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Q&As on Pilot Program of Social Bonds and Sustainability Bonds

In order to implement the policy of the Party Central Committee and the State Council on "promoting high-quality development" and "actively implementing the United Nations 2030 Agenda for Sustainable Development", and strengthen the bond market's role in supporting sustainable development, NAFMII has launched the pilot program for overseas issuers to issue social bonds and sustainability bonds in China, and released the *Q&As on Pilot Program of Social Bonds and Sustainability Bonds* (the "Q&A").

Q1: What is the background of launching social bonds and sustainability bonds?

A: In 2015, the United Nations Sustainable Development Summit formally adopted the "2030 Agenda for Sustainable Development" (referred to as the "2030 Agenda"), setting up 17 sustainable development goals (SDGs) with 169 SDG targets that the world strives to achieve by 2030. It aims to turn to the path of sustainable development and solve development problems in the three dimensions of society, economy and environment. At the beginning of 2021, President Xi Jinping, in his special address at the

World Economic Forum, stressed on the importance of sustainable development in addressing global challenges, bridging the North-South Gap, and jointly promoting the development and prosperity of all countries. He once again indicated the promotion of sustainable development as the vision of building a community with a shared future for mankind, as well as an inevitable choice to implementing the new development philosophy. Sustainable development is the route that China must take to achieve the high-quality development, and a prerequisite for accelerating the establishment of a “dual circulation” development pattern.

The “Green, Social and Sustainability” (GSS) bond market has been playing an indispensable role in global financing for sustainable development. Among GSS bonds, green bonds mainly serve the relevant environmental goals in the SDGs, social bonds mainly serve the relevant social goals in the SDGs, and sustainability bonds serve both the environmental and social goals in the SDGs. International development institutions are the pioneers on the GSS bond market. Prior to 2013, the issuers of global GSS bonds were mainly international development institutions. Subsequently, the issuer community has been gradually diversified. Following years of development recently, consensus on classification has been reached globally, including common principles of multilateral development institutions and voluntary principles of the International Capital Market Association (ICMA). GSS bonds have

also become the focus of international ESG investors in the field of bond investment, including a large number of medium and long-term investors.

As the sustainable development concept has been well-recognized in China, there are actual demands and practical foundations for the development of the GSS bond market. In terms of policy support, China attaches great importance to the 2030 Agenda. In 2016, China released *China's National Plan for Implementing the 2030 Agenda for Sustainable Development*, and issued a progress report or country-specific voluntary statement report on the implementation of the 2030 Agenda in 2017, 2019 and 2021, respectively. China has combined the implementation of the 2030 Agenda with national medium- and long-term development strategies such as the 13th Five-Year Plan and the 14th Five-Year Plan, and has issued a series of policy documents. The *14th Five-Year Plan (2021-2025) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035* has emphasized the need to "implement the United Nations 2030 Agenda for Sustainable Development", "promote green development and ensure harmony between humanity and nature", and "align efforts to consolidate and expand the achievements in poverty alleviation with efforts to promote rural revitalization", etc. The five development concepts of innovation, coordination, greenness, openness, and sharing put forward by China are in line with the

overall requirements of the 2030 Agenda to coordinate economic, social, and environmental development, taking into account humanity, the planet, prosperity, peace, and partnership. China's goal of "promoting common prosperity in high-quality development" is highly compatible with the central, transformative promise of the 2030 Agenda - "leave no one behind". In terms of demands, as financing instruments for sustainable development, GSS bonds should play a greater role in expanding channels for financial services to serve the real economy and satisfying people's aspirations for a better life. At the same time, the sustainable development concept is the world's common language. As the market further opens up, overseas issuers and investors entering China's bond market also have actual demands for such products. In terms of practice, a large volume of bonds have been issued in China to promote sustainable development goals including low-carbon economic transformation, targeted poverty alleviation and ecological protection, and the market has witnessed sustained growth. At the same time, more and more domestic issuers have published social responsibility reports or sustainability reports on an ongoing basis, formulated GSS bond frameworks and issued GSS bonds in the international market.

On the basis of the *Social Bond Principles* and *Sustainability Bond Guidelines* published by ICMA, as well as practices of international development institutions, the National Association of

Financial Market Institutional Investors (NAFMII) has conducted research and organized its members to launch pilot programs of social and sustainability bonds in China's inter-bank market.

Q2: What are the social bonds and the sustainability bonds?

A: Social bonds refer to the bonds issued by an issuer in China's inter-bank market where the proceeds will be exclusively used for social projects.

