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Second Party Opinion

Ziklo Bank Green Bond Framework

April 2, 2024

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Location: Sweden	**Sector:** Banks

Alignment With Principles

Aligned = ✔ Conceptually aligned = O Not aligned = ✖

✔ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

See Alignment Assessment for more detail.

Dark green

Activities that correspond to the long-term vision of a low-carbon climate resilient future.

Our Shades of Green Analytical Approach >

Strengths

Ziklo Bank's financing focus on leases for fully electric heavy commercial and freight vehicles is a positive step, in our view. Given the size, weight, and range requirements of these vehicles, consumer take up has lagged other vehicle types. At the manufacturer level, these challenges have also weighed on the adoption of zero emission technologies for such vehicles.

Weaknesses

No weaknesses to report.

Areas to watch

The bank does not currently screen car makers for lifecycle climate and environmental impacts. Although the bank plans to establish specific procedures and assess potential additional suppliers on a case-by-case basis, dedicated policies are currently lacking.

The bank's physical risk assessment does not cover car suppliers' manufacturing facilities. The bank assesses its own properties, but not the manufacturing facilities of car suppliers, which leaves some aspects of physical climate risk unaddressed. However, we note the bank's ongoing efforts to assess such risks at the supplier level and take necessary actions.

Eligible Green Projects Assessment Summary

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

Clean Transportation	**Dark green**
Heavy commercial vehicles (buses) with zero specific carbon dioxide emissions.	
Light commercial and passenger vehicles with zero specific carbon dioxide emissions.	
Fully electric freight transport vehicles (lorries/heavy trucks) with zero specific carbon dioxide emissions.	

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

Ziklo Bank AB, previously Volvofinans Bank AB (publ), is a joint venture between AB Volverkinvest and Volvo Car Corporation. The bank was incorporated in 1959 and is based in Gothenburg, Sweden. It primarily offers loans for the purchase of new or used passenger cars, trucks, and buses (32% of its portfolio). It also offers savings accounts; operational and financial leasing, insurance, and card payment services, as well as CarPay and Volvo card, a digital payment service; and loans and leasing finance for new and used trucks, including trailers, and other equipment and structures. Lastly, it provides product and sales financing services to support the sale of products marketed by Volvo and other car dealers in Sweden. As of December 2023, its operating income was €163.94 million and its loan portfolio total was about €3.785 billion.

Material Sustainability Factors

Climate transition risks

Banks are highly exposed to climate transition risk through financing economic activities that affect the environment, such as transportation. Their direct environmental impact is small compared with financed emissions. 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 Europe, there is a push to integrate climate considerations into the regulation of banks and financial markets given that environmental laws are becoming increasingly ambitious. For example, in 2017, Sweden set targets to achieve net-zero greenhouse gas emissions by 2045, with interim goals of -63% CO_2e by 2030 and -75% CO_2e by 2040 (1990 baseline), driving national economy efforts in decarbonization.

Physical climate risks

Banks finance a wide array of business sectors that are exposed to physical climate risks, including automotive and transportation. However, while climate change is a global issue, weather-related events are typically localized. Therefore, the magnitude of a bank's exposure is linked to the geographic location of the activities and assets it finances. Similarly, a bank's physical footprint might also be exposed to physical risks, different for each location, which could disrupt its ability to service clients in the event of a natural catastrophe. In Sweden, where the issuer operates, exposure to these risks is generally lower than in some other EU countries. Nevertheless, 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.

Biodiversity and resource use

Banks contribute to significant resource use and biodiversity impacts through the activities they fund or invest in. For example, the auto and transportation sectors—major recipients of bank financing—are large consumers of raw materials. For electric vehicles specifically, battery manufacturing requires scarce resources like lithium, cobalt, nickel, and graphite. Sources these can be polluting and can damage ecosystems, particularly in areas with less-stringent environmental regulations.

Access and affordability

Banks play a key socioeconomic role in providing individuals and businesses access to financial services, and ensuring payments systems function correctly; these are cornerstones of economic development and stability. Market imperfections such as low competition, incomplete information, and lack of financial literacy often result in costly alternatives for small businesses and low-income people. In this sense, ensuring affordable access to financial services, especially to the most vulnerable, remains a challenge for the banking industry. Banks, through cost efficiencies and subsidised interest rates, play a significant role in addressing affordability risks associated with high-cost electric vehicles.

Privacy protection

Banks rely heavily on IT systems. Client data collection, data mining, and artificial intelligence (AI) have brought significant efficiency gains and facilitated financial access. However, this has increased banks' exposure to the risk of IT infrastructure failures, cyberattacks, and other rapidly evolving risks. Disruptions (client data leakage, data theft, or AI-related unintended or biased use of private personal data) could subject banks to higher and unpredictable risks given how many customers and business partners they have. We see privacy protection risks rising but we think most banks have strong risk governance and are well prepared.

