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Raising the profile of Green Bonds in the emerging markets

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Green Bonds are supposed to help emerging markets balance infrastructure financing needs with climate safeguards to ensure that new infrastructure developments are climate smart. But, emerging markets Green Bonds issuances were only 3 percent of all regional bond issuances in 2018. How can we change this reality?

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In 2018, Green Bond issuances by emerging markets institutions and governments amounted $43 billion or just 3 percent of all regional bond issuances, according to the World Bank's International Finance Corporation (IFC), the largest global development finance institution focused exclusively on the private sector in developing countries. The emerging markets should be the centre of global Green Bond issuances and investments considering the fact that it is the emerging markets nations that are facing the worst effects of climate change. But, obviously that is not the case. Green Bonds have not gained sufficient traction in the emerging markets although, globally, the profile of Green Bonds has dramatically changed.

In 2012, global Green Bond issuances amounted to only $2.6 billion. According to a report by Climate Bonds Initiative, an international, investor-focused not-for-profit organisation working solely on mobilising the $100 trillion bond market for climate change solutions, the labelled bond market size for Green Bonds in 2018 had hit $167.6 billion and cumulative issuances since 2007 had reached $521 billion. So how do you raise the profile of Green Bonds in the emerging markets and mobilise investor and issuer interest in emerging markets Green Bonds? As a matter of fact, the emerging markets must overcome specific market challenges and develop green investments pipelines, most often from the ground up.

Why do emerging markets lag in Green Bond issuances and investments?

According to Jean Marie Masse, chief investment officer, Financial Institutions Group at IFC, the emerging markets lag in Green Bond issuances and investments, because the lack of clear environmental, social, and governance (ESG) management practices deters potential stakeholders. IFC has identified a gap in the market: the absence of a global standard on Green Bond external reviews. As a result, Green Bond investors often receive incomplete or incomparable information across their Green Bond investments. "The harmonisation of external reviews, including second opinions and other related services, will contribute to the development of accountability and quality standards for the emerging markets Green Bond market," Masse told **International Finance**. The emerging markets can build thriving Green Bonds markets only on top of the foundation of clearly defined ESG management practices.

Why is quality of data in the emerging markets inadequate? According to Masse, the data quality gaps in emerging markets exist due to the fact that historically issuers have not been formally required to report their internal initiatives on ESG factors. The variations in data quality make it difficult for investors to determine the quality of ESG analysis, as well as the relevance of this analysis to long-term financial results.

Nuru Mugambi, the curator of the Kenya's Green Bonds Program, and a director of Kenya Bankers Association, explained that the Green Bonds market is skewed in favour of developed nations because the development finance institutions located there first pioneered Green Bonds. "We have seen more activity in the past two years in the emerging markets and I believe such activity should be supported and amplified by the financial institutions and governments," she told **International Finance**. According to Mugambi, in the developing nations, the limitations to expanding the market for Green Bonds include the lack of market awareness as well as policy bottlenecks and capacity gaps for the issuance of Green Bonds, including pipeline identification.

The challenge: Developing green investment pipelines for emerging markets

Climate Bonds Initiative Head of Latin America, Thatyanne Gasparotto, told **International Finance** that the key aspect for identifying and developing investment pipelines is enhancing market participants' awareness of Green Bonds and their related processes and opportunities. "By building local capabilities across issuers, governments, and investors, we can develop a green investment pipeline," she adds. First, sovereign Green Bonds should play a key role in developing a solid pipeline of green investment avenues in the emerging markets.

Sovereign Green Bonds from national governments convey a powerful signal to local stakeholders, both potential issuers and investors, about the value proposition of regional Green Bonds. "In Latin America, we are already seeing the impact of the Chilean bond in stimulating debate. We saw a similar effect following the Nigerian and Fijian sovereign Green Bond issuances in emerging markets, and in Europe from the initial Polish and French issuances," Gasparotto told **International Financ**e.