Sustainability bonds refer to the bonds issued by an issuer in China's inter-bank market, where the proceeds are exclusively applied to a combination of green and social projects which shall comply with relevant rules and regulations applicable to green bonds and social bonds, respectively. Proceeds of sustainability bonds can also be used for projects that have both environmental and social benefits.

Sustainability bonds are different from sustainability-linked bonds (SLB). All the proceeds from issuances of sustainability bonds are required to be used for specific purposes; while the proceeds of SLBs can be used for general purposes, and its main feature is that the bond terms are linked to the issuer's sustainable development goals.

Q 3: What types of entity are eligible to issue social bonds and sustainability bonds during the pilot phase?

A: During the pilot phase, foreign governmental agencies, international development institutions, and overseas non-financial enterprises (hereinafter collectively referred to as "issuers") are eligible to register with NAFMII to issue social bonds and sustainability bonds

Q 4: What are the core elements of social bonds and sustainability bonds?

A: Social bonds and sustainability bonds should meet the four core elements of the use of proceeds, project evaluation and selection, management of proceeds, and information disclosure (as specified in Q&A5 to Q&A8).

Issuer can establish its framework for social bond or sustainability bond (the “framework”), and clearly disclose that the envisaged bonds are consistent with the four core elements. The framework can be used for one or multiple bond issuances, and shall be disclosed together with issuance documents. An issuer that does not disclose in the form of framework shall disclose in the issuance documents for each bond issuance whether it meets the core elements.

Q 5: What are the requirements on use of proceeds from issuances of social bonds and sustainability bonds?

A: The proceeds from issuances of social bonds shall be

exclusively used for the investment, construction, acquisition of assets, or relevant expenditure (such as R&D) for social projects, or to repay loans or bonds used to finance social projects. Such loans or bonds should be used exclusively for social projects that meet the definition of this Q&A.

Social projects aim to help target populations solve specific problems or bring more social benefits. Target populations can include low- and middle-income population, unemployed, people affected by natural disasters, people with disability, women, children, senior citizens, people living in remote areas, undereducated people, etc., and in some special cases, the general public. Several goals of the United Nations Sustainable Development Goals focus on social benefits and can be referenced to identify, select and evaluate social projects. During the pilot phase, social projects may include projects in the fields of medical and health, agriculture, rural areas and food security, education and employment, drinking water and sanitation facilities, inclusive infrastructure, disaster prevention and relief.

Enterprises that issue social bonds shall comply with industry regulations and policies to ensure the proceeds are used in accordance with applicable laws, regulations and policies. Social projects shall follow the principles of commercial sustainability with market-oriented arrangements for investment returns.

For enterprises issuing sustainability bonds, the criteria for identifying green projects are set forth in the *Green Bond Endorsed*

Projects Catalogue jointly issued by the People's Bank of China, the National Development and Reform Commission, and the China Securities Regulatory Commission or other international green industry catalogs such as EU Taxonomy Climate Delegated Act. For foreign government agencies and international development institutions issuing sustainability bonds, the identification criteria for their green projects are encouraged to be the abovementioned *Green Bond Endorsed Projects Catalogue*, or they can be based on international best practices and be specified in their framework or issuance documents.

Enterprise issuing social bonds or sustainability bonds must specify the specific projects or candidate project pool for use of proceeds before issuance. Enterprises shall disclose the following information regarding social projects:

- (1) social responsibility targets and the target population;
- (2) a statement explaining why the project falls within eligible social project categories, including the process and the criteria for such determination and the conclusion;
- (3) the expected social benefits of the social project, and enterprises are encouraged to quantify relevant social benefits .

If foreign government agencies and international development institutions are unable to specify the social projects or candidate project pool before issuance, they can adopt the approach of clarifying the types of social projects/green projects, and the criteria

and procedures for project evaluation and selection.

Q 6: What are the requirements for the evaluation and selection process of social projects?

A: Issuers should disclose the following information in the framework or issuance documents:

- (1) standards for qualified social projects;
- (2) the process by which the issuer judges whether a project is a qualified social project;
- (3) the process by which the issuer assesses and manages the potential social and environmental risks of the project.

Qualified social projects should not cause significant harms to other social and environmental aspects.

If an issuer needs to change its social project during the tenor of its social bonds, it shall select and disclose the qualified social project in accordance with the criteria and procedures for the evaluation and selection of qualified social projects specified in the framework or issuance documents.

Q 7: What are the requirements for social bonds and sustainability bonds with respect to the management of bond proceeds?

A: Issuers that issue social bonds shall undertake to use the proceeds exclusively for social projects, and comply with relevant

laws, regulations and national policies. Issuers shall establish a formal internal control mechanism to ensure that the proceeds are used in support of social projects. Issuers are encouraged to set up an escrow account in a domestic bank, and the bank shall manage the receipt, custody and transfer of the proceeds. Issuers can also adopt other proceeds management methods that are consistent with international best practices (such as transferring proceeds to sub-accounts, transferring proceeds into an independent investment portfolio or establish a special ledger for the account, etc.).