Issuer And Context Analysis

Climate transition risk mitigation is the focus of Ziklo Bank's framework. The clean transportation category directly aims to address climate transition risk. Moreover, the issuer says it intends to screen potential new partners and assess lifecycle and physical climate risks. While the bank has yet to determine the details, such screenings could help mitigate its physical climate and resource-use risk exposures.

The issuer is starting to reduce its carbon emissions in both its portfolio and direct activities. It aims to achieve net-zero emissions, but has not set a date. Its intermediary target is a 30% reduction (including leased vehicles emissions) by 2025, from a 2020 baseline. In 2023, it lowered this target from 40%. It discloses its scope 1, 2, and 3 (for financed vehicles) carbon dioxide emissions, where scope 3 represents almost all the bank's emissions, driven by its customers' vehicle use. Scope 3 emissions of financed vehicles showed a 16% improvement in 2023 year-on-year (reaching 234,609 tCO_2e). Average carbon dioxide emissions per kilometer has also improved steadily over the past three years, reaching 107 gCO_2e/km in 2023, from 133 gCO_2e/km in 2020. This result reflects the increase in rechargeable vehicles as a portion of the stock, to

48% in 2023 (from 39% in 2022). The green bond framework includes investments in zero-tailpipe vehicles, which will help cut scope 3 emissions further.

The bank discloses a climate risk assessment in a TCFD report that includes both transition and physical risks, although the scope of the latter is limited. The bank deems the climate transition to be more material for its business, and assesses it using dedicated scenario analysis. It follows Network for Greening the Financial System (NGFS) scenarios, which encompass six alternatives ranging from orderly transition scenarios, through to a disorderly transition, and to hot-house scenarios. While the bank is better prepared for short term risks, the overall results show how increasing risks related to the new car market and borrowing might affect the bank's operations in five years. On the physical side, the bank has conducted a risk assessment of its facilities, identifying key areas such as property damage, decreased productivity, and supply-chain disruptions. Its direct exposure is limited to Sweden, where physical risk exposure is lower than in other EU countries according to Germanwatch. The bank's lending portfolio, particularly if it adds more car-brand partners, could become more exposed to the climate transition. As the portfolio becomes more diversified, uncertainties remain regarding the associated physical climate risks of both car sellers and manufacturing facilities. However, we view positively that the bank is currently working on understanding its exposure to potential risks related to the manufacture and supply of cars, and is taking mitigating actions.

Ziklo Bank does not yet have a standardized approach to addressing the resource extraction practices of its EV battery partners but is starting to screen them. EVs are commonly seen as a primary solution for curbing carbon emissions in the personal mobility sector, but the environmental and social consequences linked to lithium, cobalt, and nickel extraction can be material. While the bank currently screens its partners using publicly available information as part of the credit due-diligence process, it plans to increase its understanding of electric car makers' upstream stages, which will help it address environmental (such as local pollution) and social (such as human rights) considerations.

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, 2021 (with June 2022 Appendix 1)

✔ Use of proceeds

The framework's green project category is 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.

Ziklo Bank will allocate an amount equal to the net proceeds from instruments issued under its green bond framework to finance a selected loan or lease that has positive environmental impacts. The project category consists of clean transportation with the objective of contributing towards climate change mitigation.

✔ Process for project evaluation and selection

The framework outlines the process to select and approve eligible projects and assets. The Green Bond Committee (GBC), which includes the treasury department head and the sustainability manager, both with veto power, will select eligible assets and include them in Ziklo Bank's green asset portfolio. Furthermore, the allocation of eligible assets to the green asset portfolio will be regularly monitored by the GBC at least annually. The bank identifies and manages ESG-related risks associated with the eligible projects similar to its regular credit approval process. Furthermore, an asset will be excluded from the green asset portfolio if it violates the inclusion criteria. We view as positive that the bank has outlined the relevant exclusion list.

✔ Management of proceeds

Ziklo Bank tracks the net proceeds using the green asset portfolio, and all the green bonds are managed on a portfolio basis. The bank's treasury department is responsible for managing the proceeds. Furthermore, under the framework, Ziklo will ensure that the value of the green asset portfolio exceeds the value of the outstanding green bonds for the duration of the bond. If a project fails to meet the eligibility criteria, the bank will remove it and replace it with projects from the green asset portfolio. Unallocated proceeds will be placed in Ziklo Bank's liquidity reserve (consisting of covered and municipal bonds). We view positively that the bank excludes financing fossil fuel infrastructure from unallocated proceeds.

