

Learning About **ESG**

Celebrating Our Planet Earth

Learning About ESG is an educational series that connects **environmental, social and governance** topics with investing.

Join us each issue to see how global developments can have implications for investors. The better we understand ESG, the bigger the role it can play in our everyday lives – and investment portfolios – contributing to a better world.

Key takeaways

- ◆ For more than 50 years, **April 22nd has been known as Earth Day**. The annual event is **the largest global environmental movement** in joining up one billion people across 190 economies.
- ◆ Investors can consider **green bonds as an investment vehicle that supports the 'green' theme exclusively**. Green bonds are issued to raise money **solely applied towards environmental projects**.
- ◆ Established practices can **aid investors to determine whether a bond is truly 'green'**, including frameworks and verification done in line with industry standards.

What is Earth Day and why is it significant?

April 22nd marks the annual Earth Day events. Now in its 51st anniversary, more than one billion people across 190 economies are expected to join forces on this day, with the sole aim **to drive transformational change for our planet.** From mobilising local communities to uniting governments on global scale, Earth Day sets **to activate the largest environmental movement in the world.**¹

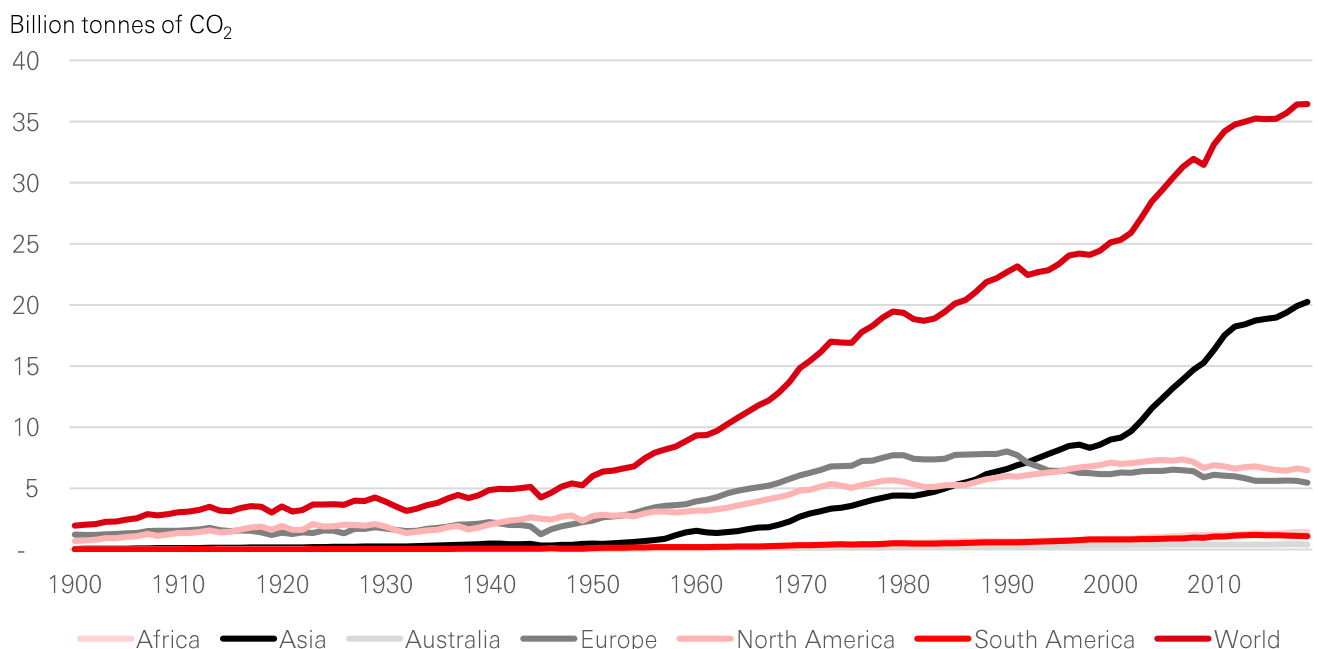
Earth Day was first held in the United States in 1970 as a response to high levels of air pollution, chemical pollution and oil spills. This was also overlaid by fears of nuclear proliferation and nuclear conflict, at a time where any legal or regulatory controls to protect the environment were non-existent.²

The historical event was founded by Senator Gaylord Nelson and saw 20 million citizens come together nationally. It marked **one of the first public articulations** of anger and anxiety about the **declining level of environmental standards**, as well as concerns on the damage inflicted upon our planet by industry, commerce and consumerism.

Since 1990, Earth Day activities have expanded internationally. In 2016, the Paris Agreement was signed by more than 190 economies on this day. This year, a world Leader's Summit on Climate coincides with Earth Day, which is said to be a key milestone ahead of the UN Climate Change Conference in November.³

However, despite the breadth of coverage that Earth Day receives, global CO₂ emissions have risen sharply from fossil fuels consumption. **Since 1970, more than double the amount of CO₂ emissions have been recorded globally, totaling to 36 billion tonnes in recent years** (see Chart 1).⁴

Chart 1: Global CO₂ emissions from fossil fuels consumption



Source: Our World in Data

1. EARTHDAY.org
2. United States Environmental Protection Agency
3. Whitehouse.gov
4. Out World in Data

Which investment vehicle supports the 'green' theme exclusively?