If the issuer needs to change the use of proceeds during the tenor of social bonds, it shall report to NAFMII and perform relevant procedures, and disclose at least five working days before the change. The amended use of proceeds shall also meet the requirements of the Q&As herein.

Issuer issuing sustainability bonds should manage the proceeds used for social projects and green projects according to the above requirements.

Q8: What are the ongoing disclosure requirements during the tenor of social and sustainability bonds?

A: Enterprises issuing social bonds should disclose information in accordance with relevant self-regulatory rules issued by NAFMII. In addition to that, enterprises shall disclose annually the use of proceeds and social projects supported or financed by such proceeds

during the preceding year (in principle, the timing for disclosure of such information shall not be later than the timing for disclosure of annual financial reports). Enterprises are encouraged to disclose the use proceeds on a semi-annual basis.

The use of proceeds disclosed shall include the allocation of funds, the balance and placement of unallocated funds, etc. Information on social projects shall include a list of projects, their progress and expected social benefits (disclosure of quantitative information is encouraged). If the issuer has the ability to track and monitor actual benefits, it is encouraged to disclose actual benefits

If a material event affecting the use of proceeds occurs, such as the sale of the social projects, the enterprise should disclose such event in a timely manner (in principle, within two working days). Changes in the use of proceeds should be handled in accordance with Q&A 7.

Issuer issuing sustainability bonds should also disclose the information of green projects in accordance with the timing requirements for green bonds.

Q 9: What are the requirements for external review?

A: Issuers are encouraged to engage external review provider to perform external review on social bonds and sustainability bonds before the issuance. External review providers are encouraged to evaluate whether the issuance documents and framework (if

applicable) meet the four core elements, and disclose their opinions.

Enterprises are encouraged to engage external review provider to perform follow-up external review on the progress and social impact (and environmental impact, where applicable) of the social projects (and green projects, where applicable) during the tenor of social bonds and sustainability bonds, and release the relevant reports on a regular basis.

External review providers appointed by issuers shall have necessary talents, expertise, strong technical strength, credibility and high market recognition in their professional fields, and have rich evaluation experience in the fields of green bonds, social bonds and sustainability bonds. The practitioners of external review providers shall perform their duties with professionalism and work ethics, abide by the principles of honesty and trustworthiness, objectivity and impartiality, and due diligence, so as to ensure the impartiality, independence, and integrity of the review results. External review providers shall disclose their qualifications, independence and review methodologies. For other requirements for external review providers, please refer to the relevant requirements for external review providers for green bonds.

Q 10: How are social and sustainability bonds labeled?

A: Bonds that meet the criteria for social bonds or sustainability bonds in this Q&As are eligible to be labeled as social bonds or

sustainability (or sustainable development, etc.) bonds.

Q 11: Is special registration required for issuing social or sustainability bonds?

A: Issuers may apply for registration specifically for social or sustainability bonds. If an issuer has an existing registered bond program, it can issue social or sustainability bonds under such program after changing relevant terms and supplementing necessary information through the procedure of modification of terms.

Q 12: Can the frameworks established by issuers in line with international mainstream principles/guidelines or practices be used to issue social or sustainability bond in China inter-bank bond market?

A: The frameworks established by issuers in accordance with the *Green Bond Principles*, the *Social Bond Principles* and/or the *Sustainability Bond Guidelines* or other mainstream international principles/guidelines/practices, the frameworks established by international development institutions based on relevant international consensus, as well as relevant external review opinions, can in principle be used to issue social bonds or sustainability bonds in China's inter-bank market.

Q 13: What supporting measures does NAFMII have for

issuances of social bonds and sustainability bonds?

A: Issuance of social bonds and sustainability bonds will help issuers achieve their sustainable development goals such as low carbon transition, raise their profiles and reputation, and attract domestic and overseas investors who focus on ESG investment, socially responsible investment (SRI), impact investment, etc.

NAFMII has been actively exploring measures to support issuers to issue social bonds and sustainability bonds. **Firstly**, NAFMII has established an expressway for the registration and issuance of such bonds. **Secondly**, NAFMII will display the list of issuers, lead underwriters and investors of such bonds on its website and WeChat official account, and launch joint promotion of the market through websites of the relevant international partners to enhance the reputation of the participants. **Thirdly**, the performance of underwriters and other intermediaries in the business of social bonds and sustainability bonds will be taken into account when NAFMII conducts business reviews.