The second point is to build a Green Bond market from the ground up. This calls for active market development programmes at the local level involving all the key finance stakeholders, including regulators, issuers, major banks and insurers, analysts, pension funds, and other potential investors. Gasparotto concurs that it is key to identify sectors, opportunities, and investment pipelines all with the aim of getting the first round of bonds into the market. Active involvement and support from the relevant multilateral development banks and development financial institutions in issuing Green Bonds is critical to developing the market in emerging markets.

The signs from the earlier issuers and investors are encouraging. For example, in March 2018, Indonesia issued the very first sovereign Green Sukuk (Islamic bond) in US dollars. The five-year issuance raised $1.25 billion and, as expected, it reached a broad range of investors including Islamic, conventional, and green investors. In fact, the Indonesian Green Sukuk was oversubscribed, signalling the growing market demand for sustainable and responsible investments or Green Bonds.

In February this year, Indonesia again issued another Green Sukuk worth US$ 750 million with a five-and-a-half-year maturity period. With regard to the Indonesian Green Sukuk issuance, the chief executive officer of Moores Rowland Indonesia (MRI), one of Indonesia's leading financial services and advisory firms with around 450 professionals working in its offices in Jakarta and Bali, James Kallman, told **International Finance**, "It's good news anytime a bond is oversubscribed and this is pretty impressive, particularly for a country that historically has a low Islamic finance penetration."

Another emerging markets sovereign Green Bonds success is Nigeria, which issued the first Climate Bonds Initiative-certified sovereign Green Bond by an African nation in 2017. The five-year debt issuance of N10.69 billion due 2022 will see the proceeds used to invest in projects that will reduce Nigeria's carbon emissions by 40 percent by 2030. In June this year, Nigeria's Debt Management Office (DMO) announced that the country's second sovereign Green Bond offer had been oversubscribed by 220 percent. The offer for N15 billion yielded a total subscription value of N32.93 billion. Confirming the success of the African nation's

Green Bond programme, the DMO said that the number of subscribers for the second issue had doubled compared to the first issue in December 2017.

In Africa, the Kenyan government is making progressive steps to prompt the market toward promoting a green and circular economy. “Together with the Green Bonds Program Kenya partners, we are engaging the national treasury to incentivise Green Bonds through fiscal policy that attracts both issuers and investors,” Nuru Mugambi, the curator of the programme, told **International Finance**.

But given that the emerging markets investors largely focus on value, how do you convince them that Green Bonds have a value proposition beyond ethical investing and safeguarding the environment? James Kallman is of the opinion that like in Europe, stakeholder aspirations will drive increasing interest in Green Bonds in the emerging markets. In this regard, Kallman told **International Finance**, “Ethically managed companies not only make society better, they also have strong brand identification and consistently produce better returns over time. There is simply no bigger ethical issue today than climate change and in a highly corporatised and globalised world, corporations have a widely recognised higher responsibility to not only not do bad, but to actively do good.”

Are emerging markets Green Bonds actually green?

Investors are also wary of ‘greenwashing’ of projects that are not environment friendly in the emerging markets. For example, a power producer in China once issued Green Bonds worth $150 million for a 2000MW coal fired power project. How do investors ensure that Green Bonds are actually green? Climate Bonds Initiative’s Gasparotto said that the emerging markets have several guidelines – the Green Bond Principles and Climate Bonds Standard – for example to ensure this. “There are several stock exchanges in Latin America that already have Green Bond listing guidelines with others under development. So there are developments at market level happening now,” she told **International Finance**.

A consortium of the world’s leading investment banks established best practice guidelines called the ‘Green Bond Principles’ (GBP) in 2014. An independent secretariat hosted by the International Capital Market Association (ICMA) is now conducting the ongoing monitoring and development of guidelines. The GBP outlines the required transparency, accuracy, and integrity of the information that issuers have to disclose to stakeholders. But still, the Green Bond Principles do not provide enough clarity on demarcating financing as ‘green’.