As investors are increasingly aligning their portfolios with ESG factors, fixed income investments such as green, social and sustainability bonds have all gained traction. Of these, **green bonds support projects exclusively for positive environmental impact**. These projects may cover **renewable energy, energy efficiency, pollution prevention and waste water management**.⁵

The first green bond was issued in 2007 by the European Investment Bank, valued at USD807.2 million. Today, over **USD1.18trn worth of green bonds** have been issued globally.⁶

Corporate issuers of green bonds emerged in 2013, with **sovereign green bonds** following in 2016. Green bonds must be created in line with the **Green Bond Principles**, a framework from the International Capital Markets Association. A demonstration of how a green bond works can be seen in Chart 2.

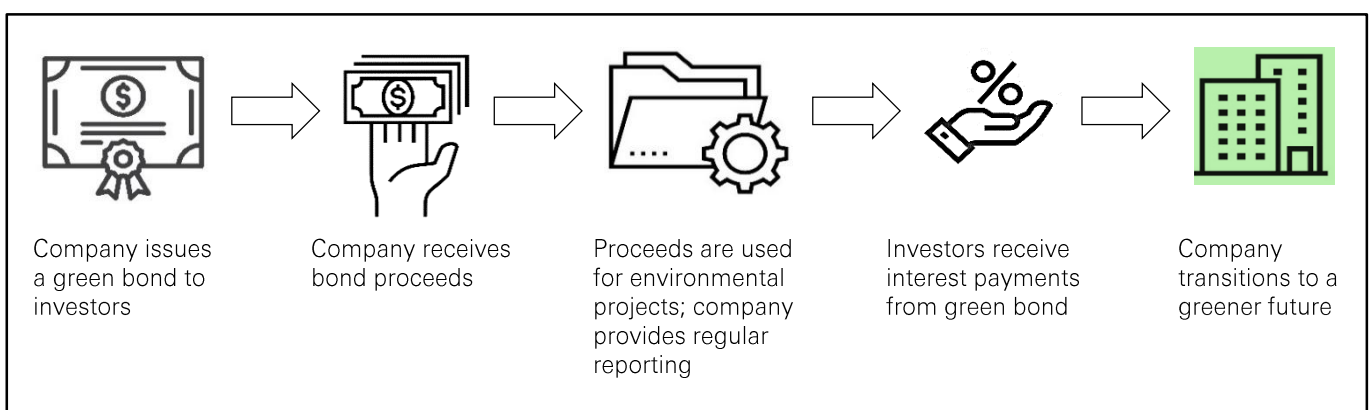
The issuer must declare that **the green bond's proceeds will be wholly spent on projects** relevant to climate change. However, the investor is **not reliant solely on the success or failure of the projects** in order for the bond

to perform. Rather, **the investor faces the whole credit quality of the issuing entity**.

Investors can also consider the issuer's green projects and overall credit quality **to gauge investment risk**. For example, if the issuer's credit quality wholly depended on the success of green projects, then the bond's credit quality would be much lower, and its coupon rate much higher.

Green bonds can provide **opportunities for non-green companies to adopt more sustainable business practices**. A large number of green bonds are issued by utilities, conglomerates and banks. These firms may not be wholly green, but have green projects to fund and **are beginning the transition to a lower carbon future**.

Chart 2: How a green bond works



Source: HSBC Asset Management, April 2021

5. Green Bond labelling is a voluntary and recommended process aimed at promoting the integrity of the green bond market. The intention is to encourage transparency and disclose on the specific use of proceeds. Although the use of proceeds for a green bond can be verified by a second party opinion, third party verification or other equivalent process, HSBC Wealth and Personal Banking cannot guarantee the issuer will indeed manage the use of proceeds to fund green projects (e.g. climate change adaptation and/or mitigation, renewable energy, energy efficiency, sustainable land and natural resource use, water and waste management, pollution prevention and control) as there is no legal way to enforce the declared use of proceeds.
6. Climate Bonds Initiative

What should investors look for when considering green bonds?



Investors should take note that **green bond issuers are allowed to 'self-declare'** that their bond is green, leaving it up to **bond market practitioners to decide that the bond is truly green or not.**

Some practices have been established to aid investors, including bond issuer frameworks and verification done in line with industry standards.

Investors are encouraged to take on these practices for **additional in-depth analyses on green bonds**:

- Issuers are required to create and publish '**green bond frameworks**', or documents that explain why the issuer is issuing green bonds, the types of green project(s) intended for funding, and frequency of reporting on bond proceeds.
- In recent years, green bond verifiers have emerged and most green bonds are thus accompanied by a **second party opinion; or a third party verification against a set of criteria**, or both.
- Investors should also consider the **data that issuers produce during the life of the bond**. There are two types of data:
 1. **Information on how much of a bond's proceeds is spent** on each specific environmental project and over what timescale
 2. **Estimates on the environmental impact of projects funded by the green bond**; example metrics used are tonnes of CO₂ emission reduction achieved, tonnes of solid waste no longer emitted or cubic meters of conserved water use

Glossary

Earth Day: a series of events held on April 22nd every year where global economies come together as the largest environmental movement

Green bonds: a financial debt instrument issued by governments, sub-sovereigns (i.e. states, provinces, cities, or towns), financial institutions and companies to raise money exclusively for environmental projects

Green Bond Principles: a framework issued by the International Capital Markets Association to promote the integrity, transparency, disclosure and reporting of green bonds

Second-party verification: a document done by industry professionals which states whether or not the green bond was put together in line with the green bond principles

Third-party verification: a process whereby a green bond is compared against a set of criteria put together by professionals, stating what a green bond in particular sectors should look like (overseen by Climate Bonds Initiative, a non-profit organisation that mobilises the green bond market for climate change solutions)

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