



PACIFIC ISLANDS FORUM



DEMYSTIFYING GREEN AND BLUE BONDS FOR THE PACIFIC REGION

JULY 2022

FRONT & BACK COVER CAPTION: Coral reef in tropical sea on a background of green island.
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ABBREVIATIONS

| | |
|--------------|---|
| ABS | Asset Backed Securities |
| ACMF | ASEAN Capital Markets Forum |
| ADB | Asian Development Bank |
| AF | Adaptation Fund |
| ASEAN | Association of Southeast Asian Nations |
| BBP | Blue Bond Principles |
| CBI | Climate Bond Initiative |
| CFO | Chief Financial Officer |
| DBS | Development Bank of the Seychelles |
| DFIs | Development Finance Institutions |
| EBRD | European Bank for Reconstruction and Development |
| EEZ | Exclusive Economic Zone |
| EIB | European Investment Bank |
| ESCAP | Economic and Social Commission for Asia and the Pacific |
| ESG | Environmental, Social, and Governance |
| EU | European Union |
| FAQs | Frequently Asked Questions |
| FEMM | Forum Economic Ministers Meeting |
| FRDP | Framework for Resilient Development in the Pacific |
| FSM | Federated States of Micronesia |
| GBP | Green Bond Principle |
| GBPT | Green Bond Project Team |
| GBS | Green Bond Standards |
| GCF | Green Climate Fund |
| GDP | Gross Domestic Product |
| GSS | Green Social and Sustainability |
| IADB | Inter-American Development Bank |

| | |
|----------------|--|
| ICMA | International Capital Market Association |
| IEA | International Energy Agency |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| IPCC | Intergovernmental Panel on Climate Change |
| KPI | Key Performance Indicators |
| LAC | Latin America Caribbean |
| MDB | Multilateral Development Bank |
| MFI | Micro Finance Institution |
| MoF | Ministry of Finance |
| MPA | Marine Protected Area |
| MRV | Monitoring, Reporting and Verification |
| NDC | Nationally Determined Contribution |
| NIB | Nordic Investment Bank |
| PES | Payment of Economic Systems |
| PFM | Public Finance Management |
| PICs | Pacific Island Countries |
| PIFS | Pacific Islands Forum Secretariat |
| PNG | Papua New Guinea |
| REDD+ | Reducing Emissions from Deforestation and Forest Degradation |
| RMI | Republic of the Marshall Islands |
| SBG | Sustainability Bond Guidelines |
| SBP | Social Bond Principles |
| SDGs | Sustainable Development Goals |
| SeyCCAT | Seychelles Conservation and Climate Adaptation Trust |
| SIDS | Small Island Developing States |
| SLB | Sustainability-Linked Bond |
| SLBP | Sustainability-Linked Bond Principles |
| SPO | Second Party Opinion |
| SPT | Sustainability Performance Targets |
| UNCDF | United Nations Capital Development Fund |
| UNDP | United Nations Development Programme |
| UNEP-FI | United Nations Environment Programme Finance Initiative |

KEY POLICY MESSAGES

- ***Bonds will not deliver all the necessary funding required by Pacific Island Countries (PICs) to enable them to build resilience to climate change and disaster risk.*** Bonds provide another option in the range of funding sources that countries can use, however they will not provide enough funds on their own. A combination of instruments is required to meet the national development goals and achieve the transition to low carbon and climate-resilient economies.
- ***Debt financing can fill gaps in grant-based finance.*** Debt financing instruments are a critical source of sustainable development finance. Grants-based financing is highly desirable for PICs however, it is highly unlikely that this modality will be available in the required scale, mainly due to limited donor appetite.
- ***Thematic bonds are an appropriate debt financing instrument.*** Appropriately structured loans including thematic bonds can be a feasible option for PICs to finance their recovery as well as their resilient and low carbon development pathway. Sovereign green and blue bonds are part of a set of financing tools that have the potential to provide the additional capital to cushion the widening sustainability financing gaps in PICs and to protect their development gains, as well as the productivity of their natural ecosystems, from disasters and climate change.
- ***The potential benefits of thematic bonds extend beyond just accessing additional capital.*** Adoption of green and blue bonds can also bring new sources of expertise and private sector innovations into the region. Their adoption can challenge policy makers to develop consistent and well-governed approaches for comprehensive and sustainable environmental solutions.
- ***Use of bond proceeds must be effective as they create long term debt liabilities.*** Sovereign green and blue bonds are debt instruments that create long term financial liabilities that will need to be repaid. It is vital that they are used in an effective and strategic manner.
- ***Enhanced Public Financial Management (PFM) and broad inclusion will be required to meet transparent material bond information demanded by investors.*** Sovereign green and blue bonds also offer opportunities to improve PFM systems of PICs. The required transparency of material information associated with thematic bonds necessitates that PICs strengthen their budget and planning process.

This will include monitoring and evaluation (M&E) capability, as there is increasing demand from investors for robust results-based reporting and accountability of bond investments. Increasing the scope of material information will require expansion of the bond constituency, necessitating inclusion of NGOs, CSOs and citizens in determining local outcomes, assessing investment impact and identifying further investment priorities. This could result in an increase in the cost of bond issuances, potentially rendering them uncompetitive as a funding source in some PICs. Embedding environmental and social dimensions directly into national economic planning will be required. Having a clear national sustainable financing strategy (including robustly costed project pipelines) which provides clarity on how and where green or blue bonds issuance will play a role in delivering that strategy is critical. This means that PICs must strengthen their resilience integration and mainstreaming approach and adopt a culture of incorporating environmental and social aspects in their economic and financial planning processes. The adoption of sustainability bonds will be a natural step for financing if this is the case.

- **Regional thematic bond issuance has scale benefits.** Considering the need for issuers to make bond size attractive to investors and the need to increase regional resilience to climate change and disasters, there is potential for PICs to seriously consider regional bond offerings. PICs may need to consider exploring the potentials and the viability of setting up (or strengthening) the regional enabling environment which would include relevant institutions, frameworks and protocols that can support a regional thematic sustainable bond offering on common investment areas such as ocean and fisheries.
- **Mobilization of investments from a wide range of investors, including PIC institutional investors as well as community, is important.** There is potential for PICs to leverage institutional investors and key private sector players in their respective countries particularly their national superannuation funds, insurance companies and sovereign wealth funds. These mechanisms tend to hold a significant pool of private capital to invest in sovereign/regional green and blue bonds. Additionally, PICs need to explore tapping into mobilizing the finance from community groups such as church institutions and diasporas to support a range of local issues.
- **The integrity of thematic bond frameworks is critical.** Pressure is increasing from the institutional investor community on the integrity of thematic bond frameworks. The decision to issue a thematic bond must be supported by a genuine desire to implement robust project selection and impact reporting processes. Whilst thematic bond frameworks allow a degree of allocation of funds already in progress, ensuring that clear additionality of impact will be created with bond proceeds is critical to support an effective bond issuance.
- **Partnership with competent development institutions for bond issuance may be necessary.** Multilateral Development Banks (MDBs) and partners offer a rich pool of technical resources that can support the region in thinking through and piloting either a sovereign or regional sustainability bond. The Asian Development Bank (ADB) is an active party in this space having issued its first blue bond denominated in AUD and NZD to finance ocean-related projects in Asia and the Pacific. Additionally, it has launched a Blue Bond Incubator to boost ocean investments which could benefit PICs.

BOND MARKET OUTLOOK

As the US\$1 trillion market for green bonds continues to expand, participants in the issuance process could look to globally agreed standards as a reason to why these thematic issuances have been able to rapidly scale, whilst at the same time maintaining impact without sacrificing on greenwashing. The transparent guidelines and independent review process bring clarity to the pre-issuance and post-issuance requirements, which benefits both the issuer and the investor.

The issuer has full visibility on which projects are eligible for green bond proceeds and understand what is required in terms of monitoring, reporting and verification (MRV). On the other hand, the investor is afforded additional transparency over the impact achieved with the proposed investment, and is better informed over which bond to invest in.

The blue bond market has not yet experienced this same growth in issuances. Blue bonds are especially relevant to the Pacific region, due to the reliance on marine resources and the vast exclusive economic zones (EEZ) of countries in the Pacific. To date, blue bonds must be issued under the Green Bond Principles (GBP), as there are no globally accepted blue bond guidelines. The United Nations (UN), the Asian Development Bank (ADB) and the International Finance Corporation (IFC) among others, have all published blue bond standards which the market could look to. Whilst they have value in outlining eligible blue sectors and best practice for blue bond issuances, these standards need to be better aligned with the GBP.

Resulting from the reality that blue bonds must be issued under the GBP, and the added complexity involved, the need for bespoke guidelines for the blue economy to bring clarity to this segment of the market is evident.

It has been argued in this paper, that Blue Bond Principles (BBP) are needed in order to standardize inclusion and exclusion of projects, in alignment with the Use of Proceeds bond lifecycle. This will assist in building the depth of the project pipeline and rapidly increase the value of capital being funneled towards the globe's waters. As the pipeline of projects builds and gains strength of impact, the transparent issuance process would encourage investor demand and build the blue bond market.

The creation of the BBP would lead to a further segmentation of the international bond market, which should encourage a diverse range of investors looking to increase investments into climate and nature positive outcomes. The segmentation would bring clarity to this sub-sector, and subsequently growth in the cumulative value of blue bond issuances over time.

Bond issuance also creates opportunities for strengthening Public Financial Management (PFM) which is hugely relevant to the wider development context. Bond issuance is a long-term debt commitment which places responsibilities of issuers on lifecycle monitoring and reporting on the Use of Proceeds. To avert the growing clamor of "greenwashing" from investors, there will inevitably be a need to move beyond Use of Proceeds-type reporting for bonds. This forces expansion of what is "material" to report on bonds, progressing towards objectively verifiable green / blue outcomes and impact.

Increasing the scope of material information will expand the bond constituency, necessitating inclusion of NGOs, CSOs and citizens involved in determining local outcomes and impact and in identifying further investment needs. The Pacific can further strengthen these aspects, including through the promotion of citizens budgets and Supreme Audit Institutions to meet these growing market demands for enhanced materiality. Consequently, such demand for more information might result in increased issuance costs that might discourage some PICs from pursuing this sustainable financing modality and might opt to pursue vanilla bonds instead.

Additionally, as the sustainability themed bond market matures and expands, there is also a possibility that the different labels assigned to these bonds will disappear. Global trends indicate that more and more investors are beginning to embrace these modalities, as tools for responsible investments.

In many ways, the tardiness of the region to be involved in this US\$1 trillion market, creates an opportunity to learn from others and overstep them with systems in place for full and robust material reporting, creating a portfolio of desirable deep green and blue bonds issued at market leading rates.

1

INTRODUCTION

The aim of this report is to provide clarity to Pacific Small Island Developing States (PSIDS) on two emerging financing mechanisms, green bonds and blue bonds, that could provide complementary financing pathways to PICs climate finance and sustainable development agendas.

Pacific Island Countries (PICs) continue to face significant challenges accessing external finance to effectively support their resilient development agenda as articulated in the Framework for Resilient Development in the Pacific (FRDP). PICs are severely constrained in their abilities to internally generate and source domestic public finance to meet their multifaceted development challenges, which are being compounded by climate change and increasingly regular and intense weather-related disasters. PICs, therefore, are forced to depend heavily on external finances such as official development assistance, foreign investment, remittances, and funding from private sector investments to support their resilient development agenda.

The frequency and the magnitude of disasters that have devastated PICs in recent years have left many PICs with short recovery time frames and huge financial gaps. Pressure is now growing amongst PICs to access more financial resources to strengthen their resilient development pathways¹. However, the cost of pursuing such a pathway is also increasing. The threats of disasters, climate change and health pandemics (i.e. COVID-19) have created a large and growing funding gap, and have also reversed development gains. The International Monetary Fund (IMF) has estimated that the annual gap for climate finance alone for the region to be US\$1 billion². A recent assessment by the Lowy Institute estimated that the emergence of COVID-19 has rolled back 'decades' of development gains in the Pacific³.

To fill these funding gaps, mobilizing funding from sources other than public sources is critical. PICs are currently exploring the relevance and the practicality of a number of innovative mechanisms that seek to leverage non-public finance. Amongst the array of emerging instruments are sustainable thematic debt instruments such as Green, Social,

¹ Amundi & IFC (2019). Emerging Market Green Bonds Report 2019, pp 1-36.

² Fouad, M, Novta, N, Preston, G, Schneider, T, Weerathunga, S. (2021) Unlocking Access to Climate Finance for Pacific island Countries, pp 1-103.

³ Roland, R & Dayant, A. (2020) Avoiding A Pacific Loss Decade: Financing the Pacific's COVID-19 Recovery. <https://www.lowyinstitute.org/publications/lost-decade-pacific>

Sustainability, SDG, and Blue Bonds⁴, which are currently gaining traction worldwide. The global market for these bonds is rapidly growing, exceeding US\$1 trillion to date⁵. Around 20 countries globally have issued sovereign bonds of such a nature (mainly green bonds), three of which are SIDS (i.e. Belize, Fiji and Seychelles)⁶. At the regional level, a 2021 Economic and Social Commission for Asia and the Pacific (ESCAP) report argued that sustainability-themed debt instruments were feasible for PICs⁷.

The rapid expansion of the sustainability debt market is indicative of a shift in attitude of corporate business, governments and investors towards sustainable and resilient economic growth, and more importantly the need to be in line with the net-zero goals that the majority of countries around the globe have committed to. It is expected that the sustainable debt market is poised for exponential growth over the coming years as companies, national governments and sub national governments globally seek funding to deliver on their climate change related goals. Furthermore, these organisations are overhauling their operations and processes to pivot away from high-carbon assets and activities,⁸ in line with the global goal of a net-zero or carbon neutrality development pathway.

The uptake of sustainable debt instruments amongst PICs however, has been minimal. To date, Fiji is the only PIC that is actively pursuing these financial instruments, having issued sovereign green bonds in 2017 and having recently launched its Blue Bond for 2022 at the United Nations Framework Convention on Climate Change (UNFCCC) Conference of the Parties (COP) 26. Amongst the array of interconnected challenges that hinder PICs effective participation in the sustainability debt market; a key barrier that prevents the uptake of these instruments (particularly amongst governments and the private sector), is the lack of awareness of how sustainability debt instruments work. There is also a negative perception that sustainability/green projects carry high risk and low returns and have a high failure rate⁹. Tackling these general concerns (and misconceptions) and providing clarity on what these instruments are, and how they work, could be the starting point for a meaningful discussion on the potential of these instruments. Furthermore, it is important to identify where sustainable debt instruments can add value in the general resilient financing landscape of the region.

There is a significant barrier to bond issuances beyond the debt service payments and additional debt stock. There is a lack of ready-to-go projects that can create a return profile which contribute to the debt flow and can help to offset payments. This is a bottle neck for the bond issuance, as not only is there a benefit to projects with a returns profile, but there is a capacity barrier for governments understanding what can and can not be financed.

⁴ The major difference amongst these bond categories is on how the proceeds will be applied. This will be explored in detail in the actual analysis.

⁵ As per Climate Bond Estimates. The sustainability debt market has been dominated by green bonds, but the share of other labelled bonds has also grown in recent years, both in terms of amount issued and number of issuers.

⁶ As per CBI 2020 estimates.

⁷ Emose, G (2021) Sustainability Bond for the Pacific: Feasibility Study, ESCAP, Macroeconomic Policy and Financing Development Division, March 2021, Bangkok.

⁸ Keating, C. (2021) Why 2021 could be the landmark year for sustainable debt. Available: <<https://www.greenbiz.com/article/why-2021-could-be-landmark-year-sustainable-debt>>

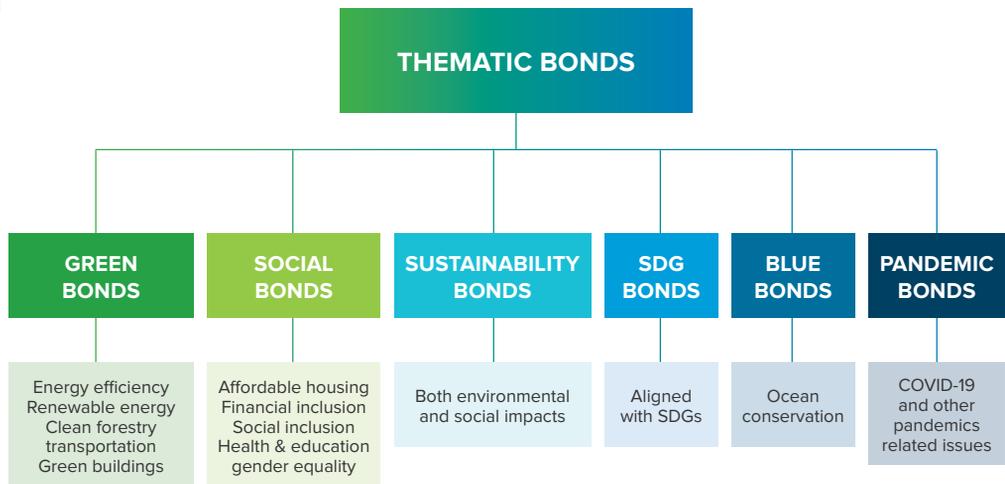
⁹ ibid

2

OVERVIEW OF THEMATIC BONDS

The sustainable bond market comprises several thematic bond types. These include green bonds, transition bonds, Sustainable Development Goal (SDG)-linked bonds, social bonds, and blue bonds, as outlined in Figure 1. These bonds all contribute to the broader goal of advancing the SDGs in the global market, but they differ slightly in terms of structure and design.

FIGURE 1. Types of thematic bonds¹⁰



2.1 Use-of-Proceeds Bonds

The first important bond structure which is already widely established is Use-of-Proceed (thematic) bonds which include green, social and sustainability bonds. These bonds are activity centric, where the issuers commit to using the actual funds raised from the bonds to achieve certain social, green or SDG objectives. Income from these bonds has, to date, been fixed coupon in nature.

¹⁰ UNESCAP (2021) An Introduction to Issuing Thematic Bonds, Bangkok, pp1-40.

2.2 Sustainability Linked Bonds

The second innovative way that bonds are being used to integrate the SDGs into the bond market is to include a covenant that links the coupon of a bond to the issuer’s achievement of climate change related priorities and broader SDGs. These bonds tend to be more focused on changing the behaviour of the issuer. Essentially, progress or lack thereof towards the SDGs will determine whether there is a decrease or increase in the instrument’s coupon. To date, the prevailing approach within the corporate sustainability linked bond (SLB) market and the limited sovereign SLB market has been to penalise non-performance through a higher rate of interest, rather than to reward performance through a lower rate of interest.

