Growing the US Corporate Green and Social Bond Market- Findings & Recommendations 2018

There is increasing investor demand for bonds that both meet risk/return requirements and contribute to the UN Sustainable Development Goals (SDGs). Though issuance of green and social bonds is on the rise, the US issuers are predominately municipalities and quasi-governmental agencies. And where there is corporate green or social bond issuance, there is a sector concentration in financials and utilities. Investors would like to stimulate responsible growth in the US Corporate green and social bond market.

In spring of 2018, APG Asset Management US Inc. and TIAA/Nuveen co-hosted 20 institutional investors and underwriters to exchange views on the obstacles to corporate issuance and discuss how they could help overcome them.

Problem Statement: Despite overall growth of the Green and Social bond market, US Corporate issuance is lagging. Much of the current discussion has been rightly focused on standards and regulatory oversight. How can we, as institutional investors and underwriters, help grow the US Corporate green and social bond market without any sacrifice of standards or product integrity?

This paper shares the main findings from that discussion and offers recommendations for follow-up actions that could be taken by investors and underwriters either collectively or within the remit of their own business activities.

Identifying obstacles

1. Lack of awareness outside an organization's sustainability departments

The underwriters in attendance highlighted a lack of awareness about and/or enthusiasm for green and social bonds at investment banks outside of the sustainability team. Syndicate teams perceive designing sustainability products that fit both the issuers' and potential investors' needs as too complex. The balance between the ease and value of issuance has not been consistently demonstrated and communicated.

Attendees also noted a lack of internal alignment and interaction about green and social bonds by the C-suite of potential corporate issuers. Investor interest is not being effectively transmitted to senior decision makers in ways that highlight the potential upside of meeting the additional requirements of social and green issuance. If a company's leadership does not actively endorse green and social issuance, there is little likelihood of corporate issuance moving forward very quickly.

While investors put out broad sustainability messages, underwriters and companies are not hearing the same messages from portfolio managers.

2. Perception of higher cost/risk without any financing benefit

The potential positive reputational impact of green and social bond issuance is often not well communicated and can be overshadowed by fear of criticism and negative media attention for not being "green enough". Although there does not seem to be a direct financing benefit associated with green/social issuance, there is a benefit from investor diversification by having a broader, more diverse group of investors participating in an issue.

3. Unclear threshold: when is a bond "green enough?"

Many companies and underwriters perceive the qualifications and standards for green bonds as amorphous. They are also uncertain whether investors require second party opinions for green or social bonds and whether this is a worthwhile cost. Some issuers express concern about assuming liability as long as requirements are not clear. Underwriters and issuers want clear guidance on what meets investor green & social standards and requirements.

4. Required size of issuance is too big

Institutional investors often won't consider smaller scale issuance. The size requirement coupled with narrowly defined acceptable use of proceeds excludes smaller potential issuers.

5. Lack of sector diversity

Current corporate green bond issuance is largely concentrated in the Banks and Utilities sectors. US corporate issuers in other sectors are generally risk-averse and want to see others in their industry participating in the green/social bond market before they join in. While there are examples of successful corporate green and social issuance in Europe, issuance has been more limited in the US. This leads to a vicious cycle of US companies waiting for others in their sector to be the test case.

Overcoming the obstacles: what can we do?

Investors: give corporate bond issuers a clear demand signal

Demand and desire for green and social bonds must be proactively, consistently, and clearly communicated.

- Publish statements of support, targets, and standards for corporate green & social bond issuance
- Practice "dual inquires": tell underwriters what you want to see come to market and provide feedback on what has already been offered
- Strengthen and increase education for investment professionals around sustainability
- Explain what percentage of an investment is being allocated to dedicated ESG portfolios

Proactive communication and reverse inquiries help raise awareness that sustainability issues are truly important for the investor community. This approach can help relieve the perceived risk of a negative market response to a potential green bond program. Underwriters want to hear directly from those who will actually make the investment decision. This means both increasing the population of "green savvy" investment professionals and making sure those professionals participate in calls/roadshows. Giving feedback and asking questions at every touchpoint can also create positive pressure on corporate Investor Relations teams to relay the message to their leadership.

Underwriters: become educators and facilitators

As the link between investors and issuers, underwriters are well-positioned to advance the green and social bond market by connecting their bankers and potential issuers to investor demand.

- Educate bankers on how to address sustainability questions

- Encourage communication among issuers' treasury, finance, and sustainability teams
- Facilitate conversations between potential issuers and investors early in the process
- Develop products that could facilitate smaller deals
- Engage with issuers around sustainability in the normal course of business, not just when issuing a green bond

Underwriters play an important role in amplifying investor demand and stimulating ways to meet it. They can proactively gauge investor appetite for potential issuance, and work with their internal teams to understand and address sustainability questions from issuers. Underwriters can also request that potential issuers bring their treasury and finance teams to investor meetings and calls on green bonds and general sustainability updates. This could augment broader efforts to educate the current workforce on the growing role of sustainable finance**.**

Underwriters should also explore ways to aggregate green and social projects to a size that would meet minimum index inclusion requirements and broaden the use of proceeds from CAPEX plans to potentially include repeatable projects. This would enable issuers to access funding for their smaller scale initiatives and attract institutional buyers. Though it is admittedly difficult to expand the use of proceeds while maintaining "green integrity," it should be explored to allow a more diverse set of issuers to potentially join, and help grow, the green and social bond market.

Investors and underwriters: work together to drive growth through innovation

- Expand the horizons beyond the current & obvious sectors
- Consider the wider sphere of sustainable/impact investment products
- Involve critics in the discussion

As a way to increase green bond diversification, investors and underwriters could consider, and even encourage, issuance in healthcare, transportation, and consumer goods, etc., by reaching out to potential leaders in those sectors. After identifying "low hanging fruit," underwriters could look deeper into their corporate client lists. Investors and underwriters should also look beyond "green and social only" issuance. Investors could connect their responsible investing ambitions to the UN's Sustainable Development Goals (SDGs) and the UN Global Compact. Underwriters could develop platforms and products to help link green bonds to broader impact investments and map them to the SDGs.

Since US companies will likely be more receptive to examples of successful green or social issuance programs in the US, underwriters and investors could point to successful municipal green and social bonds. It is also important to listen to the concerns and skepticism of critics. Fostering an honest dialogue about what green bonds are and are not could help align stakeholders around the shared goal to grow the market.

APG thanks all who participated in *Growing the US Corporate Green & Social Bond Market: Investor and Underwriter Roundtable*.
