

Logical Framework

Task A6.1 of project “Green Financial System for Kazakhstan”

Final Report

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1. Introduction

The Logical Framework for the development of a Green Financial System for Kazakhstan describes the necessary financial, regulatory and institutional elements that are required for the development of a green financial system. A green financial system is the result of a complex interaction of many stakeholders, whose capabilities, interests and motivations are analyzed in this report. The key objective is to develop a system with the ability to deliver the financing to make green investment projects in targeted sectors of the Kazakh economy attractive to project developers and investors, including both private companies and municipalities. The financing should be provided via selected financial instruments and at terms that enable green investments at a magnitude that is sufficient to achieve the ambitious targets set out in the Green Economy Concept and the Nationally Determined Contribution (NDC).

The Framework consists of three major levels of analysis: (1) a detailed Stakeholder Analysis that pictures the interests, contributions and interactions between all major actors; (2) an Objective Tree that illustrates the hierarchy of objectives as well as their input-output relationships how each sub-objective is connected to the overall objective of successfully implementing the GFS; (3) a Flow Chart that illustrates the sequencing of key steps in the development of the Green Financial System. The focus of the Logical Framework is a dual one, both on what it takes to make individual green projects attractive and financially viable for project sponsors and what it takes to build an overall Green Financial System. The former perspective is emphasized more strongly in the Objective Tree and the latter in the Flowchart, while the Stakeholder Analysis incorporates both views. The approach is illustrated in Figure 1 below.

The chosen approach is consistent with the European Commission's Logical Framework approach which is now used (in one form or another) by most multi-lateral and bi-lateral aid agencies, international NGOs and by many partner governments.¹ It replicates key steps, i.e. the stakeholder analysis, the problem analysis and the objective analysis. The approach also takes into account the best practices and lessons learned from other countries' experiences with the development of Green Financial Systems. In particular China's experience² is reflected, as the major building blocks of the Chinese Green Financial System are also integrated into the Flowchart.

The Logical Framework is designed to frame the thinking of the project team and the key stakeholders about the complexity of Kazakhstan's Green Financial System. It will be used as guidance for the development of the GFS, as well as for the communication on it. The team's work is focused on building the capacity of the Astana International Financial Center as well as that of other important stakeholders. It does so by providing analysis and recommendations on the policy, regulatory and institutional measures that need to be taken for the development of the Green Financial System, the implementation of the recommendations is beyond the scope of the project.

¹ See European Commission. Aid Delivery Methods. Volume 1. Project Cycle Management Guidelines, March 2004, p.18.
https://ec.europa.eu/europeaid/sites/devco/files/methodology-aid-delivery-methods-project-cycle-management-200403_en_2.pdf

² See The People's Bank of China. Guidelines for Establishing the Green Financial System. 2.9.2016.
<http://www.pbc.gov.cn/english/130721/3133045/index.html>

