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Bringing green bonds into focus

Measuring impact and debunking the 'greenium' myth

A recent research report from S&P Global estimates green, social, sustainable and sustainability-linked bond issuance will top US$900 billion in 2023, accounting for as much as 16% of total issuance. Of this, green bonds are expected to dominate the market, with law firm Linklaters finding 935 green bonds were issued globally in the six months to June 30, raising about US$351 billion.

Naturally, this growth has come as awareness and concern around climate issues has increased; most green bonds today are funding technologies required to decarbonise economies and the energy transition. The OECD estimates about US$7 trillion is needed each year through to 2030 to meet climate and development objectives.

While the first green bond was issued in 2008, the significant growth in market volume of sustainable bond issuance has really come about in the last decade or so, BNP Paribas Asset Management portfolio manager, green bond and social bond strategies Arnaud-Guilhem Lamy explains.

"The sector diversification of the green bond market has also been impressive for the last five years: you have corporates, financials, governments, agencies, across the entire yield curve, and multi-currency. We are currently seeing a US$2 trillion market for green bonds which is now very well diversified," he says.

It will be even further diversified come mid-2024 when the Australian government begins issuing sovereign green bonds, as announced in April this year. The program intends to enable "investors to back public projects driving Australia's net zero transformation and boosting the scale and credibility of Australia's green finance market."

BNP Paribas Asset Management's green bond and ESG analyst Xuan Sheng Ou Yong previously told *FS Sustainability* that the asset manager is "definitely looking forward" to Australia's program kicking off, saying: "The more green bonds that come on, it suggests that more capital and much more attention is focused on what is needed to transform the country to aligning with net zero."

While mitigating climate change is a primary objective of projects financed by green bonds, they are also used for other purposes, including managing water, waste, and pollution.

Providing examples of the kind of impact a green bond can have, Lamy says: "The obvious one that comes to mind is a utility installing an offshore wind power plant or an industrial installing solar to provide power to its facilities. We also have industrials improving the energy efficiency of their process, or real estate sectors renovating buildings to reduce their energy consumption, making it far more efficient and reducing their carbon footprint."

"So, the output of the first example would be the production of renewable energy in terms of Mk/h while the benefit of the second would be calculated in terms of avoided Co2 emissions."

In terms of measuring or verifying impact, Lamy explains that BNP Paribas Asset Management does an assessment of reporting following investment in a green bond.

"If the issuer doesn't provide a transparent report of impacts, proceeds and verification within 12 to 24 months, then we would divest," he says.

"At the strategy level, we've also reported on both the output, such as green energy produced, energy savings, and on the outcome, such as the avoided emissions."

However, verification isn't always so straightforward.

"Indeed, the main risk is that most green bonds are auto labelled and defined as green by the issuer itself. The European Commission has defined a new standard with the EU taxonomy, but it doesn't cover everything, and the green bond standard is not ready yet," Lamy explains.

Outlining BNP Paribas Asset Management's approach, Lamy says it begins with analysts examining the issuer's ambitions for building a long-term sustainable business model.

"We look for a 'Do no significant harm' principle and we carefully examine the quality of proceeds, including the whole chain value; it's great to fund the transition from diesel train to electric trains but if electricity is produced through a coal power plant, what is the point?" he states.

Then, as mentioned, one year after issuance the impact report is dissected.

"Here we have added the expertise of a provider who is able to recalculate the Co2 emissions which have been avoided thanks to the invested projects, so that we can challenge the issuers," he says.

"So, there's a lot of work to be delivered when analysing green bonds but it's worth it because it enables us and our investors to proactively participate in the energy transition."

That's something BNP Paribas Asset Management has been doing since 2002 when it first committed to sustainable investing. Now, more than two decades on, sustainability is core to the group's strategy and investment philosophy, Lamy explains.

"As part of this, we have been managing green bonds since 2017. As the strategy has grown in favour, our assets under management have more than tripled since the start of 2020," he says.

"The investment teams are also strongly supported by a well-resourced Sustainability Centre of 30 ESG experts to deliver on our sustainability ambitions."

And while the outcomes achieved with green bonds differ vastly from those of traditional bonds, they really aren't that different.

"With green bonds, you typically benefit from the financial characteristics and financial performance of a standard bond. Indeed, the credit risks of a green bond are the same as a classic bond from the same issuer, same maturity given that they have the same rank," Lamy explains.

"And the factors driving green bond performance are the same as those that affect traditional fixed income assets. The main ones being interest rates, credit or default risks, and liquidity risk."

That said, Lamy says investors are increasingly choosing green bonds as part of their core fixed income allocation. Looking at returns, he notes that when you look at the performances of a global green bond index, it's highly correlated, around 0.90, with a global aggregate index, especially since the beginning of the year given that durations are now close to each other.

And no, investors are not being lumped with a 'greenium', he says. A 'greenium', or green premium, refers to the amount by which the yield on a green bond is lower than an otherwise identical traditional bond.

In Lamy's view, the 'greenium' is nothing more than an urban legend – a view supported by BNP Paribas Asset Management's own analysis looking at green bonds versus the equivalent yield for the standard bonds of the same issuer and same maturity.

"The average greenium was three basis points, just 0.03%. That's obviously an average and it doesn't tell the whole story but most of the time it remains within 0 to 0.05%," he points out.

"So, the so-called 'greenium' is not meaningful in my opinion." FS

The quote

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Watch the video on www.fsitv.com