Facing Climate Change Head On

Achieving both mitigation and adaptation through Climate Bonds

Nowadays, everybody seems to aim at sustainability and rightly so: For our planet to remain a habitable place for many future generations to come, we have to start producing our goods, food, energy and infrastructure in a fully sustainable way. Sustainable investing, specifically sustainable debt will foster and fuel this shift. This change will have a huge impact on our economy, and we hope that in order to achieve 100% sustainable investing, the finance world will turn entirely to Green and Social Bonds. Our last article shed some light on how companies are even met halfway with the option to issue Sustainability-linked Bonds that set interim goals towards more sustainability. Unfortunately, with climate change advancing in quantum leaps and many people already having to endure its dire consequences, this is still not enough. Therefore, we want to introduce you to the Climate Bonds Initiative in this week's article, which is another standard by a different NGO, however, based on the ICMA's green, social and sustainability-linked bonds principle, we examined in the last two articles of this series.

Creating solutions specifically to not only mitigate, but also to adapt to climate change, is the goal of the international non-profit **Climate Bonds Initiative**, which is the only organization that provides actual certifications for green bonds with strict and unambiguous requirements. The initiative introduced the Climate Bonds Standard and Certification Scheme to finally bring about the necessary change.

While Green and Social Bond Principles are the global standard for bonds of a combined volume of $1,600 billion, Climate Bonds are a relatively new to the sustainable bonds market, but they are growing rapidly with the total volume of bonds issued worth $178 billion as of June 31, 2021.

Just like Green Bonds, Climate Bonds are issued to raise funds for climate change mitigation or adaptation projects, such as renewable energy plants or climate mitigation-focused funding programs for instance. Some of the Climate Bonds Initiative's requirements are even based on **ICMA's Green Bonds Principles (GBP)**. However, while **GBP** mainly rely on voluntary guidelines, Climate bonds issuers are required to adhere to a rigid certification process in order to attain the desired certification. Moreover, with climate bonds, verifier readiness assessment and verifier assurance procedure are mandatory during the pre- and post-issuance process.

Only an issuer who adheres to all the following requirements is eligible for a climate bond certificate: The Climate Bonds certification scheme requires fixed income instruments to comply with the Climate Bonds Standards (CBS), which are based on the GBP and Green Loan Principles. The sector criteria require that Use of Proceeds (projects & assets) must be consistent with the Paris Agreement goal of 2 Degrees Celsius warming and must align with the net zero emissions by 2050 trajectory.

Independent verification needs to be performed by verifiers approved by the Climate Bonds Standard Board and external reviewers must use consistent methodologies based on the International Standard on Assurance Engagements ISAE 3000. The issuer must carry out annual reporting throughout the instrument's maturity to maintain the certificate. It is possible to do a retroactive certification after issuance and also to do certification for multiple issuances (Programmatic Certification).

Types of Climate Bonds

Aside from the types of green bonds the ICMA framework provides, the Climate Bonds Initiative has twelve additional types of bonds to offer - some of which can be highlighted with the subsequent real-life examples:

> A **Convertible Bond** is a corporate bond that can be converted by the holder into the common stock of the issuing company. Climate Bonds' latest State of the Market report has the Japanese company Sumitomo Forestry issuing the first green convertible bond worldwide. For 5 years, the use of proceeds will be exclusively allocated to refinance the acquisition of 30,000 hectares of timberlands and related assets comprised of the plantation forests in New Zealand. As the first green bond with Stock Acquisition Rights,

the deal adds structural diversity to the market.

- The **Pfandbrief** is collateralized by long-term assets such as property mortgages or public sector loans as stipulated in the Pfandbrief Act. The German Berlin Hyp bank already issued its seventh mortgage-backed Green Pfandbrief and also its thirteenth Green Bond in benchmark format, which runs until January 2028. The bank sees the green bond market as much more than a niche segment and claims that for many investors, the ESG component was an important investment criterion.
- A **Sukuk** is an Islamic financial certificate, similar to a bond in Western finance, that additionally complies with Islamic religious law, commonly known as Sharia. Since the traditional Western interest-paying bond structure is not permissible, the issuer of a sukuk essentially sells an investor group a certificate, and then uses the proceeds to purchase an asset that the investor group has direct partial ownership interest in. The issuer must also make a contractual promise to buy back the bond in the future at par value.

Already feeling dizzy from all the different types of bonds and their requirements? We here at FORRS can accompany you with technical and managerial support for the specification of suitable projects for all the different types of Green, Social, Sustainability-linked and Climate Bonds. For a successful certification process later on, be it with ICMA bonds or Climate Bonds, the devil as always is in the detail. This is why we also support you in the verification process for both

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