Industry Dialogue

Green & Sustainable Bonds: Showing action behind intent

Background

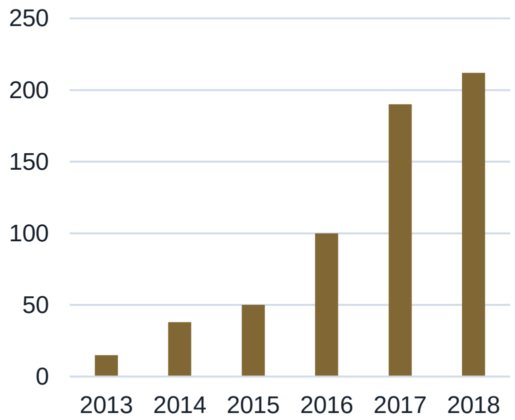
London Stock Exchange Group recently convened fixed income practitioners from issuers, investors and bank DCM teams to discuss the growth and dynamics of the Green and Sustainable Bond market and why this instrument has become an important tool in the global transition to a sustainable, low carbon economy

A rapidly-growing segment
More than US$580bn of bonds have now been certified under the Green Bond Principles and the Climate Bonds Initiative tracks a total of US$1.5tn of bonds that are ‘climate-aligned’, that is, issued by companies that have climate-positive business or for which the proceeds will be used for climate-positive infrastructure.

Issuance has grown substantially year on year, with forecasts that this segment could grow to up to 25% of the total bond market. A recent European Commission report highlighted that EUR180bn of green investment is needed each year for the next 20 years, with debt markets being a key source of that capital.

London Stock Exchange was the first major exchange to launch a dedicated green bond segment in 2015 and has supported a diverse array of countries and companies to raise capital to deliver their sustainable business strategies.

To sustain such growth and scale this asset class to the levels needed to support the transition to a low carbon economy, market participants must create new tools and common approaches.



Total market value (US$bn per year)
Source: www.bonddata.org

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Discussion
Elena Chimonides from London Stock Exchange's Fixed Income Primary Markets Team set the scene with a summary of the green bond market and the trends within it. She highlighted that the green bond segment is a growing niche, which has seen significant growth in recent years. Issuance increased by an average of 50% per year to 2017 and exceeded US$200bn in 2018.

The market is characterised by increasing diversity, both in terms of issuers and investors: initially issuance came from Nordic issuers and supra-nationals. It is now global, with more corporates coming to market and with larger bonds: BBVA of Spain and several Chinese banks have recently issued their first green bonds in London, each of US$1bn and over, including China Construction Bank's sustainability bond. Green bonds are being issued by corporates that are transitioning to a low carbon economy as well as 'pure play' green companies.

Different certifications reflect diversity in the use of proceeds with issuers focussing not only on Green Bond principles or Climate Bonds but also on Social Bond and Sustainable Development Goal Principles.

There is a growing recognition that green or sustainability bond proceeds can be applied to climate adaptation: In April 2018 Fiji became the first emerging market sovereign to list a green bond on London's International Securities Market, raising capital that will support more than 80 domestic climate mitigation and adaptation projects. Fiji has significant exposure to climate change; therefore, this represents a vital investment in that country's future: proceeds will be used for renewable energy development, avoided-deforestation projects and upgrading infrastructure for climate resilience.

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Greater diversity increases the importance of transparency, along with robust checks and balances to give confidence to investors. These exist in the form of certification standards that require third party assurance and will continue to develop. London Stock Exchange requires independent verification to a third-party standard for inclusion in its green bond segment.

The issuers present were asked for their perspective on the costs of issuing green bonds relating to certification, versus the value generated. Ines Faden da Silva, Treasurer of Tideway London, explained that a specific requirement from Tideway's Board when initially considering a green bond, was that it

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should not require a ‘cottage industry’ inside the firm to deliver it. Tideway’s experience was that whilst some extra work was involved, it was not onerous and created value within the business, as the process galvanised management and staff around the concept of sustainability and the role of the company in delivering a sustainable future.

Richard Spencer, Assistant Treasurer of Anglian Water, agreed, highlighting that following Anglian’s first green bond, they have now chosen to use this route continuously, because green bonds make a clear statement about how the company behaves and what it delivers.

Madeleine King, Co-Head of European Credit Research at Legal & General Investment Management, agreed that green bonds provide a signal about the issuer that it has a meaningful sustainability strategy, has identified the material environmental risks and opportunities that the business faces and that it is investing to deliver upon that strategy, to address those risks and opportunities. This is useful to investors when deciding whether to participate in a wider programme of issuance from a particular organisation.

