GREEN BONDS – CHINA, US, CORPORATES, ESG OR GREEN – WHAT IS IT ALL ABOUT?
It seems like a lot of voices focus on headlines rather than what is actually on the table. For a start, when we look at China, reflecting our conversations with key stakeholders, there is no doubt about the ambitious intentions of China’s policy makers nor that China will become a (if not the) key stakeholder in this market. However, China is large and to secure a stable development good research and planning is required. The good news is that China takes this very seriously and does its homework. China has established close collaborations with international stakeholders to learn from already implemented strategies in terms of policy development, regulation and market innovations. Policy recommendations include a national green financial system (green banks, green funds, public-private partnership etc), where Green Bonds are an integral part, to channel funds of loans, private equity, bonds, securities and insurance to green industry. However, these are preparations for the next five-year plan (2016-2020) and patience will be needed in order to cater for these requirements. We expect the focus of authorities to be on gaining experience in terms of regulation, transparency and scientific vetting before finalizing a comprehensive regulatory framework. If the further development then follow earlier patterns, it is likely that a few local governments/municipalities or institutions will implement the system before a country wide implementation takes place.
In the US, the situation is slightly different. Rather than going for growth driven by Washington DC, it seems like President Obama uses his defined mandates to activate various work streams - so not a strong broad wave, but certainly a massive shift. This was evident in Presidents Obama’s speech “Remarks by the President in Announcing the Clean Power Plan” held on August 3 where our three key take-aways were:

1. Highlighting that 1000+ mayors have signed an agreement to cut carbon (which shouldn’t be too difficult since carbon reduction and water quality is about resource efficiency and resource efficiency is good for the budget).

2. Pointing out the imbalance in penalties for pollution. Where water pollution and chemical waste are penalized, the penalty for air pollution is missing. Is Obama talking about a carbon tax?

3. Motivation:
   a. Stressing the importance of the US’s role for a global agreement.
   b. Pointing at the impact of air pollution for health.

Additionally Obama singles out climate change as THE nr 1 challenge we face – saying:

1. “870 million tons of carbon dioxide will be kept out of the atmosphere” which will “reduce premature deaths from power plant emissions by nearly 90%” and lead to “90,000 fewer asthma attacks among our children each year”.

2. “We’re the first generation to feel the impact of climate change and the last generation that can do something about it”.

Based on the increasingly vibrant activity among public related borrowers, including US municipalities, and President Obama’s reinvigorated Climate Action Plan, our guess is that the public sector will be the fastest growing part of the Green Bond pie next year.

Then we have the corporates - what are they waiting for? We have numerous meetings with corporates and the message is generally clear: they will enter the Green Bond market. However, they will not enter before they identify the values. In the Swedish market, where a number of corporates have entered the Green Bond market, the drivers have been a) a closer relationship to investors (and more investors) b) a chance to talk about their business and business philosophy (integrating operations and finance) and c) a possibility to show leading Green technologies and thought leadership. However, rich corporate cash pools have (and is) a challenge since it removes a significant portion of focus away from funding vehicles.

Lastly, we have the equally important debate about ESG or social Bonds and Green Bonds. It is our firm belief that the only ESG element which provides both scalability and economic value for all stakeholders is the Green (the Environmental part in ESG). However, numerous clients show increasing interest in exploiting the ESG or social bond market’s capacity in financing their health, social and educational efforts. Hence, we are certain that this market will develop. At the same time it is important for issuers - and their bankers - to recognize that investors who engage in ESG and social bonds want to articulate their participation. In other words, investors require a clear definition of how the money is being spent and the expected achievements. The only way to do that is by having a simple and tangible product. In conclusion, we believe that all areas of ESG will be explored but the only products which will have lasting success are those that explain what the investor buys in a way that allows the investors to clearly communicate their participation. We will do our part to contribute to this development.

CICERO’S “SHADES OF GREEN” UP AND RUNNING

Since the most frequently appointed provider of second opinions, CICERO, announced the introduction of “Shade of green”, a handful of gradings have been done (although not all of them have been made public yet). This includes the first Second Opinion with a Dark green grading which went to the Latvian electricity utility Latvenergo AS which issued its inaugural, 7 year Green Bond of EUR 75 mn on June 3.

