Feature

KEY POINTS

- Green bonds could help raise much needed finance to tackle climate change.
- Green bond credentials are intentionally broad in scope to encourage a green low carbon economy.
- Investors and issuers can take advantage of the Green Bond Principles and second opinion providers to prevent disputes and provide transparency of climate projects derived from the use of green bond proceeds.

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Bond, green bond: a licence to tackle climate change

This article offers a brief overview of green bonds and the use of proceeds from a green bond issuance.

It does not analyse the various bond structures, but instead, provides an easy to follow narrative of the broad scope of projects that can benefit from categorisation under the umbrella of green bonds. It also highlights the importance of clarity, information sharing and transparency in a green bond issuance with a view to dispute prevention and better investor relations.

CLIMATE CHANGE

A change in the earth's climate or "climate change" is an issue that first saw international governments unite in 1979, when the first World Climate Conference (WCC) took place. Fast forward to 1992 and many countries joined an international treaty referred to as the United Nations Framework Convention on Climate Change (UNFCCC), designed to provide a framework for international co-operation with a view to combating climate change to limit average global temperature increases.

It was not until after 1997 that developed countries became "Parties" to emission reduction targets, established by The Kyoto Protocol. The Kyoto Protocol came into force on the 16 February 2005 and is of course legally binding.

Fast forward 10 years and 2015 saw what many might refer to as "history in the making". This is because on the 12 December 2015 in Paris, France at the 21st Conference of the Parties (COP 21), the Paris Agreement was adopted. The Paris Agreement is intended to, among other matters, accelerate investment for the development of a sustainable low carbon future.

"GREEN" IS THE "NEW BLACK"

The transition to a low carbon and of course, sustainable future has gained much media attention. Not least in part due to President Barack Obama's administration as well as celebrities such as Leonardo Di Caprio lending a voice to the climate change and green cause.

The last few years have seen a surge in investments that are capable of demonstrating green credentials. This surge is, in part, stimulated by a growing awareness amongst investors of the potential positive co-benefits that can be derived from green(er) investments. As a result, green bond investments are becoming "the new black" and are increasingly vogue.

> Because there is such a broad and diverse range of projects for which green bond proceeds could be used, what counts as "green" always raises debate.

THE GREEN BOND MARKET

A green bond is similar to other types of debt security, though it comes with an added flavour – green. It is different from a regular bond because it is issued to raise capital specifically to support projects that have environmental and climate related benefits.

In addition to the usual evaluation of the financial characteristics of a bond such as the credit quality of the issuer, the price, the coupon, and the maturity, there is, as one might rightly expect, an evaluation of the particular environmental purpose of the project. Investors can, in an increasingly climate-conscious and social media age, enjoy the added co-benefit that a positive press might bring whilst also benefitting from the return on investment.

USE OF PROCEEDS

Green bond proceeds can be used for several different types of climate and environmentally friendly projects. Projects such as biodiversity conservation can qualify as green. The provision of clean(er) transportation (such as Toyota's green bond issuance) and automotive infrastructure development such as electric and/or hydrogen refuelling stations are also front runners in the race towards funded decarbonisation and emission reductions.

Clean and/or drinking water projects, energy and fuel efficiency projects that contribute towards a reduced carbon footprint are also eligible for funding using green bonds. Renewable energy (such as solar and off and on-shore wind projects) will continue to see green bond investment. Sustainable land use projects including land used for crop growth to support bio-fuel as a fossil fuel alternative (whilst it may come under some pressure from environmental groups), are also likely to see green funding.

Sustainable waste management including waste to energy projects aimed at reducing the amount of waste that ends up in land fill as well as the use of energy from the process of waste treatment are also projects that are likely to see growth as a result of raising capital through green bonds.

Because there is such a broad and diverse range of projects for which green bond proceeds could be used, what counts as "green" always raises debate. This is particularly so where the

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issuance is structured as a green revenue bond. Difficulties could arise where proceeds may be used for related or unrelated green projects, or indeed where the intended environmental benefit falls shorter than intended by the investor or indeed the issuer.