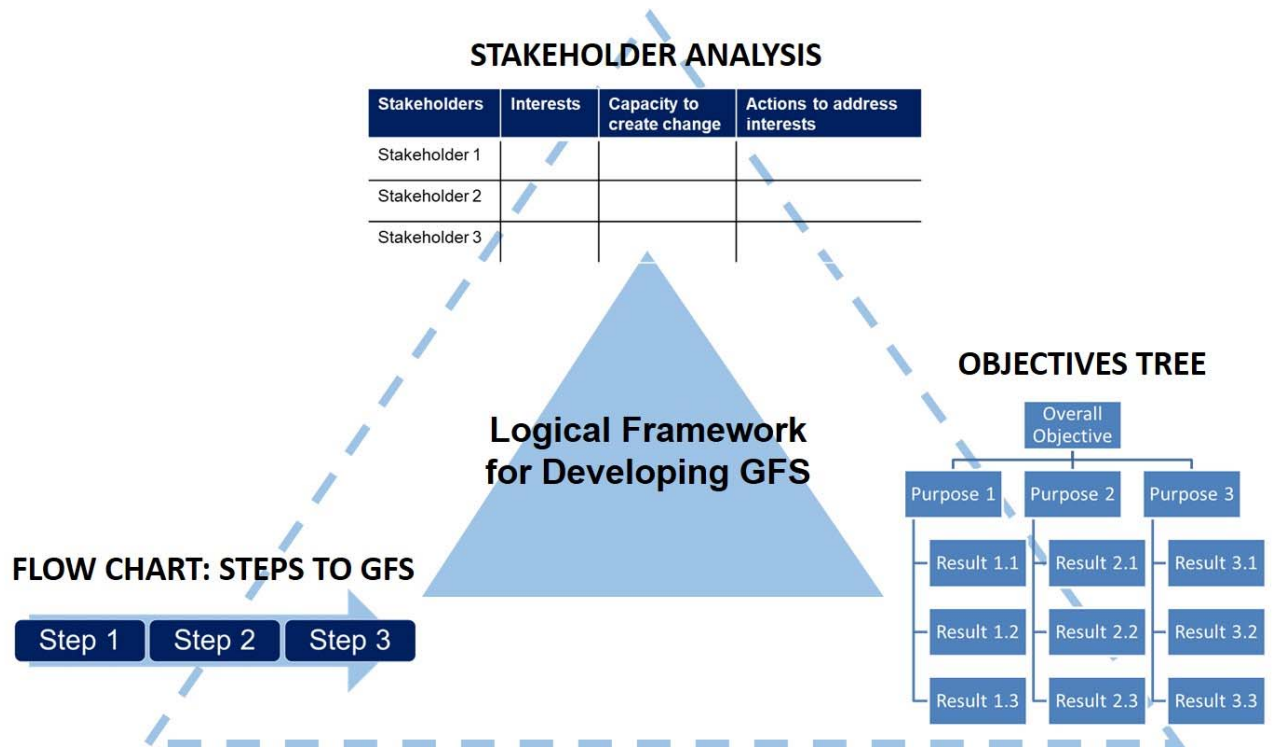


Figure 1. Approach to Development of Logical Framework

2. Stakeholder Analysis

Many stakeholders interact with the development of a Green Financial System in Kazakhstan. While their interests may diverge, their cooperation is needed to make the GFS successful. Only then can the system ensure that sufficient green financing is available to projects that contribute to achieving the targets set under the Green Economy Concept, the Nationally Determined Contribution under the Paris Agreement and the respective policies for Renewable Energy and Energy Efficiency. The following Stakeholder Analysis Table shows how each of the listed stakeholder groups is affected by the barriers that prevent financing to flow towards green projects. For each group, it is shown how the stakeholders can contribute to overcoming the existing barriers and how the design of the Green Financial System can ensure that their interests are protected.

Table 1. Stakeholder Analysis Table

Stakeholder and basic characteristics	Interests and how affected by the problems	Capacity and motivation to bring about change	Possible actions to address stakeholder interests
<p>Project Developers and Sponsors</p> <p>Characteristics of the companies (public vs. private; large vs. small, intl. vs. local) and their ability to provide financial support to “green” projects vary substantially by industrial sector.</p>	<ul style="list-style-type: none"> • Project Developers and Sponsors are interested in attracting green financing in terms of equity and long-term debt along with other forms of support. • The insufficient access to long-term capital in local currency prevents projects from being realized • Characteristics of the green projects (e.g. cash flow profile, currency risks) vary significantly by sector. 	<ul style="list-style-type: none"> • Project Developers and Sponsors understand the technical & financial characteristics, the risk profile and the barriers that green projects in their sector entail. They often have a limited understanding of how green financial instruments work. • Some project sponsors, are sophisticated investors capable of launching their own bonds. • They are willing to invest in the development of projects provided that <ul style="list-style-type: none"> ○ the regulatory environment is supportive ○ projects are financially attractive ○ development risks can be successfully managed • Industrial associations can help coordinate dialogue and action between companies and government. 	<ul style="list-style-type: none"> • Provide long-term green loans at attractive interest rates • Provide access to market-based incentives (ETS, Feed-in-Tariffs, etc.) that reward the positive externalities generated by green projects • Provide additional support for the projects, incl. <ul style="list-style-type: none"> ○ Access to credit enhancement instruments (government guarantees) ○ Access to risk mitigation instruments (currency hedging) ○ Support during the early project development phase (technical assistance) • Provide capacity building on green financial instruments, in particular on disclosure and monitoring requirements • Green financial instruments may need to be targeted to individual sectors, or groups of sectors with similar company and project characteristics (e.g. issuing of green bonds can only be done by large, listed companies)

