MARKET COMMENTARY

Green Bonds

2 April 2019

Rhys Petheram, Fund Manager; Jon Wallace, Analyst

Rhys joined Jupiter in 2006 and is currently a fund manager in the Multi-Asset team. He co-manages the Jupiter Global Ecology Diversified fund (SICAV).

Before joining Jupiter, Rhys was an analyst at Towers Perrin Australia and a credit analyst for utilities at Moody's Investor Services.

Jon joined Jupiter in 2009 and is an analyst in the Environment & Sustainability team.

Before joining Jupiter, Jon worked at Forum for the Future, a sustainability advisor to corporate and public organisations.

About Jupiter
The listed British investment manager with boutique-like investment approach, located in London and founded in 1985, employs more than 400 employees worldwide (thereof about 35 fund managers). Today Jupiter is one of the UK's most respected asset management groups. „The Jupiter Global Fund SICAV" (a Luxembourg based UCITS structure) provides clients outside the UK access to the diverse investment capabilities through its 29 sub funds which are registered for distribution in several European countries. Jupiter's total AUMs are GBP 42.7 bn as of 31 December 2018.

Green bonds – two steps forward, one step back?

Green bond issuance passes a milestone, but there is still a race to be run. With worldwide green bond issuance breaking through the $500bn mark, it brings up the question, in which direction the market should take from here.

For a market not much more than 10 years old, the scale of labelled green bond issuance certainly impresses, demonstrating that this is an asset class investors have a growing appetite for. According to data from Credit Agricole, green bond issuance is now over 5% of total EUR supply, excluding government bonds.[i] With high hopes that the green bond market can play a pivotal role in closing the wide financing gap to meet, for example, pressing climate change targets, this is welcome news. Within the EU alone, it is estimated that around €180 billion a year of additional investments in energy efficiency and renewable energy are needed to achieve its 2030 climate targets.[ii]

But this race is far from over, and having engaged with and invested in the market since 2013 when the corporate green bond market first emerged, we argue here that the difficult teenage years will prove pivotal if it is to fulfil its potential.

Calling for 'additional capital'

Quantity is one thing, quality another. If the purpose of green bonds is to help scale the finance flowing to environmentally-sustainable investments to help re-orientate the economy onto a sustainable pathway, it is destined to disappoint if market participants can't match and demonstrate this ambition. Central to this is 'additionality', a question of whether the activities financed by a green bond would have happened anyway, and whether these bonds are meaningfully contributing towards tackling issues such as climate change.

These notions might sound obvious to many, but the conversation about additionality is only beginning to be heard amongst the key market makers. We welcomed the focus on additionality in the recent annual Green Bond Principles (GBP) consultation. However, it is striking that amongst its members – those who have issued, underwritten or invested in a green bond – over three quarters believe that green bonds are providing additional capital. Amongst the GBP's wider 'observers'[iv], in contrast, this number drops to just over half of respondents.[v] Given those outside the direct industry are therefore twice as likely to think that additionality needs to be addressed, we think this highlights a worrying credibility gap at a moment when the long-term future purpose of the market is in the spotlight.

Cognisant of these issues, the Technical Expert Group (TEG) appointed to help deliver the EU's Sustainable Finance Action Plan (including an EU-wide green bond standard later in 2019), stated at its launch that "additionality and incentives for issuing green bonds will be subject to further evaluation."[vi] The two issues – additionality and incentives – are closely linked, in our view. The prospect for incentives for green bond issuance to be misaligned with wider sustainability goals is great without first limiting the possibility of 'greenwashing' – one area the action plan aims to tackle squarely.[vii]

Focus on long-term climate goals

Looking ahead to the next wave of issuance, we think addressing these issues can't come soon enough. Take for example the telecoms sector, where Telefonica and Verizon have both recently issued green bonds whose proceeds are helping to finance the conversion of telecoms infrastructure from copper to fibre and to upgrade the network to 5G. Although in both cases the bonds are aligned to the Green Bond Principles, we fear that both did little to close the financing gap that the EU is hoping to overcome. It is highly likely that the estimated €137 billion needed to bring fibre broadband networks to EU households will be fully financed regardless of sustainable financing initiatives such as the green bond market[viii].

Moreover, this figure represents around three-quarters of the annual financing gap of new capital needed for renewable energy and energy efficiency projects if there is to be a realistic chance of hitting the EU's 2030 climate goals. Fibre broadband will certainly play a role in the ecosystem of solutions needed to meet this goal: for example,

Rhys Petheram, Fund Manager; Jon Wallace, Analyst

Rhys joined Jupiter in 2006 and is currently a fund manager in the Multi-Asset team. He co-manages the Jupiter Global Ecology Diversified fund (SICAV).

