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THE INCREASING IMPORTANCE OF GREEN BONDS AS INSTRUMENTS OF IMPACT INVESTING: TOWARDS A NEW EUROPEAN STANDARDIZATION

GREEN BOND: A DEFINITORY APPROACH (1)

It's difficult to give a clear definition of what makes a bond «green»

- «Green bonds offer new possibilities for investors who are looking for opportunities that incorporate environmental, social and sustainability considerations» (Eurosif, European SRI Study, 2018)

- «Green Bonds are fixed income securities which finance investments with environmental or climate-related benefits» (Ehlers and Packer, 2017)

- «Bonds or debt securities specifically issued to finance environmental protection, sustainability or specific climate mitigations and adaptation measures» (Sean and Padraig, 2014)

- «Green Bonds as a Socially Responsible Investment (SRI) instrument» (Panda Pradiptarathi, 2017)

- Green Bonds can be seen also as a particular category of the "*Sustainable Development Bonds*" (SBPs by ICMA)

WHY GREEN BONDS ARE SO IMPORTANT?

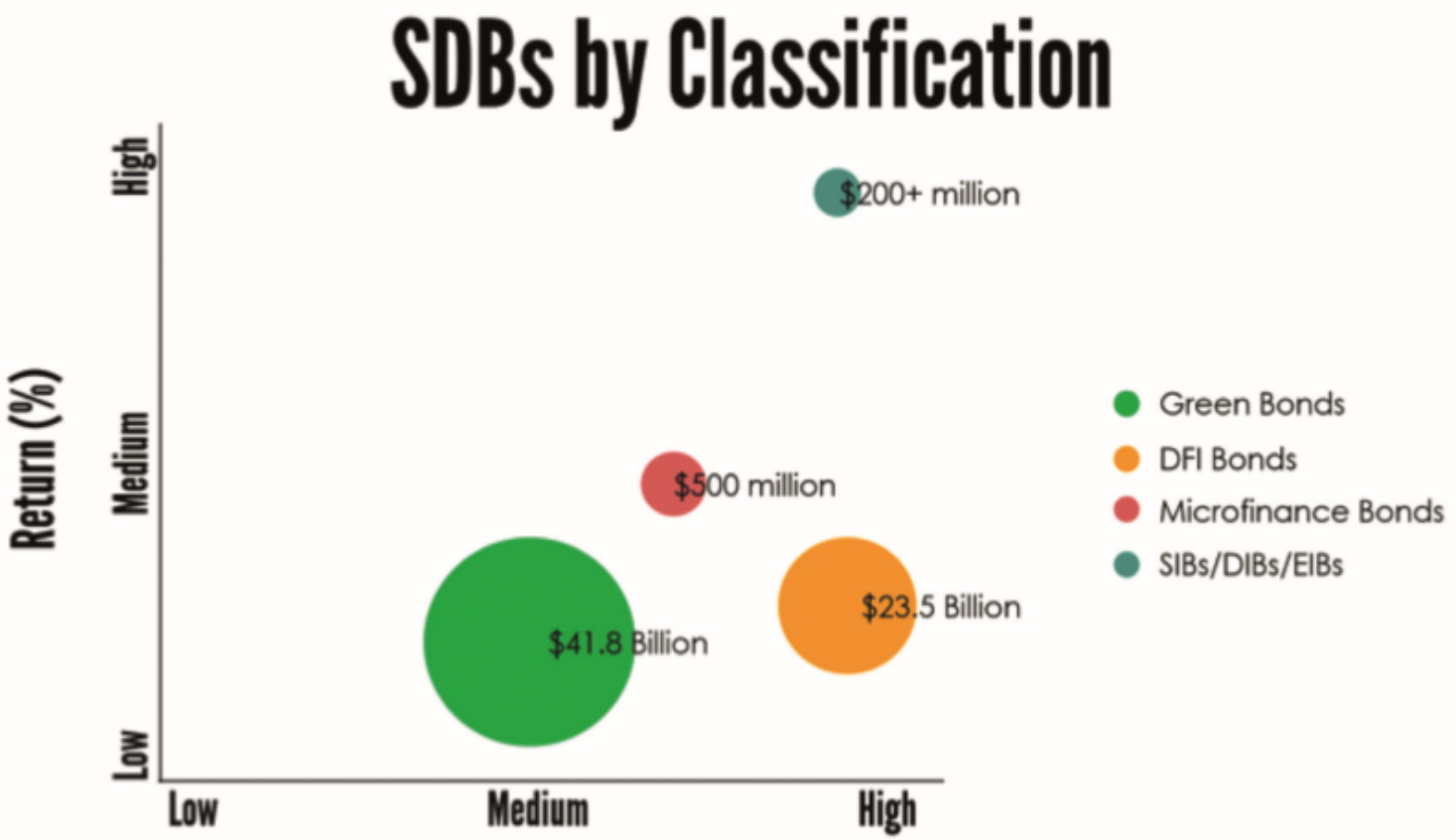
In 2015 the UN 2030 Agenda for Sustainable Development was adopted and on January 2016 the SDGs (17) of this agenda came into force. It is a very ambitious project that aims to reduce inequalities, to end all the forms of poverty and tackle climate changes.

Green bonds are surely one of the financial instrument being able to underpin the SDGs of UN 2030 Agenda. In fact, Green Bonds are a particular category of the "*Sustainable Development Bonds*".

Source: United Nations

SUSTAINABLE DEVELOPMENT BONDS

SDBs are debt securities issued by private or public entities to finance activities or projects linked to sustainable development.
The Green Bonds represent the largest share of the SDBs market with a value of $41,8 billion and typically have low-medium returns (around 2-3%) and impact.



Source: European Impact Investing Luxembourg

GREEN BOND: A DEFINITORY APPROACH (2)

The most referred definition is the one given according to «Green Bond Principles» (ICMA*, June 2017) : «a green bond is *a type of bond where the proceeds will be applied to finance or re-finance, in part or in full, a new or/and an existing eligible Green Project*»

According to this approach, a green bond has to be aligned with the four Green Bond Principles:

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

* *ICMA= International Capital Market Association*

USE OF PROCEEDS

The proceeds have to be used to finance «Green Projects», namely projects being able to provide clear environmental benefits (in activities linked to climate change, natural resources depletion, loss of biodiversity, air, water or soil pollution)

It is also necessary an assessment of these benefits and, where it is possible, it has to be quantified by the issuer.

It is also possible to refinance an existing project: in this case it is recommended to communicate the amount of resources that will be used for refinance and which projiect is going to be refinanced.

It is difficult to decide if a particular activity is to be considered *green* and this is one of the biggest problem concerning this field (risk of ***greenwashing***, that can be defined as «*the selective disclosure of positive informations about a company's environmental or social performance, without full disclosure of negative information on these dimensions, so as to create an overly positive corporate image*» *(Lyon and Maxwell, 2011)*

PROCESS FOR PROJECT EVALUATION AND SELECTION

The Green Bond issuer should communicate to investors the following informations (ICMA, June 2017):

- The environmental sustainability objectives;
- The process by which the issuer determines how the Projects fit within the eligible Green Projects categories;
- The related eligibility criteria, including, if applicable, exclusion criteria or any other process applied to identify and manage potentially material environmental and social risks associated with the Projects.