Stakeholder and basic characteristics	Interests and how affected by the problems	Capacity and motivation to bring about change	Possible actions to address stakeholder interests
<p>Commercial Banks in Kazakhstan</p>	<ul style="list-style-type: none"> • Commercial Banks are interested in lending to bankable green projects on a commercial basis. • Lending is currently not allocated to green projects due to perceived high risks, poor economic viability. • Barriers to lending include <ul style="list-style-type: none"> ○ Deposits are in foreign currency, needed loans are in local currency ○ Deposits are short-term, needed loans are long-term ○ Interest rates and collateral requirements are high ○ Difficult to finance investments as opposed to working capital. ○ Green projects are currently not considered profitable on their own, need government support • Banks currently do not have own targets or incentives for green financing. • Banks currently do not have an obligation to assess the environmental / safety risks of projects or to report on environmental exposure 	<ul style="list-style-type: none"> • Commercial Banks can provide private sector co-finance for green projects if risks and barriers can be addressed. • They can play an important role in allocation of green loans (potentially refinanced by green bonds) in the areas of project origination, selection and due diligence, environmental assessments • Many banks are unfamiliar with the requirements of green finance works. • Many banks are unfamiliar with green project types, such as renewable energy, energy efficiency, etc. • Large commercial banks may be able to issue green bonds themselves 	<ul style="list-style-type: none"> • Provide capacity building via banking associations on green financial system to Commercial Banks, in particular on the needs of green projects in different sectors as well as on disclosure and monitoring requirements • Provide financial instruments to mitigate risks and barriers • Refinancing for green loans (long-term, local currency) • Generate demonstration effect by helping first-mover projects in different sectors to reach financial close

Stakeholder and basic characteristics	Interests and how affected by the problems	Capacity and motivation to bring about change	Possible actions to address stakeholder interests
<p>Public Financial Institutions / National Development Banks / Sovereign Wealth Fund</p> <p>Existing experience in channelling funding to certain sectors under government programmes.</p>	<ul style="list-style-type: none"> Public Financial Institutions and Development Banks are interested in operating green financial instruments They are operating on a commercial basis. Institutions currently do not have own targets or incentives for green financing. Institutions currently do not have an obligation to assess the environmental / safety risks of projects or to report on environmental exposure 	<ul style="list-style-type: none"> Public Financial Institutions and Development Banks have experience with complex financial instruments and programmes. Access to long-term finance at below-market interest rates, due to government support Potential access to co-finance from international IFI's due to government guarantees and high credit rating Potential issuer of green bonds at international capital market and potential provider of green loans either directly to companies or indirectly via participating banks Securitization of green loans and refinancing via green bonds 	<ul style="list-style-type: none"> Provide capacity building support for issuance of green bonds to lower transaction costs <ul style="list-style-type: none"> Selection of green standards Definition of green instruments and formulation of relevant operation procedures and regulations Government guarantees to improve credit rating and access international capital market Government help to manage currency exposure
<p>Central Government Ministry of Finance Ministry of Economy</p> <p>Sovereign credit rating is close to investment grade</p>	<ul style="list-style-type: none"> Responsible to achieve environmental targets in Green Economy Concept, NDC, Renewable Energy and Energy Efficiency policies Mobilize sufficient co-financing from private and international investors Integrate green economy targets into national plans 	<ul style="list-style-type: none"> The Central government can provide market-based incentives (subsidies, ETS, Feed-In-Tariffs) to price externalities It can provide dedicated funds to a public financial institution for mezzanine loans, equity and different forms of guarantees It can provide currency hedging 	<ul style="list-style-type: none"> Capacity Building on Green Financial System

Stakeholder and basic characteristics	Interests and how affected by the problems	Capacity and motivation to bring about change	Possible actions to address stakeholder interests
<p>Central Bank / Banking Regulator</p> <p>Central Bank currently does not have a mandate to regulate climate and environmental risks</p>	<ul style="list-style-type: none"> • Manage climate risk as a systemic risk. Prevent overinvestment in non-green assets • Ensure health of banking system 	<ul style="list-style-type: none"> • The Central Bank does not have experience in regulating green finance • It has experience regulating non-green financial instruments and would build on this experience in regulating green financial instruments, for example by requiring a certain share of bank lending to be “green” • It can supervise the green performance of banks and reward well-performing banks via access to privileges or permits • It can provide preferential re-lending to targeted green sectors 	<ul style="list-style-type: none"> • Impose mandatory disclosure of climate risks for banks and insurance companies • Impose Mandatory disclosure of environmental and safety risks for banks and insurance companies. Consider this information in capital adequacy ratios • Capacity building on Green Finance