Moores Rowlands’ Kallman is of the opinion that while there are several standards, over a period of time, it is inevitable that the most rigorous, consistent, and trusted one will become accepted as the golden standard. Kenya has established a Green Bonds Program that has taken a comprehensive approach incorporating international best practice into the local context. The programme’s partners include Kenya Bankers Association (KBA), Nairobi Securities Exchange (NSE), Climate Bonds Initiative, Financial Sector Deepening (FSD) Africa, and Netherlands Development Finance Company (FMO). “The programme has adopted the International Capital Market Association (ICMA) Principles and Climate Bonds Standards for Green Bonds. Moreover, the Kenya Capital Markets Authority has released issuer guidelines that recognise these two global standards as acceptable for Green Bond certification, says KBA’s Nuru Mugambi.

The GBP recommends that organisations disclose the use of proceeds in the form external reviews at the time of Green Bond issuances, and then through annual impact reports released by Green Bond issuers. IFC conducted a study to analyse the scope and quality of ESG data collected by leading ESG data providers and identified specific constraints in the emerging markets. First, there are gaps in data reported by companies in the emerging markets. Second, ESG data providers use proprietary ESG scoring frameworks that differ with respect to material relevance, indicator selection, and weightage. These differences result in conflicting ESG analysis and scores. Third, ESG reporting standards and guidelines differ across and within emerging markets. Even when companies report on the same topics, the data they report may not be comparable.

To solve these challenges, in the first half of 2019, IFC explored ways to improve material ESG reporting, including working with an ESG data provider to increase the scope of coverage of emerging market issuers as well as to broaden the coverage of collected ESG indicators. Jean Marie Masse of IFC told **International Finance** that the organisation is also exploring ways to use Artificial Intelligence (AI) and Machine Learning (ML) to support ESG data collection and analysis. IFC has identified opportunities to complement the organisation's work with ESG data providers by expanding the coverage of emerging market issuers and widening real-time information collection consistent with the IFC ESG Performance Indicators using AI and ML.

"Overall these efforts will play a key role in increasing market transparency and catalyse additional opportunities and investments in quality emerging markets Green Bonds. This is fully in line with IFC's developmental mission and the Green Bonds in emerging markets are at the cusp of what we expect will be a faster pace of new issuance growth meeting mainstream investors' investment criteria while mobilising critical funding to help emerging markets cope with the consequences of climate change," says Jean Marie Masse.

Where will all the climate-smart capital come from?

Rapid economic development not only exposes emerging markets to higher climate change risks, but it also presents unprecedented challenges. The main challenge is to de-carbonise economies while maintaining a sustainable economic development trajectory. IFC is of the opinion that in the quest to build sustainable infrastructure, emerging markets should balance higher infrastructure financing with environmental and social safeguards to ensure that new infrastructure is built climate smartly. But, where will all the required climate-smart capital come from?

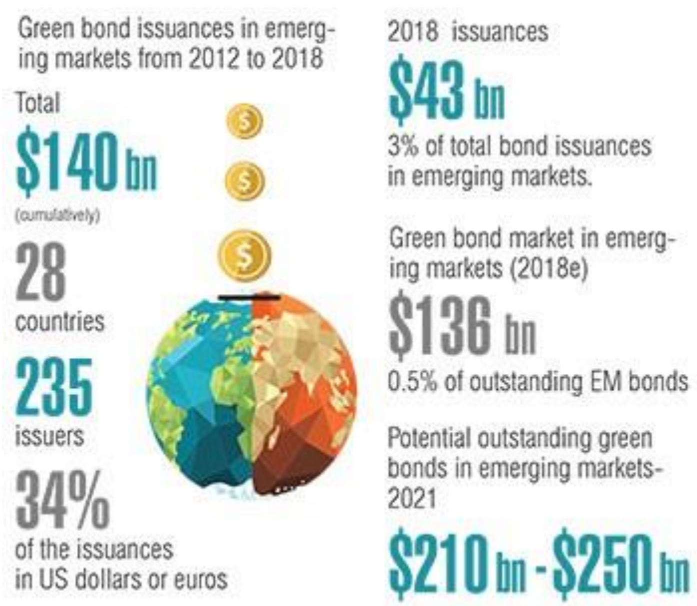
There is $147 trillion of private institutional investor capital in the world, according to IFC. Much of this capital is located in developed markets and the Organisation for Economic Cooperation and Development (OECD) countries alone account for $84 trillion. Developed nations' mainstream institutional investors typically have minimal exposure to emerging markets bonds and long-term infrastructure financing projects, perhaps due to the scarcity of appropriate investment avenues. Jean Marie Masse of IFC told **International Finance** that leveraging this capital remains a challenge. In the developed world, policy makers, issuers, and investors mobilise Green Bond investments. To make the process seamless, the European Union (EU) has also proposed an EU Green Bonds Standard. However, a similar mobilisation is absent in the emerging markets and investors are mostly not aware of such investment opportunities.