It is, however, critical to note that bonds are just ONE tool for raising sustainable development funding. Bonds in general offer several features that could make them particularly useful for governments, corporations and other entities looking to arrange sustainable development funding for sustainable development pipelines or to meet sustainability targets. The strengths and criticisms of thematic bonds are summarised in Table 1.

TABLE 1. Strengths and criticisms of thematic bonds

| STRENGTHS | CRITICISMS |
|---|--|
| <p>The benefit of bonds to an issuer¹¹:</p> <ul style="list-style-type: none"> • Bonds offer considerable structuring flexibility in tailoring yield, tenor, security priority over other debts as well as other terms, to suit the needs of both target investors and issuers. A bond issue may have several tranches, each with different features, aimed at different groups of investors. This is useful when taking a blended finance approach. • Bonds with fixed coupons protect against changing interest rates. In addition, by deferring principal payments to maturity, bonds reduce cash outflows over the term. • For corporate issuers, bonds can be used to raise capital without diluting equity holders | <ul style="list-style-type: none"> • Price: Thematic bonds are actually not cheaper, as price is not determined by the usage of the proceeds in certain ways. Investors tend to prioritize the ‘credit ratings’ to determine the interest rate to charge. • Fungibility: There is always a risk of proceeds (i.e. money) being used for other purposes instead of ‘green investments’ unless there is comprehensive reporting and monitoring which can be time consuming and resource intensive. • Identification: The combination of promises to bond buyers and fiscal austerity can have unintended trade-off consequences, as it may mean reductions of investments in other critical development areas. |

¹¹ Emose, G.(2021) Sustainability Bond for the Pacific: Feasibility Study. ESCAP, Macroeconomic Policy and Financing for Development Division, March 2021, Bangkok.

STRENGTHS

The benefit of bonds or investors¹²:

- Each bond is a unique instrument that can be readily transferred or traded. This reduces liquidity risk by giving investors greater flexibility in managing their portfolios.
- Bonds are instruments which many investors- governments, business, multilateral agencies, and others, are familiar with and are therefore more likely to consider.
- Bonds can tap into a new base of investors that might not normally participate in equity or loans.

CRITICISMS

- **Impact:** Proving the desired impact of bonds proceeds can be complex and not straight forward.
- **Ear-marking:** Linking bonds to specific expenditure can also result in overfunding or underfunding of initiatives, as it allows the opportunity for investors to pick and choose what part of the fiscal budget they will finance.

¹² ibid

3

DEEP DIVE INTO GREEN BONDS

3.1 The Green Bond Principles (GBP)

The Green Bond Principles (GBP) is a voluntary process that emerged out of an international need to promote transparency and disclosure and, importantly, promote integrity in the green bond market. The GBP act as a safeguard to the risk of ‘greenwashing’; the practice of channelling proceeds from green bonds towards projects or activities that have negative environmental benefits or that do not contribute to making progress against stated targets and objectives.

The GBP are a methodology for developing a green bond framework that ensures that projects financed are clearly defined and that the issuer sets up a robust governance procedure to safeguard and promote environmental integrity, thereby making sure that it can deliver on its green commitments to investors.

The GBP provide a high-level categorisation of eligible green projects and explicitly recognizes several broad categories of eligibility of green projects which contribute to environmental objectives of the issuer (refer to the Appendix). The categories given are by no means an exhaustive list but serve as a guidance for the broad themes of projects that are likely to be defined as green. The different types of green bonds are detailed in the Appendix.

3.2 Benefits of Green Bonds

The benefits of green bonds, as well as the barriers and opportunities associated with them are summarised in Figure 2 and Table 2.

FIGURE 2. Benefits of green bonds



INVESTORS

- compliance with regulations and policies
- investing in sustainable products and initiatives without taking on additional risks
- development of better-informed investments strategies
- broader restricted investment portfolios
- remove cost of environmental due diligence



ISSUERS

- increase investor demand and diversification
- improve relationships with debt providers
- strengthen issuers reputation and brand value
- help communicate issuers sustainability narrative and strategies
- allows project to be funded at a cheaper rate compared to if they were to be invested in, individually



SYSTEMS

- stimulate positive stock market reaction and improvements in financial performance
- foster green innovations
- help transition towards low-carbon and resource efficient economies
- contribute to public-private partnerships development opportunities
- facilitate climate policies

TABLE 2. Barriers to and opportunities for scaling up the green bond markets¹³

| BARRIERS | OPTIONS |
|---|--|
| <ul style="list-style-type: none"> • Underdevelopment of a domestic institutional investor base, underdevelopment of the credit rating systems, lack of benchmark yield curves, lack of risk hedging instruments and insufficient market liquidity. Many of these fundamental challenges, if addressed in a synchronized way, can be immediately beneficial to the development of a local currency green bond market. • There is a general lack of knowledge for most countries on existing international standards. For some, the understanding on the benefits of the green bond market amongst policy makers, regulators as well as potential bond issuers and investors is lacking. • Relatively high costs of meeting green bond requirements particularly the high cost of a second opinion or third-party insurance (ranging from US\$10k-US\$100k) can be a barrier for small issue. | <ul style="list-style-type: none"> • Promoting the integrity of green bonds and raising the regional/national awareness of their benefits. This could be done through effective market education on the benefits of green bonds as well as demonstration issuances. • Promoting technical assistance for developing local green bond guidelines. • Providing technical assistance (TA) for local currency bond market development. TA is critical in developing areas such as benchmark yield curves, ratings, risk mitigation mechanisms and hedging products. |

¹³ OECD. Green Bonds: Country Experiences, Barriers and Options. Available < https://www.oecd.org/environment/cc/Green_Bonds_Country_Experiences_Barriers_and_Options.pdf>

- Lack of supply for labelled green bonds. In some markets, investor appetite might be relatively strong, as evidenced by significant oversubscriptions of recent issues. This indicates that the supply of labelled green bonds is a constraint and also reflects the lack of bankable green projects that can be financed or refinanced through green bonds. Fostering an enabling environment for pipelines of green projects to emerge at scale is critical.
- Difficulties for international investors to access local markets. A problem that hinders international investor access to local markets is that green bond definitions and disclosure of requirements vary across markets. These differences increase transaction costs due to re-labelling and re-certification. Another critical barrier to cross-border green bond investing is the lack of risk hedging products.
- Lack of domestic green investors. In markets where green bonds are mostly bought by local investors due to either capital controls or definition barriers, the existence of institutional investors that have a preference for green assets is important to ensure there is sufficient demand. However, due to factors such as the lack of disclosure requirement for the institutional investors to reveal environmental information of their asset holdings, and the lack of capacity to quantify the environmental costs and benefits of their investments, many investors do not have the tools to distinguish between green and non-green assets.
- Incubating local green investors. These include:
 - Strong government signals in support for green investments;
 - Green finance associations that can help raise awareness and provide training for green investment practices;
 - Encouragement for institutional investors to examine the environmental performance of their asset holdings;
 - International collaboration on capacity building are necessary steps in 'greening' local investors; and
 - Giving strategic investment mandates for green bonds by public entities (e.g. pension funds, sovereign wealth funds, development banks).
- Enhancing the role of MDBs/DFIs and public entities in developing green bond markets. This is one of the low-cost approaches to developing green bond markets as it leverages the substantial experiences of these entities. Possible areas that MDBs and DFIs can contribute to include:
 - Demonstration issuance, including issuance in local currency green bond markets; Providing credit enhancements;
 - Providing analytical tools for environmental impact analysis for green bond supported projects;
 - Setting up vehicles to aggregate investor demand for emerging markets green bonds;
 - Serving as an anchor investor for green bonds; and
 - Providing means to support premiums (e.g. credit guarantees on green projects)

3.3 Sovereign Green Bonds

Most green bonds that have been issued to date have been “use of proceeds” bonds where the proceeds from this type of bond are earmarked for green projects but are backed by the issuers entire balance sheet. Included in this classification of bonds is the sovereign green bond which is offered by national governments. Issuance of sovereign green bonds is gaining traction and in 2020 accounted for 12 percent of green bond issuers. A 2021 survey conducted by Climate Bond Initiative (CBI) indicated that 22 national governments have already issued a sovereign green bond, and an additional 14 countries have indicated their intention to issue a sovereign green bond in the near future¹⁴. Motivations for issuing sovereign green bonds can be summarised as follows:¹⁵

- Issuing sovereign green bonds can support the **growth of a local green market**. When a government issues sovereign green bonds it creates a perception of a ‘responsible’ issuer that serves as a model for other issuers. Sovereign green bonds can provide investors with safe, liquid investment opportunities which frees up capital for other lower-rated and less liquid securities.
- Green bonds are also issued as part of an overall set of financing tools that are designed to **contribute to the achievement of a government’s long-term strategic development initiative**. In most cases, these strategic initiatives are closely linked to the goals of the Paris Agreement as well as the net-zero ambitions that governments have set for themselves.
- The process of issuing a sovereign green bond typically involves tracking activities, such as undertaking a budget tagging exercise, as well as a commitment to report on the allocation of proceeds and their impact. These audits **increase the transparency of ministries to both parliament and to external stakeholders**.
- Green bonds tend to **broaden and diversify the investor** base and can also encourage investors to develop dedicated green, social and sustainability investment strategies.
- **A broader investor base can facilitate tighter pricing**, and this can encourage governments to identify and develop a pipeline of suitable ‘green’ expenditures.
- The process of issuing sovereign green bonds tends to be collaborative in nature. The use of proceeds, for example consists of **international collaboration** as funds are being used to finance projects beyond the borders of the issuing country.

¹⁴ CBI (2021) Sovereign Green, Social, and Sustainability Bond Survey. Available <<https://www.climatebonds.net/files/reports/cbi-sovereign-green-social-sustainability-bond-survey-jan2021.pdf>>

¹⁵ CBI (2021) Sovereign Green, Social, and Sustainability Bond Survey. Available <<https://www.climatebonds.net/files/reports/cbi-sovereign-green-social-sustainability-bond-survey-jan2021.pdf>>

BOX 1. Fiji's Green Bond Case Study

CASE STUDY – FIJI GREEN BOND, 2017

Overview

In October 2017, the Reserve Bank of Fiji issued its first green bond, raising Fijian Dollars (FJD) 100 million, to channel capital towards initiatives aimed at increasing the country's resilience to the impacts of climate change. This made Fiji the first emerging market in the world to issue a green bond.

Background

In 2016, Fiji experienced widespread damage as a result of Tropical Cyclone Winston, the strongest tropical cyclone ever recorded. Affecting almost two-thirds of the population, the economic consequences from the damage caused by the cyclone, included the loss of approximately one-third of the country's GDP in the immediate aftermath, with economic impacts into the longer-term unknown¹⁶.

As a result of the economic losses incurred, the Fijian Government worked to develop its first green bond issuance, looking to channel proceeds directly to vulnerable communities in order to address the country's climate change mitigation and adaptation priorities, and increase community resilience.

Challenges

In the decade after Tropical Cyclone Winston, it has been estimated that Fiji will need more than FJD 9.3 billion in order to reduce its vulnerability to the impacts of climate change¹⁷.

Climate change adaptation in particular, is a key challenge for Fijian communities at present and also into the future. The impacts of climate change are already a leading cause of poverty each year, with the impacts expected to increase over time¹⁸.

As part of the allocation of the proceeds, the green bond framework publicised the potential negative risks associated with project implementation, however understanding these risks are part of the issuance process; and as part of the project selection phase, the most positive projects relative to their negative impacts were selected¹⁹.

¹⁶ IFC (2017) A Green Bond to Help Fiji Secure a Greener Future. Available: <[¹⁷ Government of Fiji and World Bank \(2017\) Climate Vulnerability Assessment MAKING FIJI CLIMATE RESILIENT. Available: <\[http://ourhome-ourpeople.com/assets/WB-SummaryReport_FA01.pdf\]\(http://ourhome-ourpeople.com/assets/WB-SummaryReport_FA01.pdf\)>](https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/cm-stories/fiji-green-bond-for-a-greener-future#:~:text=Fiji's%20green%20bond%2C%20launched%20in,to%20people%20in%20developing%20countries.>></p></div><div data-bbox=)

¹⁸ ibid

¹⁹ Government of Fiji (2017) Green Bond Framework the Republic of Fiji. Available: <<https://www.rbf.gov.fj/wp-content/uploads/2020/03/Fiji-Green-Bond-Framework-October-2017.pdf>>

Bond Terms

| | |
|-------------------------|---|
| Issuer: | Government of Fiji |
| Amount: | 100 million Fiji dollars |
| Pricing date: | 1 November 2017 – May 2018 |
| Settlement date: | 1 November 2017 – May 2018 |
| Maturity date: | 1 November 2022 and 1 November 2030 |
| Issue price: | 100 |
| Coupon: | 5 years: 4.00 percent; 13 years: 6.30 percent |
| Denomination: | Fiji Dollars |

Oversubscription of the bond was more than double for the first tranche of FJD 40 million.

As part of the measures taken to increase the climate resilience of the country's economy, proceeds were allocated to enhance crop resilience and flood management for key agricultural products such as sugar cane. In addition to this, proceeds will also be allocated to renewable energy projects, as part of the country's ambition to transition to 100 percent renewable energy generation by 2030²⁰.

To help maximise the efficiency of the issuance process and impact of the proceeds, technical assistance was provided by the World Bank and IFC²¹.

Project Evaluation and Selection

The 2017 Fiji green bond issuance aligned with the International Capital Market Association (ICMA) Green Bond Principles (GBP). The projects selected under these principles aligned with the seven broad green sectors for eligibility, including climate change resilience and renewable energy. Second Party Opinion was provided by Sustainalytics.

Management of Proceeds

The Ministry of Economy created a ring-fenced sub-account whereby proceeds of the green bond issuance were received, allocated and then managed. This is part of best-practice so that proceeds can be transparently managed and impact be measured.

A further point of consideration is that the issuance of two tranches was part of the proceeds management of the green bond, as multiple tranches minimise the debt obligations and is also better able to match eligible expenditure allocations, in comparison to a singular tranche.

²⁰ Government of Fiji (2020) Fiji's Updated Nationally Determined Contribution. Available: <<https://www4.unfccc.int/sites/ndcstaging/Published-Documents/Fiji%20First/Republic%20of%20Fiji%27s%20Updated%20NDC%2020201.pdf>>

²¹ World Bank (2017) Fiji Issues First Developing Country Green Bond, Raising \$50 Million for Climate Resilience. Available: <<https://www.world-bank.org/en/news/press-release/2017/10/17/fiji-issues-first-developing-country-green-bond-raising-50-million-for-climate-resilience>>

Impact

Impact reporting of the allocation of the proceeds of the green bond was published annually until the full proceeds were allocated.

In line with the challenges faced by the country, over 90 percent of proceeds from the bond issuance were allocated towards climate change adaptation projects. The hope is that the increased adaptive resilience of communities in Fiji will lead to exponential cost savings in the future – this is due to positive multiplier effects and externalities of the reduced impact of climate change related hazards associated with increased community and business resilience²².

²² Reserve Bank of Fiji (2019) THE FIJI SOVEREIGN GREEN BOND 2019 UPDATE. Available: <<https://www.rbf.gov.fj/wp-content/uploads/2020/03/Fiji-Sovereign-Green-Bond-Impact-Report-2019.pdf>>

4

DEEP DIVE INTO BLUE BONDS

4.1 Blue Bonds and Blue Bond Principles

A blue bond is a relatively new form of a sustainability bond. It is a debt instrument that is issued by governments, development banks or others to raise capital from investors to finance marine and ocean-based projects that have positive environmental, economic and climate benefits. The blue bond operates like any conventional bond, where investors lend money to a bond issuer who then agrees to repay the interest every year for the term of the bond plus the principal of the bond at maturity. In a blue bond, proceeds are directed to projects that meet the principles and the criteria of a project that is categorized as 'blue' i.e. projects that specifically relate to sustainable ocean or marine related investments. Blue bonds are aligned to support the achievement of SDG 6 and SDG 14, as well as activities that are related to SDG 2, 7, 12, 13 and 15.

At the time of writing this paper, no formal Blue Bond Principles (BBPs) exist although progress is being made towards their development, initially through the production of a Blue Bond Playbook. Similar to GBPs, the Blue Bond Principles when finalised will act as a voluntary framework for issuers to align with, to promote best practice in the issuance of this type of instrument.

The BBPs are expected to lay out a transparent process which an issuer must follow both pre- and post-issuance. The principles will then explicitly define eligible and ineligible marine related sectors where proceeds must be allocated. A clear list of exclusion criteria will be developed.

As with an issuance aligned with ICMA's GBPs, an issuance aligned with the future Blue Bond Principles would require a sub-account to be created on behalf of the issuer, in order to ring-fence proceeds, and transparently manage the allocation of proceeds and external impact reporting.

4.2 Benefits of Blue Bonds

Compared to green bonds, blue bonds are an emerging, innovative funding instrument that are designed to specifically focus on funding ocean and marine-related solutions, creating sustainable opportunities for the blue economy and signalling responsible ocean stewardship commitments to the market.

Blue bonds have the additional benefit of including sectors with an ocean linkage. Focus areas include shipping, ports and coastal infrastructure but the bond also has the capacity to focus on wider areas that contribute to ocean sustainability. These could be as far reaching as sustainable tourism, fisheries and aquaculture development.

There is the potential to also develop offshore/marine-based renewable energy and, water and sanitation projects as infrastructure investments and a more classic return profile.