MANAGEMENT OF PROCEEDS AND REPORTING

MANAGEMENT OF PROCEEDS: The proceeds of the bond have to be set aside in un sub-account, or in a sub-portfolio or in any event in a system that can be tracked by the issuer in the best way (ICMA, June 2017).

REPORTING: Issuer should provide clear, up to date information regarding the use of proceeds, renewed at least annually until the full allocation. There should also be showed a list of the projects in which the proceeds were channelled and a description of these projects. Moreover qualitative indicators and, if it is possible, quantitative performance measurements are recommended (ICMA, June 2017).

GREEN BONDS CERTIFICATION

In GBPs it's recommended also that issuers use an «external review» to confirm the alignment of their GD with the key features of the same GBPs (as Consultant Review, Verification, Certification, Rating)

Actually, there is more than one rule for deciding if a bond can be considered a green bond. For example we can mention the following:

- Climate Bonds Initiative (CBI) certification
- Cicero Second Opinions
- Moody's Green Bond Assessements
- Standard & Poor's Green Evaluations

CICERO SECOND OPINIONS

CICERO (Center for International Climate Research) is an indipendent center research based in Oslo. It provided the *second opinion* in relation to the first green bond issued by World Bank in 2007. Second Opinions are characterized by four different degrees of assessment.

SHADES OF GREEN	EXAMPLES
Dark green is allocated to projects and solutions that correspond to the long-term vision of a low carbon and climate resilient future.	Wind energy projects with a governance structure that integrates environmental concerns
Medium green is allocated to projects and solutions that represent steps towards the long-term vision, but are not quite there yet.	Plug-in hybrid busses
Light green is allocated to projects and solutions that are environmentally friendly but do not by themselves represent or contribute to the long-term vision.	Efficiency in fossil fuel infrastructure that decreases cumulative emissions
Brown for projects that are in opposition to the long-term vision of a low carbon and climate resilient future.	New infrastructure for coal

Source: Cicero Second Opinions on Green Bond

CLIMATE BONDS CERTIFICATION

This certification is characterized by two phases (Climate Bonds Standard, version 2.1):

1. ***Pre-Issuance Certification***: Assessment and certification of the bond issuer's internal processes, including its selection process for projects & assets, internal tracking of proceeds, and the allocation system for funds. This includes a Verifier undertaking procedures to assess the readiness of the issuer and the proposed bond to conform to the Standard, and follows an agreed Protocol (or checklist) to assess the conformance with the Pre-Issuance Requirements of the Climate Bonds Standard.
2. ***Post-Issuance Certification***: Assessment and certification of the bond, which must be undertaken after the allocation of bond proceeds is underway, and includes assurance from the Verifier that the issuer and the bond conform with all of the Post-Issuance Requirements of the Climate Bonds Standard.

GREEN BOND PRINCIPLES AND RATING AGENCIES' GREEN CERTICATIONS

Green Bond Principles	Moody's Green Bond Assessments	Standard & Poor's Green Evaluations[1]
Use of proceeds Use should be described and present clear environmentally sustainable benefits.	*Use of proceeds* Assessment depends on percentage of proceeds allocated to eligible project categories. Weighted 40% as a factor.	*Mitigation* Assesses the environmental impact of financing proceeds over the life of the assets. Weighted 60% as a factor.
Process for project evaluation and selection Decision-making process should be outlined; in particular, how projects fit into green categories, eligibility criteria and environmental sustainability objectives.	*Organisation* Sub-factors: effectiveness of environmental governance and organisation structure; rigorous review and decision-making process; qualified personnel and/or reliance on third parties; explicit criteria for investment selection; external evaluations for decision-making. Weighted 15% as a factor.	*Governance* Considers whether well defined procedures in place for: - Selecting projects eligible to be financed - Appraising and managing environmental impact - Complying with environmental regulations Weighted 19% as a factor.
Management of proceeds Net proceeds should be tracked by formal internal process.	*Management of proceeds* Sub-factors: segregation and tracking of proceeds on accounting basis; tracking of the application of proceeds by environmental category and project type; reconciliation of planned investments against allocations; eligibility rules for investment cash balances; external or independent internal audit. Weighted 15% as a factor.	*Governance* Considers whether well defined procedures in place for preventing proceeds of the bond from being used for other purposes than the intended green financings. Weighted 6% as a factor.
Reporting Issuers should provide annual list of projects to which proceeds are allocated.	*Disclosure on use of proceeds* Sub-factors: description of green projects; adequacy of funding to complete projects; quantitative descriptions of targeted environmental results; methods and criteria for calculating performance against targets; reliance on external assurances. Weighted 10% as a factor. *Ongoing reporting and disclosure* Sub-factors: reporting and disclosure post-issuance; ongoing annual reporting; granular detail on nature of investment and environmental impact; quantitative assessment of impacts to date; comparison of assessments of impacts with projections at time of issuance. Weighted 20% as a factor.	*Transparency* - Use of proceeds reporting - Impact reporting and disclosure - External verification of impact data Weighted 15% as a factor.

Source: BIS Quarterly Review, September 2017

	CBI CLIMATE BONDS CERTIFICATION	CICERO SECOND OPINIONS	MOODY'S GREEN BOND ASSESSMENT	STANDARD AND POOR'S GREEN EVALUATION
USE OF FUNDS MUST BE TIED TO GREEN INVESTMENT	✓	✓	✓	✓
ELIGIBILITY CRITERIA DIFFER BY SECTOR	✓	✗	✗	✓
EX POST MONITORING/ASSESSMENT	✗	✗	✓	✗
GRANULAR ASSESSMENTS OF GREENNESS	✗	✓	✓	✓
QUANTITATIVE WEIGHTS FOR SPECIFIC FACTORS	✗	✗	✓	✓

DIFFERENCES AMONG THE CERTIFICATIONS

Source: BIS, Quarterly Review, September 2017

TOO MANY CERTIFICATIONS

- The Green bonds market is evolving rapidly, but it accounts for less than 1% of the whole bonds market. Creating an EU standard could help to channel more resources in green projects.

- Moreover, since the relevant amount of green bond issuances, it is also fundametal to decide if a bond could be considered or not as a green bond. Infact, there are too many certifications and it is not clear the characteristics that a bond has to have for being considered as a green one (problem for both investors and issuers…).

