Green Bonds and climate protection

Topic of the month December 2015

COP 21 leads the way for investments in climate protection

Expectations for a success of the climate summit in Paris are high. While the UN Climate Change Conferences are annual conferences that assess the progress in dealing with climate change, COP 21 is being held in Paris from November 30 to December 11, 2015.

From an investor’s perspective, climate change can be addressed in different ways. In any case, the achieved impact on the topic – which is climate protection – is the goal that stands in the limelight. Within the field of sustainable investment, the topic of achieving an “impact” has clearly been gaining importance over the last years.

Investors aim for enhanced “impact” with regards to ESG

However, one has to distinguish between “impact investments” in a narrow sense and the “impact generated by investments” from a somewhat broader perspective. “Impact investments” in a narrow sense are defined as investments in companies and organizations with the clear goal of producing measurable social and environmental effects, or impacts. There has to be a measurable benefit for society out of the investment, whereas a positive financial return out of the investments is not mandatory. Examples for impact investments in a narrow sense are microfinance investments, community investments and social entrepreneur investments. The size of impact investments in a narrow sense is still rather small.

Sustainable investments, on the other hand, increasingly focus on the creation of sustainable value via the investment beside the financial return. From this point of view “impact” stands for the impact on companies and issuers, the impact created in an ESG dimension. One way of achieving this goal are valid engagement and voting policies drawn up by the investor and the direct engagement with companies and issuers. The second possibility is to focus on the company or issuer and the corresponding products or services itself. Green bonds are a good example for the latter approach, an investment that focuses on the topic of climate protection and therefore shows high impact, focused on the “E” out of the “ESG” classification.

Green Bonds with high growth in the past and in the future

Green Bonds are bonds which are used to finance environmental projects, like renewable energy, clean water or green buildings. The market for Green Bonds is still in its development phase, but growing fast. The current market volume is approaching USD 100 bn, therefore the figure almost doubled compared with the end of last year. Since 2013, the market volume has more than tripled. The average issuing volume is also on the rise.

Nowadays, Green Bonds are not only issued by multi-lateral organisations, but also by more and more companies and commercial banks. In 2014, the Green Bond Principles (see appendix) created a framework for a standardisation of this new asset class.

The significance of Green Bonds for the three dimensions of ESG

- E (Environmental):
  The background of Green Bonds is, due to the focus on climate protection, primarily to be found in the environmental dimension of ESG. During the process of issuing green bonds a lot of ecological topics are taken care of.
- S (Social):
  Social and community-related topics are considered by some potential investors, however, they are not in the focus when issuing a green bond.
- G (Governance):
  The fact that Green Bonds can theoretically be issued by any potential issuer leads to the necessity of a standardisation and specific requirements. On the other hand, Green Bonds make it possible for issuers that have not yet focused on the topics of sustainability or climate protection to issue earmarked bonds and set new strategic priorities.

Issuer engagement with respect to green bonds

Climate change represents one of the major extra-financial risks in today's financial markets. As part of its thematic engagement activities, the SRI team of Raiffeisen Capital Management has addressed the most important issuers of Green Bonds and asked for details. The idea behind the engagement was to tackle the allegation of "greenwashing".

The answers to the questionnaires showed that the yield which the market is willing to pay for Green Bond issues currently remain on the same level like for traditional bonds. Therefore the issuer has no financial advantage or disadvantage from a Green Bond transaction. However, the issuer has to cover additional costs for the setup of internal structures – like for project monitoring – and for a "second opinion" of a third party.

Some issuers believe that the pricing for Green Bonds will improve in the future, Green Bond issues might become cheaper for the issuer and therefore reflect the additional value created in the field of climate protection. In addition to that, "second opinions" have to follow minimum standards in order to avoid reputation risks.

All issuers regard transparency as the best way to counter the allegation of "greenwashing". Issuers that do not guarantee the required quality – like transparency and a „second opinion" – face increasing reputation risks. The number of NGOs that cover the topic of Green Bonds has increased.

Green bonds are an increasingly attractive mechanism for both private and public sector organizations to raise capital for projects, assets or other activities that benefit the economy, environment and society. '

Raiffeisen-Green Bonds

Raiffeisen Capital Management launched the Raiffeisen-Green Bonds fund in September 2015. The fund invests primarily in Green Bonds with investmentgrade ratings. The FX-component is hedged. Among the issuers within the fund are corporates, supranationals and agencies. The fund focuses on developed market issuers. The holdings of the fund are screened for both green bond quality criteria and for the specific sustainability assessment criteria of Raiffeisen Capital Management. Exclusionary criteria like nuclear energy are applied.

Conclusion

COP 21 and the financing of the measures taken after the summit will strongly support the Green Bond market. The standardization of the asset class of Green Bonds is improving, therefore the investor base should continue to thrive.

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Raiffeisen Capital Management (Raiffeisen Kapitalanlage-Gesellschaft) is part of Austria's largest banking group and with a market share of 17 percent in investment funds one of the leading national Asset Management Companies. Beyond its home market, Raiffeisen Capital Management has been quite active on the international markets for many years and is now a respected player in several European countries. Headquartered in Vienna, the company currently manages EUR 30 billion in assets (as of end of June 2015, incl. advisories), with institutional investors accounting for EUR 17 billion.
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