A success spelled Green Bonds

In 2008 the first bond ever labeled as a 'Green Bond' was issued by the World Bank, with the Second AP Fund as one of the initiating investors. Since then, a global market for green bonds has evolved, with over USD 80 billion in gross issuance. The Second AP Fund has interviewed Heike Reichelt, head of investor relations and new products at the World Bank, who explains the main reasons behind the success.

Text: Lars Mattsson

But to start with, let's get a picture of what green bonds actually are. In brief, green bonds are a fixed income product that helps mobilize private capital for climate projects.

"Today, international institutional investors have trillions of USD under management and are developing strategies that explicitly assess climate risks and opportunities in different asset classes", says Heike Reichelt and explains that green bonds were developed to meet demand from institutional investors looking for investment options for their fixed income portfolios.

A closer link between source and purpose

A back-to-back comparison between 'ordinary' bonds and their green siblings shows no differences when it comes to financial aspects. The credit quality of World Bank green bonds is identical to other World Bank bonds (AAA/Aaa), and investors are not taking specific country or project risk.

The main difference derives into eligible investment projects and a transparent process for reporting. This provides a closer link between the source of funds from the investors, and the environmental and social purpose of the investments they support.

"Investors can show their stakeholders, that they are making financially sound investments, and also supporting these climate activities through their investments", clarifies Heike Reichelt.

An urgent matter

"Climate change affects all of us – not just vulnerable parts of the population and those living in developing countries that the World Bank serves. But they are the ones who are hit hardest. They feel the effects of extreme and volatile weather patterns most, including food shortages and higher food prices when crops are affected by droughts and flooding."

According to Heike Reichelt, this development will only get worse – and by how much depends on what the world does to support climate-smart investments and change incentives. That's key to finding a global climate solution and a cleaner, safer and healthier planet for everyone.

This is where Green Bonds fit in, by mobilizing private sector financing for climate activities.

"And there's an important signaling effect as well: the fact that there are investors out there looking for these types of investment products and asking for detailed metrics on environmental performance will change incentives".

Proceeds are earmarked for eligible green projects

The World Bank's green bond proceeds are earmarked to support only eligible green projects. They undergo a rigorous review and approval process including early screening to identify environmental and social impacts and designing concrete mitigation actions.

The progress, outcomes and impacts of projects are monitored throughout implementation and the ultimate effectiveness of all projects is evaluated in terms of the objectives they were set to achieve.

Personal favorite project so far

By June 30, 2015, the World Bank had 77 green bond eligible projects supported by green bond proceeds. The total committed amount for these projects is USD 13.7 billion.

"My favorite project is an eco-farming project in China, where methane gas generated from animal waste on rural farms is used to provide gas for light, cooking and heating in homes. The project has many benefits, but in terms of greenhouse gas metrics, the expected savings are about one million tons of CO_2e per year, which is equivalent to taking 210,000 passenger cars off the road", says Heike Reichelt.

One other example is a project in Mexico on efficient lighting and appliances and one in Colombia to modernize the bus system.

World Bank in brief

The World Bank, rated Aaa/AAA by Moody's/S&P, is an international organization that was founded in 1944. It functions as a global development cooperative, owned jointly by 188 countries. The World Bank offers its members funding, expertise and project coordination support, to enable them to achieve equitable and sustainable economic growth in their national economies, and to develop effective solutions to pressing regional and global, economic and environmental problems. The World Bank has been issuing bonds on the international credit markets for over 65 years, to fund its sustainable development initiatives and to make a positive impact.

Heike Reichelt

"The Colombia project will massively improve efficiency and safety of riding a bus in Colombia, and improve air quality, in addition to reducing greenhouse gas emissions", says Heike Reichelt.

Growing number of investors and issuers

For a market to succeed, one of course need demand from investors. Since the AP funds and other Scandinavian investors first asked for green bonds, many more investors have joined the green bond market – across Asia, Europe and North America – and appreciate having different issuers to choose from.

Although recognized as the first issuer of the 'green bond' that has been used as a model and replicated by others, World Bank is far from being alone in the market these days. The World Bank is still a leader with over 100 green bond transactions in 18 currencies and a total issuance of about USD 8.5 billion between 2008 and June 2015.

Among other issuers, there are other multilateral development banks, energy and utility companies, large industrial corporations and banks as well as governmental bodies and local organizations – and the European Investment Bank (EIB). It is also considered to be a pioneer together with the World Bank in the field of green bonds.

Playing a crucial role

The World Bank has been playing a crucial role in building the green bond market, by setting the foundation and acting as a catalyst through a transparent process. This means that investors have high quality, tradable fixed income products that meet their financial needs and support climate actions. At the same time issuers can broaden their investor base and raise additional financing, while creating awareness when it comes to green projects according to Heike Reichelt.

"From our point of view, the total volumes aren't as relevant as the diversification of issuers and the incredible amount of dialogue among capital market participants that the green bond market has generated, leading to a better understanding of and need for climate finance".

She underlines investors' huge importance for the market development: "As a matter of fact, the first green bonds were developed in response to specific requests and in close collaboration with Scandinavian pension funds, like the Second AP Fund and SEB – all in line with our demand-driven strategy".

Bright future for green bonds

According to Heike Reichelt, the prospects for green bonds are good. And more important: This will lead to positive effects when it comes to the global climate, and investing in projects that benefit society in general.

"The interest this market has sparked has helped changing how investors think about their investments and how issuers think about the projects they are financing. As long as investors continue to ask questions about the expected social and environmental impact of their investments, issuers – especially corporates – will change their behavior, step by step", concludes Heike Reichelt.