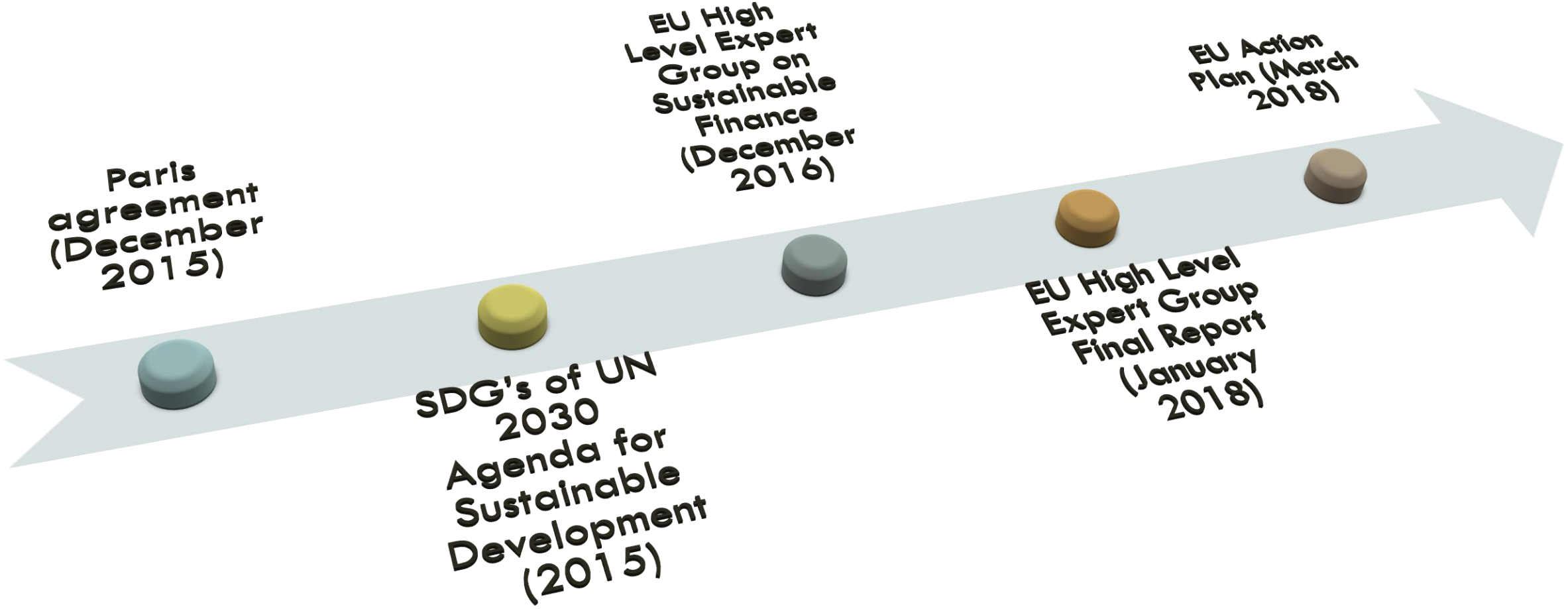
- For this reasons at European level it has been understood the importance of a clarification of what could be considered *sustainable*. It's fundamental to develop a sustainable taxonomy being able to identify under which conditions an investment could contribute to the EU's sustainability objectives (EU High Level Group on Sustainable Finance, 2018).

THE ISSUES THAT ARE TO BE SOLVED

The current market best practices are not completely satisfying and they lead to several issues that EU Green Bond Standard will try to address (High-Level Expert Group on Sustainable Finance, Final report 2018):

- Uncertainty on the application of some aspects of best practice;
- Confusion on green project definitions;
- Doubts on the additionality of certain green projects and their impact, as well as concerns that green bonds have in some cases merely been used to re-label existing investments;
- Insufficient disclosure and data on how green bonds lead to the scaling up of investments in green projects and activities; and
- Inconsistencies in the quality of certain external reviews and verifications, and the qualification of their providers ("Recommended" and not "Required").

TOWARDS A SUSTAINABLE GROWTH



EU STANDARD FOR GREEN BONDS

The EU Taxonomy is also essential for creating an EU Standard for Green Bonds, since HLEG defines a Green bond as a bond that satisfies the following characteristics (High-Level Expert Group on Sustainable Finance, Final Report 2018):

1. The proceeds will be exclusively used to finance or refinance in part or in full new and/or existing eligible green projects, according to the future EU Sustainability Taxonomy; AND
2. The issuance documentation of the bond shall confirm the intended alignment of the EU Green Bond with the EU Green Bond Standard; AND
3. The alignment of the bond with the EU Green Bond Standard has to be verified by an independent and accredited external reviewer.

COMPARISON WITH GREEN BONDS PRINCIPLES

As we can see, the Green Bond Principles are simply voluntary issuance guidelines, while EU Green Bond Standard will provide a more precise assessment of a bond, addressing issues linked to the areas that require more accurate criteria.

Specific topic	Green Bond Principles provision	EU Green Bond Standard provision
Reference of alignment with GBPs/EU GBS in legal documentation	Recommended	Required
Eligibility criteria for green projects	Guidance on high-level categories	Compliance with a detailed EU Sustainability Taxonomy
Disclosure of proportion of proceeds used for refinancing	Recommended	Required
Impact monitoring and reporting	Recommended wherever possible	Required to report whether issuer is monitoring impact or not and if so, disclose estimated/actual impact.
External review requirements	Recommended. External review may be partial, covering only certain aspects of an issuer's green bond or associated Green Bond framework or full, assessing alignment with all four core components of the GBP*	Required. External review must confirm, at a minimum, the alignment, at issuance, of the EU green bond with all four core components of the EU GBS*, or alternatively, confirm the alignment of the EU Green Bond programme as a whole.
Publication of external review	Recommended	Required
Accreditation of external reviewers	Not addressed in GBPs	Sets out accreditation requirements for external reviewers.