As you may recall, CICERO presented its new Shades of green in late March. But to recap what it is and how it works, the purpose of grading the Green Bond frameworks is to enhance transparency and help investors better understand how green the projects investors finance really are. The grading is based on a “broad qualitative assessment of each project according to what extent it contributes to building a low-carbon society.”

CICERO’s three Shades of green are:

- **Dark green - Implementing a 2050 climate solution today**
  Example: Investments in renewable energy such as solar or wind.
• **Medium green - On the way to a 2050 climate solution**
  Example: Investments in sustainable buildings with good energy efficiency ratings.

• **Light green - Short-term gains but not a long-term climate solution**
  Example: Energy efficiency improvements in industry that result in short-term reductions of greenhouse gas emissions but do not shift away from a fossil fuel-based economy.

With a fixed reference point (2050 Carbon Goal) it becomes easier to validate the technologies and the questions get more specific. Where it is clear that all shades are needed to address the overall challenges, it also allow for a discussion around long term plans and actions needed to move from light Green to darker Green.

The grading primarily depends on what project types will be financed by the Green Bonds in accordance with the issuer’s definitions in the Green Bond framework, but governance and transparency aspects are also factored in to the grading. This methodology is therefore very much in line with the way CICERO has performed their Second Opinions previously. Hence, the “new” Second Opinions with a defined Shade of green do not differ from the earlier ones but add a layer of transparency in order to support investors in their ambition to make well-informed investment decisions both from a financial and environmental point of view.

It is important to note that, as before, it is the Green Bond framework, rather than the issuer per se, that receives the Second Opinion and the Shade of green.

From now on, all new Second Opinions from CICERO as well as the Expert Network on Second Opinions (ENSO) will include a Shade of green. At SEB, we expect several of the earlier issuers with a Second Opinion from CICERO (which includes every Multilateral Development Banks that have announced that they have a Second Opinion) to request a Shade of green on their Green Bond frameworks going forward.

Given the way CICERO defines the different Shades of green, it is our expectation that issuers like municipalities and financial institutions (including the MDBs), often will have difficulties achieving a Dark green grading. This corresponds to the fact that these issuer types typically have very broad environmental responsibilities and engagements and therefore normally include a broad set of project categories in their Green Bond frameworks. Some of these will fall into the Medium and/or Light green categories. This does not, however, preclude that these investments both are crucial from an environmental point of view and perfectly in line with the ESG mandates of many investors. In conclusion, the new Shades of green methodology add transparency to the investment decision process and thereby support the due diligence done by investors.

**SEB LAUNCHES GREEN LOANS**

As a continuity of the engagement in the Green Bond market, and most importantly, in response to client demand, SEB has made available its first labelled Green Loan. The inaugural Green Loan was extended to the Swedish construction company Skanska and will finance the construction of a Nordic Eco-labelled (Svanen) residential building in Stockholm.

SEB has developed a Green framework to which the purpose of the proceeds of all Green Loan financing must be aligned in order to qualify. To ensure that SEB’s framework meets high environmental standards, it has been evaluated by the International Institute for Sustainable Development (IISD) which is part of the CICERO-led Expert Network on Second Opinions (ENSO).

The financial terms, as with Green Bonds, are in line with conventional loans but through the value of connecting institutional activity and operations with climate financing, borrowers are beginning to see the long-term value of green engagement. Hence we expect the Green Loan market to take hold in the coming year.

**IMPACT REPORTING MAY LEAD TO SEGMENTATION**

While impact reporting is not a prerequisite for Green Bond issuers, it is increasingly in demand from investors. An example of this was given by the INCR’s (Investor Network on Climate Risk) in their "A Statement of Investor Expectations for the Green Bond Market" where they state that "Issuers should communicate to investors, at least annually, information concerning the beneficial climate, environmental and other impacts of their projects" and that "Impact reports should be publicly available and include expected results..." This goes beyond the wordings in the updated version of the Green Bond Principles, which recommend qualitative and, where feasible, quantitative follow-up of expected environmental impact (where confidentiality and competitive considerations permit).

