

Green Bonds : the revolution in fixed income



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Summary

Green and sustainable bonds constitute the best vehicles on bond markets to accelerate the low-carbon transition.

- ▶ **1. The first green bond - the Climate Awareness Bond - was issued in 2007 by the European Investment Bank.**
- ▶ **2. A deep and fast-growing market:** green and sustainable bonds amounted to 1,450 billion dollars at the end of September 2021¹.
- ▶ **3. Issuances since the start of the year reached \$450 billion** at the end of September 2021².
- ▶ **4. The risk of greenwashing increases as the market grows:** to forestall any reputational or regulatory risks, the reference framework must be consolidated to harmonise and formalise criteria that will enable the assessment of the ambition, integrity and transparency of green and sustainable bond issuances.
- ▶ **5. Mirova is among the first asset managers to invest in green and sustainable bonds (since 2012)** and has introduced a unique and integrated investment process. The assets under management in the Mirova Global Green Bond strategy amounted to €822 million at 30/09/2021. Furthermore, Mirova has invested €3.4 billion on the green and sustainable bond market through its various strategies.

The world was alerted to climate and environmental issues more than 30 years ago by the IPCC³, and governments took measures to deal with these subjects more than 10 years ago, with the goal of reaching carbon neutrality and thus limiting global warming to 1.5°C⁴. And yet we are far from this target: the UN published a report in September 2021 stating that the world is on a catastrophic trajectory headed towards 2.7°C of global warming⁵. It has therefore become a necessity to undertake an industrial and environmental revolution to accelerate the environmental and energy transition.

Through green and sustainable bond issuances, investors can contribute to the low-carbon transition while making a twofold impact: financial and environmental. Such is the purpose of the Mirova Global Green Bond⁶ strategy.

AN INCREASINGLY DEEP MARKET

“Green” and “sustainable” bonds defined

These are debt securities issued on the financial markets by a company or a public entity (government authority, international agency, etc.) to finance projects that contribute to the environmental and energy transition: development of zero-carbon mobility, energy renovation of housing and public or private commercial buildings, or the development and storage of renewable energy.

Green and sustainable bonds differ from traditional bonds on two essential aspects:

- ▶ the **commitments** made by the issuer on the **precise utilisation of the capital raised** which must exclusively concern the financing or refinancing of projects aiming to achieve a positive environmental and/or sustainable impact,
- ▶ the **annual publication of a report** providing investors with details of the sustainability benefits generated by the effective use of the funds.

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** Environmental, Social and Governance

1. Source: Environmental Finance, Mirova.

2. Source: Environmental Finance.

3. Intergovernmental Panel on Climate Change

4. The Paris Agreement's central aim is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5°C.

5. Source: UMFCCC report, Sept 21.

6. The Mirova Global Green Bond Strategy is exposed to the following risks : capital loss, financial derivatives instruments, debt securities, liquidity, changing interest rates, emerging markets, credit risk, sustainability risks, below investment grade securities or unrated securities, counterparty risk, exchange rates, changes in laws and/or tax regimes, ESG driven investment.

The European Union, the birthplace of green bonds

In July 2007, the European Investment Bank (EIB) made the first green bond issuance in history with the **Climate Awareness Bond**. This climate bond was soon emulated by other issuers.

In 2008, it was the turn of the **World Bank** to issue its own green bond, followed by **local government authorities**, then by **large corporations**, primarily from the energy sector, before the first **national governments** followed suit.

It was not until 2014 however, and the publication of the Green Bond Principles, that the market truly took off. Seven years later, Europe is leading the way in green and sustainable bond issuances, but this may not last, with **China** and the **United States** in the process of actively establishing a foothold on this market.

2021, a record-breaking year

As the world strives to “build back better” in the **post-Covid world**, green and sustainable bond issuances are gaining in popularity, their exponential growth beating even the most optimistic forecasts.