Source: EU High Level Group on Sustainable Finance, 2018

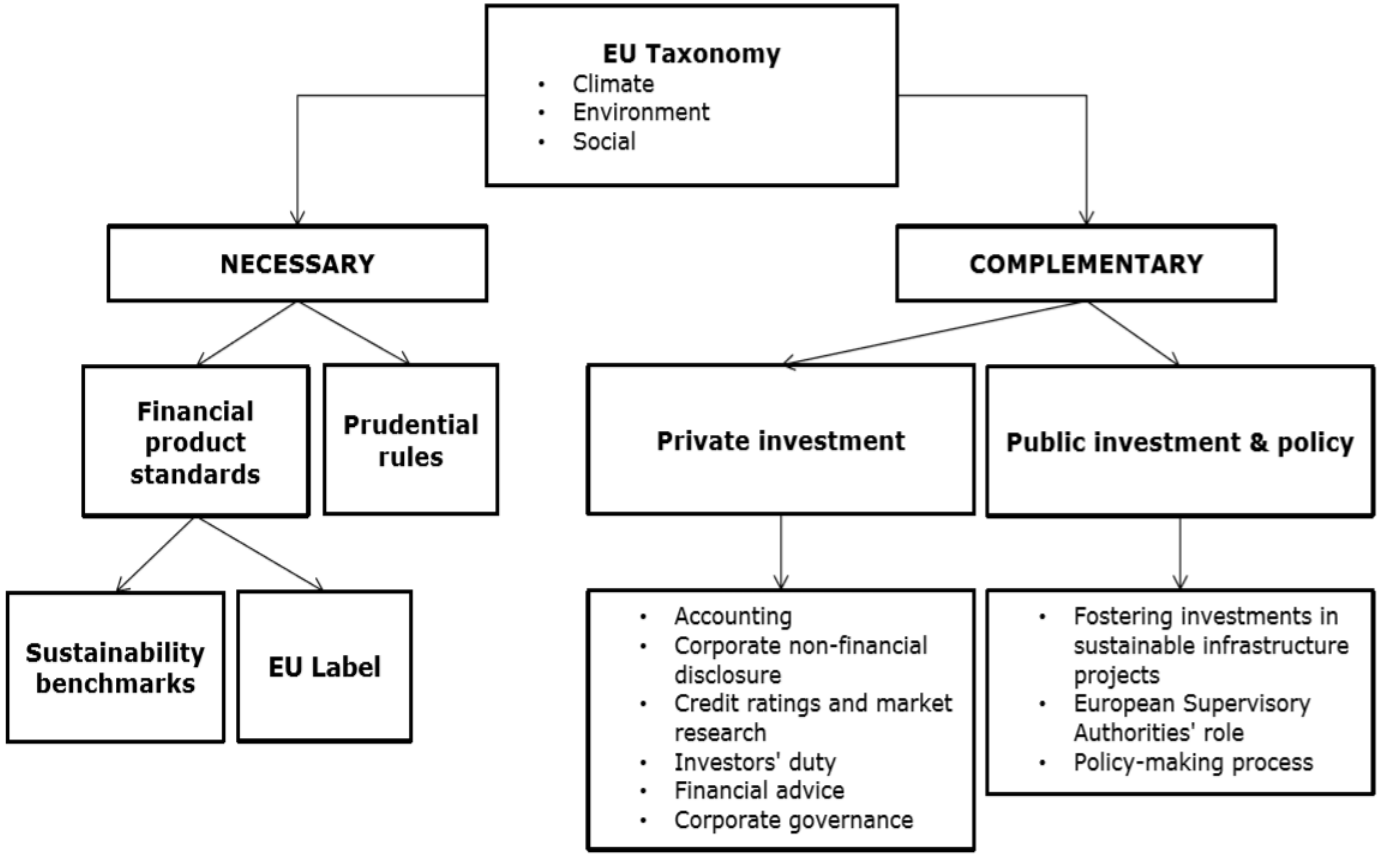
EC ACTION PLAN (MARCH 8,2018): FINANCING SUSTAINABLE GROWTH

Three fundamental goals of EC Action Plan:

1) reorient capital flows towards sustainable investments in order to achieve sustainable and inclusive growth;

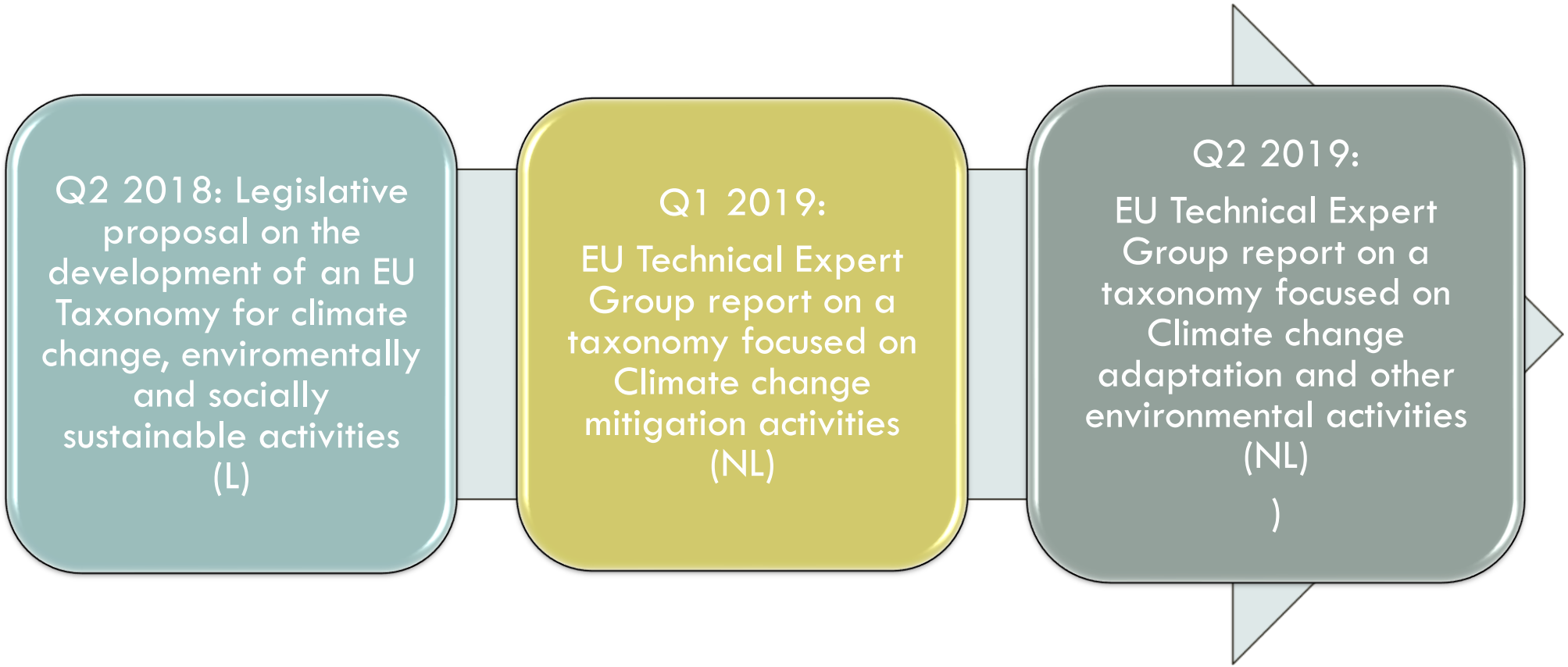
2)manage financial risks stemming from climate change, resource depletion, environmental degradation and social issue";and

3) forster transparency and long-termism in financial and economic activity



Source: European Commission, Action Plan: Financing Sustainable Growth, March 2018

ACTION 1: ESTABLISHING AN EU CLASSIFICATION SYSTEM FOR SUSTAINABILITY ACTIVITIES



Source: European Commission, Action Plan (2018)

This existing relevant investment gap can be reduced through a clarification about the meaning of sustainability. In other terms, "*a shift of capital flows towards more sustainable economic activities has to be underpinned by a shared understanding of what "sustainable" means. A unified EU classification system –or taxonomy- will provide clarity on which activities can be considered 'sustainable'. It is at this stage the most important and urgent action of this Action Plan*" (European Commission Action Plan, 2018)

A SPECIFIC FOCUS ON GREEN BONDS

The importance that the European Commission, Action Plan (march 2018) gives to Green Bonds can be understood by reading the Action 2 of the Plan

Action 2: Creating standards and labels for Green Financial Products

1. *As a first step, the Commission's Technical Expert Group on Sustainable finance will be responsible, on the basis of the results of a public consultation, for preparing a report on an EU green bond standard by Q2 2019, building on current best practices (NL)*.*

*2. Within the framework of the Prospectus Regulation, the Commission will specify by Q2 2019 the content of the prospectus for green bond issuances to provide potential investors with additional information (L2)**.*

3. The Commission will explore, as of Q2 2018, the application of the EU Ecolabel framework to financial products, to be applied once the EU sustainability taxonomy is adopted (NL).