While investors increasingly ask for impact reporting, they also worry that lack of standardization in reporting procedures will make their impact analyses and comparison a cumbersome task. To that end, a welcome initiative was taken in March by four Multilateral...
Development Banks (AfDB, EIB, IFC and IBRD) as they presented a report entitled: Green Bonds - Working Towards a Harmonized Framework for Impact Reporting. This came about in response to the confusion that became evident when various MDBs had co-financed the same project but reported different environmental impact due to different methodologies. Among other things, the report states that “Impact reporting should be based on ex ante estimates of expected annual results for a representative year once a project is completed and operating at normal capacity”.

The World Bank launches a Green Bond Impact Report
On July 31, the World Bank maintained its position in the forefront of the Green Bond market by launching its Green Bond Impact Report in direct response to investor requirements. This comprehensive (29 pages) report includes a list of the 77 projects to which disbursements have been made from the proceeds of the IBRD’s 100 Green Bonds totaling USD 8.4bn.

While the World Bank isn’t alone in delivering ambitious annual reports, we expect their Green Bond Impact Report to serve as inspiration for many other issuers, also outside the Multilateral Development Bank segment. But it is unlikely to become a role model of one-size-fits-all reporting. Issuers differ massively both in terms of scope in their Green Bond activities and resource/capacity to deliver impact reporting. Hence, as long as issuers do not finance themselves more cheaply by issuing Green, it will be difficult for specific issuers to digest substantial, additional costs connected to reporting.

Likewise, there will be issuers who are motivated to take impact reporting even further, i.e. to measure and report on the actual environmental impact ex-post of the activities financed with their Green Bond proceeds. Differences in ambition level and seniority in the market from both investors and issuers is likely to provide various strategies. To support this development and secure stability, one of the key developments over the next 12 months will be structuring and categorization of data – eventually – this should lead to some segmentation in the Green Bond market and even some price differentiation in terms of commitment to and quality of impact reporting.

MARKET UPDATE AND OUTLOOK
The Green Bond market recovered handsomely in the second quarter after a dormant start of the year. Issuance almost doubled to USD 12.1 bn from 7.3 bn in the first quarter.

Total issuance of Green Bonds 2015 YTD
USD bn

Source: Climate Bonds Initiative

Modified target for full year issuance
The acceleration in issuance during the second quarter in conjunction with indications from our clients globally, supports our view that issuance will continue picking up speed this autumn. Our target for total issuance during the full year of USD 70 bn is not out of reach but it is, admittedly, probably a bit on the optimistic side. We have, therefore, modified our target to USD 50-70 bn which would bring total cumulative issuance of Green Bonds above USD 100 bn. The salient conclusion of this is that the Green Bond market by now is an established part of the bond market but that all parties involved will need to
re-double efforts in order for the Green Bond market to realise its full potential.

League table for the second quarter

According to data from Climate Bonds Initiative, Bank of America Merrill Lynch (BAML) grabbed the first place among underwriters during the second quarter ahead of Credit Agricore-CIB and Citi. SEB came fourth and Morgan Stanley fifth. Despite failing back on the volume, SEB is still spearheading the role as structured advisor with helping around 35 issuers with their Green frameworks in line with our overall priority to remain the thought leader (qualitative leadership).

Top 10 Green Bond underwriters 2Q 2015

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Ccy</th>
<th>Amount (mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANZ Bank</td>
<td>AUD</td>
<td>600</td>
</tr>
<tr>
<td>Arizona State University</td>
<td>USD</td>
<td>182</td>
</tr>
<tr>
<td>Berlin Hyp (Pfandbrief)</td>
<td>EUR</td>
<td>500</td>
</tr>
<tr>
<td>BRF SA</td>
<td>EUR</td>
<td>500</td>
</tr>
<tr>
<td>City of St Paul (Minnesota)</td>
<td>USD</td>
<td>9</td>
</tr>
<tr>
<td>Fortum Värme</td>
<td>SEK</td>
<td>2500</td>
</tr>
<tr>
<td>Latvenergo</td>
<td>EUR</td>
<td>75</td>
</tr>
<tr>
<td>Nelja Energia</td>
<td>EUR</td>
<td>50</td>
</tr>
<tr>
<td>Rapid Holding (Senvion)</td>
<td>EUR</td>
<td>400</td>
</tr>
<tr>
<td>San Francisco Public Utilities Commission</td>
<td>USD</td>
<td>32</td>
</tr>
<tr>
<td>Swedish Export Credit (SEK)</td>
<td>USD</td>
<td>500</td>
</tr>
<tr>
<td>TenneT Holdings</td>
<td>EUR</td>
<td>1000</td>
</tr>
<tr>
<td>Transport for London</td>
<td>GBP</td>
<td>400</td>
</tr>
<tr>
<td>University of Virginia</td>
<td>USD</td>
<td>98</td>
</tr>
</tbody>
</table>