Stakeholder and characteristics	and basic	Interests and how affected by the problems	Capacity and motivation to bring about change	Possible actions to address stakeholder interests
Astana Centre	International Financial	<ul style="list-style-type: none"> • Mandate to develop green financial system • Pilot introduction of the GFS on the territory of the AIFC with further expansion on the territory of Kazakhstan 	<ul style="list-style-type: none"> • Recommend / develop Green Standards, incl. verification system and accreditation system for verifiers • Recommend targeted green sectors • Recommend and Supervise green financial instruments and their operators • Track demand for green investment and actual green finance provided • Arrange capacity building and support for other actors, incl. project companies, commercial banks, public financial institutions • Maintain relationship with international initiatives on green finance <ul style="list-style-type: none"> ○ International Commitments: G20, UN, OECD ○ Financial Stability: Financial Stability Board, IMF, World Bank ○ Intl. Organizations for banking, securities, insurance, pensions, accounting 	<ul style="list-style-type: none"> • Capacity Building on Green Financial System • Support from Central government

Stakeholder and basic characteristics	Interests and how affected by the problems	Capacity and motivation to bring about change	Possible actions to address stakeholder interests
Ministry of Energy	<ul style="list-style-type: none"> Responsible for implementation of Green Economy Concept and NDC Need to ensure sufficient funding for green investments to reach targets 	<ul style="list-style-type: none"> Ministry can provide market-based incentives to reward companies for the positive externalities of green projects (ETS) It can select Methodologies to calculate positive externalities from green projects (environmental savings) It can regulate and supervise the certification process for green offsets 	
International Institutional Investors Insurance Companies, Pension Funds, etc.	<ul style="list-style-type: none"> Interested in investing in green infrastructure funds / green securities, that are certified according to a recognized green standard. Required to meet rules and targets for institutional investors <ul style="list-style-type: none"> Share of green investments Disclosure on environmental, social, governance risks Interested in highly liquid market for green securities 	<ul style="list-style-type: none"> Institutional investors can drive disclosure / transparency requirements through the whole financial chain to the project level They can re-finance loans provided to green projects 	<ul style="list-style-type: none"> Issue green bonds according to recognized green standards Provide government guarantee for green bonds

Stakeholder and basic characteristics	Interests and how affected by the problems	Capacity and motivation to bring about change	Possible actions to address stakeholder interests
<p>International Financial Institutions (IFIs): AIIB, BRICS Bank, EBRD, WB, ADB, CDC, EIB, KfW, GIB</p> <p>Bilateral / Multilateral Donor Countries, such as US AID or GIZ</p> <p>Green Climate Fund</p>	<ul style="list-style-type: none"> Interested in contributing to successful launch of green financial system in line with best international practices 	<ul style="list-style-type: none"> IFIs and Donors can provide backing / co-financing for early green bond issues They can provide capacity building and technical assistance for the launch of the Green Financial System and the early green bond issues They can drive disclosure / transparency requirements through the whole financial chain to the project level 	<ul style="list-style-type: none"> Strong commitment by policy makers to green financial system Set up of robust governance structure, with one designated entity (AIFC?) driving the development of the green financial system
<p>International and Domestic Exchanges</p>	<ul style="list-style-type: none"> Interested in new trading financial products Interested in highly liquid market for green securities 	<ul style="list-style-type: none"> Exchanges can list Kazakhstan's green bonds in local currency / in foreign currency and raise green finance from domestic and international investors. They can include Kazakhstan's green bonds in green indices and help investors to diversify risk away from individual green bonds. 	<ul style="list-style-type: none"> Capacity building for local exchanges

3. Objectives Tree

The **Overall Objective** of developing a Green Financial System for Kazakhstan is to enable the country to achieve the ambitious targets set out in the Nationally Determined Contribution (NDC) and the Green Economy Concept. Moreover, the “Kazakhstan 2050” Strategy defines transitioning towards a low-carbon economy as a key goal.³ In November 2016 Kazakhstan also adopted the UNDP Sustainable Development Goals (SDGs)⁴ and committed to integrating them into the national legal framework. Kazakhstan also undertook national consultations in 2014 with more than 2,000 participants from various groups of the society.⁵ At present, it is not yet clear how the SDGs will be implemented on the national level.