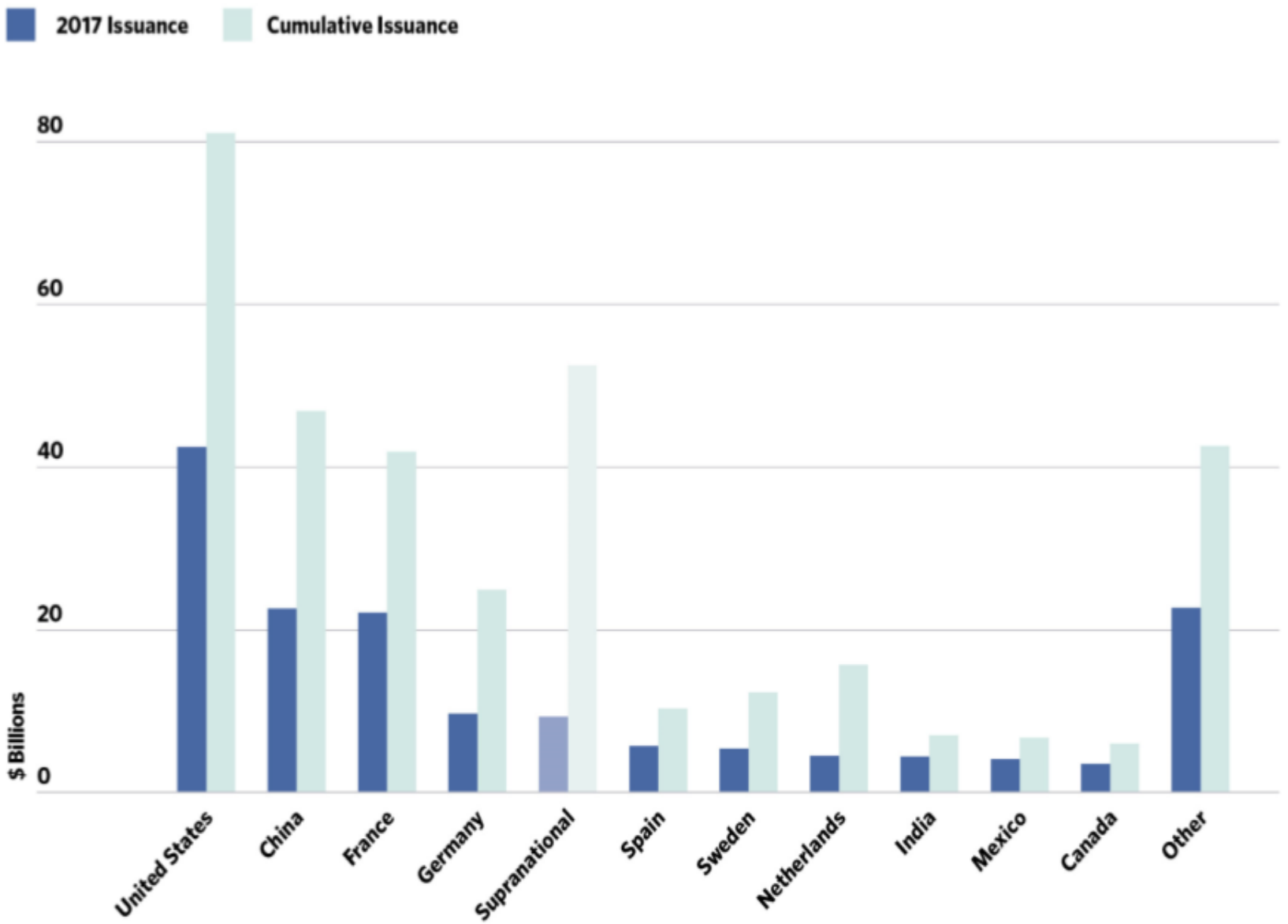
* NL= Non legislative measures ** L2= Level 2 measures

GREEN BONDS MARKET

In the last years the global issuance of Green Bonds has increased and in 2017 has reached USD 155.5 bn (Climate Bond Initiative, 2017).

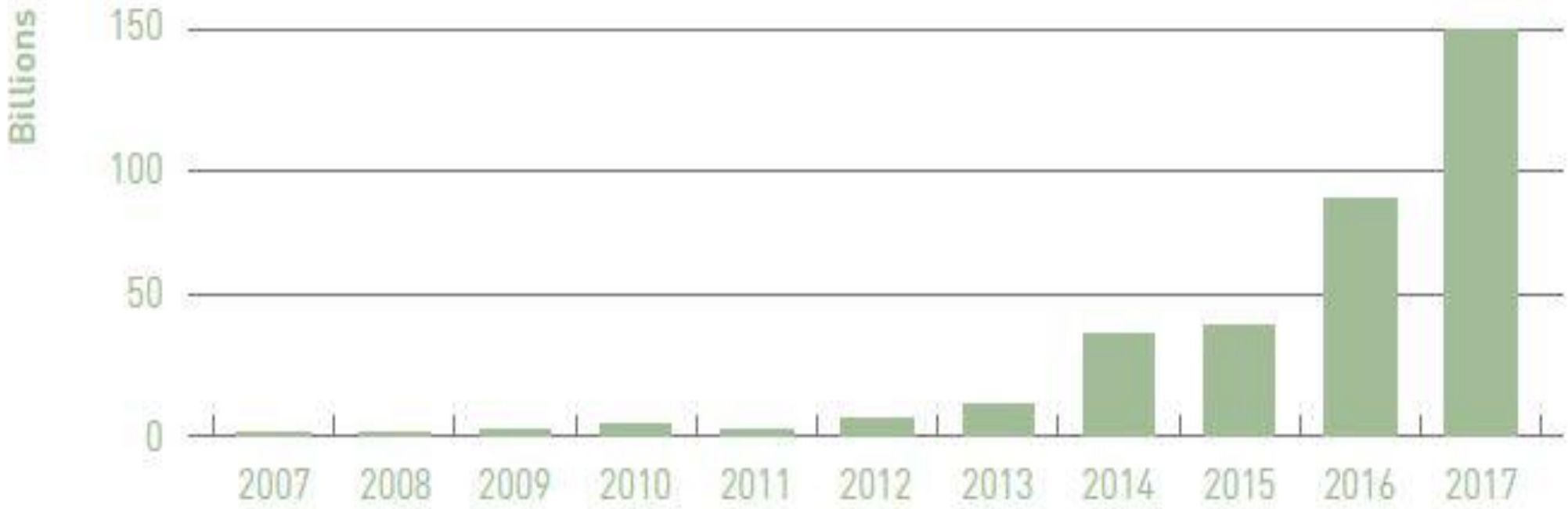
- The 56% of the 2017 issuances is linked to USA, China and France, but it is also appreciable an important growth of the Emergent Market's issuance of Green Bonds.
- In USA the most relevant issuer is US Agency Fannie Mae, with USD 24.9 bn. In China the Green Bonds market is dominated by the private banks (74% of issuance) while in France, the French sovereign bond is the main issuer (Climate Bond Initiative, 2017).