IFC is a pioneer in Green Bonds market making and the organisation is active in the emerging markets. It has a tremendous record in this regard and its involvement promises mobilisation of more emerging markets issuances and investments. Since launching the Green Bond Program in 2010, IFC remains one of the world's most prolific issuers of Green Bonds. In 2013, IFC was the first issuer to list a billion-dollar Green Bond in the global market. This was globally heralded as a landmark transaction that proved that Green Bonds could be viable mainstream finance products. To date, IFC has issued around 150 Green Bonds worth almost $10 billion in 16 currencies.

To develop the Green Bonds market in emerging markets, IFC plans to work on model Green Bond transactions issued by emerging markets issuers, release market research reports to disseminate information about the opportunities in green financing in emerging markets, and build tools to communicate it. "Mobilising public and private institutional investors to deploy billions of dollars in capital for climate investments is essential to alleviate the impact of climate change. The award winning Amundi Planet Emerging Green One (EGO) Fund does just that. As the largest Green Bond fund in the word, the fund is helping to scale climate finance in emerging markets," says IFC's Jean Marie Masse.

Why China is the undisputed emerging markets Green Bonds leader

In the emerging markets, no discussion about Green Bonds can be completed without mentioning the major strides that China has made. China's official *China Daily* newspaper reported that the country's Green Bonds revolution is part of a project to turn the country from the biggest global source of environmental pollution to the global leader in climate change mitigation. In 2018, Chinese institutions issued $30 billion worth of Green Bonds that met international Green Bonds classification norms.



James Kallman of Moores Rowland Indonesia told **International Finance** that with three of the world's four most populous countries and two of the largest democracies in Asia, including Indonesia, Asia Pacific is the region where one can expect greater attention and growth in Green Bond issuances, particularly given the multi trillion-dollar infrastructure needs. "As with most products and services, no company can ignore the China market and China is embracing green finance in full throttle. China has announced huge Green Bond issuance plans for the Belt and Road Initiative and domestically there may be no bigger threat to the Chinese leadership than the environmental concerns of the population," adds Kallman.

Ultimately, consumers will force companies to accept the Green Bonds revolution

As of now, the Green Bonds market is the most developed segment of thematic impact-oriented bonds. Green bonds deliver several benefits to issuers and investors. The main benefit for issuers is that they can target a larger investor base by attracting a dedicated pool of green and socially responsible investors. Positive publicity and media coverage are the other softer benefits of issuing a Green Bond. According to data from Bloomberg Barclays Indexes, in the euro market, Green Bonds returned 0.34 percent in 2018, while the overall investment-grade market returned 0.41 percent. In addition to comparable returns, Green Bonds provide an additional element of transparency to ensure that the funds are used to invest in environment friendly assets.

James Kallman of Moores Rowland Indonesia told **International Finance** that mass adoption and mainstreaming of Green Bonds is inevitable in the emerging markets too. “Corporations are for-profit animals and this means they will follow consumer preferences, and, relatively quickly so in this age of information and digital disruption. Take the case of electric vehicles. Previously a niche space for a few brand lines and, of course Tesla, today there are no automobile companies without an EV strategy. And, this industry is a case in point for the entire green economy. There have, perhaps, been few companies in history with a lower cost of funding than Tesla,” says Kallman. Ultimately, in the capitalist world order, no emerging markets organisation can ignore the funding benefits, the unique branding, or the consumer and institutional loyalty that Green Bonds bring.