The key benefits of blue bonds are:

- They are being designed to facilitate the urgent need for finance directed at protecting the marine environment. Incentivizing traction for investments in sustainable blue economies has been challenging and thus instruments such as blue bonds are critical as they can act as a bridge to attracting private investments, and particularly investment from the capital markets into ocean health related projects.
- They can offer SIDS great opportunities to develop a thriving blue economy²³. Given that the EEZ of 22 PICs accounts for 10 percent of the total ocean surface (i.e., 10 million square miles) and these economies are entirely reliant on long-term oceanic health, this creates a clear opportunity for the issuance of blue bonds. Blue bonds offer opportunity through financing a strategically designed portfolio to build back better with great potential to bring increased financing, more effective implementation at a local level and to make a meaningful impact on the region's blue economy.
- Blue bonds are designed to directly raise capital for projects that have a direct impact on ocean and marine-related issues, while at the same time advancing social inclusion, economic growth, environmental protection and the achievement of the broader SDGs. Given that blue bonds emphasize investing in sustainable blue economies, this means that the focus of investments tends to go beyond just investments in marine conservation and restoration and water-related infrastructure, to also considering more business opportunities that will positively impact the ocean and support sustainable development.
- By carefully selecting projects with bond proceeds, opportunity can be created to secure private sector financing and build further public-private sector partnerships or investments that will benefit a country's blue economy sector.
- The issuance of blue bonds will contribute to raising awareness on the critical role of ocean and marine resources and the overall global need for marine environmental protection.
- Blue bond issuance will result directly in the development of a country's blue economy through sustainable use of ocean resources and contribute to the long-term preservation of livelihoods of countries whose communities depend on the ocean.

²³ See Appendix for definition of Blue Economy.

4.3 Pre-requisites of a Blue Bond Issue

The following five requirements must be in place before issuing blue bonds:

- **Willingness to take on new debts:** For countries such as PICs who already face multiple challenges managing their fiscal space and already have high debt burdens now being exacerbated by COVID-19, the timing of when to take on new debts, such as blue bonds, is critical. Adopting such instruments can add to a country's debt stock. This can be offset by the returns profile of the projects that are covered by the bond, however the balance should be thoroughly considered and thought through.
- **A robust ocean governance system must be in place²⁴:** This includes strong institutions with mandates to protect the ocean, as well as clearly defined strategies and policies with goals for a sustainable blue economy and protecting ocean ecosystems. Clear regulatory frameworks to define which types of economic activities are allowed in and adjacent to the oceans, and an effective system of monitoring and enforcement²⁵ will also be required.
- **Effective management systems to avoid perverse incentives:** Blue Bonds require economic activities that interact with the ocean and must be tightly and transparently managed to avoid perverse incentives that can have negative implications, such as the over development of the fisheries sector²⁶. A blue bond can also be used to fund the improvement and operations of ocean governance systems.
- **Sustainable blue economy sectors are clearly defined:** Blue bonds are debt instruments and therefore the money must be repaid to investors with interest²⁷. It is therefore critical that well defined sustainable blue economy sectors are identified such as sustainable fishing, eco-tourism, water management and marine-based renewable energy²⁸. Investment in these sectors will contribute to the growth in GDP of the issuing country and will promote stronger fiscal positions and lower the chances of debt default.
- **Minimum scale criteria and project portfolio that supports this:** Due to the costs involved in issuing bonds, typically issuances of this type will need to be at least US\$50-500 million in scale²⁹. This requires identifying a sizable portfolio of projects which proceeds can be allocated to.³⁰

4.4 Sovereign Blue Bonds

Sovereign blue bonds have strong potential to be a critical instrument for achieving a sustainable blue economy in developing countries³¹. This is of great relevance to the Pacific region, given the important role of the ocean to their economies, and the shift towards leveraging the blue economy to support and sustain their sustainable development pathways. Blue bonds could supplement other new emerging funding mechanisms that are specifically targeted at ocean-based initiatives such as the Global Fund for Coral Reefs³².

²⁴ ADB (2021) Sovereign Blue Bonds: Quick Start Guide, Available < <https://www.adb.org/sites/default/files/publication/756966/adb-sovereign-blue-bonds-start-guide.pdf> >

²⁵ *ibid*

²⁶ *ibid*

²⁷ *ibid*

²⁸ *ibid*

²⁹ *ibid*

³⁰ *ibid*

³¹ Roth, N., Thiele, T., Unger, M (2019) Blue Bonds: Financing Resilience of Coastal Ecosystems. Key Points for Enhancing Finance Action, pp 1-70.

³² <https://globalfundcoralreefs.org/>

The growing interest in sustainability focused investments creates potential for price competition for sovereign issuances of this type and to expand the range of investors open to participation. Furthermore, the issuance process which is a fundamental part of the relevant bond framework assures that the impacts of the proceeds are maximised due to the transparency, external reviews, and post-issuance reporting. Over time, this issuance process and data gathering will provide an iterative test bed for proceeds to create impact that is maximised, towards marine positive outcomes. Ultimately, a blue bond issuance would allow greater finance to be channelled towards the conservation and regeneration of marine ecosystems.

BOX 2. Seychelles Blue Bond Case Study.

CASE STUDY – SEYCHELLES BLUE BOND 2018

Overview

Seychelles is a Small Island Developing State whose economy and livelihood is highly dependent on the ocean, its resources and other blue economy sectors. Tourism and the fisheries sector are the two most important sectors, which significantly contribute to their GDP and provide employment to 17 percent of the population. Fish products make up 95 percent of the Seychelles total value of domestic exports.

As the economy grew and fisheries became more exploited, the Seychelles recognized the need to rebuild and sustainably utilize fish stocks through improved governance and management of the sector. However, the costs of transitioning to sustainable fisheries can be substantial for a small island state, both in terms of management costs and the socio-economic losses as fish stocks are recovering. The potential for a sovereign blue bond to finance this transition was first identified during discussions between Seychelles, the Prince of Wales’ Charities International Sustainability Unit, and the World Bank. Seychelles was keen to explore innovative financial instruments for its development agenda, particularly since its graduation to a high-income country, which limits its access to grants and donor aid.

Structure of Seychelles sovereign blue bonds

The sovereign blue bond was issued with a ceiling value of US\$15 million, with a maturity of 10 years. The blue bond, as well as the program of marine and ocean-related activities it will support, was prepared with assistance from the World Bank and the Global Environment Facility. This support includes a partial World Bank guarantee (US\$5 million) and a concessional loan from the Global Environment Facility (US\$5 million), which will partially subsidize payment of the bond coupons. These credit enhancement instruments allowed for a reduction of the price of the bond by partially de-risking the investment of the impact investors, but also by reducing the effective interest rate for Seychelles by subsidizing the coupons.

Investors

Since the total amount of the blue bond is of relatively low volume in market terms, it was privately placed with three socially responsible impact investors based in the United States, namely Calvert Impact Capital, Nuveen, and Prudential. The placement agent was Standard Chartered Bank, and the trustee was the Bank of New York.

Use of the proceeds

The proceeds were used to capitalize a Blue Grants Fund (\$3 million) and a Blue Investment Fund (US\$12 million), each of which will provide financing for marine and ocean-related activities that contribute to the transition to sustainable fisheries. These proceeds will be managed by the Seychelles Conservation and Climate Adaptation Trust (SeyCCAT), which will administer grants from the Blue Grants Fund, and the Development Bank of Seychelles (DBS), which will administer loans from the Blue Investment Fund. The two funds are designed to complement each other.

Benefits of the bond to the Seychelles

The main beneficiaries are Seychellois whose livelihoods depend on marine resources and the ocean. This includes artisanal and semi-industrial fishers, operators in tourism and seafood value chains, including aquaculture; national and local institutions engaged in the management of marine resources, including fishers' associations and government entities. Ultimately, the general population will benefit from a healthier marine environment and increased food security.

Impact on Seychelles' overall debt portfolio

The debt amount from the blue bond is small compared to the current debt portfolio of the country and the impact of the blue bond placement on the sustainability of the debt of Seychelles is not material. The blue bond is a general obligation of Seychelles and its repayment is not dependent on any obligations created through the use of the proceeds.

Contribution to climate change adaptation

The bond will strengthen Seychelles' resilience to the impacts of climate change. This will be made possible with the expansion of the marine protected areas network to 30 percent of their Exclusive Economic Zone (EEZ) and the promotion of sustainable fisheries through proper control and management, based on the project's ecosystem-based adaptation approach. The blue bond also complemented the debt-for-nature swap that Seychelles undertook in 2015 with The Nature Conservancy. In this case, an exchange for for greater ocean protection and climate change adaptation. The blue bond initiative will also help Seychelles to diversify its economy and reduce its vulnerability to climate change by adopting climate-smart ocean economies. This will be through the expansion of seafood value chains.

Sourced from The World Bank (2018)³³

³³ World Bank (2018) Sovereign Blue Bond Issuance: Frequently Asked Questions. Available < <https://www.worldbank.org/en/news/feature/2018/10/29/sovereign-blue-bond-issuance-frequently-asked-questions>>

TABLE 3. Summary of Green Bond & Blue Bond Frameworks.

| | Principles | Project Eligibility | Use of Proceeds | Process of Evaluation and Selection | Management of Proceeds | Monitoring and Reporting | SDGs likely receive the most impact |
|--------------------|--|---|--|--|--|---|-------------------------------------|
| GREEN BONDS | <p>Consistent with the GB Principles (ICMA)</p> <p>Investments in climate change mitigation and adaptation projects.</p> | <p>The definition of 'Green' is left for the issuer to determine. Categories suggested by the ICMA principles include (non-exhaustive):</p> <ul style="list-style-type: none"> - Renewable Energy sector - Efficient Energy sector - Sustainable Transport - Resilient Energy Infrastructure - Water Supply and Other Urban Infrastructure and Services - Agriculture | <p>Clear communication to investors on environmental sustainability objectives, process to determine eligibility with Green Project Categories, process applied to identify and manage potentially material environmental and social risks associated with the projects (may come in form of exclusion lists). External review encouraged.</p> | <p>The net proceeds of the green or blue bond, or an amount equal to these net proceeds should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer's lending and investment operations for the projects (Source Green Bond Principles)</p> | <p>Annual update on the use of proceeds and lists of projects to which the proceeds have gone to. Description of expected impact based on qualitative impact performance indicators and where feasible, qualitative performance measures. Transparency is of particular value in communicating the expected impacts of projects (Source: Green Bond Principles).</p> |  | |
| BLUE BONDS | <p>Consistent with the GB Principles (ICMA)</p> <p>Investments that contribute to ocean health through ecosystem and natural resource management, pollution control and</p> | <p>Blue project definition is left for the issuer to determine. Categories suggested by the ICAM principles, and the Sustainable Blue Economy Finance Principles include (non-exhaustive):</p> <ul style="list-style-type: none"> - Marine ecosystem management and natural resource restoration- - Fisheries management - Sustainable aquaculture - Solid waste management - Resource efficiency and circular economy - Non-point source pollution - Wastewater management - Ports and shipping - Marine-based renewable energy | <p>Same as above as the blue bond offering process is closely aligned to the existing green bond process.</p> | <p>Same as above as the blue bond offering process is closely aligned to the existing green bond process.</p> |  | | |

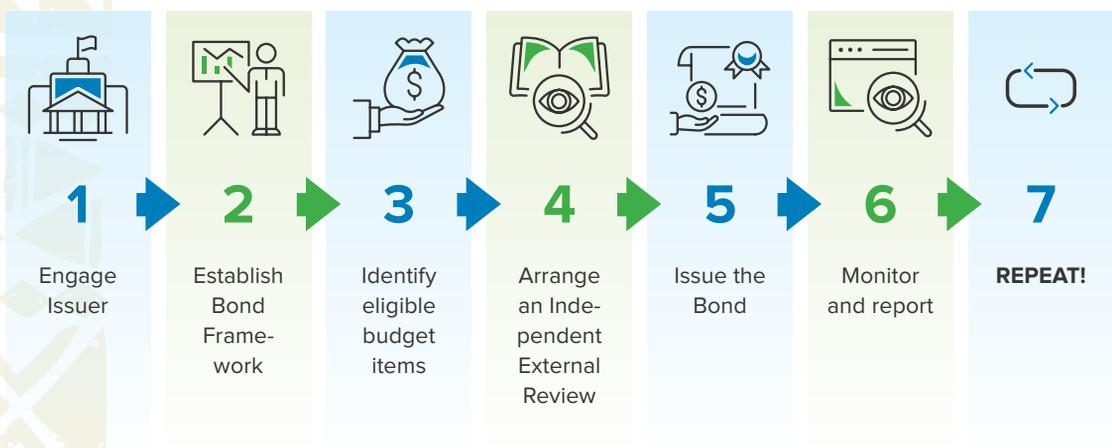
5

STEPS TO ISSUE A THEMATIC BOND

When issuing a blue or green bond, there are important sequential steps to be followed. A bond framework for the issuance must be completed in a way that aligns the goals of the issuer with sustainable development goal, social, green and blue use of proceeds and exclusions. The steps below are designed to show what should be done in preparation and during the process.

This paper has identified seven key steps an issuer must go through to efficiently issue a green, blue or social bond. These steps are described below and are explained in depth in the Appendix. In addition, there are a series of other steps including policy, institutional and budget work that needs to be undertaken in parallel.

FIGURE 3. Seven Steps to Issuing Sustainability Bonds³⁴



³⁴ UNDP and BwB (2022) MoF Capacity Building Exercise 2022.

6

LESSONS LEARNT AND OUTLOOK

6.1 Lessons Learnt from International Experiences for PICs

Below are some key lessons learnt for PICs, based on international experience.

It is critical to note that the lessons learnt listed below, while segregated for the purpose of readability, cover both types of bonds as they share the same issuance process.

6.1.1 Green Bonds

- Having a clear national sustainable development strategy and understanding how and where green bond issuance can play a role in delivering against that strategy is critical. Experience from countries in the Latin America Caribbean (LAC) region indicate that before green bonds come to light, issuers in this region had already incorporated environmental and social aspects in their economic and financial decisions. Issuing of a green bond therefore felt like a natural step when looking for funding³⁵.
- A well-defined project pipeline is an important prerequisite. It is a costly exercise to offer to issue a green bond and to wait to allocate the resources. The GBP strongly articulates the need for transparent management of unallocated proceeds and thus to attract investors, issuers need to identify suitable projects before issuance. They also need to specify these projects to the best extent possible in the Green Bond Framework. This often requires a separate range of funding to enable the development of concepts that have undertaken initial stages of feasibility.
- Having a small project pipeline that does not fully meet the acceptable issuance size threshold upon issuance should not prevent countries from issuing green bonds, as long as other eligible assets are available to include³⁶. In addressing the issue of ‘scale’ a green bond can include ‘mixed use of

³⁵ EU-LAC Foundation (2020) The Potential of the Green Bond markets in Latin America and the Caribbean, pp 1-78.

³⁶ Qadir, U., and Creed, A. (2022) Green Bonds for Climate Resilience. Global Center on Adaptation: A Guide for Issuers, p 1-34.

proceeds⁷- that is, a portion of proceeds may relate to adaptation and another to investments in mitigation³⁷. This is a widely adopted approach for green bonds. The aggregation mechanisms of bonds can present a promising path to reaching these issuance volumes particularly for small and medium sized projects³⁸. Aggregation is a strategy used by green banks and specialized aggregation companies to bundle small and medium sized individual projects to a sufficient size, so that the task of evaluating the transaction and documenting the arrangement can be cost-effective³⁹. While aggregation and securitization in the green bond market are still very nascent, work is progressing and could significantly scale-up access to investors⁴⁰.

- Green bonds are not only meant for mitigation projects such as renewable energy projects and can be a useful tool for diversifying investments in other sectors. Other countries are using green bonds to finance their initiatives such as green infrastructure, sustainable agriculture, water and sewer systems- initiatives that contribute to a country's climate change adaptation agenda and advancement of the SDGs⁴¹.
- Transparency is a key component of any sustainable thematic bonds. Measuring and reporting the impact of projects funded by thematic bonds is more than just a requirement for an investor. It is a tool for defining targets and it is an essential process to align objectives and strategies and prioritize actions. This requirement means that PICs must make the necessary investments in their M&E systems and should be willing to embrace the principles of transparency, particularly in demonstrating impacts and how investments are contributing to the intended outcomes.
- The Fiji experience in its green bond issuance offers insightful lessons learnt that may be of relevance to other PICs. The need for PICs to strengthen their peer-to-peer learning and connections across ministries of finance is critical in ensuring that sharing of knowledge in the region is effective.

6.1.2 Blue Bonds

- Blue bonds are debt instruments. Pursuing these instruments requires a willingness to take on new debt. For PICs who are already facing challenges managing their fiscal space and with high debt burdens also being exacerbated by COVID-19, the timing of when to take on new debts such as blue bonds is critical. Adopting such instruments can add to a country's debt stock.
- To issue blue bonds, a robust ocean governance system must be in place⁴². This includes institutions with mandates to protect the ocean, as well as clearly defined strategies and policies with goals for a sustainable blue economy and protecting ocean ecosystems. Clear regulatory frameworks to define which types of economic activities are allowed in and adjacent to the oceans, and an effective system of monitoring and enforcement⁴³ need to be in place. Blue bonds require economic activities that interact with the ocean and must be tightly and transparently managed to avoid perverse incentives that can have negative implications, such as the over

³⁷ ibid

³⁸ ibid

³⁹ ibid

⁴⁰ ibid

⁴¹ ibid

⁴² ADB(2021) Sovereign Blue Bonds: Quick Start Guide, pp 1-3.

⁴³ ibid

development of the fisheries sectors⁴⁴. A blue bond can also be used to fund the improvement and operations of ocean governance systems.

- As blue bonds need to be repaid with interest, it is critical that they are used to fund sustainable 'blue' economic activities that can generate returns from a GDP perspective. Fitting blue bonds to support marine protected areas that disallow economic activities and other conservation activities that do not have a revenue base will be challenging, if they do not contribute to overall economic development. It is therefore critical that well-defined sustainable blue economy sectors are identified such as sustainable fishing, eco-tourism, water management sector and marine-based renewable energy⁴⁵.
- Blue bonds will require a sizable pipeline of loan projects. Due to the costs involved in issuing bonds, most blue bond projects need to be at least US\$50-500 million in scale⁴⁶. Servicing the debt of such magnitude over time will require that a sizable portfolio of blue projects must be identified⁴⁷.
- Blue bonds can be issued as a subset of green, social and sustainable bonds, and should be grounded in globally recognized principles. Until there is a widely accepted set of blue bond principles, issuers are encouraged to use ICMA's social and green bond principles, adapted to a blue use of proceeds. Other frameworks including the UN Global Compact Sustainable Ocean Principles and the Blue Economy Financing Principles can also serve as a guide for responsible business practices.
- Blue bonds are not just for fisheries and shipping companies. Blue use of proceeds can be allocated to sustainability projects that are directly operating in or by the ocean, seas and freshwater such as ports, shipping, infrastructure, tourism, fisheries, aquaculture, offshore renewable energy; and projects that have a direct impact on the ocean, seas and freshwater such as manufacturing, consumer-packaged goods designed for waste reduction, sustainable textiles, integrating SMEs with sustainable practices to increase value chain resilience, reducing agrochemical runoff, water and sanitation⁴⁸. Projects within the blue economy can reduce negative impacts (e.g., poor waste management) as well as accelerate a positive contribution (e.g., sustainable fisheries), with numerous sectors having a role to play. Incorporating a particular focus on women, small producers, minority groups, and migrants into these projects is also critical⁴⁹.
- Blue bonds are well suited for financing projects within the blue economy given that most of these projects will require upfront capital with long, stable returns overtime, for example low carbon shipping, offshore energy and aquaculture projects⁵⁰. There is therefore a need to finance sustainable ocean business opportunities or strategies through structures in which large institutional investors can invest in. Blue bonds provide a targeted vehicle to secure capital for ocean-related projects and investors that are planning to make a significant contribution to the SDGs.