The following table sets out the specific targets to be achieved:

Table 2. Summary of key green economy targets

Sector	Target	2020	2030	2050
GHG Emissions (1990 baseline)	NDC Unconditional		15%	
	NDC Conditional (on international support)		25%	
Water	Eliminate national level gap	Full population access	Access for agriculture (by 2040)	
	Eliminate basin level gap	Consolidated	Each basin	
Agriculture	Labor Efficiency	3-fold increase		
	Wheat yields (t/h)	1.4	2.0	
	Water spent on irrigation (m/t)	450	330	
Energy Efficiency	Reduction energy intensity of GDP (2008 baseline)	25%	30%	50%
Electricity	Share of alternative sources of energy (includes nuclear)	3% (renewables only)	30%	50%
	Reduction GHG emissions in electricity production	2012 level	-15%	-40%
Waste Management	Municipal solid waste coverage		100%	
	Share recycled waste		40%	50%

³ <http://kfm.gov.kz/en/activity/strategy-and-program/strategy-kazakhstan-2050/>

⁴ <http://www.kz.undp.org/content/kazakhstan/en/home/presscenter/speeches/2016/11/22/ statement-on-the-promotion-of-the-sustainable-development-goals-in-kazakhstan.html>

⁵ http://kz.one.un.org/content/unct/kazakhstan/en/home/presscenter/statement-on- _opportunities-presented-by-sdgs-for-kazakhstan-by-.html

The development of the Green Financial System should also be seen in the context of Kazakhstan's overall national development strategy, in particular the "Kazakhstan 2050" Strategy.⁶ This document calls for Kazakhstan to enter the top-30 club of most developed states in the world by 2050. The goal is to create new sources of economic growth and to maintain a favourable investment climate, focused on profitability and return on investments. The resources of the National Fund should be directed at long-term strategic projects. An important goal is developing new industries with an emphasis on expanding the export-oriented non-energy sector. The target for the share of non-energy exports is a doubling by 2025 and a tripling by 2040.

As a resource-rich country, Kazakhstan's economy is heavily impacted by developments in raw materials markets, which made up 75% of export revenues⁷ in 2013 and 66% in 2015. The predominant export is oil, and swings in the oil price heavily affect the overall economy and the exchange rate in particular. Since mid-2014 the international oil price has fallen by approx. 50% and the Kazakh Tenge has lost more than 30% of its value against the Euro and more than 40% against the US dollar. These developments have had a great impact on the attractiveness of green investment projects and the availability of government funds that can be steered into green investments. For example, many of the renewable energy projects that were in the pipeline are no longer considered profitable at the lower exchange rate.

For the purposes of this project a wide definition of green investment is applied. The starting point is needed climate finance for mitigation and adaptation purposes, in particular the commitments made as part of the NDC under the UNFCCC. Beyond that it includes the investment needed to achieve the targets set out in the Green Economy Concept and the relevant national Energy Efficiency, Renewable Energy and Environmental legislation.

At the **Purpose** level, a green financial system needs to establish an array of financial services and incentives that make the necessary investments in low-carbon technologies, energy efficiency and renewable energy economically viable, while also ensuring that other stakeholders, such as commercial banks, investors, regulators and policy makers are able to meet their objectives. At the **Results** level, the development effort needs to provide a comprehensive framework for the GFS, including the technical structure of the financial instruments, the regulatory mechanisms and the institutional architecture. The latter should also clarify the role of the AIFC and its relationship with the financial sector, while the regulatory framework should establish a clear terminology and definitions for Green Finance and embed the Standards to be applied into Kazakhstan's financial institutions.

