Topic : Sustainable Bonds – Green and Social Bonds

Guidelines: 600-800 Words

Deadline: 48-72 hours

Sustainable bonds - Green and social bonds

Understand what environmental investing can yield - Sustainable, green and social bonds

Climate change and the drive to create a sustainable future long ago moved beyond the headlines. The impetus to impose real and actionable change on all sectors has grown in urgency as the signs of traumatic environmental change have grown impossible to ignore. For investors this has yielded a vision that a sustainable global economy can become possible through institutional capital supporting wide ranging and impactful change.

Bond markets are crucial in this effort, particularly as they provide the kind of capital that can finance these large-scale green initiatives. Since the Sustainable Development Goals were issued in 2012, there has been a determination to set goals for change across political, economic, and environmental sectors. To reach these targets, funding is crucial. And estimated funding needs are vast - the UN Conference on Trade and Development estimates that 5-7 trillion dollars will be needed annually to create the kind of change that our future demands.

Environmentally responsible investing was originally predominated by equities, yet as sustainable initiatives have developed and matured, the fixed income market for these kinds of instruments has grown both in demand and supply. Green bonds, and, in recent years, social and sustainable bonds have begun to fill the need for socially responsible investments.

Generally defined as debt instruments where all proceeds go to environment and/or social projects, green, social and sustainable bonds are a unique opportunity to support sustainability in a real way, and also, on a portfolio level, offset some of the financial instability that climate change has increasingly caused.

These types of bonds are true debt instruments, and as such regulated under the same regime as other types. However, are certain rules that the issuers must follow to claim the designation of green, social or sustainability bonds — and each type of bond has a separate target for the proceeds:

- **Green bond** - these bonds must provide clear environmental benefits in the prospectus, for more information check the Nasdaq's requirements for Green Bonds here;
- **Social bonds** - intended for specific populations, including: those below the poverty line, vulnerable and marginalized groups and communities. End projects can involve such things as affordable housing, or micro-finance, among others, see Nasdaq criteria here; and

- **Sustainability bonds** - a newer instrument designed solely to finance, or re-finance, already existing green or social projects. They were created with this mixed profile in order to allow cross-category socially conscious investment, e.g. supporting those social projects with environmental benefits and/or vice versa. Nasdaq criteria here.

However, it is well to remember that the "socially conscious" aspect of these particular instruments is not always straightforward. Third party verification by bodies such as the Climate Bond Standard Board are not standard, so transparency can be a problem.

Additionally, it can be hard to measure what constitutes a positive social impact with these projects — nuclear energy, anyone? There are initiatives to institute across the board verification and impact studies, but it is not yet complete.

These types of bonds do hold high attractiveness to institutional investors seeking to cushion shocks from recent market turbulence. In addition, there are definite benefits in terms of tax exemptions and tax credits.

With these reasons in mind, it is no surprise that these socially conscious fixed income investments have hit the market in increasing numbers despite an overall debt slow down. In 2018, these bonds equalled 2% of new issues on the market and in 2019 estimated issuance will reach $180 billion.

Despite tightening monetary policies in the US and Europe, rising environmental concerns are likely to see this sector of the bond market grow. But although issuance will be high - returns may not be. The inherent nature of the projects these bonds support means that cash flows will likely remain low. However, increasingly successful new green technologies could see this change.

Things to remember when considering green, social or sustainable bonds:

- **Risk is risk** - whether or not the environmental impact is beneficial, weak financials and poor performance should raise red flags
- **Not every bond is equal** - remember that these bonds come as structured products: Standard Use of Proceeds Bond; Revenue Bond; Project Bond; and Securitized Bond. Understand their particulars before getting in too deep.
- **Reporting criteria must explain sustainability** - understand the selection, focus and result of the project which you are helping to sustain. Transparency remains a problem in this sector and can affect credit risk.
- **Liquidity can be low** - considering the size of the market and current issuance rates, these are not especially liquid assets. Entering and exiting a position can be difficult and this might effect the investment term.

- **Low yields** - Yields remain low, although income can be tax exempt.

Overall the prospect for this market looks good as regulation and transparency remain on the forefront of issues to be dealt with. Also, as environmental concerns grow, these instruments will likely increase in volume and real results. These are definitely a strong source of financing for sustainable projects as well as a fixed income investment worth looking at.