⁴⁴ ibid

⁴⁵ ibid

⁴⁶ ibid

⁴⁷ ibid

⁴⁸ IDB Invest and UN Global Impact (2021) Accelerating Blue Bonds Issuances in Latin America and the Caribbeans, pp 1-42

⁴⁹ ibid

⁵⁰ ibid

6.1.3 Regional Considerations and Outlook

BOX 3. Regional Green Bond Exchange – Jamaica

Regional Green Bond Exchange

Through its Readiness Programme, which provides grants, technical assistance for policy development and capacity strengthening, the Green Climate Fund (GCF) is providing support for Jamaica to create the Caribbean's first green bond marketplace on its national exchange. The bond market is designed as a source of debt capital to finance climate-focused business opportunities in the Caribbean, as well as allowing local and international investors to support climate resilience and low carbon development. The GCF Readiness grant will be used to assess the debt market and develop the regulatory framework to foster a conducive environment for a green bond market ecosystem. It will also be used to raise awareness in the marketplace among potential issuers and investors.

Source from GCF(2021)⁵¹.

- It is critical for PICs to note that the amount of sustainability financing is decreasing, in part due to the global Covid-19 pandemic and the global impact on economies. This indicates that the pool of international finance, particularly public finance, will become more scarce moving forward as the global economy attempts to recover. While increased grant financing is highly desirable to PICs given their debt realities, it is highly unlikely that such modalities of financing will increase, as there is limited appetite from donors who are also facing domestic crises and finance impacts. Appropriately structured loans, including thematic bonds, can be a feasible lower cost option for PICs, to meet the cost of their recovery as well as their sustainable development priorities. It has been argued that the concerns about current debt sustainability for PICs may be misplaced. The worries of excessive debt are less relevant in the context of the pandemic, as long as increased spending stimulates the economy and is therefore enough to justify the additional debt servicing costs⁵².
- Leveraging the potential of domestic institutional investors such as national pension funds, sovereign wealth funds, domestic banks and insurance companies is still largely underutilized in PICs. International trends indicate that these institutional investors hold a significant pool of capital that can significantly contribute to a PICs sustainable development. Thematic bonds offer an opportunity for these institutional investors to mobilize their private capital. This would be in line as it is with their capital adequacy requirements but also the current uncertain atmosphere of investment, where there is a notable shift of the private sector towards a preference for lower risk investments (as such thematic bonds might be of interest)⁵³.

⁵¹ GCF (2021) GCF Spotlight Small Islands Developing States (SIDS). Available: <https://www.greenclimate.fund/sites/default/files/document/gcf-spotlight-sids_1.pdf>

⁵² Rajah, R., and Dayat, A. (2020) Avoiding A Pacific Lost Decade: Financing the Pacific's COVID-19 Recovery. Policy Brief. Lowy Institute. Available <<https://www.lowyinstitute.org/publications/lost-decade-pacific>>

⁵³ Emose, G. (2021) Sustainability Bond for the Pacific: Feasibility Study. ESCAP, Macroeconomic Policy and Financing for Development Division, March 2021, Bangkok.

- The ability of PICs to issue sovereign bonds is limited. Like in many small developing countries, PICs will require additional guarantors and other forms of credit enhancement to mitigate risks and costs of bond issuance. These guarantors are most likely to come from MDBs who are considered established players in this market segment. For PICs it might be worth exploring a concept where they develop a regional borrower, bundling projects from a range of countries and having the backing of several sovereign states⁵⁴.
- The reality of PICs is that only a few PICs might have the necessary capacity and institutions that will qualify them to act as issuers on a stand-alone basis. Therefore, the most likely issuers are either the MDBs themselves or transactions in which MDBs act as guarantors of bonds issued by sovereign PICs.
- Private placement of bonds could be an alternative route for PICs in issuing their respective green/blue bonds as in the case of the Seychelles (see Box 2). The private placement format requires identification of a potential buyer that lacks market-making liquidity. The private placement instrument allows specific targeting and is in many cases appropriate for smaller transactions that will, due to their size, fail to attract liquidity⁵⁵.
- Large-scale institutional investors, including those that participate in the issuance and underwriting of sovereign debt, are typically constrained by a minimum size of transaction which they can support. Smaller bond issuances can therefore cause problems in terms of attracting key underwriting banks and creating the scale needed for creating competition to invest in the transaction. This limitation on size presents a challenge for many of the 17 countries within the Pacific Region when issuing thematic bonds, as they may not be able to issue bonds of the size needed. A potential opportunity exists for the region however, which should be considered to seek to address both the size and counterparty limitations described above. Within the region, individual countries can establish their own frameworks for issuing thematic bonds such as green or blue bonds. These frameworks would govern allowable expenditure in those countries alone. Bonds could be issued locally at a smaller scale but could be packaged into a portfolio for investment, thereby creating greater scale needed to attract a wider pool of institutional investment. This type of portfolio approach also creates a natural hedging against individual country risk. From a debtor country perspective this regional approach can deliver economies of scale in pre-issuance terms in respect of drafting and agreeing thematic bond frameworks, appointment, and delivery of SOPs and through centralized investor reporting post-issuance.
- To meet their own sustainable development needs and priorities as articulated in the various national strategies and plans such as the Nationally Determined Contributions (NDCs), PICs must diversify their sources of funding and green financial mechanisms. Although the green and blue bond markets are still growing, they will not be sufficient to fully finance these agendas. **A combination of instruments is required to meet sustainable development goals and achieve the transition to low carbon and climate-resilient economies.**

⁵⁴ Roth, N., Thiele, T. and Von Unger, M., (2019) Blue bonds: financing resilience of coastal ecosystems. Key Points for Enhancing Finance Action. Blue Natural Capital Financing Facility: Technical guideline prepared for IUCN GMPP.

⁵⁵ ibid

- PICs are encouraged to ask for technical assistance. The role of MDBs, Micro Finance Institutions (MFIs) and UN Agencies are critical in green/blue bond structuring, given the lack of technical capacity within PICs. Fiji is a good example, seeking the support of the IFC in every step of their green bond process. They are also using the same approach in soliciting the help of the UNDP and the UNCDF in structuring their blue bonds. Investments to strengthen the development of capital markets will be critical. Trading of green and blue bonds requires a given infrastructure of fixed-income markets. PICs fixed-income market is, however, relatively young and largely undeveloped. Promoting broader access of the private sector and government to bond financing requires a minimum efficient scaled. Creating adequate conditions to encourage participation in debt markets thus involves institutional changes. PICs must therefore take steps to develop their debt markets if bonds are to catalyze climate finance.

7

APPENDIX

Overview of the climate and disaster finance landscape in the Pacific region

Numerous works on clarifying the climate finance and disaster finance landscape exists in the region (see for example the works of Samuwai (2021)⁵⁶, Betzold (2016)⁵⁷, Atteridge and Canales (2017)⁵⁸ as well as technical and policy analysis from UNDP, PIFS, IMF, ESCAP to name a few. These works have attempted to quantify the totality of climate finance flows into the region, identifying sources of climate finance, its sectorial distributions as well as estimating the gaps that might exist. The most recent estimation on the climate finance gaps in the Pacific is US\$1 billion⁵⁹. Additionally, each PSIDS's national landscape have also been demystified as a consequence of numerous projects being undertaken in the region that have a specific focus on climate and disaster risk finance. PIFS has also been very active in the space in disseminating climate finance and disaster risk finance knowledge products that are both country specific and from a regional lens.

A 2021 UNDP report provided 13 key analytical insights on the current trends of climate finance in the Pacific. The report undertook a systemic analysis on the current regional climate finance landscape to unpack the effectiveness challenges currently face by PSIDS. The key messages highlighted by the report were that⁶⁰:

- The climate finance discourse in the Pacific was too 'access' centric, where accessing more climate finance seems to be the main pre-occupation of the region, and minimal focus on the effectiveness of climate finance on the ground;
- The Pacific have accessed significant amount of climate finance in the past decades, the impacts of climate changes continue to have a profound impact on the achievement of the PICs development priorities thus, it is unclear whether just accessing more finance will suffice in terms of building resilience.

⁵⁶ Samuwai, J. (2021) Understanding the Climate Finance Landscape and How to Scale it Up in Pacific Small Island Developing States. UNESCAP, Macroeconomic Policy and Financing for Development Division. Bangkok.

⁵⁷ Betzold, C.(2016) Aid and Adaptation to Climate Change in Pacific Island Countries. Development policy Center Discussion Paper No,46.

⁵⁸ Atteridge, A, and Canales, N. (2017) Climate Finance in the Pacific: An Overview of Flows to the Region's Small Island Developing States. Stockholm Environment Institute, pp 1-70.

⁵⁹ Fouad, M, Novta, N, Preston, G, Schneider, T, Weerathunga, S. (2021) Unlocking Access to Climate Finance for Pacific Island Countries, pp 1-103.

⁶⁰ UNDP (2021) Climate Finance Effectiveness in the Pacific: Are we on the right track? Discussion Paper, pp 1-56.

- The majority of climate finance in the region is primarily delivered through short-term project based initiatives and are 'off-budget' in nature. This narrow approach tends to be poorly integrated into development thereby making it harder to achieve long-term impact for communities.
- The requirements for access and accreditation to multilateral climate funds is a distraction for country systems achieving better quality results.
- Climate finance appear to be disconnected from the priorities of the people most impacted by climate change. Longer term community resilience needs to be the key driver, rather than simply filling in the financing gaps.
- Attracting and incentivizing private sector investments in the Pacific remains a missed opportunity and solutions need to be cognizant of the specific context and size of private sector enterprises in the Pacific.
- What is required is a development focus approach to climate financing which allows for a greater focus on the drivers of vulnerability and more programmatic, evidence-based and inclusive interventions.
- Climate finance needs to demonstrate how to better integrate, climate ambition at scale into wider development policies, plans and budget frameworks and should be used to leverage broader development finance.
- Streamlining and simplifying access procedures across funding instruments could support a more efficient allocation of climate finance resources.
- In-country systems reform can help improve climate finance effectiveness through the integration of climate change considerations into the Public Finance Management (PFM) systems and central planning budgeting process.
- Financing and support from the international community can be better adapted to the Pacific context by allowing more scope for risk-taking, innovation and a diverse range of financial instruments. Similarly, donor partners need to integrate climate change considerations more comprehensively into their mandates and performance systems.
- There is a need for a stronger partnerships and greater collaborations. Learning networks can help to take more effective climate finance approaches to scale within and across PICs.

The findings above reveals that the climate finance issue of the Pacific is both a 'quantity and quality issue' and that focusing on accessing finance is just a part of the solution. The enabling environment in which these finances are implemented is also critical in ensuring that PICs derive the maximum value from each dollar invested in climate related initiatives. More importantly, the report highlights the importance of taking a holistic approach to climate finance as a component of the overall development finance of countries that must ultimately aligned and be in tune with the realities on PICs on the ground⁶¹.

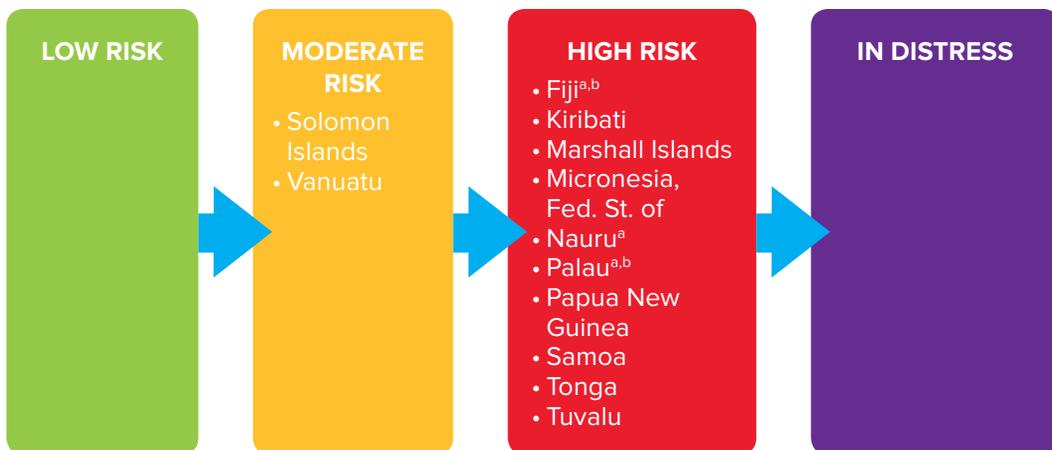
⁶¹ ibid

Consequences of the widening financing gap for sustainable and resilient development in the region

Given the high dependency of PICs on external public finance, the consequence of the annual global sustainability finance shortfall (now exacerbated by COVID-19) of US\$4.2 trillion to developing countries⁶² have also increased pressure amongst PSIDS on the need to diversify and explore alternative and innovative financing modalities from other sources other than public finance. The pandemic has magnified the ‘scissor effect’ of the SDG financing gap by increasing financial needs and decreasing availability of resources⁶³. For example, in the Pacific, it has been estimated that a multiyear (3 years) US 3.5 billion (with increase in grant assistance and or appropriate structured loans)⁶⁴ is needed for the region to fully recover from the pandemic-however, willing donors appears in short supply⁶⁵. Pacific leaders have now prioritized exploring innovative financial sources that are suitable and contextual relevant to PICs⁶⁶.

Debt financing for PICs makes an important contribution to the financing of the SDGs for PICs. However, the current debt to GDP ratios for many PICs are ‘uncomfortably’ high as a consequence of the COVID 19 ⁶⁷ The IMF have indicated that for low-income countries, seven (7) PICs as being risks of debt distressed” Kiribati, Republic of the Marshall Islands (RMI), Federated States of Micronesia (FSM), Papua New Guinea (PNG), Samoa, Tonga, and Tuvalu⁶⁸. While the Solomon Islands and Vanuatu have been rated as being moderate risks of debt distressed, they however, are categorised as having limited space to absorb shocks. Among the middle-income countries, Fiji, Nauru and Palau, the IMF assessments indicates a sustainable debt for the three countries, although in the case of Fiji and Nauru, the IMF alerts that the debt situations is subject to high risks. No PICs are considered by the IMF to be low risk⁶⁹.

TABLE 4. Risks of Overall Debt Distress in PiCs⁷⁰



⁶² OECD (2021) Closing the SDG Financing Gap in the COVID-19 Era- Scoping note for the G20 Development Working Group. Available <<https://www.oecd.org/dev/OECD-UNDP-Scoping-Note-Closing-SDG-Financing-Gap-COVID-19-era.pdf>>

⁶³ ibid

⁶⁴ Rajah, R, and Dayat, A. (2020) Avoiding a Pacific Lost Decade: Financing the Pacific’s COVID-19 Recovery. Policy Briefs, Lowly Institute. Available: <<https://www.lowlyinstitute.org/publications/lost-decade-pacific>>

⁶⁵ The Guardian (2020) Pacific nations face ‘lost decade’ due to economic cost of COVID. Available: <<https://www.theguardian.com/world/2021/sep/29/pacific-nations-face-lost-decade-due-to-economic-cost-of-covid>>

⁶⁶ PIFS (2021) 2021 Pacific Islands Forum Economic Ministers Meeting (FEMM) Outcomes. Available <<https://www.forumsec.org/2021/07/15/2021-forum-economic-ministers-meeting-outcomes/>>

⁶⁷ Roger, S. (2021) Debt Landscape and Fiscal Management Issues in Pacific Small Island Developing States, Background Paper, pp 1-20.

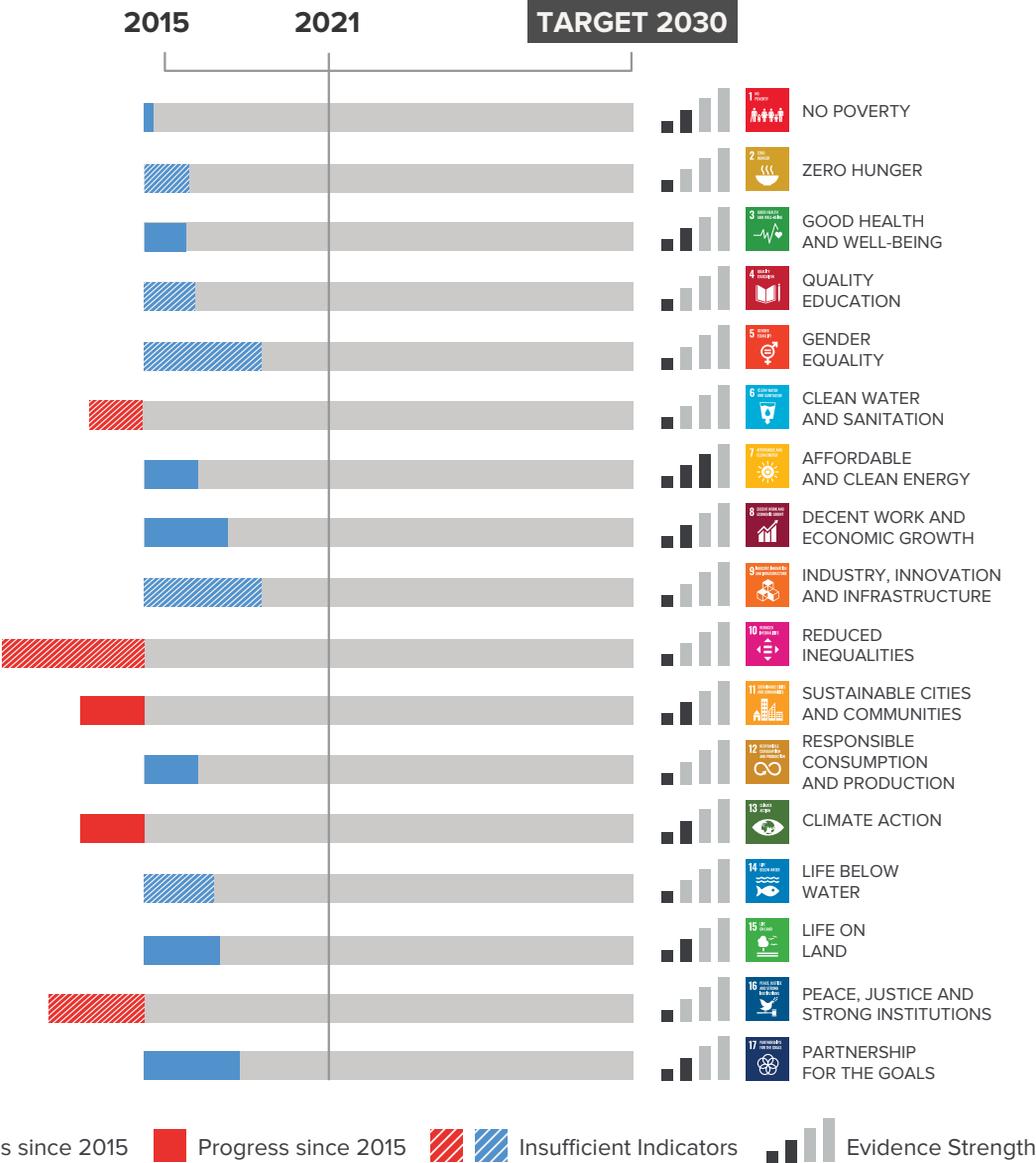
⁶⁸ IMF (2022) List of LIC SSAs for PRGT- Eligible Countries. Available <<https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf>>

⁶⁹ ibid

⁷⁰ Sirimaneetham, V. (2022) Ensuring Public Debt Sustainability in the Pacific Small Island Developing States, Issues Paper, pp1-25.

