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Second Party Opinion

Al Rajhi Bank's Sustainable Finance Framework

Sept. 15, 2022

Founded in 1957 and headquartered in Riyadh, Saudi Arabia, Al Rajhi Bank provides banking and investment services to private individuals and corporate clients both domestically and internationally. The bank operates through a network of over 500 branches and consists of five segments: Corporate Banking, Retail Banking, Small and Midsized Enterprises, Treasury, and International Business. All its services offered are in accordance with Islamic requirements, and the bank is listed on the Saudi Arabian Stock Exchange.

In our view, Al Rajhi Bank's Sustainable Finance Framework published September 15, 2022, is aligned with:

- ✓ Social Bond Principles, ICMA, 2021
- ✓ Social Loan Principles, LMA/LSTA/APLMA, 2021
- ✓ Green Bond Principles, ICMA, 2021
- ✓ Green Loan Principles, LMA/LSTA/APLMA, 2021
- ✓ Sustainability Bond Guidelines ICMA, 2021

Issuer's Sustainability Objectives

Al Rajhi Bank aims to contribute to the sustainable development of Saudi Arabia in line with the kingdom's Vision 2030, which targets enabling social responsibility, increasing employment, and offering citizens a fulfilling and healthy life. As such, the bank aims to increase financial inclusion in the country and provide social and economic benefits to populations traditionally seen as financially underserved or disadvantaged, particularly low-income citizens, female entrepreneurs, and young people.

Furthermore, in line with the King Salman Renewable Energy Initiative, Al Rajhi Bank wants to maintain its position as a key participant in financing renewable energy projects in the country to aid in expanding renewable energy generation capacity, diversifying local energy sources, and contributing to the reduction of carbon dioxide (CO2) emissions in Saudi Arabia.

The bank has developed a sustainable finance framework with the purpose of aligning its financing strategy to its value proposition through the targeted financing of green and social initiatives and projects.

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Second Party Opinion Summary

Use of proceeds

Alignment  Al Rajhi Bank's Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

Score Not aligned **Aligned** Strong Advanced

The issuer has committed to allocating an equivalent amount to the net proceeds of the debt instruments issued under its Sustainable Finance Framework to eligible green or social projects that contribute to at least one sustainable objective. The issuer has committed to a three-year look-back period for refinanced projects and to disclose the share of refinancing versus new financing.

Process for project evaluation and selection

Alignment  Al Rajhi Bank's Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

Score Not aligned **Aligned** Strong Advanced

The framework clearly describes the process for project selection and evaluation, including exclusionary criteria for eligible projects. It identifies the bank's Sustainable Finance Working Group (SFWG) as the body responsible for proposing and approving eligible projects; ensuring their continued eligibility; and identifying and managing potential social and environmental risks associated with them.

Management of proceeds

Alignment  Al Rajhi Bank's Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

The issuer has committed to earmark an amount equivalent to the net proceeds from instruments issued under the framework for allocation toward eligible projects using a sustainable finance register. They will be deposited in Al Rajhi Bank's general funding accounts, and any proceeds temporarily unallocated will be invested according to the bank's standard liquidity policy in cash or cash equivalents.

Reporting

Alignment  Al Rajhi Bank's Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

Score Not aligned **Aligned** Strong Advanced

The issuer has committed to disclosing allocation and impact reporting annually until full allocation. The reports will include the list of eligible sustainable projects and the amount of proceeds allocated to each eligible project category, the breakdown of proceeds allocated to financing and refinancing, and, subject to data availability, the actual impact of projects financed, among others.

Framework Assessment

Use of proceeds

The Principles make optional recommendations for stronger structuring practices, which inform our alignment opinion as aligned, strong, or advanced. For use of proceeds, we consider the commitments and clarity on how the proceeds are used.

 Al Rajhi Bank’s Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

Commitments score

Not aligned **Aligned** Strong Advanced

We consider Al Rajhi Bank’s overall use of proceeds commitments to be aligned with the relevant principles. Al Rajhi Bank commits to use an amount equal to the net proceeds of instruments issued under its framework to finance or refinance eligible green and/or social projects in line with the environmental and social project categories of the relevant principles.