By the end of September 2021, green and sustainable bond issuances had already surpassed those for all of 2020, amounting to **450 billion dollars**.⁷

This boom can be explained firstly by the growing number of sovereign bond issuances - **Italy, Spain, the United Kingdom and the European Union** have all issued their first green bonds -, and secondly by the acceleration in the issuing activity of energy generation companies, real estate firms and industrial manufacturers, most notably in the automotive sector.

The green and sustainable bond revolution is fully underway, making these instruments a fast-growing market.

50 SHADES OF GREEN

Beyond a “green” bill of health

The green and sustainable bond market faces two major challenges:

► a framework which is currently work-in-progress: today,



Mirova has developed a methodology to analyse and assess green bond issuance programs which leads to a very rigorous selection rate



any company can self-label as green their current bonds program. Indeed, many frameworks exist, but there is currently no universal label that sets standards for positive environmental and/or sustainable impact;

- a lack of traceability and transparency on the use of proceeds.

These two factors may lead to a lack of impact and consistency in the sustainability strategy deployed.

Fixed income investors may therefore be confronted with different shades of green. Indeed, since a green bond may be green in name only, it is essential to ask the right questions and fully examine the issuer's sustainability strategy in order to maximise the environmental/sustainable impact of the projects financed.

One of the most sizeable challenges that this market must therefore address is the establishment of globally-recognised norms and standards.

To this effect, on 6 July this year, the **European Commission** took another major step forward by launching its strategy to finance the transition to a sustainable future, its proposals including a **regulatory framework, a green taxonomy⁸ and a European green bond standard**.⁹

AT THE HEART OF THE MIROVA APPROACH: IN-DEPTH ANALYSIS OF GREEN AND SUSTAINABLE BONDS¹⁰

To demonstrate the impact and ambition of the bond program, Mirova seeks to ascertain as accurately as possible the extent to which it meets several criteria.

To do so, Mirova has developed a methodology to analyse and assess programs for green bond issuances – but also for social and sustainable bonds – which draws in particular on the framework of the “Green Bond Principles”.¹¹ This leads to a very stringent selection rate: at the end of December 2020, 45% of these bond issuances were excluded from the Mirova Global Green Bond strategy's investment scope.

Among the key features in this process:

- Analysis, assessment and selection phase: integrity and ambition
- The funds must be earmarked for green and/or social projects. To maximise impact, Mirova studies their perti-

7. Source : Environmental Finance.

8. European standard applicable to companies, investors and Member states to list the proportion of their activities and investments considered green.

9. <https://www.climatebonds.net/2021/07/eu-action-sets-new-baseline-ec/ecb-promise-systemic-change-europes-finance-sector-landmark>

<https://www.latribune.fr/entreprises-finance/banques-finance/qu'est-ce-qu'un-green-bond-760714.html>

https://ec.europa.eu/commission/presscorner/detail/en/speech_21_4609

10. For further information on our methodology, visit the Mirova website at: www.mirova.com/fr/recherche

11. Voluntary process guidelines for the issuance of green bonds. Further information at: <https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/>

nence and consistency with the Sustainable Development Goals (SDGs) set by the United Nations in 2015. Furthermore, with the emergence of the EU green taxonomy, Mirova analyses and, in some cases, challenges the technical criteria proposed by the European Commission's green list, as well as those proposed by the issuers.

- ▷ The environmental and/or social impacts and benefits of the project must be clear and ambitious enough to make significant progress towards the goal it intends to reach.
- ▷ From a general perspective, Mirova examines how the financed projects fit in with the global and sustainability strategy of the issuer.

► Long-term monitoring phase: discipline and transparency

▷ Issuers must:

- implement the necessary processes to minimise and manage the various environmental and social risks of the project while maximising the benefits. Risk management is central in our analysis; a transaction generating positive environmental benefits can also generate negative externalities. For example, projects in which infrastructure needs to be built may lead to a negative impact on local populations or biodiversity.

• supply:

- an annual report on the allocation of the proceeds up to bond maturity;
- an impact assessment to verify the environmental benefits generated by the projects or activities financed. Mirova also pays attention to the accuracy and transparency of the impact reporting associated with the projects, with clearly identified performance indicators.

