Green Bonds

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What are Green or Climate Bonds?

The term "Green" or "Climate" Bonds refers to bonds which are publicly listed on a Stock Exchange which have been marketed by the issuer as 'Green' or "Climate", where the proceeds of the issue are for green or climate assets or projects.

The Climate Bonds Standard and Certification Scheme is a labelling scheme for bonds. Rigorous scientific criteria ensure that it is consistent with the 2 degrees Celsius warming limit in the Paris Agreement. The Scheme is used globally by bond issuers, governments, investors and the financial markets to prioritise investments which genuinely contribute to addressing climate change.

A "Green" Bond is a bond specifically earmarked to be used for climate and environmental projects. These bonds are typically asset-linked and backed by the issuer's balance sheet, and may also be referred to as climate bonds.

"Climate" themed Bonds are represented by a broader universe of bonds whose proceeds are for climate projects but that are not categorised as Green. This universe is much wider than the specific Green Bonds market.

The Green Bond market kicked off in 2007 with the AAA-rated issuance from multilateral institutions European Investment Bank (EIB) and World Bank. The wider bond market started to react after the first USD1bn green bond sold within an hour of issue by IFC in March 2013. The following November there was a turning point in the market as the first corporate green bond issued by Vasakronan, a Swedish property company. Large corporate issuers include Scottish & Southern Energy (SEE), SNCF, Berlin Hyp, Apple, Engie, ICBC, and Credit Agricole.

SolarCity (now Tesla Energy) issued the first solar Asset Backed Security (ABS) in November 2013. The biggest ABS issuer is Fannie Mae and Housing Agencies, such as the New York State Housing Finance Agency use Green Bonds extensively.

The Green Bond market has seen strong growth, with the market really starting to take off in 2014 when USD37bn was issued, reaching USD 167.3bn in 2018. The US and China are the largest issuer of Green Bonds. Energy and Building projects account for nearly 60% of the investment uses of Green Bond issuances.

What are the Green Bond Principles & Climate Bonds Standards?

Voluntary best practice guidelines called the "Green Bond Principles" (GBP) were established in 2014 by a consortium of investment banks: Bank of America Merrill Lynch, Citi, Crédit Agricole Corporate and Investment Bank, JPMorgan Chase, BNP Paribas, Daiwa, Deutsche Bank, Goldman Sachs, HSBC, Mizuho Securities, Morgan Stanley, Rabobank and SEB. Ongoing monitoring and development of guidelines has since moved to an independent secretariat hosted by the International Capital Market Association (ICMA).

The GBP emphasise the required transparency, accuracy and integrity of information that will be disclosed and reported by issuers to stakeholders. The GBP have four core components:

1. Use of Proceeds
2. Process for Project Evaluation and Selection
3. Management of Proceeds
4. Reporting

The Green Bond Principles do not provide details on "green". The green definitions are left to the issuer to determine. Broad green project categories suggested by the principles include:

- Energy
- Buildings
- Transport
- Water management
- Waste management & pollution control
- Nature-based assets including land use, agriculture and forestry
- Industry & energy-intensive commercial
- Information technology & communications (ICT)

World Bank and IFC have their own criteria or definitions of eligible green projects.

The Climate Bonds Initiative provides green definitions that are sector specific, developed by scientists and industry experts. These fall into eight broad categories with sector specific standards being used for Certification.

How do Green Bonds differ from "Vanilla" Bonds?

The green "use of proceeds" bond market has developed around the idea of flat pricing - where the bond price is the same as ordinary bonds. Prices are flat because the credit profile of green bonds is the same as other vanilla bonds from the same issuer. Therefore, green bonds are pari passu to a vanilla issuance.

What are the benefits of Green Bonds?

There are five key benefits to issuing a Green Bond.

- Highlights the organisation's focus and actions on green assets and business activities
- A Positive marketing story to promote the green credentials of the organisation
- Diversify the investor base, the organisation can now attract Responsible Investors and Environment, Social and Corporate Governance specialist investors
- There is a shortage of Green Bond issuances for the level of demand
- Brings together internal teams in order to do the investor roadshow (environmental team with Investor relations and other business areas) which also promulgates more effective working relationships

Green bonds are priced the same as a vanilla bond, and have the same recourse to issuer, but have some additional transaction cost because issuers must track, monitor and report on use of proceeds. These costs are often offset many times over with the benefits above.

So, what to do next?

The issuance of a bond is a highly technical and complicated process, requiring careful project management.

An organisation will need to start by clearly identifying the investment requiring funding and the financial performance of that investment. The investment will need to have an initial appraisal to establish whether or not it will qualify to meet the Climate Bonds standards criteria. If it meets the criteria, the organisation will need to appoint

- Investment Bankers to plan the issue, price the issue, file required documentation, and sell the issue
- Underwriter(s) to underwrite the bonds, assume the risk of buying the newly issued bonds from the corporation or government unit and then resell the bonds to the public or to dealers who sell them to the public.
- An approved verifier of the Climate Bonds
- An accountant to review the financial forecasts for the investment
- Lawyers to prepare the necessary legal documentation

The process will then require an experienced Director or Manager level individual to manage the process through to conclusion. It is a process that requires careful, experienced management to bring together the business plans and information for the offer document and manage the internal and external resources and stakeholders.

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