In practical terms there ought to be very little, if any, litigation arising from the use of green bond proceeds for two reasons. First, the legal documentation of the issuer should describe with great care and make clear the intended use of proceeds. The documentation should also be clear on the environmental benefits that the proceeds are intended to achieve. The more information that can be provided, the better as that in itself prevents the parties being at cross purposes. To aid this process of information sharing, issuers and indeed investors can keep in mind the Green Bond Principles (GBPs).

GREEN BOND PRINCIPLES

Whilst being a voluntary set of principles, GBPs contribute towards reducing the prospects of disputes and stimulating the green bonds market. This is because the GBPs are designed to provide issuers with guidance on the key components involved in launching a credible green bond. Intended also to assist investors the GBPs help to ensure the availability of information necessary to evaluate the environmental impact of their green bond investments. The GBPs are also designed to assist underwriters by moving the market towards standardised disclosures which it is hoped will facilitate transactions and growth of the green bond market.

A SHADE GREENER: SECOND OPINION

The second reason as to why there ought to be very little, if any, litigation arising from the use of green bond proceeds is that issuers can seek a second opinion as to the green credentials of the bond, pre-issuance.

A second opinion can be sought from among others, the Center for International Climate and Environmental Research – Oslo (CICERO). CICERO is an independent, not-for-profit research institute. CICERO provides second opinions on an issuing institution's framework and guidance for assessing and selecting eligible projects for green bond investments. CICERO second opinions also assess the framework's robustness in meeting an institution's environmental objectives.

CICERO prides itself as the world's biggest provider of second opinions of green bonds and has launched what it refers to as its Shades of Green methodology. The methodology is designed to provide a grading system as part of its reviews of green bonds. The system is designed to provide an insight as to the green credentials of a particular green bond and its evaluation of the green bonds is intended to bring transparency.

THREE SHADES OF GREEN

The CICERO methodology consists of three shades of green. The traffic light system of the shades is aimed to inform the investor that the darker the green, the greater the positive climate and environmentally friendly impact, combined with the swifter implementation, today (as opposed to in five years' time). In other words a green bond will achieve a "Dark" green shade from CICERO in respect of the implementation of a climate solution that can today achieve the 2050 climate targets.

Dark green investments are deemed as those in the renewable energy sector such as solar and/or wind. However it is unclear to what extent factors such as mining for the raw materials required for the development and operation of a wind turbine, are factored in to the dark green grading equation. Of equal, if not greater significance, is the ability of the national infrastructure to be able to cope with over production and insufficient demand. As the green bonds market matures, the key to future dark green investments with maximum climate benefits may well be in the development of energy storage solutions.

Similarly, where a climate solution project investment is "on the way to a 2050"target it could benefit from a grading of a "Medium" green shade. Of particular significance is the third shade which is the "Light" green shade. Projects of this nature can provide short-term gains as opposed to long-term climate solutions. In other words, there may be short term greenhouse gas emission reductions through various energy efficiency improvements within the project as intended by the issuer, though the project does not provide for a transition from a fossil fuel dependency to a low carbon economy.

CONCLUSION: WHERE NEXT

In conclusion, it is apparent that there are numerous different types of projects that can qualify as being green based on the GBPs. It is also clear that green bond credentials of any given issuance are inevitably dependent upon the green credentials of the given projects to which the issuer might apply the proceeds.

Apple Inc's green bond issuance (2016) for renewable energy, energy storage and energy efficiency projects supports the notion that green credentials of an issuance are broad in scope. It may be that environmental proponents argue that such issuances are "greenwashed" and are of limited benefit to the environment. Others might consider that "an aspect of green" is better than none.

One thing is certain: investor appetite for green bonds is likely to continue to grow significantly in 2016 and beyond irrespective of an immediately quantifiable benefit to the environment. In the infamous words of Shakespeare:

> 'What's in a name? that which we call a rose By any other name would smell as sweet.'

Whilst "green" definitions are broad, green bonds can provide a realistic revenue stream for investors and a much needed cash injection towards a better, greener future. ■

Further Reading:

- Green bonds: we know they're hot, but what does green mean? [2014] 10 JIBFL 661.
- LexisPSL: Banking & Finance Practice notes: Green bonds.