The rising public debt and debt servicing costs, particularly in the poorest and vulnerable countries such as the PICs are putting SDG financing level under intense pressure. Amid tighter fiscal spaces, copying financially with future emergency situations such as natural disasters and health outbreaks, the PICs abilities to advance their SDGs have been limited particularly on poverty reduction, health care services and education⁷¹. It is also worrying that PICs are regressing on Goals relating to clean water and sanitation, reduced inequalities, sustainable cities and communities, climate actions and institutions⁷².

FIGURE 4. SDG Progress in PICs⁷³



⁷¹ ibid

⁷² ibid

⁷³ Eurodad et al (2022) Debt Challenges in Pacific Island Countries and Resolution Options. Available < <https://www.unescap.org/events/2022/pacific-regional-debt-conference-addressing-debt-sustainability-pacific-aftermath-covid> >

There is also a high risk that the persistent fiscal deficits and debt levels could prompt some governments in the region to adopt more austerity measures instead of increasing of building up the fiscal space through spending and increase investments in SDGs, adaptation and mitigation, as well as recovery⁷⁴. Access to substantial sources of finance (grants or concessional terms) as well as broadening the revenue will be critical for PICs moving forward. Additionally, reforms and systemic changes of the global debt architecture is critical for more enduring changes to the associated debt burden conundrum faced by PICs⁷⁵.

PICs response to addressing this financing gap

PICs like other developing countries have recognized the importance of using public finance to leverage other external sources of finance. They have also undertaken the necessary steps to invest in their national systems and processes to ensure that they strengthen their enabling environment required to proactively and effectively engage with a more diverse range of financing instruments and arrangements. A wave of readiness investments is currently underway in the Pacific where PICs are investing in strengthening their Public Finance Management (PFM) as well as their broader enabling environment, underpinning the importance of having the right infrastructure in place to ensure access as well as effective use of finance.

PICs have also implemented several innovative finance modalities domestically to supplement their public finance gap particularly in the financing of their climate change and disaster risk agenda. Some of the innovative financial models that have been adopted by PICs include national and regional trust funds, green taxation, subsidies, national and regional accredited entities to the Green Climate Fund (GCF) and the Adaptation Fund (AF), parametric insurance, budget support, cash programming, equity and guarantee-based financing, payment for ecosystem services (PES) mainly REDD plus and more recently green bonds⁷⁶. Other related innovative financial mechanisms that are currently being explored in the region include carbon payment mechanisms, blue bonds and debt for climate swaps.

Challenges in mobilizing private sector finance in PICs

PICs have also recognized the importance of the private sector investments in supporting their climate and overall resilient agenda. The critical role of the private sector is clearly reflected in PIC's NDC where a significant portion of their investments towards transition to a more sustainable, green and resilient development pathway is contingent upon external sources including private finance. Private sector finance has long been perceived as critical to bridging the existing financing gaps given its catalytic ability. In the right environment, the typical leverage ratios of private sector financing originated from every US\$1 of public finance invested can range from 3 to 15: ¹⁷⁷. However, private sector is not a panacea for solving the current financing problem but plays an important role in complementing and scaling-up public sector engagement. Mobilizing private and public funding must therefore follow a coherent strategy.

⁷⁴ ibid

⁷⁵ Sirimaneetham, V. (2022) Ensuring Public Debt Sustainability in the Pacific Small Island Developing States, Issues Paper, pp1-25.

⁷⁶ Samuwai, J. (2021) Understanding the Climate Finance Landscape and How to Scale it Up in Pacific Small Island Developing States. UNES-CAP, Macroeconomic Policy and Financing for Development Division. Bangkok.

⁷⁷ UNEP (2008) Public Finance Mechanisms to Mobilise Investment in Climate Change Mitigation, pp1-40.

However, it is also critical to note that the benefits of private sector engagement go beyond just financial investments. Benefits include innovation, responsiveness, efficiency and provision of specific skills and resources. Moreover, private sector investments, and initiatives such as research and development partnerships, knowledge sharing platforms, technology and skill transfer, and infrastructure investment that have the potential to kick-start development, increase in productivity gains, generate better quality jobs, strengthening skills and promote technological advancements contributing to resilience and sustainable development. Furthermore, the promotion of resilience and sustainable developments through incentives programs could also improve viability of vital investments making those services more accessible and affordable for the poor, and the jurisdiction a more attractive investment destination.

Numerous initiatives have been undertaken in PICs to incentivize investments in projects that supports the climate and resilient agenda of PICs⁷⁸. However, sustaining these investments have been weak and, in most cases, failed⁷⁹. In addition, COVID-19 has added another layer of complexity to soliciting private sector engagement, following a reduction of private sector finance across all SDG sectors in developing countries in 2020, rolling back progressed that has been achieved in the last 6 years⁸⁰.

A 2021 Pacific Islands Forum Secretariat (PIFS) report heightened the engagement of the private sector in the region has largely been through a ‘service provider’ modality where private sectors are primarily engaged by governments and donors to implement climate related projects⁸¹. Lacking in the region is the investment that will organically grow private sector actors’ involvement and investments in climate related initiatives where their involvement goes beyond just providing adhoc service deliveries but to create and develop markets that will result in the creation of co-benefits across the spectrum of all the sustainable development goals⁸².

Numerous interconnected challenges hinder the engagement of private sector in the climate and sustainable development areas in PICs. The work of (Zhan & Santos-Paulino, 2020)⁸³ identified three broader categories of constraints to private sector contributions to green and sustainable initiatives.

These challenges are:

- **Mobilizing funds in financial markets:** these include market failures and a lack of sound system for corporate disclosure of environmental, social, and governance performance, misaligned incentives for market participants, and start-up and scaling problems for innovative financing solutions.
- **Channelling funds into sustainable initiatives:** these include entry barriers, inadequate risk-return ratios for investment, a lack of information and effective packaging, and the promotion of bankable projects and a lack of investor expertise.

⁷⁸ Samuwai, J. (2021) Understanding the Climate Finance Landscape and How to Scale it Up in Pacific Small Island Developing States. UNES-CAP, Macroeconomic Policy and Financing for Development Division. Bangkok.

⁷⁹ Samuwai, J., Hills, J., Michalena, E. (2019) Thinking Outside the Box: Deepening Private Sector Investments in Fiji’s Nationally Determined Contributions through Scenario Analysis. Sustainability, MDPI, pp1-15.

⁸⁰ Zhan, J. and Santos-Paulino, A. (2021) Investing in the Sustainable Development Goals: Mobilization, Channeling and Impact, Journal of International Policy, 4, pp 166-183.

⁸¹ PIFS (2021) Opportunities for the Private Sector Engagement in Climate Change Action in the Pacific, Policy Brief, pp 1-22.

⁸² Samuwai, J., Hills, J., Michalena, E. (2019) Thinking Outside the Box: Deepening Private Sector Investments in Fiji’s Nationally Determined Contributions through Scenario Analysis. Sustainability, MDPI, pp1-15.

⁸³ Zhan, J. and Santos-Paulino, A. (2021) Investing in the Sustainable Development Goals: Mobilization, Channeling and Impact, Journal of International Policy, 4, pp 166-183.

- **Maximizing the positive impacts:** these includes minimizing the risks and drawbacks of private sector investments in sustainability sectors including persistent weak absorptive capacity in some developing countries, social and environmental impacts risks, and the need for stakeholder engagement and effective impact monitoring.

The challenges mentioned above mirrors the realities of the private sector engagement in the Pacific. Private sector in the region are relatively conservative and this is perpetuated by regulatory regimes that emphasizes investor protection and confidence, and the avoidance of overly risky behaviour⁸⁴. Emose (2021)⁸⁵ in observing the behaviour of private sector in the Pacific noted the following commonalities;

- Investors are typically risk averse, reflecting historical shortcomings in investor education and an emphasis on safeguarding capital and ensuring a “safety net”.
- There is a strong preference for “bricks and mortar (property) and highly liquid assets like cash and term deposits. This is common in countries where the capital markets are in their infancy and where investor education on alternative investments is weak. Reliance is therefore placed on the traditional banking system and property market, of which investors are more familiar.
- Strongly yield-driven which is common in less-developed markets. There is a strong preference for liquidity and regular cash flows as a safety net and indicator for quality. For example, investors in the South Pacific Stock Exchange tend to prefer companies with high dividend yields and consistent dividend payout records.
- Preference for local currency investments as there are usually capital controls that limit the ability to transfer domestic savings into offshore currencies. The availability of hedging instruments for the purpose of protecting investments against adverse changes in exchange rate is low and mostly offered by foreign banks. Available evidence on prices indicate that the cost may be too high for investors to swap their fixed income exposure between foreign and domestic currency.
- Only institutional and high net worth investors are relatively active participants in countries where there is a developed capital market such as Fiji and PNG.
- There is high sensitivity to tax incentives for investments making any tax-related regulations in favour of bonds an attractive way to support insurance.
- Many institutional investors have significant cash flow requirements to meet investor and/or beneficiary payouts and therefore require investments in cash and fixed income securities that provide regular cash flow.
- Some institutional investors have investment policies that specifically limit exposure to unlisted assets or assets other than cash or fixed income. As a result, cash and fixed income securities tend to make up a substantial part of the investment portfolio.

⁸⁴ Emose, G.(2021) Sustainability Bond for the Pacific: Feasibility Study. ESCAP, Macroeconomic Policy and Financing for Development Division, March 2021, Bangkok.

⁸⁵ ibid

Furthermore, it has been highlighted that the bottlenecks that hinders the private sector in the region from harnessing the growth of the sustainability financing sourced from the global capital markets are;

- Underdeveloped financial systems of most PICs. Apart from Fiji and PNG, most PICs lack capital markets and have financial systems dominated by a few commercial banks, leading to high cost and low take-up of credit,
- Underdeveloped non-bank financial institutions, including credit institutions, development banks, pensions funds, insurance companies, insurance brokers and microfinance institutions,
- Underdeveloped private insurance markets, due mainly to inadequate market infrastructure and legal frameworks, and a lack of consumer protections regimes.
- Low domestic savings leading to limited availability of investable funds for medium-small and medium entities (MSMEs) who accounts for the bulk of the private sector actors in the region,
- Low rates of investments,
- Low financial inclusion which limits MSME access to financial services⁸⁶.

Opportunities for the private sector in PICs to harness sustainable financing

Enhancing investments in the SDGs is not only critical for the implementation of the 2030 Agenda for Sustainable Development but also makes good economic sense. It has been estimated that achieving the SDG's could open up US\$12 trillion market opportunities and create 380 million new jobs by 2030⁸⁷. Additionally, it is also projected that bold climate action could yield cumulative economic gain of US\$26 trillion by 2030, compared to with a business-as-usual scenario⁸⁸.

Additionally, the rapidly growing international market for thematic bonds provides indications that investors are now increasingly emphasizing the importance of Environment, Social and Governance (ESG) investments, and like in the case of Fiji will seriously consider a well-structured thematic bond. In fact, Fiji's Green Bond case which saw and oversubscriptions of more than double the initial offering as well as Malaysia's thematic bond experience which was oversubscribed by 6.4 times⁸⁹ provides indications that there is a real opportunity and pathway to accelerate and scale up private sector investments in sustainable development initiatives.

Generally for PICs, the potential of the private sector to significantly contribute to sustainable development have been underutilized. PICs have been to a larger extent failed to leverage the potential of institutional investors in their respective countries, particularly the banks and the national superannuation funds, insurance companies and sovereign wealth funds which tend to hold significant pools of capital⁹⁰. Recent studies have recommended that thematic bonds tend to appeal to such institutional investors as portion of their investment portfolios requires them to invest in low risks products such as bonds to safeguard their capital⁹¹. There is therefore potential for PICs to ride the 'thematic bond issuance wave' by targeting these domestic institutional investors as well as international investors.

⁸⁶ *ibid*

⁸⁷ Business and Sustainable Development Commission (2017) *Better Business, Better World*, pp 1-122

⁸⁸ *New Climate Economy* (2018) *Unlocking the Inclusive Growth Story of the 21st Century*, pp 1-208.

⁸⁹ UNESCAP (2021) *An Introduction to Issuing Thematic Bonds*, Bangkok, pp1-40.

⁹⁰ Emose, G.(2021) *Sustainability Bond for the Pacific: Feasibility Study*. ESCAP, Macroeconomic Policy and Financing for Development Division, March 2021, Bangkok.

⁹¹ *ibid*

TABLE 5. Selected Sovereign Wealth Fund and Pension Fund In PICs⁹²

| FUND | COUNTRY | ASSETS (US\$ MILLIONS) |
|---|-----------------|------------------------|
| Cook Islands National Superannuation Fund | Cook Islands | 75 |
| Fiji National Provident Fund | Fiji | 4,064 |
| Revenue Equalization Reserve Fund | Kiribati | 733 |
| Kiribati Provident Fund | Kiribati | 77 |
| Niue International Trust Fund | Niue | 26 |
| Mineral Resources Stabilization Fund | PNG | 1,022 |
| Nambawan Super | PNG | 2,294 |
| NASFUND | PNG | 1,543 |
| Solomon Islands National Provident Fund | Solomon Islands | 452 |
| Tokelau Trust Fund | Tokelau | 68 |
| Tuvalu Provident Fund | Tuvalu | 48 |
| Tuvalu Trust Fund | Tuvalu | 133 |
| Retirement Fund Board | Tonga | 77 |

Harnessing capital markets

On the advantage side as previously indicated, the rapid expansion and increasing role of capital markets to deliver sustainable development finance to the private sector provides the potential for the Pacific to harness these investments to scale up the limited ‘choices’ of finance sources at their disposal. In 2020, despite the impacts of COVID-19, the global value of sustainability themed investments surged to about 80 percent from 2019 levels to US\$3.2 trillion providing indication that the global capital markets is increasingly aligning itself with sustainable development outcomes including the SDGs⁹³.

The benefits of harnessing the increasing demand for sustainability financing instruments goes beyond just increasing the quantum of investments in countries or bridging the financial gaps. Engaging capital market instruments can address key bottlenecks and challenges faced by developing countries’ private sector in attracting and mobilizing sustainability finances. Capital market instruments are critical tools in helping developing countries, particularly those that are vulnerable to climate change, to transform/transition their business as usual (BAU) economic models to one that is more sustainable development centric-paving the way for PICs to leverage more sustainable development finance in the long term⁹⁴.

⁹² *ibid*

⁹³ UNCTAD (2021) Sustainable Finance Surge despite volatile markets during the COVID-19, says UN Report. UNCTAD/PRESS/PR/2021/016. Available < <https://unctad.org/press-material/sustainable-finance-surges-despite-volatile-markets-during-covid-19-says-un-report>>

⁹⁴ Zhan, J. and Santos-Paulino, A. (2021) Investing in the Sustainable Development Goals: Mobilization, Channeling and Impact, *Journal of International Policy*, 4, pp 166-183.

Additionally, given the urgency to access finance to enable developing countries to cushion the multiple disasters that they are facing, capital market instruments, particularly sustainability/social centric bonds can be rapidly deployed to fund crisis relief and recovery⁹⁵.

On the other side there are several disadvantages of using the capital markets for financing the blue economy. Whilst capital markets can facilitate scale and bridge the financing gap as we have seen in the above section, these products that utilise the capital markets can be complicated and difficult to understand. In order to reach the point of issuing debt effectively with the target of achieving sustainable development, and with optimal outcomes for the chosen thematic, significant engagement work and capacity building is needed.

Further, raising finances on the capital markets, (even before considering additional use of proceeds/KPI covenants) requires a level of understanding from the issuer and a credit rating that meets the benchmark for attracting the necessary level of investment. There is an appropriate balance on the scale of the bond that is needed to support the issuance and make optimise its performance and this can be hard to meet.

If the issuance is too small, it is unlikely to attract significant interest from investors and the cost associated with the issuance is unlikely to make the upside worthwhile. Too large however and this could lead to an excessive debt burden which the sovereign may struggle to efficiently allocate. Equally, the debt service payments are likely to cause issues down the line if cash flow for the government is to decline and economic conditions deteriorate.

Stiglitz (1991) argues that capital markets rely on open communication and therefore on complete information. In some regions, reporting methodologies have important limitations and therefore the monitoring and impact verification required by investors can be a serious administrative and informational burden. This can negate the potential for scale that is afforded by the capital markets in the first place.⁹⁶

Traditional Bonds vs. Sustainable/Thematic Bonds

Traditional Bonds are financial instruments where an investor (“creditor”) lends money to a government or a company (“debtor”) for a predefined period of time (“tenor”). In exchange, the debtor country commits to make interest payments (“coupon”) at pre-agreed points of time. On top of that the debtor agrees to repay the amount of money lent from the creditor at maturity.

