ENERGY, UTILITIES & INFRASTRUCTURE PRACTICE

The rise of Green Bonds: Beneficial for the environment and for investors

BY ENERGY, UTILITIES & INFRASTRUCTURE TEAM

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A) What is a Green Bond?

In general, a green bond is an investment product for the raising of finance for climate change solutions and the promotion of projects with environmental benefits. Practically, it is a debt instrument like any other bond with the following main characteristics:

- It offers a fixed return and its proceeds are used to finance (or refinance) environmentally friendly projects;
- It can be issued by a company, a financial institution or even the government for a fixed period; and
- It finances projects in areas such as energy, transportation, waste management, construction, water and land use.

B) Regulatory Framework

Green Bonds are framed by the **Green Bond Principles (GBP)** and the **Climate Bonds Standard & Certification Scheme**. They provide guidelines, regulations and incentives regarding the green finance framework.

The **GBP** are voluntary process guidelines that contribute to the transparency of the process and promote integrity in the development of the green bond market by clarifying the approach for issuing a green bond. They consist of four main components which are as follows:

- The use of proceeds of each green bond should be specified in the documentation for transparency and integrity reasons, in order to justify its "green" purpose;
- The project evaluation and selection process that provide investors with information necessary to assess whether a project is "green" and what is its environmental impact;
- The management of proceeds (revenues) that should be reported.
- The reporting obligation of the issuers that contains a brief description of the green projects and the amounts allocated, as well as their outcome.

The Green Bond Principles help to ensure investors of what they are buying and avoid "greenwashing".[1]

[1] "Greenwashing" refers to the process of providing misleading information about a company's practice, products, etc. in order to make the consumers to believe that they are environmentally friendly or to present the projects with a viable and environmentally

The Climate Bonds Standard & Certification Scheme, included in the **Climate Bond Initiative (CBI)**[2], is a certification system that contains environmental standards with which projects must comply.

The strict scientific criteria, included in the **CBI,** ensure that the projects, for which green bonds are issued, are compatible with the 2°C heating limit as provided for by the Paris Agreement.[3] The **Certification Scheme** is applied globally by bond issuers, governments, investors and financial institutions.

C) Why issuing Green Bonds?

Overall, it has been characterised as a "win-win" situation for both the bond issuer and the investor, as the issuance of green bonds can contribute to a sustainable future. Companies can further enhance their reputation due to their upgrade of credit rating by international financial organizations.[4]

Green bonds are an economical financing mechanism and provide better financial flows which enable countries to raise funds in order to meet their climate targets.

From the investors' perspective, seeking to diversify their portfolios, they benefit from the trend of oversubscription that characterizes the green bond market due to its lower risk, which means that the demand for this type of investment is higher.

From the issuers' perspective, green bonds may attract investors specializing in environmental projects, who may not otherwise invest in the issuers' companies and they enhance investors' demand for green financial instruments.

Green bonds give to bond issuers an extra guarantee for the investors who trusted them and promote stakeholder's demands for more responsible businesses.[5]

D) What is the process for issuing a green bond?

The process for issuing a green bond is as follows:

- The issuer has to identify and disclose the eligible projects and assets related to green bonds and disclose that the use of proceeds will be utilized for projects of

efficient way in order to achieve favourable lending terms.

[2] The Climate Bonds Initiative (CBI) is a registered charity in England and Wales, launched to increase investments contributing to the transition to a low-carbon and climate resilient economy. It provides standards and guidance on green bonds and publishes studies on the evolutions of the green bonds market every year since 2012.

[3] The Paris Agreement is an agreement within the United Nations Framework Convention on Climate Change (UNFCCC), dealing with greenhouse-gas-emission mitigation, adaptation, and finance, signed in 2016. The goal is to keep the increase in global average temperature to well below 2 °C above pre-industrial levels and to pursue efforts to limit the increase to 1.5 °C, recognizing that this would substantially reduce the risks and impacts of climate change.

[4] For example, TERNA ENERGY has recently been upgraded by ICAP in terms of credit rating; from BB to A. A-rated businesses are characterized by their very important financial figures and their significant market position.

[5] The first green bond was issued by Delta Techniki SA with the contribution of the Wealth Fund Services and the National Asset Management in February 2018.

environmental and social importance.

- A Verifier will have to ascertain that the issuer is complying with the **GBP** and will issue a verification report.[6]

- The Climate Bonds Standard Board[7] will then issue a certification related to the green bond and based on the verification report.[8]

- The issuer is obliged to inform the Climate Bonds Standard Board in case it becomes non-compliant after the issuance of the abovementioned certification.

Regarding the verification process, it is important to distinguish the two stages; pre-issuance of green bonds and post-issuance of green bonds. A Verifier has to assess whether the issuance of the green bond comply with the **GBP** and the **Climate Bonds Standards**. After the issuance of a green bond, the Verifier, on behalf of the issuer, will confirm that the use of proceeds of the bonds is related to environmental-friendly projects and that the management of funds complies with the guidelines.

E) Challenges in practice

Although green bonds have gained a significant place in the financing of energy-related projects in Europe, in practice their expansion remains small compared to the total bond market.

For issuers the challenge is the high cost of the green bond issuance and the risk of not having the expected returns as they would expect with the common bond. The extra cost refers to expenses for defining the green criteria, maintaining the "greenness" of the use of proceeds and disclosing all the relevant information to investors throughout the lifecycle of the said bonds.

It appears that in the Green Bond Market, there are multiple definitions of "green" bonds and of "green" investments. Thus, there should be a common policy for the defining process of a bond, in order to reduce the risk of misunderstanding.

Despite the challenges, the green bond market is being developed globally with a significant margin for further growth, if the above challenges will be addressed successfully.

EU Green Bond Market

The EU green bond market has grown further beyond other markets due to the existing finance infrastructure and the active political support from the EU institutions in general.

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[6] There is a directory of Verifier organizations which have been approved by the Climate Bonds Standard Board. Issuers are free to choose a Verifier from this list that matches their criteria. Following certain requirements, companies can become themselves Approved Verifiers, in order to help the Climate Bonds Standard Board to certify the increase of green bonds.

[7] The Climate Bonds Standard Board provides oversight over the implementation and operation of the Climate Bonds Standard & Certification Scheme. The Board reports to the Governors of the Climate Bonds Initiative.

[8] Recently, the bond of TERNA ENERGY MAEX, the member company of TERNA ENERGY Group, which issued it, is the first certified climate bond issued in Greece. Certification was provided by the international organization Climate Bond Initiative.

However, there are significant differences within European countries, mainly because of the various national policy frameworks. For example, the green bond market is more advanced in the Nordic countries, France, the Netherlands, Germany and the UK, and less strong in others, for example in Bulgaria.

With the recent issuances of green bonds in Greece and the contribution of financial institutions, like EBRD, it is expected that the country's market will be filled with confidence and more companies will start investing in this promising market of green bonds.

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