THE MOST IMPORTANT GREEN BOND ISSUERS BY COUNTRY



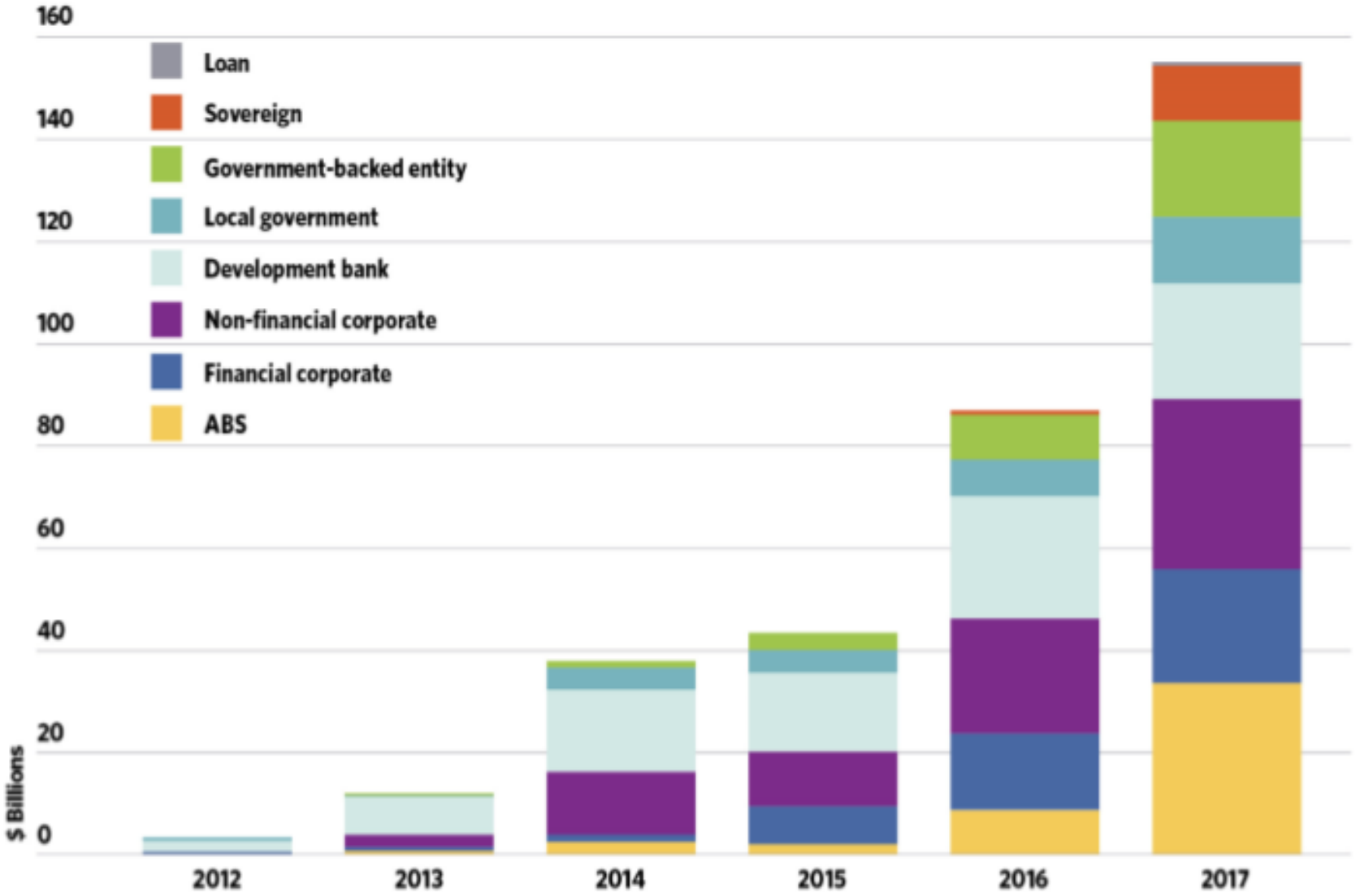
Source: Climate Bonds Initiative, 2017

Explosive growth in green bonds market



Source: Climate Bonds Initiative (2017 estimate)

GREEN BONDS MARKET EVOLUTION



Source: Climate Bonds Initiative, 2017

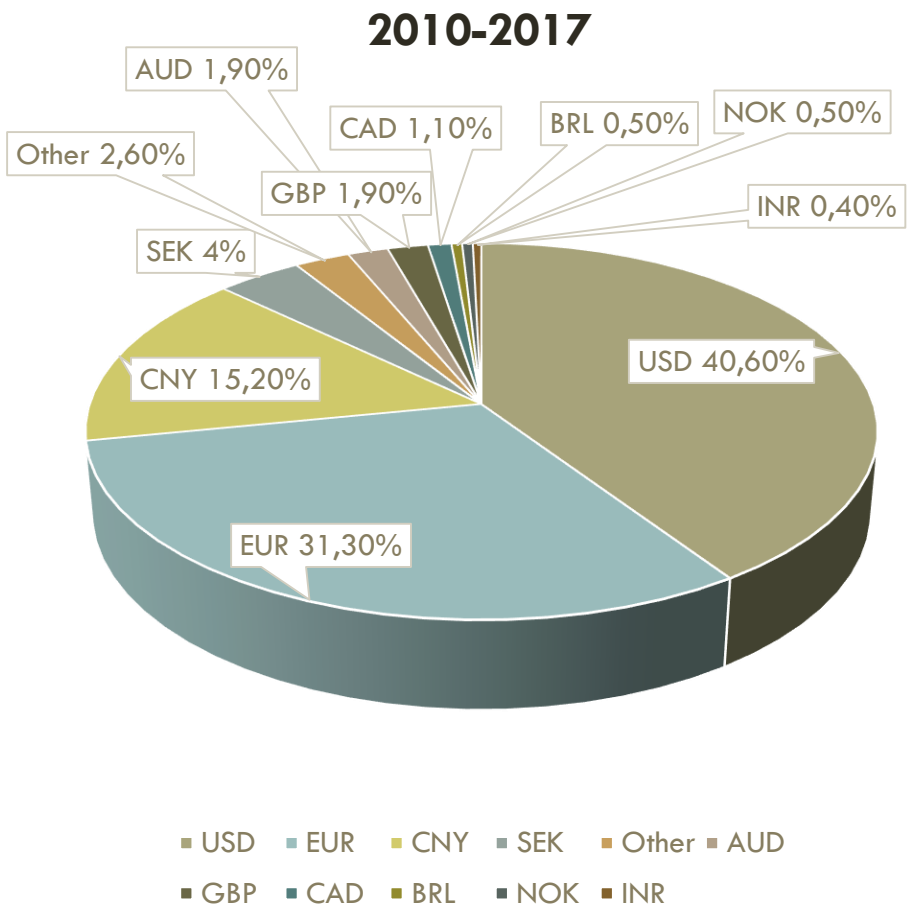
THE FIRST EFFECTS OF EUROPEAN SUSTAINABLE POLICY

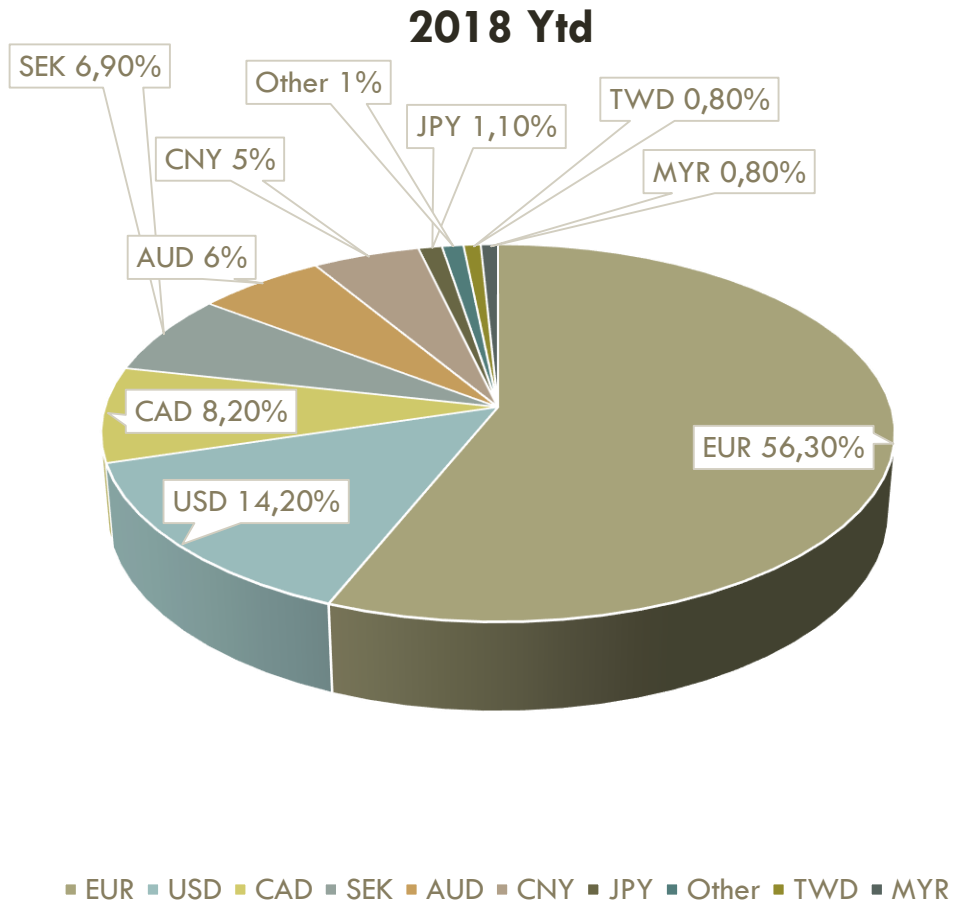
Looking at the data concerning the first months of 2018, it is clear a big shifting to EUR green bond issuances. In fact, the attention of EU in that topic has incresed in the last months and the Action Plan and the Expert Group's Final Report are very focused on green bond.