✔ Reporting

Ziklo Bank commits to disclosing the allocation and impact of proceeds annually within its green bond investor report on its website, until full allocation of the proceeds. The investor report will include information on the total amount of outstanding green bonds, a selection of eligible asset examples (such as car models in the portfolio), a description of the green asset portfolio including information on the maturity profiles of the green asset portfolio, impact reporting at the portfolio level (carbon dioxide reduction), information about the share of green bond financing in the green asset portfolio, and the amount of unallocated proceeds (if any). Where relevant, the bank strives to include information on the reduction in the carbon footprint of the funded eligible assets at the portfolio level.

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.

Over the three years following issuance of the financing, Ziklo Bank expects to allocate 100% of proceeds to the Clean Transportation project category.

The issuer expects a minority of proceeds to be allocated to refinancing projects, while the majority of proceeds will finance new projects.

Dark green

Activities that correspond to the long-term vision of a low-carbon climate resilient future.

Our Shades of Green Analytical Approach >

Overall Shades of Green assessment

Based on the project category shades of green detailed below, and considering the environmental ambitions in Ziklo Bank's green bond framework, we assess the framework as Dark green.

Green project categories

Clean Transportation

Assessment	Description
Dark green	• Heavy commercial vehicles (buses) with zero specific carbon dioxide emissions • Light commercial and passenger vehicles with zero specific carbon dioxide emissions • Fully electric freight transport vehicles (lorries/heavy trucks) with zero specific carbon dioxide emissions

Analytical considerations

- EVs, especially when powered by low-emission electricity, hold significant decarbonization potential for land-based transport. We view them as a Dark green solution. Costs are decreasing and adoption is accelerating, but further infrastructure investment is needed to scale up deployment, as indicated by IPCC. For pathways limiting warming to 1.5°C or below, nearly all electricity by 2050 is projected to come from zero or low-carbon sources such as renewables.
- All the vehicles being financed under the framework will be zero-tail pipe EVs. The issuer expects around 90% of the proceeds will be dedicated to light commercial and passenger vehicles. Therefore, a low portion of the proceeds will be invested in fully electric heavy commercial vehicles, such as buses, and freight transport, the latter including lorries and heavy trucks. In our view, the financing and adoption of electrified buses and heavy-duty vehicles is an important step toward reducing carbon emissions from transportation networks.
- As part of the credit approval process, the bank screens its clients and assigns a risk score. We understand that if a potential customer operates in an environmentally more harmful sector, which could lead to a negative score, the bank can refuse the loan or lease. The issuer also excludes financing EVs that will transport fossil fuels. We also note the risks related to EV production (including in the value chain). Sourcing minerals for lithium-ion batteries, for example, might cause local environmental hazards and increase vehicles' lifecycle emissions. The issuer is developing internal processes to assess the life-cycle risks/impacts of its car suppliers, which we view positively. Ziklo Bank has disclosed that, in future, when it considers new potential partners it will assess them on a case-by-case basis against identified best practices.
- Electricity grid emissions are a material consideration when evaluating the environmental benefits of EVs. If the grid relies heavily on fossil-fuels, then carbon dioxide emissions are still a part of a vehicle's use phase. In Sweden, however, the grid is mainly based on low carbon and renewable sources and compares well to other EU and non-EU countries (for example emissions are under 8g CO_2/kwh in Sweden, 378g CO_2/kwh in Germany, and 373g CO_2/kwh in the U.S.).

- The bank regularly performs a physical risk assessment of its facilities. Key risks are damage to properties, reduced productivity, and supply-chain delays. However, its direct exposure is contained because it only operates in Sweden. Key physical risks in Sweden include floods, droughts, storms, and landslides, with extreme weather events potentially becoming more relevant due to the overall increase in the national average temperature. Sweden's exposure to these risks is generally lower than in some other EU countries due to its geographical location and climate. While the direct exposure of the bank's facilities to physical climate risk may be less significant, the exposure of car manufacturing facilities and retailers could be more pronounced. As the bank expands its portfolio of automotive partners, the indirect exposure to physical risks, particularly through the impact on manufacturing facilities of these partners, remains unclear.

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

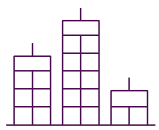
Note: For us to consider use of proceeds aligned with ICMA Principles for a green project, we require project categories directly funded by the financing to be assigned one of the three green Shades.

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).

Mapping To The U.N.'s Sustainable Development Goals

Where the Financing documentation references the Sustainable Development Goals (SDGs), we consider which SDGs it contributes to. We compare the activities funded by the Financing to the International Capital Markets Association (ICMA) SDG mapping and outline the intended linkages within our SPO analysis. Our assessment of SDG mapping does not impact our alignment opinion.

This framework intends to contribute to the following SDGs:

Use of proceeds	SDGs
Clean Transportation	 **11. Sustainable cities and communities***

*The eligible project categories link to these SDGs in the ICMA mapping.

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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