European University Institute

ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

FLORENCE SCHOOL OF BANKING & FINANCE

Green(ish) Bonds?

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Online Debate Highlights

by Christy Ann Petit, European University Institute

Background

Institutional investors are increasingly attracted by a host of new financial instruments such as green bonds, social bonds, sustainability bonds or indeed sustainability-linked bonds. This forms part of a broader endeavour to rely on private sources to fund sustainable investments. Among these instruments, green bonds – the "stars of climate finance" according to the Financial Times – have shown high market uptake. Green bond issuances are regularly, if not systematically these days, oversubscribed. Set against the background of an ongoing policy and academic discussion on the need for more transparent green bond markets, this online debate will discuss the merits and limits of green bond financing.

Specifically, this digital event will discuss the following questions:

- How green are green bonds really?
- How could trust in the green bond market place be increased and sustained?
- Are non-binding green bond standards showing their limits?
- Is a new and binding green bond standard needed to eliminate any risk of green-washing?
- Are green bonds fairly valued by market players or is there a green bubble at play?

The panel featured:

Gianfranco Gianfrate
EDHEC Business School

Justine Leigh-Bell
Climate Bonds Initiative

and has been chaired and moderated by

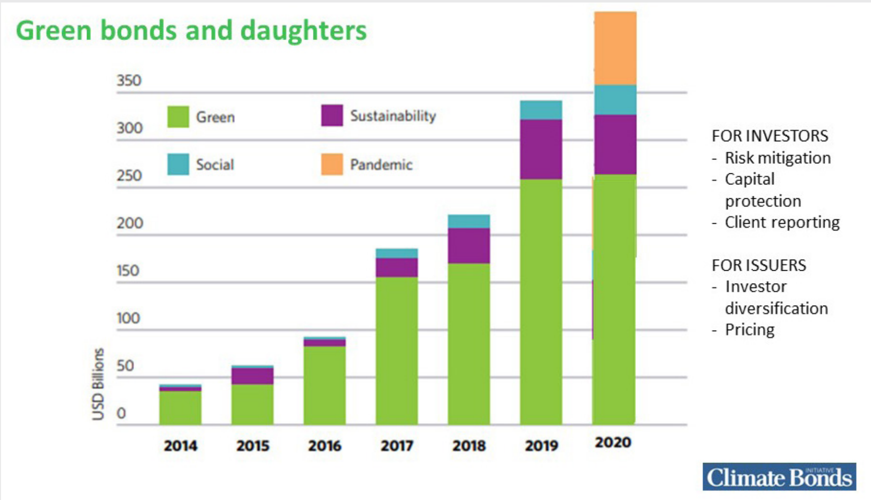
Thorsten Beck
(Cass Business School and Florence School of Banking and Finance, European University Institute)

Merits and limits of green bonds:

1.
Green bonds and shades of green

What are green bonds? This online seminar clarified key distinctions, and highlighted the necessity to look at what green bonds actually finance. Green bonds capture a broader universe than climate bonds. Indeed, green bonds not only finance assets that contribute to climate mitigation and adaptation (as climate bonds), but also finance other types of biodiversity and restoration projects investments (*Leigh-Bell*). Green bonds have many 'daughters' according to her: social bonds, sustainability bonds and pandemic bonds. In a simple approach, green bonds contribute 100% to the environmental objectives, while sustainable bonds go beyond the environment by including social and sustainable aspects.

Fig. 1
Green Bonds and Daughters



Slide from Justine Leigh-Bell presentation - *available here*

The definitional component, currently debated, gained further insights with a typology of 'shades of green bonds' presented by Gianfrate. Based on the CICERO second party opinion's established categories: dark, medium, and light green bonds. The dark green bonds embody the highest climate credentials, addresses climate change issues in the short and long term, with both climate mitigation and adaptation dimensions. The medium green bonds have fewer good credentials with tackling mainly short-term climate issues. The light green bonds capture carbon footprint reduction in the short term, without evidence on their contribution to mitigation and adaptation of climate change. Leigh-Bell considered the last area of light green bonds questionable.

