THE WORLD BANK

Green Bond Symposium

Hosted by the World Bank Treasury

Background

The overall goal of the green bond market is to help mobilize private sector financing for climate-friendly investments. The World Bank Treasury hosted a Green Bond Symposium in Washington, D.C. on November 19, 2013, to convene a group of investors, issuers and intermediaries so they could share perspectives of the evolving green bond market.[1] The objective of the Symposium was to come to a shared understanding of green bond features that are most valuable for fostering further development of the market by including new investors, issuers and products while ensuring high standards of integrity and quality. The size and format of the Symposium - including having an external facilitator - was chosen to allow for an open and inclusive discussion among these three key groups of market participants on all the various topics that have thus far been mostly discussed bilaterally between participants. The following summarizes the key areas discussed.

Summary

The Symposium highlighted that the green bond market is evolving, growing quickly, and already shows diversity of investor preferences and issuer strategies. The Symposium participants all reaffirmed a deep commitment to the common purpose and recognized urgency for the market to grow to address pressing environmental issues at local, national and global levels.

The differentiating element of green bonds compared to other bonds is that proceeds are earmarked to support climate-friendly activities. To date, green bond issuer groups already include supranationals, government agencies, cities, states, and also corporates. Investors expressed a desire for more choice of products for their growing portfolios - green bonds from more issuers and more diverse types of green bond products (e.g., securitizations) that offer different risk profiles.

The main elements of issuers' green bond processes that emerged as important to investors to maintain high standards of quality and integrity in the market can be summarized in the following **five areas**, all communicated to investors in a transparent way.

The Five Key Areas of the Green Bond Process:

I. Determining the Issuer's Criteria/Definitions for "Green"

The issuer engages with investors and uses internal and/or external input/opinions to determine which projects they will consider as eligible for financing through green bonds.

II. Selecting Eligible Projects

The issuer designs and implements its approach for choosing eligible projects.

III. Earmarking and Allocating Proceeds

The issuer sets up the internal process so that green bond proceeds can be earmarked and allocated to eligible projects.[2]

IV. Monitoring and Reporting on Impact

The issuer defines expected project outcomes and indicators/metrics to measure the impact of selected projects, and reports to investors (ex-ante and, as available, ex-post).

V. Ensuring Transparency and Compliance

The issuer establishes internal and/or external procedures to ensure compliance with its stated green bond process and makes the whole green bond process transparent. Depending on the type of issuer and product, investors will look for different levels of internal and external comfort for different stages of the process.[3] It is important for issuers to get a good understanding of investor expectations as they explore green bond issuance, including through direct engagement with prospective investors.

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[1] Ten experienced green bond investors, ten issuers/expected issuers of green bonds (plus an issuer considering green bond issuance), and seven intermediaries convened in Washington, DC, for the Symposium, to share their perspectives and learn from each other.

[2] Investors clarified that green bond cash proceeds could be warehoused as part of the regular, short-term conventional investment process prior to disbursement.

[3] External providers of third party opinions that were mentioned include academia (like Cicero), ESG research providers or rating agencies that can provide helpful information about issuers, auditors for verification of the process, and climate bond certifications for the bonds themselves.

The main points highlighted by investors were:

1) Transparent disclosure of definitions and processes by issuers combined with strong governance and impact reporting is paramount.

A range of definitions and criteria already exists to define what constitutes a green investment or program and can act as a guide for new participants. For example, as a guide to new issuers, they can use the criteria and process that were set up, following an engagement process with investors, by the first green bond issuers. Using third party opinion providers and/or external advisory services could also be helpful for issuers considering green bond issuance, and depending on the issuer and product may also be required by investors. While there are broad, common aspects of what is considered "green", the investors at the symposium noted that one, prescriptive standard set of definitions of "green" would not meet every investors' needs and could prevent new or existing issuers from financing climate-focused and environmentally beneficial projects that the investors may want to support. Many investors have set up their own, dynamic criteria and definitions that they use to determine eligibility of green bonds for their portfolios and mandates. Some focus on the issuer overall, and others more on the use of proceeds for the bond. In any case, investors asked for transparency and impact reporting from issuers, so that they can assess the suitability of the bond issuances for their respective mandates and portfolios and compare products. Also, strong governance procedures/reputation of an issuer and/or third party certifications for newer issuers with less track record help provide comfort that an issuer's disclosures fairly represent its actual process and activities.

2) Financial characteristics of green bond products are the determining factor for an investor to participate in a transaction.

Prerequisites for portfolio managers to invest in a transaction include traditional considerations such as risk/return characteristics, size, currency, maturity, expected liquidity, and structure. Investors generally rely on traditional financial risk/return metrics to evaluate bonds and therefore require financial returns at the same level as conventional bonds of the same issuer with comparable size and maturity. However, there were some investors whose portfolios place more emphasis on the expected impact of the issuer's green program, who said they may accept differentiated pricing of an issuer's green vs. conventional bonds of similar size and maturity.

3) The expected level of external "comfort" needed depends on the type of issuer and product.

For early green bond issuers such as the World Bank and other multilateral development banks, third party opinions were very helpful in the initial stages of the green bond market development. But the absence of these opinions for such issuers would not have deterred an investor from buying the bond due to the issuers' reputation and track record. However, as more issuers enter the market (such as corporate issuers) and more new products emerge (such as securitization programs) third party opinions would become, on a case-by-case basis, more relevant to ensure credibility. Third party assurances seemed to be more important for investors that do not have established internal processes to evaluate issuers and products for factors such as the ability to adhere to strong environmental and social safeguard policies. Some investors noted the reputational risk of holding bonds that seem "green" in name only, e.g., from an issuer where there is concern about governance for earmarking and other aspects of the green bond process and/or if the issuer has other activities with questionable environmental impact. Transparent disclosures of the earmarking process, compliance procedures, investor engagement and third party certifications for such issuers may help mitigate this risk. Participants recognized that third party opinions increase the issuance costs of green bonds.

4) Recognition that this is an "evolution not a revolution."

The overall goal of the market is clear: to mobilize finance for environmental challenges at scale. Participants of the Symposium recognized that it will be a step-by-step process to achieve this goal and to create a green bond market that meets every participant's needs. For example, the area of results and standardized impact reporting was recognized as a "work-in-progress" where the on-going work of multilateral banks would be valuable.[4] Investors acknowledged that there would be gradual enhancements to reporting over time, and asked for more standardized reporting so they can compare products.

The Symposium closed with a rich set of perspectives about how the market for green bonds can continue to grow with integrity of purpose and high standards of quality for the process. Participants noted that "one size does not fit all" both in terms of a bond's financial characteristics and definitions of "green". They expressed a desire to "keep it simple" and accept a "step-by-step" approach that works towards progress, and not allow "perfect to be the enemy of good". At the same time, the group expressed the need for all participants - investors, issuers and intermediaries - to adhere to high standards and accept responsibility for their part, so the green bond market can continue to grow and achieve its goals. There was appreciation for the thought-provoking exchange of what were sometimes diverging views, underscoring the value of continuing an open dialogue among market players during upcoming conferences and other gatherings, and raising awareness.

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[4] Investors suggested that the ongoing work of multilateral development banks to harmonize climate finance definitions and greenhouse gas accounting could serve as a guide for other issuers.