The framework lists seven eligible environmental categories: (i) the production, transmission, and storage of energy from renewable sources, (ii) energy efficiency, (iii) clean transportation projects related to low-carbon vehicles and associated infrastructure, (iv) water and wastewater management, (v) pollution prevention and control, (vi) green buildings including data centers, and (vii) the sustainable management of natural resources and land use for sustainable forestry. We note that:

- Renewable energy sources include biofuel and biomass. The issuer has committed for eligible projects related to biofuel or biomass to be restricted to waste sources that will not deplete existing terrestrial carbon pools or compete with food production.
- The energy efficiency category comprises projects that reduce emissions in different industries, including upgrading old generation (3G/4G) communication networks to 5G. The issuer has committed to restrict eligible communication networks projects to the replacement of existing old generation networks rather than the expansion of new networks which, in our view, provides some level of environmental benefit.
- The pollution prevention and control category is restricted to nonhazardous waste treatment, including collection and storage projects not related to landfill activities.

The framework also lists three eligible social categories that cover projects benefiting a specific target population and projects benefiting the general population. Projects benefiting a specific target population are in line with governmental initiatives and correspond to the categories of employment generation and affordable housing. Projects benefiting the general population comprise the construction or expansion of public, free, or subsidized health care and education facilities.

The issuer has committed to a three-year look-back period for refinanced projects and to disclose the share of financing versus refinancing, which we see as contributing to the transparency of the use of proceeds practices. Finally, we consider that all eligible projects contribute to at least one environmental or social objective. That said, the framework could better identify the intended sustainability objective of each project category.

Process for project evaluation and selection

The Principles make optional recommendations for stronger structuring practices, which inform our alignment opinion as aligned, strong, or advanced. For our process for project selection and evaluation, we consider the commitments and clarity on the process used to evaluate and select eligible projects to fund with the proceeds of the sustainable finance instrument.

 Al Rajhi Bank’s Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

Second Party Opinion

Commitments score

Not aligned

Aligned

Strong

Advanced

We consider Al Rajhi Bank's overall process for project selection and evaluation commitments to be aligned with the relevant principles.

The process for identifying and selecting eligible projects is clearly stated within the framework, including through the provision of an exclusionary list of projects to which proceeds will not be allocated (those where the majority of revenues are derived from fossil fuels, nuclear power generation, conflict minerals, weapons, mining and/or oil and gas, or other sources that fail to meet Shariah guidelines).

The framework identifies the bank's Sustainable Finance Working Group (SFWG) as the body responsible of proposing, evaluating (in accordance with the eligibility criteria disclosed), and selecting eligible projects to be financed, which we view positively. Furthermore, they will ensure that all eligible projects are assessed from an environmental and social risk-management perspective. However, the framework does not include further information on the process to manage identified risks, which would improve the transparency of the process.

The SFWG, which will meet bi-annually, includes representatives from its finance, corporate social responsibility, treasury, risk, corporate (structured finance and small and mid-sized enterprise), and retail (real estate and money service business) departments. We believe this supports the correct skill sets to ensure the criteria is followed and risks are correctly identified and managed.

For eligible social project categories, the framework discloses eligibility criteria in line with government definitions and local programs sponsored by the government, which we see as a strength of the framework. We also see positively the bank's well-defined eligibility criteria for some of the green project categories, including those related to the environmentally sustainable management of living natural resources and land use, clean transportation, and green buildings. However, not all project categories include clearly defined thresholds or incorporate market-based taxonomies, which in our view may reduce the associated benefit of those projects.

Management of proceeds

The Principles require disclosure of the issuer's management of proceeds from sustainable finance over the life of the funding. The alignment opinion focuses on how clear in the documentation is the issuer's commitment to ensure that the funds raised will remain dedicated to eligible sustainability projects throughout the life of the sustainable finance funding.