▷ The proceeds from the green and/or sustainable bond issuance must be managed and tracked by the issuer in line with the "Green Bond Principles" framework and, as far as is possible, analysed by an external auditor who verifies the funds tracking and allocation method.

▷ Should one or more of these events lead to the conclusion that a green and/or sustainable bond no longer meets the required criteria, Mirova then undertakes discussions with the issuer as to whether measures can be taken to improve the situation. If this proves unsuccessful, the green and/or sustainable bond will no longer be considered as such.

This methodology goes hand in hand with an engagement strategy aiming to support firms, and in particular bond issuers, throughout the lifecycle of the green securities

SUPPORT THROUGHOUT THE GREEN BOND LIFECYCLE

This methodology is accompanied by an engagement strategy aiming to support firms, and in particular bond issuers, throughout the lifecycle of the green securities. This strategy calls on contributions from all the ESG research and fixed income management teams: this is Mirova's response to the issue of "greenwashing" on the green and sustainable bond market. Indeed, the aim is to be well-acquainted with transactions and issuers thanks to constructive and thorough dialogue, since the non-fulfilment of expectations invariably leads to the securities concerned becoming ineligible, or to divestment if they were already in the portfolio.

► Phase 1: Pre-transaction

Mirova is always open to discuss with potential issuers, and seeks above all to encourage them to participate while maximising environmental benefits. Mirova is also regularly called upon by banks' origination teams to share its views on the conditions and criteria of the structuring of green transactions.

► Phase 2: Primary market issuance

During the evaluation process for transactions arriving on the primary market, analysts engage in dialogue with the issuers. The aims are to gain a better understanding of the transaction's positive impact, list risk exposure, and most importantly analyse all measures implemented by the issuers.

