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Growth In Green Bond Market Underscores Need For Market Standards.

The significant growth that we have seen in the past year in green/climate bond issuances - \$11.4 billion in 2013 and an estimated \$40 billion in 2014 - strongly suggests a threshold market acknowledgement of the enormous potential in these instruments. Growth in the market and a rapid increase in the volume of climate/green bonds strongly suggest that we are approaching a broad yet fundamental market acceptance of this new asset class. If so, it is important that we begin to shift gears and move from proving the model to creating the market infrastructure that incorporates meaningful standards to support a wider and more liquid market for climate/green bonds.

Green bonds and climate bonds are issued to pay for environmental projects. These are often issued by large institutions, such as World Bank, Bank of America, and Toyota that invest in both environmental and non-environmental projects. However, the proceeds from these bonds are invested exclusively in environmental projects. Many, but not all green bonds are climate-focused. Climate bonds, however, are totally linked to assets that encourage a rapid transition to a low-carbon and climate resilient economy.

These bonds can be considered the equivalent of infrastructure bonds tailored specifically to finance climate solutions, thus providing institutional investors with the opportunity to direct their capital into investments that more appropriately meet their financial and social preferences.

When tied to specific climate change mitigation investments, these finance instruments allow markets to raise capital or, more specifically, support the private sector in raising capital to:

- build renewable energy generation and its enabling infrastructure,
- widely implement energy efficiency measures in cities and industries, and
- support adaptation measures that will boost the economic development of communities in the face of climate change.

Green bonds are not so different after all

Bonds are financial products best suited to both the financing of energy projects with long payback periods and to providing institutional investors with security of returns over the longer term. They are used to unlock "patient capital," specifically taking savings which require secure returns over long periods of time (such as those held by pension funds) and investing them in low-carbon projects that have high up-front costs but solid payback rates over the longer term. Developing a market specifically for climate-themed bonds will help grow markets more broadly for associated "green" debt capital.

These bonds need not differ significantly from existing issuances of debt. The only difference is that the funds they attract are supported by real and verifiable energy projects that in some certifiable manner serve to mitigate greenhouse gas emissions. They also allow investors to report to their members on how their secure investments are making a contribution to addressing climate change.

However, to foster liquidity in a themed bond space, an agreed set of rules and criteria is absolutely essential to assure investors of the integrity of each environmental themed bond. A system of standards for the labeling of green debt holds the promise of being a key enabler for pension fund investment and freeing up significant amounts of private capital in support of climate change mitigation.

To flourish, green bonds need standards

In a direct effort to encourage transparency, disclosure, and integrity in this environmental bond market, a consortium of nearly fifty financial institutions are backing a set of voluntary “Green Bond Principles” (GBPs). These GBPs were initially drafted by four of the financial institutions – Bank of America Merrill Lynch, Citi, Crédit Agricole Corporate, and JP Morgan Chase – with guidance from issuers, investors, and environmental groups. They are designed to serve as voluntary guidelines on recommended processes for the development and issuance of green bonds.

These critical standards are intended to help issuers, investors, and underwriters by:

- providing guidance on the key components involved in launching credible green bonds,
- ensuring investors have adequate information to assess the environmental impact of their investments, and
- moving the market towards standard disclosures which will facilitate transactions.

These voluntary guidelines are fundamentally designed to encourage transparency and integrity in the market and to prevent “greenwashing” – the practice of deceptively promoting something as green or good for the environment. This is particularly important as the issuer base shifts from trustworthy, multinational development banks to corporate issuers. To the extent that the GBP can achieve the objectives outlined above, these instruments will ultimately truly matter when they can consistently attract a new and broader investor base, thus becoming vehicles for channeling lower cost capital into energy efficiency, renewable energy, and climate change adaptation efforts.

The Green Bond Principles can further serve to catalyze this market, transforming green/climate bonds into a “mainstream” asset class by creating more certainty around investment integrity. U.S. sub-national issuers of capital can and should play a critical role in helping to foster and develop this new asset class as well as the market infrastructure in which these instruments may flourish. The bottom line is that these new investment vehicles need to be treated like, and designed like, more traditional financial products, and the Green Bond Principles are a very good start to growing this important climate market instrument.

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