Frank Cerveny, Head of Sales at MTS, London Stock Exchange Group’s electronic trading platform for Fixed Income, then highlighted the importance of a liquid secondary market for green bonds. In operation for more than 30 years, MTS is one of Europe’s leading electronic fixed income trading markets, with over 500 diverse counterparties and average daily volumes exceeding EUR 100 billion, ensuring optimum liquidity for all participants.

Primary issuance of green bonds is growing, however, they have low secondary-market trading compared with mainstream bonds - and often with other ‘non-green’ bonds from the same issuer. This is for a number of reasons, including their relative size and a stronger desire from investors to hold the segment.

Creating greater visibility, trading data and liquidity would help the segment mature and grow by allowing institutional investors to analyse and trade Government, SSAs and corporate bonds.

There is clear evidence that transparency drives liquidity, therefore, identifying green bond issuers, underwriters and trading of green bonds will help maintain their visibility post-issuance. Giving investors the tools to track, analyse and trade green bonds should enable comparison with the wider market, reduce uncertainty and increase investment in this new asset class.

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Frank explained that MTS intends to support awareness and liquidity in the green bond market and is engaging with sell-side participants to see whether they are prepared to commit to providing indicative prices and axes for green bonds. MTS is also seeking input from all participants on the types of information and analytics that would add most value.

Alexandra Bergmann, Managing Director at Mizuho Securities underscored the importance of data analytics for this segment: better information to show patterns and trends will help to feed and grow it. More data will enable the validity of assumptions about the segment to be tested. She added that often because green bonds are smaller than others from the same issuer, they are more likely to be held, which differentiates the yield from a company’s other bonds. Visibility of quotes, trading and liquidity could create a virtuous circle.

Carsten Richter, Head of Flow Credit Trading at Unicredit, highlighted the general perception that green bonds should have a premium as an example of where more data can assist: If green bond issuance is a signal of company performance and strategy relating to ESG matters – should this be reflected in the whole curve for those issuing green bonds i.e. all of that company’s issuance?

Philip Brown, Managing Director, Capital Markets at Citi agreed that the decision to issue a green bond is closely related to corporate strategy and the role of companies in the transition to a low carbon economy. He contended that this underscores a need for greater focus on driving corporate as well as sovereign issuance. If ESG reporting and performance is closely related, the importance of integrity and consistency in ESG scores is ever more significant, highlighting the importance of developing tools in the ESG rating industry that provide materiality to specific industries and greater transparency.

Jaakko Kooroshy, Head of Innovation & Standards, Sustainable Investing at FTSE Russell agreed, explaining that this is a continual focus for FTSE Russell: greater recognition of the materiality of ESG factors to corporate performance is driving interest in the underlying data.

Since the launch of FTSE4Good in 2001, more than 100 different indexes have been launched, tracking ESG performance and green revenues. FTSE Russell is now working on the alignment of fixed income ratings to equity in relation to ESG and green revenues, following the acquisition by London Stock Exchange Group of the Yield Book and Citi Fixed Income Indices.

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Jaakko also highlighted that incorporating sustainability parameters to ‘tilt’ portfolios towards strong ESG performance, rather than a binary inclusion / exclusion approach is becoming the norm.

A more nuanced selection process enables larger, core equity funds to apply ESG parameters, with examples including the Taiwan Bureau of Labour Pension Fund and HSBC Bank’s UK Pension Scheme, which has allocated more than £4 billion to the Future World Fund for its equity default option; The Future World Funds tracks the FTSE All World ex-CW Climate Balanced Factor Index.

The next step is that asset managers are starting to build their own investment scenarios and hypotheses based upon FTSE Russell’s deep data sets for ESG and green revenues, making auditability of data from the score down to each individual data point vital.

Adrian Rimmer, Senior Advisor, Green Finance at London Stock Exchange Group, summarised the discussion:

- Green Bonds are an important and growing asset class, not only in terms of the use of proceeds but also as a signal about the issuer: there is a strong desire to see more issuers, especially corporates
- The benefits to issuers outweigh any initial extra effort involved: they provide new capital, send a strong signal to investors that there is a clear, meaningful sustainability strategy and can strengthen internal engagement
- As issuance of green bonds grows, better understanding of the secondary market dynamics is vital and the participants welcomed moves for more trading data and analytics
- It’s about the company. Whilst a bond may have a green label, investors make a clear link to the strength of the corporate ESG performance and green business strategy
- As a reflection of corporate behaviour, culture and long term sustainable business strategy, it is vital that ESG data has integrity, granularity and a full audit trail in order that investors can analyse a range of assumptions with confidence.

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Full details of London Stock Exchange Group’s sustainable finance activities can be found at our Global Sustainable Investment Centre: www.lseg.com/sustainable

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