2.
Market development and 'greenium'

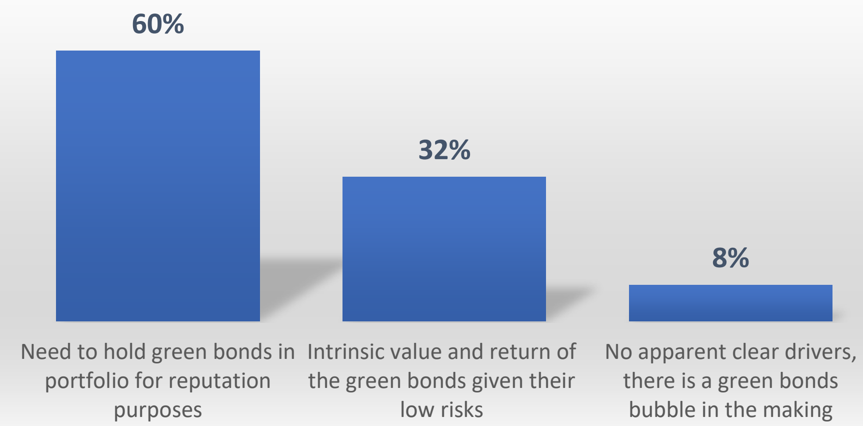
Since 2014 which marked pioneer issuances by the European Investment Bank and the World Bank, we have observed a year-on-year growth of green bonds (*see Figure 1*). Green bonds are no longer a small niche (*Gianfrate*) and the level of demand cannot be underestimated (*Leigh-Bell*).

So, what is driving green bonds development? There is a share of the market that is driven by the reputation advantage, while the intrinsic value in issuing green bonds is gaining grounds. Leigh-Bell therefore concurred with the participants' view expressed in the poll during the online seminar (*see Figure 2*). The green bonds bubble concern seems quasi out of sight which was considered reassuring by the moderator and chair of the debate Thorsten Beck.

Empirical studies show that a 'greenium' or green premium is found in both the primary and secondary markets (*Gianfrate*, between -1 and - 9 basis point). However, the existence and magnitude of this greenium are not settled in academia (with diverging results from Baker et al. (2018), and, Larker and Watts (2020) as regards US municipal bonds markets).

Fig. 2

In your view what is driving the current green bonds spree?



Poll results from the participants
Number of respondents: 62

3.
Salient points for private stakeholders in green bonds issuances

On the one hand, risk mitigation, capital protection and client reporting are fundamental concerns for investors. On the other, diversification and pricing constitute issuers' main concerns in getting access to the investment pool of green bonds (*Leigh-Bell*). The last ten years have seen a development of green bonds, which served as an educational tool to organize the green finance market and scale it up. Gianfrate took the view that in a perfect ideal world, the green bonds would be available naturally without such reliance on institutional investors, and instead effective actions from governments.

Current challenges

4.
Certification and verification – a common methodology?

There is a growing need for certification and verification of bonds' greenness (*Gianfrate*). At the moment, the assessment of the green credentials relies on ratings, specialised audit reports, second-opinions in a rather fragmented way. The shades of green methodology proposed by Gianfrate measures the extent to which the projects financed via green bonds are fully consistent with the transition towards a low-carbon and climate-resilient economy (Gianfrate et Spinelli, 2021). Moreover, Leigh-Bell considered important to reinforce both the second-party opinion and the third-party review with which the verification comes ex post.

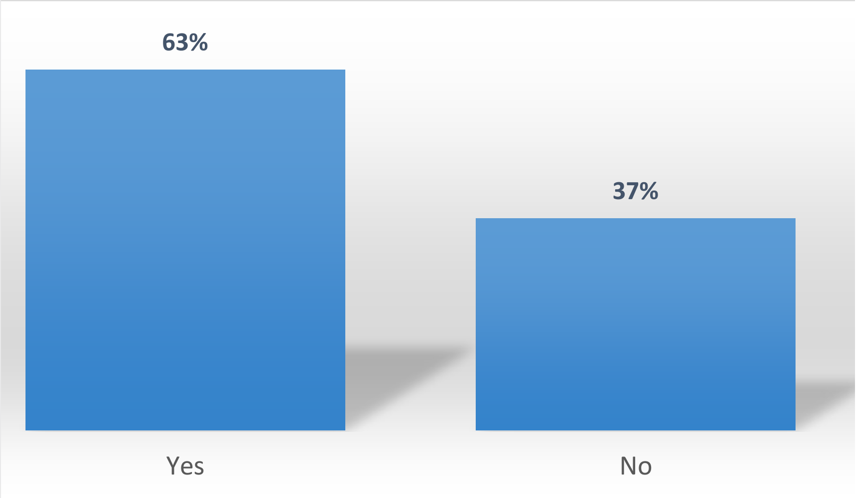
5.
Market perception and ownership

But how can one compare in a meaningful way green bonds to other bonds? This question exhibits how difficult it is to rely on recent data that is not stable or reliable at the moment (*Gianfrate*; also referring to Berg et al. 2020). The participants in the online seminar considered that the market cares about the different shades of green, even though there is a robust part of 37% that seemed sceptical about it it (*see Figure 3*).