Moving into the third quarter, we saw the first Chinese issuer branding a bond Green as Goldwind issued a USD 300 mn bond which was almost five times oversubscribed. Goldwind’s bond is a general purpose bond but since more than 95% of the company’s revenues come from wind power plants and wind turbine manufacturing assets it has been labelled as a Green Bond. While we obviously support the idea of pure play Green Bonds, it is a little more challenging in praxis. Firstly, will pure plays allow investors to define strategies without too much extra work or is it supporting an already existing niche? Secondly, will investors be able to claim they did their homework in the case of mismanagement by the company? We are doubtful to this and consequently recommend both an earmarked account and reporting – even for pure play companies. This is especially the case since an important purpose of Green Bonds is to raise more bonds for pure play products. Hence, pure play companies should be interested in helping investors to create broader strategies.

In June, the Global Real Estate Sustainability Benchmark (GRESB) released its Green Bond Guidelines for the Real Estate Sector as a complement to the Green Bond Principles and with the aim to provide a framework for 1) identifying green project eligibility, 2) implementing and managing investment proceeds, and 3) communicating Green Property Bond outcomes.

The report concludes that all the eight categories listed in the Green Bond Principles include environmental impacts of relevance for the real estate industry. These categories are:

- Renewable energy
- Energy efficiency (including efficient buildings)
- Sustainable waste management
- Sustainable land use (including sustainable forestry and agriculture)
- Biodiversity conservation
- Clean transportation
- Sustainable water management (including clean and/or drinking water)
- Climate change adaptation

Furthermore, GRESB states: “Contributing one-third of global carbon emissions and consuming 40% of global energy and resources, 25% of water and 60% of electricity (in Europe and the US, this is even over 80%), the real estate sector constitutes one of the greatest potential opportunities to address environmental issues including climate change, while also creating economic opportunity for investors and
The Green Bond

asset owners.” The guidelines attest to the real estate sector’s multi-decade track record in incorporating environmental impacts through the use of independent, third-party ratings and singles out a few as relevant basis for adequately identifying projects for Green Bond financing. These include, but are not limited to: LEED, Green Star, BREEAM, CASBEE and DGNB. Similar, local certification systems exist in many countries and can serve the same purpose. In addition to these stand-alone definitions of technologies, SEB thinks that investors need assessment of governance and management systems. Hence, we keep stressing that independent, environmental specialists, who know what is needed for prudent management, need to verify these processes.

Meanwhile, a guide for municipalities’ issuance of Green Bonds was released by The U.S. Green City Bonds Coalition in late July. The report is called “How to issue a Green Muni Bond”. The Green City Bonds Coalition argues that Green Bonds are a “key part of the solution to climate change”, which in turn is expected to have dire effects on cities. Cities in general are clearly on both sides of the equation as they are major carbon emitters while at the same time being strongly exposed to the consequences of climate change in terms of extreme weather conditions and rising sea levels. For these reasons, SEB, as well as many other observers, have great expectations when it comes to Green Bond issuance from municipalities going forward. Although Sweden (City of Gothenburg) and France (Isle de France) were first out to issue Green Muni Bonds, it is in the U.S. that activity has picked up speed most notably during the last 3-4 quarters.

Upcoming Green Bonds related events:
2-4 Sep - Climate Change Capital, World Symposium on Climate Change Adaptation, Manchester
9-10 Sep - PRI in Person, London
17 Sep – Euromoney Sustainable & Responsible Capital Markets Forum, Paris
1-2 Oct – International Conference on Climate Action (ICCA), Hannover
5-8 Oct – IPCC 42nd session, Croatia
7 Oct - Environmental Finance Green Bonds Americas Conference, New York
8 Oct – SEB arranges a Conference on the links between finance and the environment, New York. For further information please contact us at: greenbonds@seb.se
9-11 Oct – Annual meeting IMF/IBRD, Lima
9-23 – UNFCCC conference, Bonn
30 Nov–11 Dec – COP 21 – Annual UN Climate Change Conference, Paris

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