Before joining Jupiter, Rhys was an analyst at Towers Perrin Australia and a credit analyst for utilities at Moody's Investor Services.

Jon joined Jupiter in 2009 and is an analyst in the Environment & Sustainability team.

Before joining Jupiter, Jon worked at Forum for the Future, a sustainability advisor to corporate and public organisations.

About Jupiter
The listed British investment manager with boutique-like investment approach, located in London and founded in 1985, employs more than 400 employees worldwide (thereof about 35 fund managers). Today Jupiter is one of the UK's most respected asset management groups. „The Jupiter Global Fund SICAV" (a Luxembourg based UCITS structure) provides clients outside the UK access to the diverse investment capabilities through its 29 sub funds which are registered for distribution in several European countries. Jupiter's total AUMs are GBP 42.7 bn as of 31 December 2018.

connecting smart devices that can enable energy efficiency. However, given the fresh concerns around additionality, in our view there is a growing expectation that investors should consider the relative impact of projects like this against those which will potentially play a more significant role in helping to achieve long-term climate goals. Investing in green bonds for potentially business as usual projects comes at an opportunity cost of unfunded projects.

Addionality as key driver for growth

Our engagements with green bond issuers across industries and geographies has encouraged us that the issue of additionality is no longer just treated as a nice-to-have concept, and the EU Sustainable Finance Action Plan is helping to bring it in from the periphery. With market participants hopeful that green bonds can be recognised for their potentially pivotal role in helping deliver solutions for pressing global sustainable development challenges, the main challenge will be for the market to address the impression that additionality is in some way an impediment to further growth. In our view, given the scale of the annual financial gap, additionality – if it can be demonstrated – will instead be a key driver for growth in the market for green bonds.

Our approach

Overall, we warmly welcome the market's expansion in recent years. Labelled green bonds now account for 23% of the assets within the Jupiter Global Ecology Diversified fund, complementing the core holdings of the portfolio in corporations offering solutions to environmental and sustainable challenges. To be clear, green bonds typically do not finance green projects, instead they finance corporations who in turn promise to invest in green projects. From an 'impact' perspective this subtle distinction is important and is why we have continued to tighten the criteria we apply to green bonds for investment as the market matures. Alongside our financial analysis we seek green bonds from organisations with robust environmental sustainability strategies which are directly linked into a green bond framework, providing a clear pathway to achieving those objectives through additional projects in future.

Sources:

1. Credit Agricole Green Bonds 2019 Roadmap – Can they grow against the flow? 11/12/18
2. http://europa.eu/rapid/press-release_IP-18-3729_en.htm
3. https://www.jupiteram.com/UK/en/Professional-Investors/Insights/Rhys-Petheram/Rhys-Petheram-Views-on-the-standards-for-green-bonds
4. GBP 'observers' include stakeholders such as governments, NGOs and other organisations involved in sustainable finance.
5. ICMA The Green Bond Principles Annual Consultation Feedback, 7 February 2019
6. https://ec.europa.eu/info/sites/info/files/180730-teg-statement_en.pdf
7. Green washing can be defined as "the risk that products and services which are marketed as sustainable or climate-friendly in reality do not meet the sustainability/climate objectives claimed to be pursued" http://europa.eu/rapid/press-release_MEMO-18-3730_en.htm
8. https://www.ftthcouncil.eu/documents/Reports/2017/FTTH%20Council%20Cost%20Model%202017_final.pdf

Important information

MARKET COMMENTARY

Rhys Petheram, Fund Manager; Jon Wallace, Analyst

Rhys joined Jupiter in 2006 and is currently a fund manager in the Multi-Asset team. He co-manages the Jupiter Global Ecology Diversified fund (SICAV).

Before joining Jupiter, Rhys was an analyst at Towers Perrin Australia and a credit analyst for utilities at Moody's Investor Services.

Jon joined Jupiter in 2009 and is an analyst in the Environment & Sustainability team.

Before joining Jupiter, Jon worked at Forum for the Future, a sustainability advisor to corporate and public organisations.

About Jupiter

The listed British investment manager with boutique-like investment approach, located in London and founded in 1985, employs more than 400 employees worldwide (thereof about 35 fund managers). Today Jupiter is one of the UK's most respected asset management groups. „The Jupiter Global Fund SICAV" (a Luxembourg based UCITS structure) provides clients outside the UK access to the diverse investment capabilities through its 29 sub funds which are registered for distribution in several European countries. Jupiter's total AUMs are GBP 42.7 bn as of 31 December 2018.