Fig. 3

In your opinion, does the market care about the different shades of green?

Poll results from the participants
Number of respondents: 83



Based on the shades of green typology, Gianfrate and his co-author examined a sample of 64 dark-green bonds and 74 medium and light green bonds (between 2013 and November 2020). They observed a 'greenium' of -4 basis points for the dark-green bonds statistically not significant. But the bonds ownership is actually affected by the shade of green bonds. All in all, the main take-away is that the market does not seem to care about the shades of green (in terms of pricing); however, climate-aware institutional investors, such as the investors that signed the U.N. Principles for Responsible investment, do care.

Through CBI research and data gathered over years, Leigh-Bell confirmed that the issuers' network reports a price differential between green and 'regular' bonds, in other words, oversubscription is the norm. It is therefore essential to bring more opportunities out to encourage and support issuances.

6.
Stepping up the rules of the game

Voluntary rules accompanied the early market development. Nowadays, regulators, central banks, and the securities bodies are all stepping up to 'set the rules of the game' (*Leigh-Bell*). The last years have seen strong commitments for actions taken by many institutional actors both in developed and emerging markets, including within the Network of Central Banks and Supervisors for Greening the Financial System (NGFS with 87 members and 13 observers as of February 2021). Not only have we seen new recommendations, for instance the recommendations on climate-related financial disclosures from the Financial Stability Board (FSB's task force, 'TCFD' in short) but also the discussion of more consistent (voluntary and/or binding) rules worldwide that support market growth (*Leigh-Bell*).

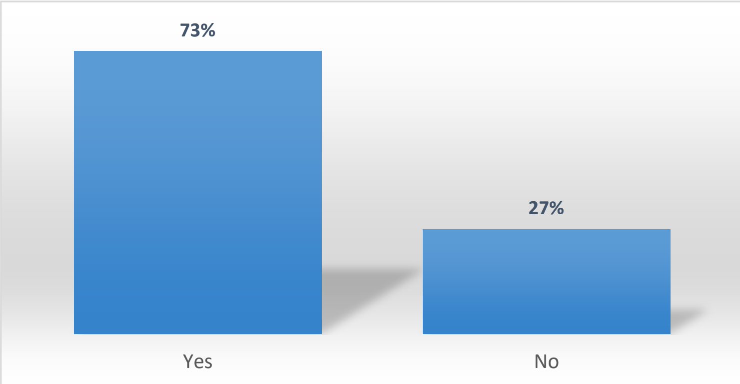
Broader considerations:

7.
National taxonomies

The market is maturing, and a better understanding of green is facilitated with the taxonomy exercise started in different jurisdictions. There is a huge demand for such national taxonomies at the core of passionate discussions. They aim at framing what we mean by green and sustainable, and at identifying a 'catalogue of activities' (*Leigh-Bell*). Participants in the online seminar supported this view with nearly three quarters in favour of national taxonomies according to the poll displayed during the event (*see Figure 4*).

Fig. 4
Is there a value to having national taxonomies set?

Poll results from the participants
Number of respondents: 121



8.
EU taxonomy for sustainable activities and regulatory initiative

The European Commission is at the forefront with its Taxonomy for sustainable activities, which is instrumental for Europe to achieve its climate commitments, and part of its sustainable action plan. The development of green bonds essentially relies on green funds, incentives, and regulatory support (*Leigh-Bell*).

9.
Green window and international flow of capital

There is a huge momentum for the next five years and beyond. The impact of Covid-19 around the world is an opportunity to leverage on green bonds finance (*Leigh-Bell*), and integrating more broadly these aspects into lending policies (*Gianfrate*). Worldwide and in Europe, there is a true 'green window' (*Leigh-Bell*) that pushes for sustainable finance and investments. Those concerns are also attached to geopolitical dynamics, including in trade with powerful economies such as China and the U.S.. Emerging economies also pay much attention. In this green international gig, the EU could lead by example, as a standard setter already in other fields (*Beck*) and move fast forward in the trajectory for reaching climate goals by 2030 and 2050.

You can watch the recording of the Online Seminar on the FBF website and YouTube Channel.

Save the date!
Do not miss the Climate Risks Online Academy, co-organised with Oliver Wyman, in scientific cooperation with the EUI's School of Transnational Governance

Contacts:

fbf@eui.eu https://fbf.eui.eu/