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Green bonds: A new tool for funding the energy transition?

"The longest journey always starts with one step" used to say François de la Rochefoucauld. On December 12, 2015, the COP21, also known as the 2015 Paris Climate Conference, ended with an historical agreement that provides fresh impetus in the fight against global warming. For the business community, this agreement is primarily a signal for continuing investments in clean solutions and technologies.

As such, the COP21 highlighted the importance of sustainable financing and the development of a tool designed to support energy transition, i.e. green bonds.

A fast growing market

Driven by so-called "socially responsible" investors[1] searching for ethical financing that respects sustainable development, the green bond market has been booming over the past few years. It grew from USD 4.5 billion in 2012, to USD 13 billion in 2013 to reach 36.3 billion in 2014[2].

In addition, the COP21 could provide a further boost to this relatively new market that should undoubtedly continue to grow tremendously in 2015. Indeed, the funding mechanism designed to raise funds for environmentally friendly projects benefit from a considerable showcase, a framework that becomes increasingly structured, and a wide variety of market players.

Clearly identified environmental projects

Green bonds are bonds that are issued to fund projects with strong environmental and/or social benefits. The fundamental difference between green bonds and standard bonds lies exclusively on the final purpose (clearly identified in the issuance of green bonds) of the environmentally-oriented investments (including, but not limited to, the protection of the biodiversity, the promotion of low-carbon means of transport and the thermal rehabilitation of buildings) or socially-oriented projects (including in developing countries).

Due to the rapid development of green bonds, and in order to clarify the conditions in which they can be properly identified, the leading international banks that operate on this market have established a number of guidelines know as the "*Green Bond Principles*"[3].

These guidelines provide issuers with valuable insights to define the issue of bonds and investors with the necessary information to assess the environmental impact of the funded projects.

These principles are structured around four axes: Use of proceeds, process for project evaluation and selection, management of proceeds and reporting[4].

Even though these principles are applied on a voluntary basis, they have generated a high level of interest and support from market players who are careful to preserve their credibility and avoid any "*greenwashing*"[5].

Towards a growing diversification of the market players

As the green bond market is becoming increasingly structured, we observe a diversification of issuers that are no longer only large market players, public authorities and bodies or big domestic organizations. The spectrum of issuers is gradually expanding.

In France, leaders in the energy industry were the first ones to implement large green bond issues that were widely subscribed. Recently, a recycling company was the first *entreprise de taille intermédiaire* (i.e. mid-market company, commonly referred to under the acronym "ETI" [6]) to issue green bonds. Other mid-sized companies operating on the renewable energy market followed the lead and used, in particular, the European Private Placements market – known as Euro-PP (cf. our November 2015 e-newsletter) – to structure their bond issue.

The green bond market is becoming more mature and liquid and deserves the full attention of investors. Recent green fundraising initiatives open up positive funding opportunities for mid-sized companies wishing to reinvigorate their growth model or carrying project with high potential for environmental progress.

Green bonds, whether used to finance energy transition projects in developing countries or innovative eco-friendly projects carried out by mid-sized companies, certainly have a very promising future.

[1] The terms "*Socially Responsible Investment*" means all steps taken to include non-financial criteria, i.e. criteria linked to social, ethical and governance issues, in investment decisions and portfolio management.

[2] Information derived from the article entitled "*Le marché des green bonds dopé par la COP21 ?*" published on the website of *Les Echos* (French leading financial newspaper) on December 8, 2015.

[3] The green bond governance framework is currently established by the International Capital Market Association.

[4] Contrary to standard bonds, green bonds are dedicated to identified investments, specified contractually in the issue prospectuses and for which regular updates must be provided to the creditors.

[5] "Greenwashing" means a form of spin in which PR or marketing is used – often deceptively – by an organization so as to present an environmentally responsible public image.

[6] An *entreprise de taille intermédiaire* (ETI) is a company with between 250 and 4999 employees, and a turnover which does not exceed 1.5 billion euros or a balance sheet total which does not exceed 2 billion euros.