Use of Proceeds Sustainable Bonds can share the same characteristics as Traditional Bonds in terms of seniority or ranking within the obligation structure of a country or company, default probability or rating, coupon, tenor and coupon payment frequency. For the purpose of this paper, we will refer to Use of Proceeds Sustainable Bonds as Sustainable Bonds. The difference between a Traditional Bond and a Sustainable Bond is in respect to additional voluntary commitments the issuer is making. Sustainable Bonds are issued under a pre-specified Sustainable Bond Framework which is aligned with Bond Principles. The most common principles are published by the International Capital Market Association (ICMA)⁹⁷.

⁹⁵ *ibid*

⁹⁶ Stiglitz, J. (1991) Government, Financial Markets and Economic Development, Working Paper No 336, pp 1-42.

⁹⁷ ICMA (2022) The International Capital Market Association | ICMA » ICMA - International Capital Market Association. [online] Available at: <<https://www.icmagroup.org/>> [Accessed 12 April 2022].

These principles are not mandatory but rather a set of voluntary guidelines. ICMA published its Green Bond Principles (GBP)⁹⁸ and Social Bond Principles (SBP)⁹⁹ as overarching principles to guide the structuring and definition of respective Sustainable Bond Frameworks. These principles are supplemented by various guidelines, e.g. High-Level Mapping to the Sustainable Development Goals¹⁰⁰, Sustainability Bond Guidelines (SBG)¹⁰¹ to help navigate through specific issues in Sustainable Bond Framework construction. Green as well as blue bonds are issued under the GBP. This document will address the differences between both bond types in the next chapter.

This Sustainable Bond Framework is developed to show how a debtor intends to select, finance and /or re-finance Eligible Projects that will deliver focused thematic (green, blue or social) benefits which are in close alignment with ICMA's principles.

Each Framework details four core components of the ICMA principles, which are as follows:

1. Use of Proceeds
2. Process for Project Evaluation and Selection
3. Management of Proceeds
4. Reporting

The Framework is conducted in a form of overarching descriptive document. Non-compliance with the eligibility categories and the descriptions within the Sustainable Bond Framework does not constitute a financial or legal default. Having said that, non-compliance will be negatively perceived by investors and other financial participants if the issuer of a bond under a specific Sustainable Bond Framework does not fulfil its obligations and is not compliant with the Framework.

Steps 1 and 2 occur pre-issuance, and are part of the ambition to match project selection and budget considerations with the additional funding and impact potential. Steps 3 and 4 occur post-issuance, where reporting mandates are in place to make sure that proceeds are fully allocated on eligible projects. The purpose of this 4-step process is so investors are reassured on the validity and outcome of their investment.

Use of Proceeds Bond vs. Sustainability Linked Bonds

Within the category of thematic bonds, there are two models which can be followed, either Use of Proceeds Bonds, or SLB.

Use of Proceeds Bonds applies a transparent project selection process, both pre- and post-issuance, in order to make visible the impact generated from the proceeds of the bond issuance. This step is required because proceeds are invested on the condition that they are funnelled to projects aligned with the bond theme.

⁹⁸ ICMA (2021) Green Bond Principles Voluntary Process Guidelines for Issuing Green Bonds. [PDF] ICMA. Available <<https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-140621.pdf>>

⁹⁹ ICMA (2021) Social Bond Principles Voluntary Process Guidelines for Issuing Social Bonds. [PDF] ICMA. Available <<https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Social-Bond-Principles-June-2021-140621.pdf>>

¹⁰⁰ ICMA (2021) Green, Social and Sustainability Bonds: A High-Level Mapping to the Sustainable Development Goals. [PDF] ICMA. Available <<https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Mapping-SDGs-to-Green-Social-and-Sustainability-Bonds-2020-June-2020-090620.pdf>>

¹⁰¹ ICMA (2021) Sustainability Bond Guidelines. [PDF] ICMA. Available <<https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Sustainability-Bond-Guidelines-June-2021-140621.pdf>>

Sustainability Linked Bonds

SLB however, vary on two important measure. Firstly whilst the selection process may overlap with a Use of Proceeds Bond, there is a performance component to a SLB. Secondly, whilst the SLB is thematic in the sense that the issuance of the bond is intended to achieve certain outcomes for the issuer, the proceeds of the bond are in fact general purpose in nature and can be used however the issuer sees fit to make progress to meet targets which have been set.

The SLB is a future-looking performance-based instrument that looks to capture the issuers sustainable ambitions by incentivising them to achieve maximum impact. This is done through key performance indicators (KPI) setting that is benchmarked against present metrics.

Importantly, tying the Bond to a KPI outcome ensures vigilance for data methodologies and data collection, that is regularly monitored, maintained and externally verified. This type of thematic bond instrument focuses on features, disclosures and also reporting.

The 5 key steps for a SLB are:

1. Selection of KPIs
2. Calibration of Sustainability Linked Target
3. Bond Characteristics
4. Reporting
5. Verification

The proceeds of SLBs are intended to be used for general purposes, hence the use of proceeds is not a determinant in its categorisation. Regardless, in select cases, issuers may choose to combine the GBP/SBP approach with the SLBP. Thus, please note that SLB are not to be confused with Sustainability Bonds (i.e. Use-of-Proceeds bonds as currently defined by the ICMA Sustainability Bond Guidelines).

For SLB, the market in 2020 was dominated by supranational entities, such as The World Bank. Development Banks such as these accounted for 68 percent of the market¹⁰².

Sustainability-Linked Bond Principles can be found, here: **ICMA Sustainability-Linked Bond Principles**

Market demand between these two instruments vary depending on the actor. On the one hand, a SLB is attractive because it indicates quantifiable outcomes that it is aiming to achieve through the allocation of the bond proceeds. This may re-assure investors that the proceeds are being allocated towards impact aligned with their climate and nature objectives. Within this instrument, there is an in-built incentive mechanism to achieve as much positive impact as possible.

¹⁰² CBI (2021) SUSTAINABLE DEBT GLOBAL STATE OF THE MARKET 2020. [online] Available: <https://www.climatebonds.net/files/reports/cbi_sd_sotm_2020_04d.pdf>

However, on the other hand, certain actors suggest that SLB lack credibility in the market as it is not in the interest of the issuer to select challenging targets. A KPI bond such as an SLB works by setting quantifiable outcomes which, if achieved, lowers the coupon repayments of the bond, making the bond cheaper for the issuer. With this in mind, it is not in the issuer's interest to set challenging targets, instead it is in their interest to select more easily achievable targets that would most likely be able to reduce their cost of debt. Of course, there is the opportunity for sector wide reform through having an impact focussed KPI instrument in a small country. This can lead to improving the attribution and causality between investments and development KPIs.

Who defines what a sustainable bond is?

As the ICMA Principles themselves are voluntary in nature, there is a vast group of stakeholders which can contribute to the definition of Green or Blue Bonds and shape the market for both categories. These include:

- International Capital Market Association (ICMA)
- Climate Bond Initiative (CBI)
- European Union (EU)
- Association of Southeast Asian Nations (ASEAN)
- United Nations Environment Programme Finance Initiative (UNEP-FI)
- People's Republic of China (hereafter referred to as "China")
- Asian Development Bank (ADB)
- International Finance Corporation (IFC)
- Investors
- Second Party Opinion (SPO) Providers
- Index Providers
- Listing Exchanges

These additional market standards align with the ICMA principles, whilst providing additional transparency and eligibility measures.

The value of these voluntary standards is that they standardise the issuance process, which helps the market scale globally. They also define what is to be considered eligible under strict eligibility and exclusion criteria. Value then accrues to issuers and investors alike, as all necessary proceed allocations are independently verified, increasing the likelihood of being funded. Overall, the standards have been effective in helping to scale up capital and generate greater positive environmental impacts.

International Capital Market Association (ICMA)

ICMA is a voluntary self-regulatory body that works to promote the development of the international capital and securities markets. Their executive committee was formed in collaboration with banking institutions across the world, with the aim of creating a set of global standards to allow for the scaling of sustainable bond issuances.

Their primary purpose has been to create the principles and recommendations that guide the successful operation of thematic bond issuances – including Green Bonds, Social Bonds, Sustainable Bonds, Blue Bonds and SDG Bonds.

ICMA is a not-for-profit association under the Swiss Civil Code and is headquartered in Zurich. Along with its 620 members, ICMA have worked together to pioneer the rules, principles and recommendations for sustainable debt instruments, among other activities.

“The mission of ICMA is to promote resilient well-functioning international and globally coherent cross-border debt securities markets, which are essential to fund sustainable economic growth and development.”¹⁰³

ICMA has developed and is maintaining a set of principles which are used to align Sustainable Bond Issuance among each other and keep high standards across various issuances. The benefit this process enables, is that it increases the transparency of issuer’s bond allocation intentions, which in turn leads investors to become more informed and make better choices. Considering that Environment, Social, Governance (ESG) factors are becoming increasingly popular in investors’ portfolios, a more informed choice will likely lead to greater demand for thematic bond issuances.

Green Bond Principles (GBP) – Further Detail

Green bonds are an adaptation of the typical ‘vanilla’ bond issuance. Specifically, it refers to an arrangement whereby an amount equal to the net proceeds of the bond will be used exclusively to finance and/or re-finance eligible expenditures falling within the eligible green categories.

The objective of such an issuance is to finance environmentally friendly projects in order to facilitate an issuer’s attempt at achieving positive environmental outcomes. Therefore, all projects financed through this instrument must, verifiably (through public disclosure), meet green taxonomy definitions.

¹⁰³ ICMA (2022) Our Mission | About Us | ICMA » ICMA - International Capital Market Association. [online] Available: <<https://www.icmagroup.org/About-ICMA/mission/>>

The GBP¹⁰⁴ are a set of voluntary process issuance guidelines that emerged out of an international effort to promote transparency, disclosure, and integrity in the green bond market. They act as a safeguard to the risk of ‘greenwashing’; the practice of channelling proceeds from green bonds towards projects or activities that have negative environmental benefits.

The GBP established a methodology for developing a green bond framework that ensures that projects are well-defined and that the issuer has robust governance procedures in place to safeguard and promotes environmental integrity, and thus deliver on its green promise to investors.

The GBP provide high-level categories of eligible green projects that recognise the diversity of current views and ongoing developments in understanding environmental issues and their consequences. The GBPs explicitly recognise several broad categories of eligibility for green projects which contribute to environmental objectives. These include:

- Renewable Energy
- Energy Efficiency
- Pollution Prevention and Control
- Environmentally Sustainable Management of living Natural Resources and Land Use
- Terrestrial and Aquatic Biodiversity Conservation
- Clean Transportation
- Sustainable Water and Wastewater Management
- Climate Change adaptation
- Eco-efficient and/or circular economy-adapted products, production technologies and processes
- Green Buildings

The categories provided are by no means an exhaustive list. They serve as a guidance of the broad theme of projects that can be defined as green. The pre-defined project sector criteria afford investors the understanding that independent verification will not allow approval if projects do not align with these eligibility criteria. Issuers also benefit, as they determine which projects to include in a bond issuance in order to label the issuance as green.

The principles and eligibility criteria are structured in a way that guides an issuer on how to formulate a bond framework. Once created, the issuer must then liaise with a second-party opinion provider (SPO) to independently verify the impact of the proposed projects and alignment with the ICMA standards, following which the framework can then be issued to the international bond market.

¹⁰⁴ ICMA (2021) Green Bond Principles Voluntary Process Guidelines for Issuing Green Bonds. [PDF] ICMA. Available: <<https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-140621.pdf>>

Types of Green Bonds

TABLE 6. Types of Green Bond Available¹⁰⁵

| BOND TYPE | PROCEEDS MANAGEMENT & INTENT | DEBT RECOURSE | EXAMPLE |
|--|---|---|--|
| “Use of Proceeds” Bond | Earmarked for green projects | Recourse to the issuer: same credit rating applies as issuers other bonds | European Investment Bank (EIB) Climate Awareness Bond (backed by EIB); Barclays Green Bond |
| “Use of Proceeds” Revenue Bond or Asset Back Security (ABS) | Earmarked for or refinances green projects | Revenue streams from the issuers through fees, taxes, etc. are collateral for the debt | Hawaii State (backed by fee on electricity bills of the state utilities) |
| Project Bonds | Ring-fenced for the specific underlying green project(s) | Recourse is only to the project’s assets and balance sheet | Invenergy Wind Farm (backed by Invenergy Campo Palomas wind farm) |
| Securitization (ABS) Bond | Refinance portfolios of green projects or proceeds are earmarked for green projects | Recourse is to a group of projects that have been grouped together (e.g. solar leases or green mortgages) | Tesla Energy (Backed by residential solar leases); Obvion (backed by green mortgages) |
| Covered Bond | Earmarked for eligible projects included in the cover pool | Recourse to the issuer and if the issuer is unable to repay the bond, to the covered pool | Berlin Hyp green Pfandbrief; Sparebank 11 Bolligkredit green covered bond |

¹⁰⁵ CBI (2022) Explaining Green Bonds. Available: < <https://www.climatebonds.net/market/explaining-green-bonds>>

Blue Bond Principles

The Blue Bond Principles are currently being developed, but to date there have been no formal guidelines issued by ICMA to advise on the issuance process for bonds where proceeds go towards coastal and marine projects. Currently, blue bond issuances must abide by the GBPs. This brings forth particular challenges in terms of clarity of project selection and impact, however the value in using a voluntary set of principles is that such issuance will follow market best practice in terms of independent second-party verification and post-issuance proceed allocation and reporting.

There are several reasons why Blue Bond Principles have not yet been created. The first reason is that the market for thematic bond issuances is new and emerging. Even though the first green bond was issued by the European Investment Bank (EIB) in 2007 under the label of a 'Climate Awareness Bond', the first ICMA principles were only published in 2014. Since the issuance process is time intensive and involves the partnership of multiple counterparties, it has taken several years for the market to gain momentum and evolve. As a result, principles have in the past emerged from where there was a real need for them. The Green Bond Principles were first, in order to specify proceeds towards climate position projects. They were followed by the Social Bond Principles (SBP), Sustainability Bond Guidelines (SBG), Sustainable Development Goals (SDG) Bond Guidelines, and Sustainability-Linked Bond Principles (SLBP).

Consequently, principles are still being developed as the market matures, as is the case with blue bonds. The creation of new principles clearly being led principally by supply and demand. Demand for thematic bonds is growing fast, and the strength of coastal and marine project pipelines is deepening, leading to a need for additional financing.

Another reason why Blue Bond Principles have not yet been published, is the issue of fragmentation within the market. Until recently, the environmental agenda has been focused primarily on climate, and the need to accelerate emissions reductions. This is exemplified by the fact that up until the end of 2019, only three bond issuances had been dedicated to the blue economy – one issued by The Republic of Seychelles, one by the Nordic Investment Bank (NIB) in order to conserve and regenerate the Baltic Sea¹⁰⁶, and the third by the World Bank¹⁰⁷.

However, as time has passed, the importance of water-based ecosystems has been increasingly acknowledged, both in terms of the wider understanding of the oceans' carbon sequestration potential, as well as in terms of the need to sustainably manage the Earth's marine ecosystems. This includes promoting and protecting biodiversity, sustainable fisheries, renewable marine energy sources, and more.

If an issuer wishes to issue a blue bond aligned with ICMA Principles, the issuance should instead align with ICMA's Green Bond Principles¹⁰⁸.

¹⁰⁶ IUCN (2019) BNC+ Framework Blue Natural Capital Positive Impacts Framework. Available: <https://bluenaturalcapital.org/knowledge-centre/positive->

¹⁰⁷ Morgan Stanley Institute for Sustainable Investing (2019) Blue Bonds: The Next Wave of Sustainable Bonds. Available: https://www.morganstanley.com/content/dam/msdotcom/ideas/blue-bonds/2583076-FINAL-MS_GSF_Blue_Bonds.pdf

¹⁰⁸ Clifford Chance (2019) BLUE BONDS EXPANDING TO THE OCEANS. Available: <https://www.cliffordchance.com/content/dam/clifford-chance/briefings/2019/11/blue-bonds-expanding-to-the-oceans.pdf>

Any consolidated concept of Blue Bond Principles must focus specifically on project categories including: blue natural capital, coastal conservation and restoration, sustainable blue economy and more. At present, there are however, other guidelines and standards that have been published by other institutions, that look to achieve high quality positive environmental impacts for life below water.

Regardless of the institution, the issuance process remains aligned with the standard Use of Proceeds issuance guidance, whereby the four key steps are:

- Use of Proceeds
- Process for Project Evaluation and Selection
- Management of Proceeds
- Reporting

Developing a blue bond framework would first involve setting a baseline aligned with the UN SDGs and other global climate agreements, that measurable targets and KPIs could be optimised towards and verified. It is believed that clear targets will attract greater demand from investors. A further best practice is regular disclosure of performance metrics post-issuance, as this will also lend credibility and increase investor confidence moving forward¹⁰⁹.

The value of post-issuance reporting is clear: it ensures compliance at an issuance level and project, AND It requires relevant stakeholders to supervise and regularly monitor project progress, meaning that safeguards and other such requirements are complied with¹¹⁰.

TABLE 7. Definition of a Blue Economy

What does Blue Economy Means?¹¹¹

To date there is no single agreed definition of what the blue economy entails and what can and cant be classified as a contributing to it. The term blue economy is a context-determined and variable concept which is broadly associated with economic activities that are dependant on the marine environment and its associated resources and services. The concept emerged out of the 2012 Rio+20 Conference and is associated with positive activities that support conservation and sustainable management alongside economic productivity. Most interventions designed to support the sustainability of the blue economy are based on the premise that by supporting and enhancing the health of marine ecosystems marine-based economies can grow sustainably. Similar to that of the established “Green Economy” model, the blue economy model aims to improve human wellbeing and social equity, while at the same time significantly reducing environmental risks and ecological scarcities. The Blue Economy model is an expansion of the Green Economy concept and it aims provides an inclusive model in which Ocean based states can relate to in terms of their economic development.

¹⁰⁹ DLA Piper (2021) Shades of blue in financing: Transforming the ocean economy with blue bonds. Insights. DLA Piper Global Law Firm. Available: <<https://www.dlapiper.com/en/us/insights/publications/2021/01/shades-of-blue-in-financing/>>

¹¹⁰ ADB (2021) GREEN AND BLUE BOND FRAMEWORK. Manila: ADB. Available: <<https://www.adb.org/sites/default/files/publication/756966/adb-green-blue-bond-framework.pdf>>

¹¹¹

At the core of the of the Blue economy concept is the urgent need to preserve the health of the ocean because of its importance to humanity and the shared survival of all life on planet earth.

