceeds Second Party Opinions, July 27, 2023
- Analytical Approach: Shades of Green Assessments, July 27, 2023
- S&P Global Ratings ESG Materiality Maps, July 20, 2022

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