⁶ <http://kfm.gov.kz/en/activity/strategy-and-program/strategy-kazakhstan-2050/>

⁷ The share was 75% in 2013. See <http://wits.worldbank.org/CountryProfile/en/Country/KAZ/Year/2013/Summarytext>

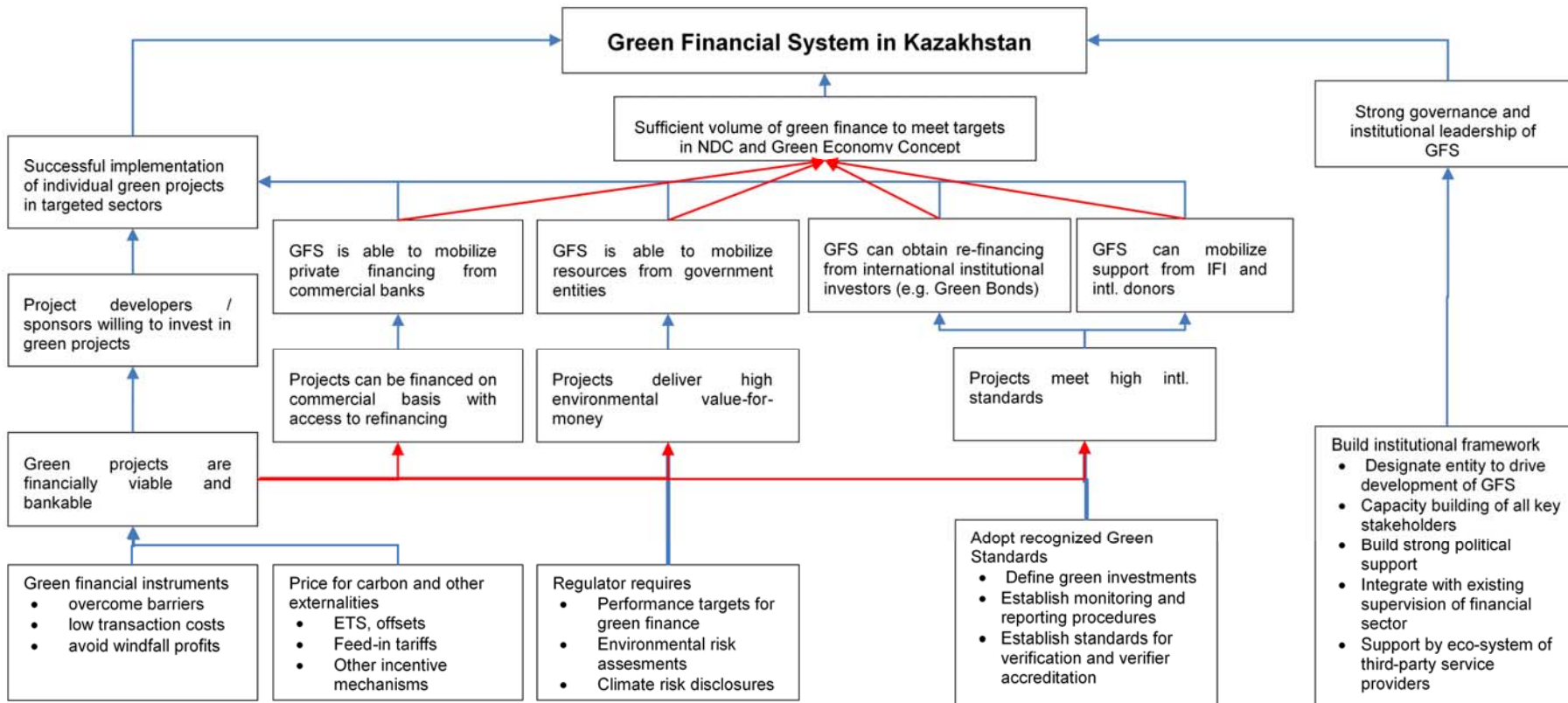


Figure 2. Objectives Tree

4. Steps in Developing a Green Financial System for Kazakhstan

The below Flow Chart (Figure 3) illustrates the sequencing of key steps in the development of the Green Financial System (GFS) for Kazakhstan. The Astana International Financial Center (AIFC) plays a key role as it has been tasked with leading the development of the GFS, and one of the major issues to be resolved is the role the Center will play within the GFS and its relationships with other key actors.

The Project Team is supporting the Astana International Financial Center during the development phase of the Green Financial System and is providing analysis and recommendations for the listed development steps. Through the work and several workshops and seminars, the team will contribute significantly to the stakeholder dialogue, the capacity building with AIFC and other key actors as well as the building of political support for the GFS.

