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Moody's Joins Effort to Standardize Green Bond Market: Ballard Spahr

The municipal green bond market is in its infancy. For it to achieve scale and widespread recognition, a process for verifying whether a bond is "green" is needed so the market can fairly judge the merits of each green bond issuance. In the absence of recognized standards, issuers can choose to label their bonds as green based upon their own subjective measures.

Only a fraction of the municipal green bonds that have been issued to date feature some type of third-party certification that the bonds are financing or refinancing a project which is benefiting the environment. Moody's has now joined the nascent effort to standardize the certification process by publishing a proposed Green Bonds Assessment (GBA) approach and methodology. Moody's invited the market community to comment on the proposed approach, and the comment period ended on February 12, 2016.

A GBA, rather than constituting a credit rating, is a forward-looking assessment of an issuer's approach to green bond financing. The Moody's GBA scorecard rates each transaction based on the review of the issuer's approach in five areas, closely following the voluntary guidelines for issuing green bonds set forth in the Green Bond Principles. The five factors are Organization, Use of Proceeds, Disclosure on the Use of Proceeds, Management of Proceeds, and Ongoing Reporting and Disclosure.

The most heavily weighted factor is Use of Proceeds, worth 40 percent of the GBA score. Under this factor, Moody's will evaluate whether the green bond proceeds are in line with the environmentally beneficial project categories listed in the Green Bond Principles and which percentage of the bond proceeds is invested into such projects. Moody's proposed GBA approach and methodology did not specify, however, how exactly Moody's will make this determination.

Ongoing Reporting and Disclosure is the second most heavily weighted factor, worth 20 percent of the GBA score. Moody's will consider the nature and the frequency of the expected updates on the status of the projects, as well as the disclosure regarding the impact on the environment, including adoption and reliance on quantitative metrics for measuring the impact, if any.

The Disclosure on the Use of Proceeds and the Management of Proceeds factors are weighted the same—each is worth 15 percent. Under the Disclosure on the Use of Proceeds factor, Moody's will evaluate the quality of the disclosure regarding the green projects in the initial offering document, specifically looking for a detailed description of the green projects, clarity as to whether the bonds are funding a new project or refinancing an existing investment, whether there is adequate funding for the projects, the quantitative measures to be used for results of each investment and the criteria and method for calculating performance against expected results. Under the Management of Proceeds factor, Moody's will evaluate the issuer's procedures for segregating and tracking the green bond proceeds, applying the proceeds by appropriate category and type and having clear investment practices, while giving weight to the existence of an audit of the issuer's tracking methods and procedures.

The least weighted factor is Organization, weighing 10 percent of the GBA score. Under Organization, Moody's will evaluate the issuer's governance and organization structure, its decision-making process relating to the green financing and its framework for determining eligible projects, setting goals and measuring and reporting results. Moody's also will take into account any external evaluations the issuer might have procured from a third-party environmental expert.

Moody's will issue a GBA on a scale of 1 to 5, with 1 being poor and 5 being excellent, based on an evaluation of the five factors described above. After an initial GBA has been issued, it may be updated from time to time to take into account the application of proceeds and the impact of the completed projects on the environment. It is not clear whether Moody's would conduct a follow-up review and update an initial GBA on its own accord, similarly to what it does on the credit rating side, or whether a follow-up review would be done solely at a request of an issuer.

Although a number of questions regarding the GBAs remain, Moody's decision to develop a structure to assist investors in evaluating green bonds is a step in the right direction and an indication that, despite skeptics, the green bond market may be here to stay.

Attorneys in Ballard Spahr's Public Finance Group have participated in every kind of tax-exempt bond financing and have extensive experience with the rules and regulations set by the IRS and U.S. Treasury.

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