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Mobilizing long-term private capital: debating the case of green bonds

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The investment needs for deep decarbonization (compatible with the below 2°C target the international community committed to) are estimated to several trillions per year. In a context of stringent public budget constraint and low cost of borrowing in capital markets, much of the discussion on the financing of deep decarbonization now focuses on ways to maximize the leverage effect of public financing on long-term capital. Green bonds are one of the promising vehicles to tap long-term savings. Genuine promise or pipe dream?

The appeal for green bonds: actors and rationale

Bonds guaranteed by AAA-rated international organisations and issued in currencies with low volatility have long track records in development financing. They offer a low-risk opportunity for both institutional and retail investors to buy low-risk assets while channeling resources to sectors that support positive development outcomes. Mobilising long-term capital *specifically* for mitigation or adaptation to climate change is the main rationale for green bonds. Green bonds are in essence debt instruments designed to channel investments into green or climate change assets and activities. Part of their appeal lies in their attraction for long-term institutional investors such as pension funds, which are deemed a potentially significant source of investment in climate-relevant projects. Following the UN Climate Summit in 2014, institutional investors pledged to invest over USD 5 billion in green bonds. The labelled green bond market has experienced rapid growth over the last three years. The total value of the green bond market reached USD 53.6 billion in 2014 according to Climate Bonds Initiative. It is worth noticing though that green bonds account for less than a fraction of 1% of the total global bond market, which is estimated at approximately USD 100 trillion. Interestingly enough, roughly 75% of green bonds have been issued by government-owned or -backed agencies and development finance institutions primarily in developed countries. Green bonds issued by multilateral and bilateral development finance institutions have raised approximately USD 30 billion cumulatively since 2007, or approximately 43% of the green bond market, growing from USD 4 billion in 2010 to USD 14 billion in 2014. The World Bank and the European Investment Bank were early issuers of green bonds to target climate activities in developing countries, driven by demand from public pension fund investors. Bilateral development agencies such as KfW, AFD and export credit agencies, such as Export Development Canada, have also issued green bonds for similar purposes. An increasing number of green bonds is also being issued by private institutions (e.g. commercial banks and corporations). In France, BNP Paribas for instance provides a striking example of commercial banks' progressive commitment to green financing. BNP has enabled bond issuers such as the World Bank or the EIB to raise several billions of dollars to fund climate mitigation projects through structured green bonds, where the coupons are actually indexed to the equity return of a basket of low-carbon stocks. In 2013, China announced plans to grow a corporate green bonds market in the country as part of meeting the objectives of the 12th Five-Year Plan. Under the China Banking Regulatory Commission's definition of green credit, there were RMB 5.72 trillion (USD 920 billion) of outstanding green loans in the largest 21 Chinese banks in 2014 which could be re-financed as green bonds. The opening of the interbank market to foreign investors was announced in February 2016—all quotas for qualifying foreign investors have been removed—partly to boost the green security market. What is expected is to channel savings away from unregulated and speculative assets into a regulated market of green investments for an overall stabilizing effect on the financing system.

Green bonds and climate finance: issues and challenges

Green bonds are not silver bullet though. Some concerns remain, in particular regarding the additionality of the “green” savings tapped. Issuing green bonds can attract new investors focused on sustainable or responsible investing, but in this initial stage of the market, most green bonds are used as a re-financing tool, re-packaging projects that could have been financed through a standard bond. It is very likely indeed that in the short term, green bonds do *not* generate additional resources. Further, for the time being, there is no agreed definition or standard for what types of projects can be financed by a green bond, and approximately 40% of the current green bond market has not

undergone an independent review of its green label. Regulatory and supervisory authorities should support harmonization of reporting standards across jurisdictions, to increase the transparency and credibility of the emerging green bonds market (an argument developed [here](#)). All these concerns are to be quickly addressed so as to turn green bonds into a genuine tool for channeling long-term savings into early climate action—be it for mitigation, or for adaptation which is seriously underfunded.

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