According to the 2015 Law “On the Astana International Financial Centre”⁸ the GFS will be first introduced within the territory of the AIFC. Within the territory, AIFC has its own financial regulator, court and arbitration system. English is the official language and common law of England and Wales is applied. There are also a number of exemptions from tax and employment laws. Once the GFS is deemed successful within the AIFC territory, it will be extended to the national territory of Kazakhstan in collaboration with the Central Bank and the Government.

⁸ Constitutional Law of the Republic of Kazakhstan No. 438 -V 3PK dated 7 December 2015

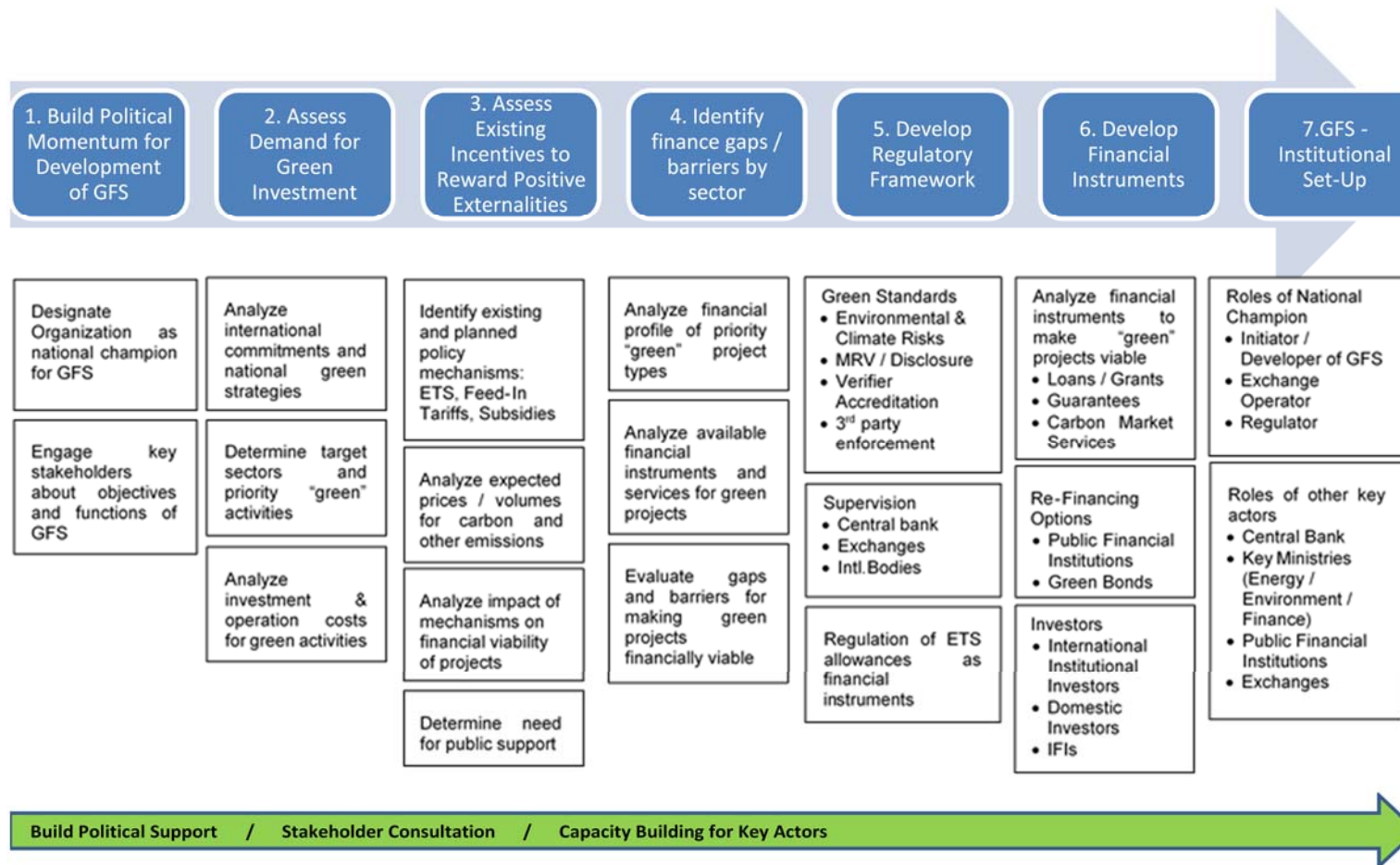


Figure 3. Steps in Developing a Green Financial System for Kazakhstan