► Phase 3: Post-issuance and analysis of impact reports

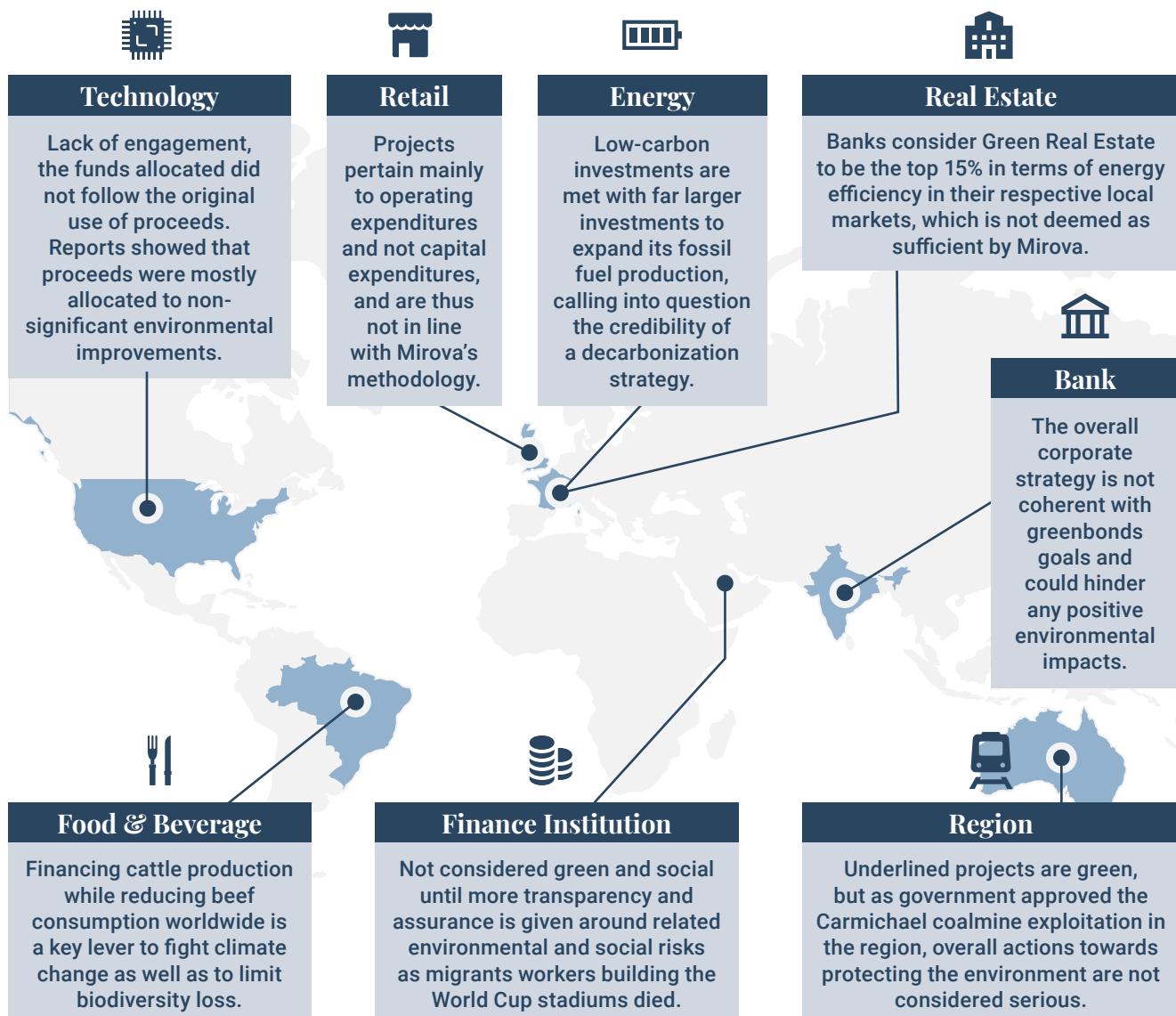
This phase takes place once the transactions have entered our fixed income portfolios. If a transaction is deemed to be controversial, Mirova's analysts engage with the issuer to understand its scale and impact. They can then assess the corrective actions taken by the issuers. The non-fulfilment of responsible investor expectations will lead to the downgrading of opinions and ratings, and to divestment from our fixed income portfolios.

Every year, the research team reviews the impact reports of issuers who have conducted transactions on the primary market 18 months previously. In the event that questions are raised as to the methodologies used to report environmental benefits, and/or any controversy around financed projects, the research team is mobilised to undertake an engagement exercise. The consequences of non-fulfilment of expectations are the same as those in the case of controversy affecting the issuer.

AT THE HEART OF THE MIROVA GLOBAL GREEN BOND STRATEGY

Examples of projects connected with green and sustainable bond programs which have not received the green light from Mirova:

Tracking down insufficient impact and ambition



At a glance: The Mirova Global Green Bond strategy

- ▶ Seeks to deliver financial and impact performance through **close collaboration with the Sustainability Research team**
- ▶ **Conviction-guided, long-term management** based on an **active selection** of issuers positioned on sustainability themes
- ▶ **Risk management embedded** into the management process
- ▶ A structured, unique and integrated management process drawing on a proprietary analysis methodology
- ▶ A focus on achieving impact aiming to align the portfolio with a **+2°C maximum scenario***

* Corresponds to action plans implemented to comply with the Paris Agreement, i.e., the average temperature increase of the planet between 1850 and 2100 that must not be exceeded.

Legal information

Mirova is an asset-management company dedicated to sustainable investment and an affiliate of Natixis Investment Managers. Thanks to its conviction-led management style, Mirova's objective is to combine a quest for long-term value creation with sustainable development. Pioneers in many areas of sustainable finance, Mirova's talents are committed to innovation in order to provide their clients with high environmental and social impact solutions. Mirova manages €23.6 billion as of June 30th 2021. Mirova has been awarded the B Corp* label and the status of "Entreprise à Mission" (mission led company). All Mirova's funds covered by SFDR regulation are classified "Article 9".

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