The market share of EUR Green Bonds is now 56% from the 33% of 2017. If we consider the period 2010-2017, the share of EUR green bonds is around 31%, so it is evident an upward trend of EUR issuances in the first months of 2018.

Focusing on the regional distribution of the green bonds in 2017, it is possible to notice that Europe has already had the main role, but in first months of this year the share of Green Bonds issued in EU has risen again, reaching 58%.

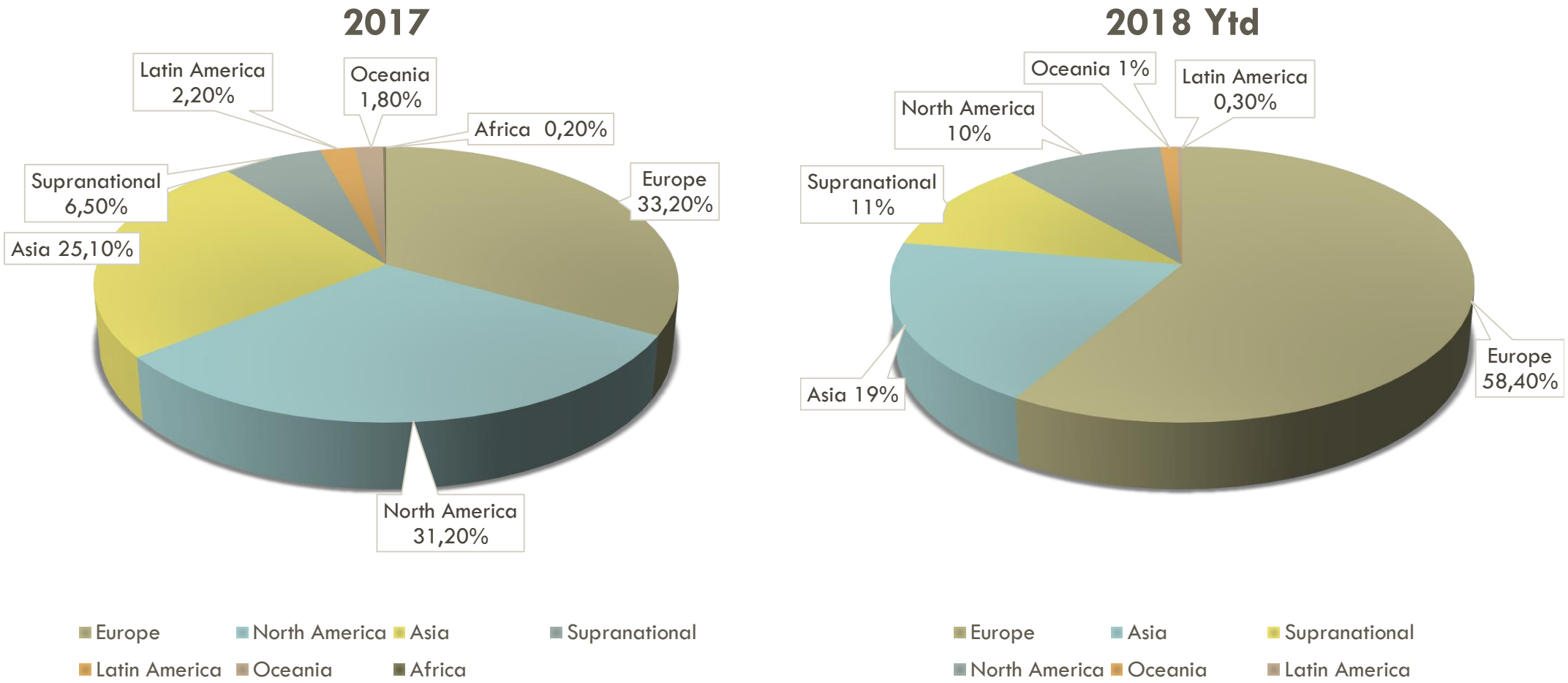
GREEN BONDS ISSUANCE BY CURRENCY





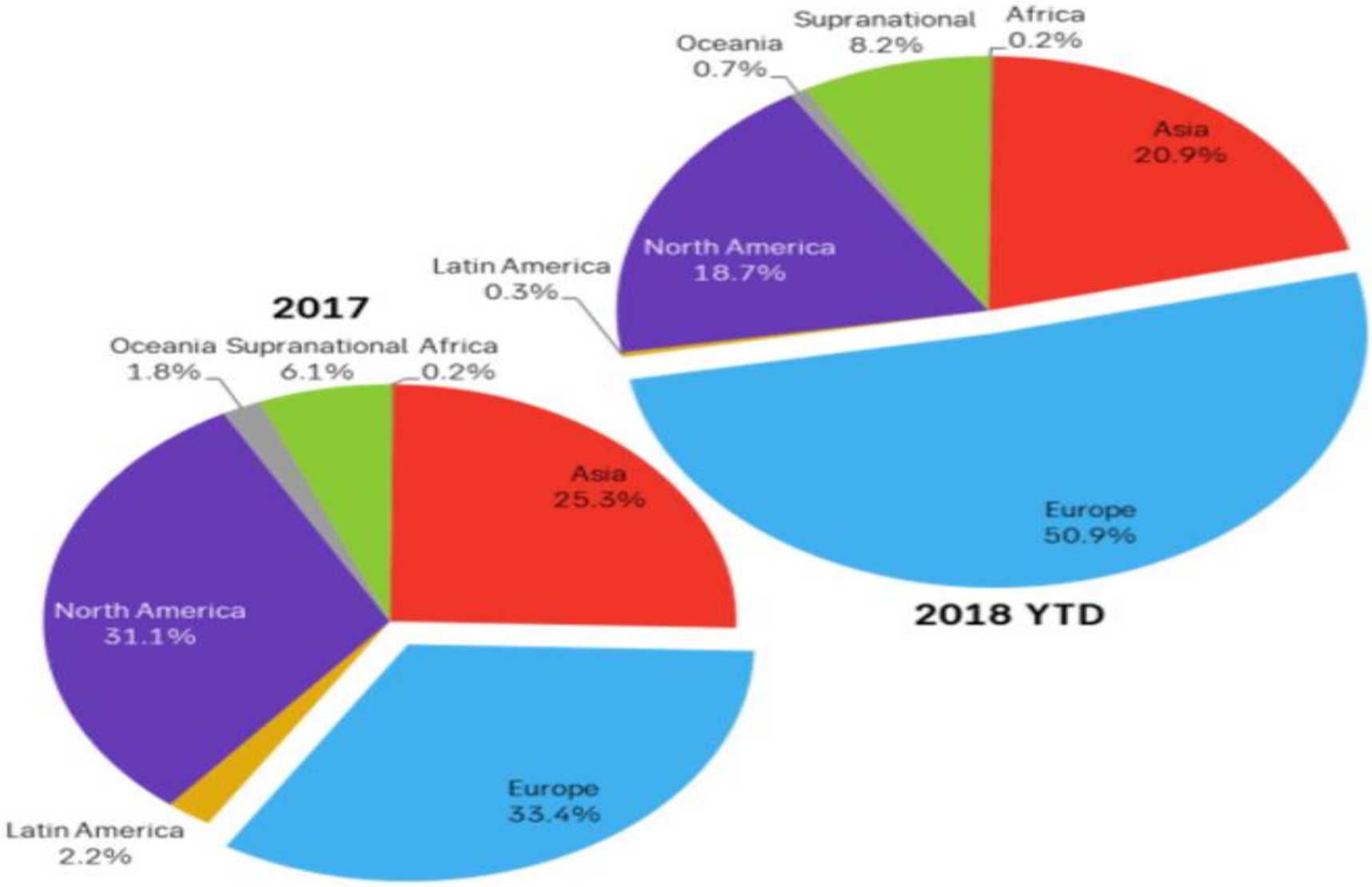
Source: SEB, March 2018

REGIONAL DISTRIBUTION OF ISSUANCES

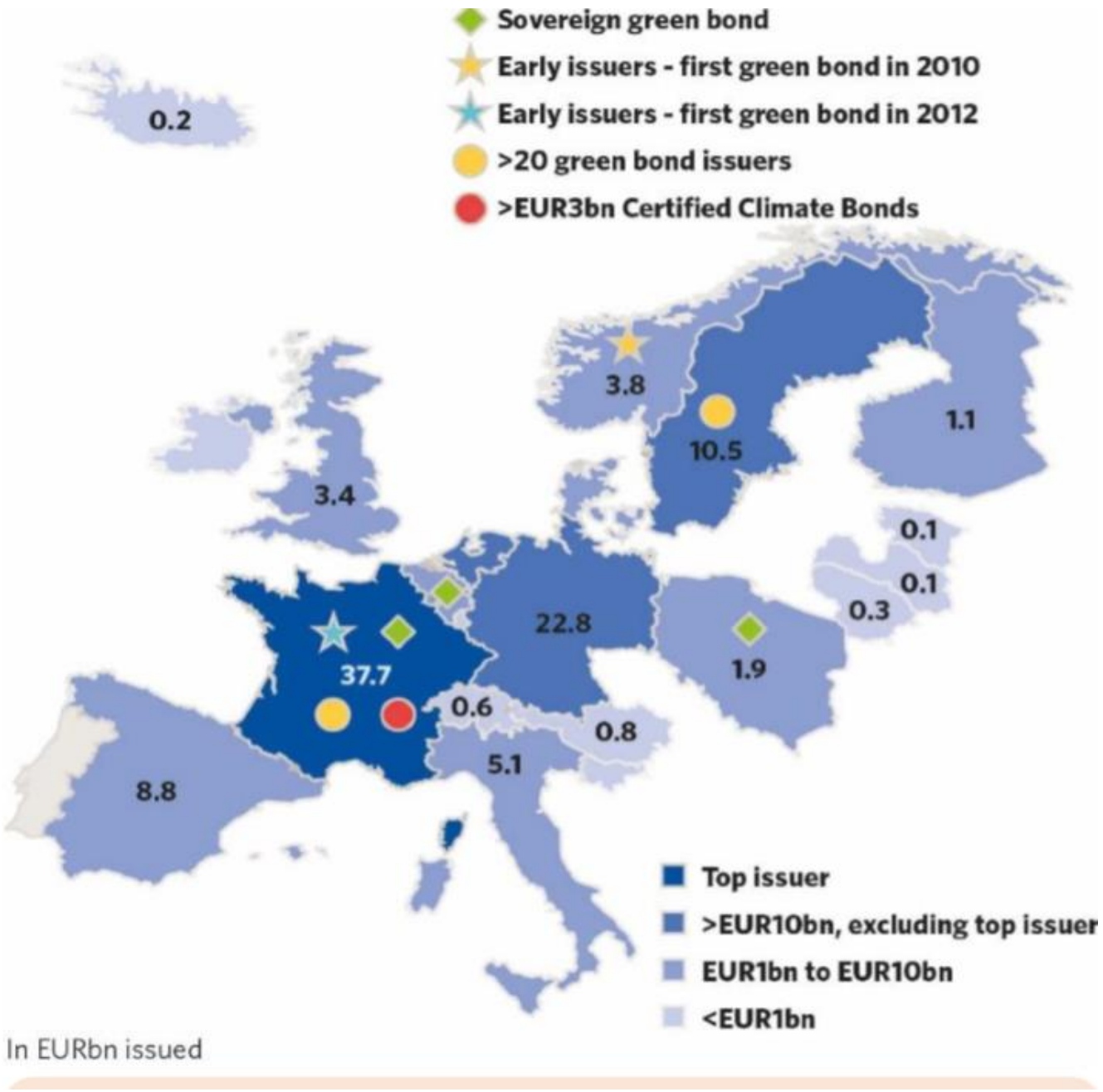


Source: SEB, March 2018

REGIONAL DISTRIBUTION OF GREEN BOND ISSUANCES (SEB, THE GREEN BOND, MAY 2018)



CUMULATIVE GREEN BOND ISSUANCE IN EUROPE



Source: Climate Bonds Initiative, April 2018

SOME CONCLUSIONS…

- Lack of clarity both in definition and in the assessment and certification of Gren Bonds (problem both for investors and issuers)

- Current level of investments are not sufficient to support an environmentally and socially sustainable economic system. Europe has to close a yearly investment gap of almost EUR 180 billion to achieve EU climate and energy targets by 2030

- Necessity of European Institutions Initiatives (HLEG Final Report and EC Action Plan) to contrast existing limits and to reach 3 goals of Action Plan.

-This existing relevant investment gap can be reduced through:

A) a clarification about the meaning of sustainability (taxonomy);

In other terms, "a shift of capital flows towards more sustainable economic activities has to be underpinned by a shared understanding of what "sustainable" means. A unified EU classification system –or taxonomy- will provide clarity on which activities can be considered 'sustainable'. It is at this stage the most important and urgent action of this Action Plan" (European Commission Action Plan, 2018)

B) the creation , building on the future EU sustainability taxonomy, an EU standard and label for sustainable financial products, regarding expecially Green Bonds (EU Green Bond Standard)

- Only at these conditions Green Bonds can really become a "**bridge" to SDGs** of UN 2030 Agenda.

THANKS FOR THE ATTENTION…