A healthy ocean ecosystem is critical to the wellbeing of ocean-based economies such as PICs. A significant proportion of their population depend heavily on food from the ocean for their major source of nutrition. This means that many local comminates are also employed in ocean-based industries such as tourism, sea food industry etc.

(Source from: Roth et al (2019)¹¹² and Island Innovation (2022)¹¹³

CBI Standards

The Climate Bonds Initiative (CBI) is a third-party institution offering certification to bond issuances that align with their Climate Bond Initiative Taxonomy and Climate Bonds Standards¹¹⁴. The taxonomy has been formulated to a standard whereby it identifies and subsequently certifies aligned bond issuances only if the underlying assets and projects selected are consistent with the transition to a low-carbon economy.

The taxonomy was developed in partnership with scientific institutions such as the Intergovernmental Panel on Climate Change (IPCC) and the International Energy Agency (IEA). It therefore acts as the bedrock of the CBI certification methodology for screening the eligibility of assets and projects within bonds.

The CBI Certification works on multiple levels. The first analysis is conducted in on the broader sector, and asks questions such as ‘what criteria must be met within this sector in order to meet global climate targets.’ In order to display whether or not this has been completed, the CBI displays a blue tick for ‘Certification Criteria Approved’, or ‘Criteria under Development.’

Then, the CBI uses a traffic light system to indicate whether or not the underlying assets and projects of a bond issuance align with a 1.5 degrees Celsius decarbonisation trajectory¹¹⁵:

- **GREEN** – Automatically Compatible
- **ORANGE** – Compatible if compliant with screening indicator
- **RED** – Not compatible
- **GREY** – More work required

¹¹² ibid

¹¹³ Island Innovation (2022) What is the Blue Economy and How can it Help my Island. Available <<https://islandinnovation.co/what-is-the-blue-economy-and-how-can-it-help-my-island/>>

¹¹⁴ CBI (2019) Climate Bonds Standard | Version 3.0 | Climate Bonds Initiative, December 2019 International best practice for labelling green investments. Available: <<https://www.climatebonds.net/files/files/climate-bonds-standard-v3-20191210.pdf>>

¹¹⁵ CBI (2021)Climate Bonds Taxonomy. Available: <https://www.climatebonds.net/files/files/Taxonomy/CBI_Taxonomy_Tables-08A%20%281%29.pdf>

The Climate Bonds Standard & Certification Scheme is comprised of the overarching Climate Bonds Standard, the Climate Bonds Taxonomy, Sector Eligibility Criteria, as well as guidance material and certification documents. The Standards align with the ICMA Green Bond Principles and use best practice MRV methodologies in order to align with global climate agreement targets¹¹⁶.

EU Taxonomy

The EU Taxonomy as a classification system for environmentally sustainable economic activities, is a key guiding instrument for all green projects initiated within the EU. It will serve as the main orientation instrument for projects, with the ultimate aim of ensuring that any new developments positively contribute to the European Green Deal.

The six environmental objectives are:

- Transition to Circular Economy
- Climate Change mitigation
- Climate Change Adaptation
- Sustainability and Protection of Water and Marine Resources
- Pollution and Prevention Control
- Protection and Restoration of biodiversity and ecosystems.

Key sectors of the EU Taxonomy include Agriculture and Forestry, Manufacturing, Electricity and Gas supply, Water and Sewage, Transport, IT, and Buildings. Bond issuances that aim to align with the EU Taxonomy must do so along four general criteria:

- Do they substantially contribute to the six environmental objectives as foreseen by the EU Taxonomy?
- Do they not significantly harm any of the other five pillars laid out by the EU Taxonomy?
- Do they comply with minimum safeguards set out by the EU Taxonomy?
- Do they comply with technical screening criteria based on relevant delegated acts?

Furthermore, in 2021, the EU Parliament published draft Green Bond Standards (GBS)¹¹⁷. This standard fully integrates the four ICMA Green Bond Principles, illustrating its desire to co-exist alongside them. The EU GBS then pushes a step further by integrating a mandatory independent external review. The intention is that by mandating external reviews as opposed to voluntary reviews, the Standards raise the average quality of green bonds, leading to greater impact in the long term¹¹⁸.

ICMA have since responded, highlighting fears of fragmentation in the market and unintended externalities¹¹⁹, especially in combination with the need for issuances to align with the EU taxonomy as well. Ultimately, it is down to the issuer to determine whether their issuance aligns with particular standards bodies and best practices, with geographical location now also a factor.

¹¹⁶ Legal & General Investment Management (2021) The Green bond Market Is the fixed income fulcrum tilting green? Available: <<https://www.lgim.com/landg-assets/lgimetff/files/green-bond-market---collaboration-lgim--cbi.pdf>>

¹¹⁷ EU Parliament (2021) on the proposal for a regulation of the European Parliament and of the Council on European green bonds (Draft). Available: <https://www.europarl.europa.eu/doceo/document/ECON-PR-700638_EN.pdf>

¹¹⁸ Herbert Smith Freehills (2022) THE EU GREEN BOND STANDARD: WILL COMPULSION FRAGMENT THE MARKET?. Available: <<https://www.herbertsmithfreehills.com/insight/the-eu-green-bond-standard-will-compulsion-fragment-the-market>>

¹¹⁹ ICMA (2022) Analysis of the amendments to the EuGB Regulation proposed by the Rapporteur of the EU Parliament. Available: <https://www.icmagroup.org/assets/documents/ICMA-update-to-its-analysis-of-the-EuGB-Regulation-04012022_2.pdf>

ASEAN Green Bond Standards

The ASEAN Green Bond Standards (ASEAN GBS) were developed by the ASEAN Capital Markets Forum (ACMF) - a body of capital market regulators promoting greater integration across capital markets. The intended purpose of these standards is to help evolve ESG debt as an asset class, and to scale up green finance to better support sustainable development.

The ASEAN GBS has four key components which fully align with the ICMA four pillars.

1. Use of Proceeds
2. Process for Project Evaluation and Selection
3. Management of Proceeds
4. Reporting

In line with these four components, the standards encourage frequent reporting practices to elevate the levels of transparency in the issuance process. As well as this, the standards encourage independent external reviews for verification, and enforce disclosure practices throughout the four components make sure the bond related disclosure is publicly available.

Being a regulatory body in South East Asia, eligible issuers must come from the region, or have an economic connection to the region. Additionally, there are strict exclusion criteria in terms of project selection. For example, the financing of fossil fuel power generation is strictly prohibited under these ASEAN GBS.

It is stressed within the standards that eligible projects must provide clear environmental benefits, and also be quantifiable. This way, the impact can be benchmarked against and verified. Eligible sectors include¹²⁰:

- Renewable energy;
- Energy efficiency;
- Pollution prevention and control;
- Environmentally sustainable management of living natural resources and land use;
- Terrestrial and aquatic biodiversity conservation;
- Clean transportation;
- Sustainable water and waste water management;
- Climate change adaptation;
- Eco-efficient and/or circular economy adapted products, production technologies and processes; and
- Green buildings which meet regional, national or internationally recognised standards or certifications.

¹²⁰ ASEAN (2018) ASEAN Green bond Standards. Available: <<https://drive.google.com/file/d/1JZOBiomtQC69clfZmOVvpu3Tjrjhs5QV/view>>

China Green, Social and Sustainability (GSS) Bond Standards

Green Bond standards have been created within China as a way of aligning national standards towards a low carbon economy. The standards have gone through several iterations to refine eligibility and minimum standards. As of 2021, the financial instruments included within these standards are (but not limited to):

- Green Financial Bonds
- Green Enterprise Bonds
- Green Corporate Bonds
- Green Financing Debt Instruments
- Green Asset-Backed Securities (ABS)

From this perspective there are certain instruments that fall within the standards' guidelines, and there are also top-level inclusion sectors which the proceeds must be aligned to, if a bond is to be classified as green as part of these standards¹²¹:

- Energy Saving and Environmental Protection Industry
- Clean Production Industry
- Clean Energy Industry
- Ecological and Environmental Industry
- Green Upgrading of Infrastructure
- Green Services

Even though the issuances are required to report on management of proceeds and post-issuance verification and impact, an important trend concerning these standards moving forward, is that according to the Climate Bonds Initiative (CBI), two-thirds of bonds issued in China classified as green, were classified at not-aligned with international standards¹²². This separation in standards has further implications for investors who may deem issuances that align with the China GSS Standards non-aligned with their internal standards. This lack of clarity requires an additional need for due diligence on behalf of the investor.

One example is that previously clean coal was classified as an eligible criterion as part of the GSS Standards, whereas this is not considered eligible as part of other international thematic bond guidelines¹²³.

Investor and their Guidelines

Naturally, each investor differs in what they deem sustainable. For example, certain investors may have internal green thresholds or taxonomies with which their portfolio must align. Traditionally this is led either by the Sustainability team or the internal Treasury of the issuer¹²⁴.

¹²¹ CBI (2022) China's Growing Sustainable Debt Market RAPID GROWTH DELIVERS IMPACTS. [PDF] Climate Bonds Initiative. Available: <https://www.climatebonds.net/files/reports/cbi_chi_sust_debt_stock.pdf>

¹²² S&P Global (2022) China green bond issuances set to cross \$100B mark in 2022. [online] Available <<https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/china-green-bond-issuances-set-to-cross-100b-mark-in-2022-68453272>>

¹²³ Zhang, H (2020) Regulating Green Bonds in the People's Republic of China: Definitional Divergence and Implications for Policy Making. ADBI Working Paper 1072. Tokyo: Asian Development Bank Institute. Available: <https://www.adb.org/publications/regulating-green-bonds-prc-definitional-divergence-implications>

¹²⁴ IFC (2020). GREEN BOND HANDBOOK: A STEP-BY-STEP GUIDE TO ISSUING A GREEN BOND. IFC.

In line with this, within definitions of ‘green’, there can be distinct differentiators. For example, a project could be defined as ‘dark green’ if it corresponds to a long-term future of low carbon and carbon resilience. Examples of ‘dark green’ projects could include wind energy farms or timber construction. Next is ‘medium green’ which tends to refer to projects that make some incremental step towards a low carbon future. Projects within this category might include, for example, hybrid infrastructure. Lastly, a project can be defined as being ‘light green’ when on their own, they do not represent solutions contributing to a low carbon future. Improving the efficiency of a fossil fuel-based industry or non-electrified public transport is considered to be within this category¹²⁵.

At the point of the bond being issued, each investor has the opportunity to view the framework and the SPO provided, in order to verify whether the issuance meets internal standards.

Second Party Opinion (SPO) Provider

The Second Party Opinion (SPO) provider partners with the issuer to provide independent verification to the bond issuance process. An SPO independently verify whether or not a particular issuance aligns with the issuer’s chosen principles, guidelines and standards. Throughout this process, the SPO provider works in combination with the issuer, the purpose of which is to appease investor fears of greenwashing and label each issuance in a readable and comparable way.

Although not mandatory, SPOs are often used to verify the bond framework and the validity of impact of the bond pre-issuance and post-issuance, for the purpose of reassuring investors before they invest their capital. The SPO’s iterative process with the issuer pre-issuance, is a means to maximise the impact of the proceeds of the bond¹²⁶. The emergence of an SPO as best practice for a thematic bond issuance is due to previous bond issuances frameworks being weakly written, leaving room for interpretation and greenwashing, and ultimately not maximising potential impact.

Obtaining a SPO is an important aspect of pre-issuance and post-issuance of a bond. Pre-issuance, the SPO ensures transparency over selected projects and goals, whilst post-issuance can be used to verify impact.

Stock Exchange Requirements

Listing Exchanges globally have played a significant role in the acceleration of thematic bond issuance, through a variety of means.

Some Exchanges have dedicated green bond lists in order to promote transparency of disclosure and reporting. This makes it easier for an investor to scope and discover thematic issuances that they hope to invest in. Through these bond lists, the additional transparency protects investor interests, and subsequently attracts capital to the most genuinely sustainable assets.

These exchanges include London, Oslo, Luxembourg, and Stockholm. They also then leverage existing and robust principles (such as ICMA), which has the further benefit of encouraging the development of best practices and common frameworks that further boost investor confidence.

¹²⁵ n.d. Shades of Green. [ebook] CICERO. Available at: <https://static1.squarespace.com/static/5bc5b31a7788975c96763ea7/t/60b75a72af17a60e035fd4d6/1622628980614/CICERO_SHadesofGreen_factsheet_v5.pdf>

¹²⁶ UNEP-FI (2018) SDG Bonds & Corporate Finance. Available:<<https://d306pr3pise04h.cloudfront.net/docs/publications%2FS-DG-Bonds-and-Corporate-Finance.pdf>>

Exchanges also have the power to reject prospective issuances under certain themes, if relevant certification is not sought, or if the issuance is deemed not sufficiently high in quality.

These exchanges also have value in that they have an ability to create publicity for issuances as part of their dedicated ESG listing options. This may help issuers connect with a broader range of investors not only for the issuance at hand, but also for developing long-term partnerships and connections.

Investor preference

Sustainability bonds are based on the premise that Investors will buy a green bond on the condition that its use of proceeds are deployed on projects that advance positive environmental outcomes. It is ultimately down to the issuer and other appropriate stakeholders to formulate and execute this process and if the project pipeline is of a high enough quality, the investor demand will follow.

The demand for green or blue bonds is relatively diversified, as the benefits of a green bond for issuers extends to investors as well - a phenomenon known as the 'Green Halo Effect'. By using a transparent, standardised implementation process such as the ICMA GBP, it is likely that the issuer will attract new types of investors, thereby diversifying their investor base.

Investors can allocate ESG related instruments differently within their portfolio, which further adds to increased demand in the market for these products. As an example, Fiji issued a green bond in 2017 which attracted new investors to the credit market¹²⁷.

The transparent issuance process helps investors become better informed about their investment strategies. As a result, investor appetite for green bonds is growing at an increasing rate, and is currently outstripping supply¹²⁸ with the majority of issuances being well oversubscribed. Despite the fiduciary duties of asset owners to obtain sufficient yield for the risk^{129,130}, certain investors may be willing to accept lower yields in return for verified environmental impact.

Looking into the future, investing in these issuances can also aid an investor's ability to negotiate new laws and reduce the risk of being impacted by boycotts due to the protection against reputational damage¹³¹.

It is important to mention however, that standards such as the CBI Standards only deliver a verdict on the Use of Proceeds of the bond, not the issuer themselves. As part of this process, investors also have an ability to review the bond framework and SPO opinion to internally verify whether or not the proceeds of the bonds will go to projects with impacts sufficient to meet internal quality thresholds. This includes whether an issuer's activities outside of the bond issuance, aligns with the signals such bond issuance sends.

¹²⁷ Climate Bonds Initiative (2021) Sovereign Green, Social, and Sustainability Bond Survey: The ultimate power to transform the market, <https://www.climatebonds.net/files/reports/cbisovereign-green-social-sustainability-bond-survey-jan2021.pdf>.

¹²⁸ CBI (2021) Green bond Pricing in the Primary Market January-June 2020.

¹²⁹ Fatica, S., Panzica, R., and Rancan, M. (2019) The pricing of green bonds: Are financial institutions special? (Tech. rep. No. 7). <https://doi.org/10.2760/496913>

¹³⁰ Gianfrate, G., and Peri, M. (2019) The green advantage: Exploring the convenience of issuing green bonds. *Journal of Cleaner Production*, 219, 127–135. <https://doi.org/10.1016/j.jclepro.2019.02.022>.

¹³¹ HSBC (2020) Interest with Principle Green Bonds – A User's Guide. Available: <<https://www.assetmanagement.hsbc.co.uk/-/media/files/attachments/common/news-and-articles/articles/interest-with-principle.pdf>>

Responsibility for implementing the environmental project naturally falls with the bond issuer. This stresses the need for a transparent issuance lifecycle which would empower the investor to make a decision on whether the projects are deemed sufficiently impactful. Given that there are few guidelines on the portion of a bond that can be financed and refinanced, this leads to investor preference deciding the market equilibrium.

What is also stressed, is the need to have a high standard of alignment with voluntary principles and high-quality definitions. From an investor's perspectives, definitions with low ambitions leave scope for greenwashing, and are therefore riskier from this perspective. Alignment with ICMA's GBP and its robust exclusionary criteria is an example of ways to avoid this¹³².

Especially for first time issuers, there may be uncertainty from the investors regarding internal capacity and collaboration between departments to source the most impactful projects, as well as whether the establishment of reporting practices is of sufficient quality to ensure transparency. These are important factors, as uncertainty can reduce demand in a green bond issuance.

Furthermore, there are factors within the issuance itself that may influence an investor's desire to become a bondholder. According to Löffler et al. (2021), of the green bonds sampled in the study, on average they have a slightly longer tenure than conventional bonds, more likely to be senior unsecured debt bonds, and most crucially, more likely not to be rated¹³³. Green bond issuers are less likely to have any credit rating on average, which can have a significant influence on institutional investors' willingness to invest in the bond.

Benchmark Index Providers

The growing demand for sustainable investing has led to an increased demand for ESG specific indices. These are rankings of Bonds depending on their positive environmental impacts, as well as overall financial performance. The ratings are compiled through the ingestion of data that is weighted depending on factors deemed most important by the Index provider, in order to rank issuances.

For Green Bond Indexes, factors could include: carbon emissions, natural resource use, energy efficiency, pollution, and more.

Different index providers (e.g. Thomas Reuters, Bloomberg etc) require different input parameters and vary in the subsequent weighting of these factors. Ultimately, they serve a purpose to inform investors on the sustainability of a bond and whether or not certain bond meets internal investor standards, which furthers the goal of transparency throughout the issuance process¹³⁴. Investors are then able to make a more informed choice with regards to their investments, and the impact they are intending to catalyse.