 Al Rajhi Bank's Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

We consider Al Rajhi Bank's management of proceeds to be aligned with the relevant principles.

Al Rajhi Bank has committed to track all proceeds from instruments issued under the framework through a sustainable finance register to earmark proceeds for allocation to eligible projects. The framework clearly communicates the information to be included in the register, which we view as an advanced exercise of transparency:

- The type of instrument (sukuk, bond, loan) and relevant information, including the pricing and maturity date, amount of proceeds, coupon, and ISIN number.
- The eligible project categories, as well as a list of the eligible projects with their description and material information, including the amount disbursed.
- The amount of unallocated proceeds.

The SFWG will monitor the eligible asset pool to ensure the continued eligibility of projects throughout the life of the instruments and replace those that fail to meet the criteria with new eligible sustainable projects. The issuer has also committed to invest any unallocated proceeds in accordance with the bank's standard liquidity policy, which includes investments in cash or cash equivalents.

Reporting

The Principles make optional recommendations for stronger disclosure practices, which inform our disclosure opinion as aligned, strong, or advanced. We consider plans for updates on the sustainability performance of the issuer for general purpose funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

 Al Rajhi Bank's Sustainable Finance Framework is aligned with this component of the SBP, SLP, GBP, GLP, and SBG.

Disclosure score

Not aligned

Aligned

Strong

Advanced

We consider Al Rajhi Bank's overall reporting practices to be aligned with the relevant principles.

The issuer commits to publishing annual allocation and impact reports until the net proceeds are fully allocated, or until no more instruments are outstanding. The allocation reporting will include: a list of eligible sustainable projects, and when possible, a description of these, including location and amount allocated; the amount of proceeds allocated to each project category; a breakdown of proceeds used for financing versus refinancing; and the amount of unallocated proceeds.

Subject to data availability, the bank intends to also provide information on the actual (for operating projects) and expected (nonoperating projects or where data is not available) environmental and social benefits of the eligible sustainable projects, including annual renewable energy generation in mega- or gigawatt hours, the annual greenhouse gas emissions avoided in tons of CO₂ equivalent, the amount or percentage of water saved, and the number of individuals and/or families benefiting from subsidized housing. We believe the level of sophistication of the social impact indicators is somewhat limited, but reflects the still-nascent stage of the social financing market.

We view positively Al Rajhi Bank's commitment to disclose the calculation methods and key assumptions used for its reporting metrics, as well as its intention to follow the Harmonized Framework For Impact Reporting. Finally, the issuer intends to engage an external reviewer to assess the alignment of the allocation of funds with the framework's criteria.

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

The Sustainable Development Goals (SDGs), which the United Nations (U.N.) set up in 2015, form an agenda for achieving sustainable development by 2030.

We use the International Capital Market Association's (ICMA's) SDG mapping for this part of the report. We acknowledge that ICMA's mapping does not provide an exhaustive list of SDGs and that ICMA recommends each project category be reviewed individually to map it to the relevant SDGs.

Al Rajhi Bank's Sustainable Finance Framework intends to contribute to the following SDGs:

Use of proceeds/KPI

SDGs

Renewable Energy



7. Affordable and clean energy*

Energy Efficiency



7. Affordable and clean energy*

Sustainable Water and Wastewater Management



6. Clean water and sanitation*

Pollution Prevention and Control



12. Responsible consumption and production*

Second Party Opinion

Environmentally
Sustainable
Management of
Living Natural
Resources and
Land Use



15. Life on land*

Clean Transportation



11. Sustainable cities and communities*

Green Buildings



11. Sustainable cities and communities*

Affordable
Housing



11. Sustainable cities and communities*

Access to
Essential
Services



3. Good health and well-being*



4. Quality education*

Employment Generation, and Programs
Designed to Prevent and/or Alleviate
Unemployment Stemming from Socio-
economic Crises



**8. Decent work
and economic
growth***

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

Second Party Opinion

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