¹³² ADB (2021) DETAILED GUIDANCE FOR ISSUING GREEN BONDS IN DEVELOPING COUNTRIES. Available: <<https://www.adb.org/sites/default/files/publication/761056/guidance-issuing-green-bonds.pdf>>

¹³³ Löffler, K.U., Petreski, A. and Stephan, A. (2021) Drivers of green bond issuance and new evidence on the "greenium". Eurasian Economic Review, 11(1), pp.1-2

¹³⁴ GIZ and SEB (2018) Green Bonds – Ecosystem, Issuance Process and Case Studies

Multilateral Development Banks (MDBs)

Since the inception of the first green bond issued by the European Investment Bank (EIB) in 2007, MDBs have pioneered investments into a variety of thematic bonds. First, they have done this through defining initial principles which were then integrated into a framework that standardised methodologies, reporting¹³⁵ and impact indicators. Implementing these techniques at scale within green sub-sectors such as renewable energy allowed the sector to grow significantly. This, in combination with the credentials that the MDBs lend to these processes, made them more commonplace¹³⁶.

Broadly, the standards and guidelines created by these institutions all align on guidelines to multiply finance towards projects that accelerate the issuer's transition to a science based, low carbon ecosystem. This has knock-on effects on the demand side, as many MDBs are also buyers of bonds. Having created the standards themselves, this gives these institutions a competitive advantage in understanding what threshold needs to be met in order to meet issuance requirements. Meaning even though the issuance is transparent, since these institutions have a deeper understanding of the relevant taxonomies, they are comparably better-informed investor than others.

Active Multilateral Development Banks in the thematic bonds space, are:

- European Investment Bank (EIB)
- Asian Development Bank (ADB)
- The World Bank (WB)
- Inter-American Development Bank (IADB)
- European Bank for Reconstruction and Development (EBRD)
- International Finance Corporation (IFC)

Requirements/ Checklist for Sovereign Thematic Bond Issue

The process of issuing a sovereign thematic bond is similar to issuing a standard bond, however there are some additional steps that needs to be taken into account. In the public sector, this can be due to the more complex organizational rule of governments, the type of expenditures that they have and their debt's benchmark role in the domestic capital market.

The IFC have outlined seven (7) key critical questions that governments must answer to gain clarity before going ahead with a sovereign thematic bond issuance. These questions are as elaborated below¹³⁷:

¹³⁵ ADB (2015) Green bonds Working Towards a Harmonized Framework for Impact Reporting.

¹³⁶ Roth, N., Thiele, T. and Von Unger, M., (2019) Blue bonds: financing resilience of coastal ecosystems. Key Points for Enhancing Finance Action. Blue Natural Capital Financing Facility: Technical guideline prepared for IUCN GMPP.

¹³⁷ IFC (2018) Guidance for Sovereign Green Bond Issuers with Lessons from Fiji's First Emerging Economy Sovereign Green Bonds, pp 1-28.

What is the purpose of the issuance?

There is a need to clearly identify the reasons or the objective of issuing a thematic bond. Moral leadership, creating a path for private sector investments, or broadening investor base are some of the common reasons why countries want to issue green sovereign bonds.

Reasons for issuance will vary across countries and it is possible that there can be a number of objectives that are driving the need to issue bonds. They include risk mitigation, cost reduction, or increases in productive efficiency.

A common purpose will allow for different departments to align on the ambitions of the bond issuance and ensure maximum collaboration and transparency for projects being funded across different sectors, and in a process which requires on-going management. Being clear on the objective(s) is critical because it requires the issuer to clarify and justify to investors why and how the thematic bond fits into their long-term vision or strategy.

What projects will be funded?

A pipeline of eligible expenditures that clearly lays out how the issuer will deploy the bond's proceeds must first be established before countries can issue a thematic bond. Pre-issuance collaboration around developing and selecting the most impactful projects to allocate proceeds to, is a vital aspect of the issuance process. Often, the success of an issuance is dependent upon the depth of projects put forward.

The GBP, whilst voluntary offer a potential guide on how to distribute the proceeds. For example, most sovereign bonds have adopted this principle or a derivation of them. All expenditure needs to be budgeted for in accordance with the public management principles, so that proceeds can be legally allocated. It is therefore important to integrate the relevant finance ministries into the pre-issuance process, to engage them in this public debt exercise.

It is critical that countries must develop a list of eligible projects/expenditures. Once the list is compiled, the next step is to undertake a high-level, technical assessment of which expenditures are most likely to qualify as 'green' as per the principles adopted. In some cases, technical support to undertake these assessments can be accessed from the World Bank or external consultancy firms, if there are capacity limitations on the issuer. Establishing the depth of the pipeline will also serve the purpose of providing a guide as to the structure of the bond, including the appropriate level of debt raised, and size of fundraising under the bond.

Who will manage the process?

It is strongly recommended that a steering committee comprising of senior government officials be set up with clear lines of authority on preparing the green bond policy framework, prospectus, eligible expenditure definitions, and ongoing monitoring and reporting. Such a governance mechanism can ensure accountability, consistency and transparency across governments and sectors.

Throughout the issuance process, there will be a need to draw on the technical expertise of particular government departments. These may include for example the central banks, who are experienced in the issuance of bonds. Other agencies such as the debt management unit, line-ministries and treasury representatives are also important partners that need to be engaged. In addition to these, legal departments will need to be engaged as these departments will be responsible for the drafting of the prospectus.

Hachenberg and Schiereck (2018)¹³⁸ suggest that the cost of framework and guideline compliance for an issuer is typically around 0.3–0.6 bps (basis points) of the total issuance amount for green bonds. This is an important consideration, especially for small issuers¹³⁹. Additionally, an issuer's interpretation of whether the benefits outweigh the costs, is a potential barrier in this process¹⁴⁰.

How long will it take, and how much will it cost to issue and manage?

The level and the nature of a country's debt will help determine the structure of the bond, including the amount, tenor, currency, frequency of issuance, calendar and maturity profile of the bond issuance. The pricing of the thematic bond tends to track that of regular government debt issuance since investors price their green bonds on the basis of sovereign risk.

The issuer will then need to consider whether the issuance will be in one or multiple tranches, and whether it will form part of the ongoing program of issuances. If climate change and renewable energy are issues of growing concern and importance, it is recommended that governments strongly consider green bonds as part of their ongoing fundraising mix and integrate a program of issuance into their portfolio.

In addition to the usual costs associated with preparation of a vanilla bond, thematic bonds require upfront and ongoing resources that are recoverable and non-recoverable through the proceeds of the green bonds. How these two types of issuances differentiate, is that a thematic bond requires additional external stakeholders to participate in the issuance process, which are often not present in a vanilla bond issuance.

Pre-issuance, in order to satisfy the global voluntary principles or standards that the issuance is being aligned with, the issuer needs to engage with an external review partner, which typically is a second-party opinion (SPO) provider. As well as this, post-issuance the issuer may need to engage with third parties with regards to post-issuance monitoring, technical assistance, and more. Ultimately, these engagements come at a cost, and needs to be strongly considered by the issuer as to whether they are required.

¹³⁸ Hachenberg, B., and Schiereck, D. (2018) Are green bonds priced differently from conventional bonds? *Journal of Asset Management* 19: 371–83.

¹³⁹ Forsbacka, K., and Vulturius, G. (2019) A Legal Analysis of Terms and Conditions for Green Bonds. *Europarättslig Tidskrift* 3: 397–442.

¹⁴⁰ OECD (2015) Green bonds Mobilising the debt capital markets for a low-carbon transition POLICY PERSPECTIVES. Available: <<https://www.oecd.org/environment/cc/Green%20bonds%20PP%20%5Bf3%5D%20%5Bf%5D.pdf>>

Depending on whether the bond is international or domestic, the usual transaction costs will include a range of items:

- obtaining ratings and market intelligence,
- appointing underwriters, arrangers, custodians, payment agents, legal counsels, registering with local regulators and stock exchanges (if listing),
- arranging roadshows, regular capital market communications, and
- secondary market monitoring.

Additional costs associated with the green bond include:

- defining, drafting and approving the green bond policy framework,
- establishing project selection processes and eligible projects,
- establishing a special account to ring fence proceeds, and
- setting up a process to earmark proceeds,
- external review – typically an SPO provider
- monitoring, reporting and verification (MRV)

An issuer must also obtain a pre-issuance external review and potential, regular post issuance audits on the use of proceeds. This includes:

- tracking proceeds disbursement,
- monitoring of projects, and
- preparation and publication of regular impact reports.

In addition, if the bond is to be issued on the domestic market, particular effort will be required to raise awareness among investors as to the specific benefits of the thematic bond. There are several ways to ensure this messaging appears, including through roadshows, one to one investor briefings with key institutional investors, and factsheets and media placement explaining the basic differences between thematic bonds and vanilla bonds.

Where and how will technical support be accessed?

Preparing for issuance of a sovereign green bond is a novel task for most countries and will require technical support. It is however important to note that the market for technical support – both privately and through institutions such as the World Bank is developing rapidly.

Technical assistance can be provided either by local technical experts – for example local legal consultants familiar with legal structures in the country of issuance – or international technical experts that may be able to leverage built up knowledge by bringing in experience from previous bond issuances.

It can be important to leverage existing contacts and local expertise, however, MDB such The World Bank and ADB and agencies such as UNDP, have experience across many bonds issuances and can provide technical assistance for issuers looking to issue such bonds.

Steps in Issuing Sustainability Bonds



STEP 1: Engage Issuer

Set Goals

The first step of engagement is to set the goals of the issuance. An issuer should be raising finance with the aim of promoting green finance and low-carbon programmes, in order to better achieve sustainable development outcomes.

Engage Decision Makers

Engagement with decision makers initiates the process of developing a project pipeline for financing with proceeds. Projects would have to be eligible by aligning with the GBP¹⁴¹ developed by the ICMA. This is returned to in Step 2 where the framework is developed.

As explored above, the GBP cover 4 pillars, which can be seen in the below Table 9. These are the principles that should be followed when issuing either a green or a blue bond. For a blue bond to be classed as blue, they should also include ocean-specific use of proceeds. The Social Bond Principles (SBP)¹⁴² cover social bonds and gender bonds as opposed to being green specific. These are all defined in the Use of Proceeds.

TABLE 8. Green/Social Bond Principles

| PILLAR 1 | PILLAR 2 | PILLAR 3 | PILLAR 4 |
|-----------------|----------------------------------|------------------------|-----------------------------------|
| Use of Proceeds | Project Evaluation and Selection | Management of Proceeds | Reporting (Impact and Allocation) |

Get Buy In

As with any issuer, managing treasuries or finance departments is a significant time burden. This is a considerable responsibility which often leaves little spare capacity. Any initiative suggested needs to be sufficiently attractive so as to be worthy of buy-in from a Chief Financial Officer (CFO), a Ministry of Finance (MoF) and any other relevant stakeholders.

¹⁴¹ ICMA (2021) The Green Bond Principles. Voluntary Process Guidelines for Issuing Green Bonds. June 2021, pp1-10.

¹⁴² ibid

A valid proposal for buy-in is also the potential cost of funding advantages from an ESG product. As previously discussed, despite the fiduciary duties of asset owners to obtain optimum return for investors, greater weight attributed to ESG products can push down yields as order books are frequently oversubscribed.

Develop Project Team

A project team helps with resourcing and internal capacity. This would include someone from the finance department, treasury (or MoF) origination (or project selection line ministries) and reporting functions. A bank, for example, would need to form a project team with colleagues from various sectors across the bank, including lending and investor relations. The creation of a Green bond Project Team (GBPT) heightens awareness and focus on sustainability issues across different entities that make up the issuer, and enhances teamwork by bringing together colleagues across the institution to work collaboratively on the process.

Expand Stakeholders

For additional perspective, it may be in the interest of the issuer to involve external parties or specialists into the issuance process. For example, in the case of Uzbekistan, who issued the first SDG Bond in Asia, Bankers without Boundaries helped support the issuance¹⁴³.

The value of opening a dialogue with external stakeholders lies in is the additional engagement and valuable feedback that this iterative process can produce.



STEP 2: Establish a Bond Framework

The bond framework must address the four pillars of the relevant thematic bond guidelines used. These pillars are then used to allocated proceeds under the bond and detail how these must be reported upon. This framework will cover the definitions for the four pillars of the bond.

Determine Categories

A key differentiator when it comes to the issuance of a thematic Bond compared to a vanilla bond, is the eligibility criteria which limits the possible sectors and projects that the proceeds can be allocated towards.

To validate the need for collaboration and transparency, this step is informed by the work carried out in Step 1 (Engage Issuer), and lays the foundation for project pipeline creation into Step 3.

¹⁴³ BwB. (2022) BwB partners with UNDP to issue first SDG bond for Uzbekistan. Available: <<https://www.bwbuk.org/post/bwb-partners-with-undp-to-issue-first-sdg-bond-for-uzbekistan>>

Pillar 1: Use of Proceeds

The first pillar as shown in **Error! Reference source not found.** 9 is Use of Proceeds of the bond: there are certain limitations on what can and can't be financed under the GBP or SBP. These rules cover identification of assets on the balance sheet that can be contained within the umbrella of the bond. This then feeds into step 3, where projects are then decided on and the split between refinancing and new projects is decided.

A typical balance between existing and future assets might be in the region of 50/50. A bond backed 100 percent by existing assets might be questioned in the market because it lacks 'additionality'.

Define Lookback Period

A bond can re-finance a portion of assets on the balance sheets as well as financing new assets. There is no rule on the lookback period, but the market prefers **3-5 years**.

Broad categories can be devised for the use of proceeds which also identifies them and facilitates reporting activities as per Pillar 3. These would change depending on the category selected and should be aligned with the priorities of the issuer. Neither SBPs or GBPs provide technical assistance for what should be included within these asset groups.

- **Renewable Energy**
- **Energy efficiency (green buildings)**
- **Pollution prevention and control**
- **Environmentally sustainable management of living natural resources and land use**
- **Terrestrial and aquatic biodiversity conservation**
- **Clean transportation**
- **Sustainable water and wastewater management**
- **Climate change adaptation**
- **Eco-efficient and/or circular economy adapted products, production technologies and processes**

Regarding how the funds might be used, a green bond's use of proceeds are typically general and broad. They cover climate change mitigation projects and climate change adaptation projects¹⁴⁴. These are broad use of proceeds instruments that also cover blue bonds, however blue bonds tend to be much more defined.

Blue bonds are designed to cover projects that contribute to ocean health through ecosystem and natural resources management, pollution control, and/or sustainable coastal and marine development.

Pillar 2: Project Evaluation and Selection

The issuer should set out the process by which they will evaluate and select the individual assets within the project categories identified in Pillar 1.



STEP 3: Identify Eligible Green and Blue Bond Budget Items

Assign Ministries & Identify Assets

The cross-ministry/cross team collaboration continues as the GBPT identify and bring forward eligible assets from existing budgets and pipelines. An additional point regarding thematic bonds is that assets located overseas as part of cooperation and development activities are classed as eligible for the proceeds.

The issuer should also ensure that a buffer of eligible assets exists, beyond the face amount of the outstanding bond(s). Assets included in the bond at issuance may mature naturally or become ineligible for other reasons and 'drop out' of the bond. Such assets can then be replaced by assets from within the buffer¹⁴⁵.



STEP 4: Arrange an Independent External Review by SPO Provider

Select SPO provider

In order to attract private investors, an external verifier must be selected to verify the issuance (SPO). Having an independent body evaluate the credibility of a thematic bond gives assurance to investors of the trustworthiness and transparency of the Thematic Bond issuance process. This process is not unique to a single set of guidelines.

The other verification option is to include a post-issuance assessment, which assures investors that the pre-issuance claims have been followed through on.

¹⁴⁴ ADB (2021) Green and Blue Bond Framework, pp 1-5.

¹⁴⁵ IFC (2020) Green Bond handbook: A step by Step guide to issuing a Green Bond, pp 1-45.



STEP 5: Issue the Bond: The usual steps for the Issuance of Conventional Bonds

Sovereign bond apply supporting material

Supporting materials produced to promote a transaction can include: A thematic bond prospectus, created to be sent round to prospective investors and create demand. Further, it may also be preferable to conduct a presentation and/or seminar on Frequently Asked Questions (FAQ).

Additional marketing material to promote issuance may be produced: This will highlight the main pieces of the bond framework and serve to verify to external parties that the new debt issued will be allocated towards helping the issuer achieve its pre-determined environmental and/or social contributions.

After issuance, an investor roadshow is important: this optional aspect of the bond issuance once more serves to further increase demand for the bond. Increasing the competitiveness of the bond will be beneficial for the issuing country, as it may make the long-term cost more affordable.

If this step were to be acted upon, a distribution partner would be pre-selected, who would then take the issuance to the bond market.



STEP 6: Monitor & Report

Produce Annual Report

Aside from a pre-issuance framework, reports will also be made available post-issuance. These reports will generally be published yearly, with best practice dictating that the issuer provide investors with both an allocation report and an impact report. The combined report should be published annually and as necessary thereafter in the event of material developments for as long as any Bond is outstanding.

In some cases, the first reporting statement may take the form of a post-issuance review carried out by an external verifier. However, for all issuances, the reporting should align with the expectations set in the SDG Bond framework.

In terms of specific definitions, an Annual Allocation Report will be provided to investors until the total amount of budgetary resources expended on eligible expenditures equals the total amount of the net proceeds of the thematic bond. The allocation report will include the following details:

- Net proceeds of outstanding bonds.
- Aggregate amount of net proceeds allocated to eligible categories in the bond framework.

- Examples of blue or green projects from each eligible category (subject to confidentiality disclosures).
- The proportional allocation of proceeds between existing projects (refinancing) and new projects.
- The remaining balance of unallocated proceeds, if any.

For proceeds that have not yet been allocated from the bond, it is recommended that a summary of the approach that is to be taken with regards to the unallocated proceeds, and the subsequent timeline required for the full amount of proceeds to be allocated.

The importance of this report is that it showcases the high level of transparency required in the issuance process, which lends re-assurance to investors on the credibility of the process.

If these processes are followed to the highest of standards, and the report published to an equally high standard, the sovereign can set a positive precedent on the bond market over good reporting practices, which would further increase the reputability of the sovereign in the global bond market for future issuance.



STEP 7: Repeat

Repeat Issuance

It may be the case that not all eligible projects were able to be included in a particular thematic bond issuance. With relevance to the strength of the project pipelines as scoped out in Step 3, it may be the case that the pipeline contains sufficient depth for a new issuance to be carried out. Of course, other considerations need to be kept in mind, such as a debt ceiling, and ability to repay, among others.

If the prospect of additional thematic bonds is sufficiently attractive, a more programmatic approach can be undertaken where the issuer can apply for a programmatic certification under the Climate Bonds Standard. In this case, only one pre-issuance verification would be required for the total pool, and post-issuance verification would only be required once a year, if bonds are issued.



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