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Towards more responsible investing

Green financing gathering steam

BACKGROUND AND HISTORY

Using financial capabilities for responsible investing. Traditionally, fund raising and investing have been focused on the financial aspect of a project and/or company. Investing decisions are confined to the risk-return analysis. However, an increasing number of investors are adopting a more holistic approach towards investing. Investors have realized that they can use their financial capabilities to steer funding towards causes that they celebrate.

Green bonds, catering to the Responsible Investor. With the growing concern on issues such as climate change and the depletion of resources, a growing list of investors are now factoring sustainability issues into their investment choices. This include having criteria such as Environmental, Social and Governance (ESG) in which it measures the sustainability and ethical impact of an investment in a company. Given the demand, the investment market began to pick up on the growing need for such products to cater to the Responsible Investor. One of the asset classes to emerge is now known as Green bonds.

A way to invest in green projects. Although the road to sustainable growth can be considered simple and clear, businesses are always apprehensive about returns from investments in green projects. Green bonds provide a convenient, yet risk-managed platform for responsible organizations, both private and public, to invest in green projects.

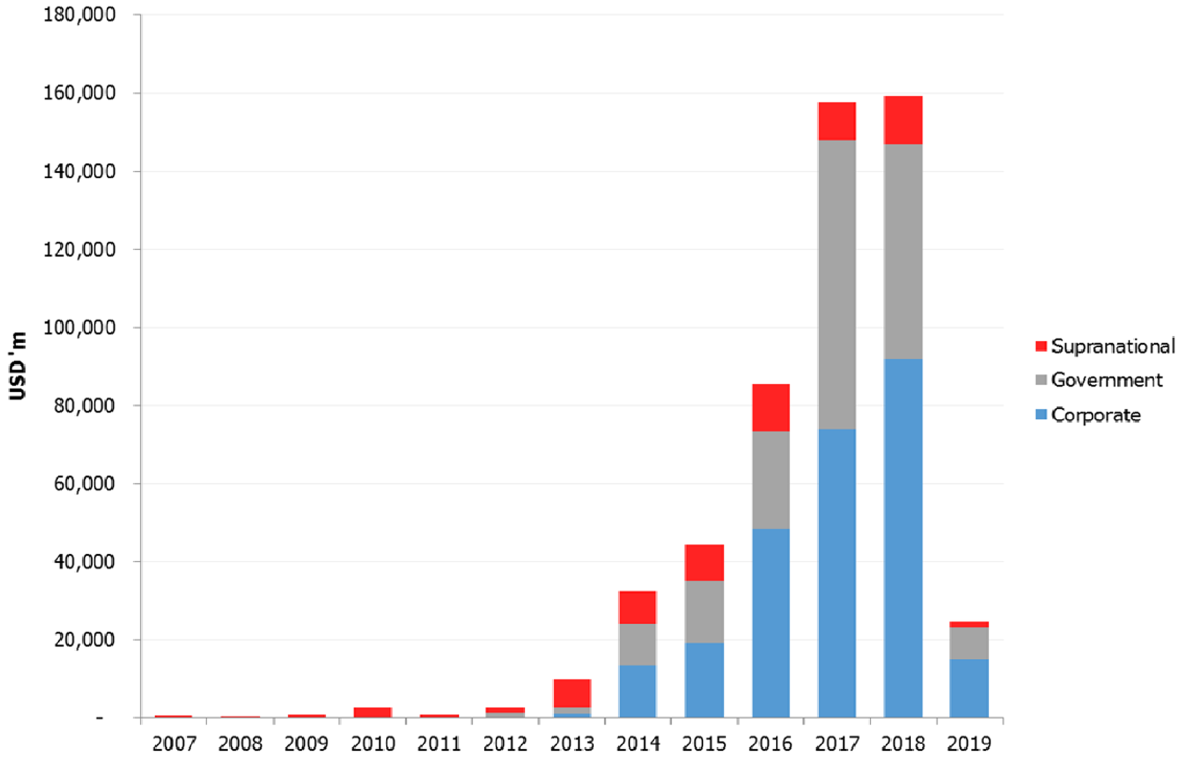
Same but different from traditional bonds. Functionally, a Green bond is like any other bonds. It is a debt instrument which offers fixed return over a defined period. The bond is voluntary and may be issued by a financial institution, the government, supranational agencies or a company. The difference is on the use of the proceeds, which is to finance or re-finance, in part or fully, new or existing sustainable projects. Examples of Green bond projects are those related to clean water, renewable energy, energy efficiency, river and habitat restoration, acquisition of land, or mitigation of climate change impacts.

EIB, the very first issuer. The first of this type of bond was issued by the European Investment Bank (EIB) in 2007, labelled "Climate Awareness Bond". The issue size of the equity-linked bond was relatively small at EUD650m and carries an annual coupon of 1.375%, with a final maturity date of 15 November 2019. The fund raised is earmarked for disbursements to EIB lending projects within the fields of renewable energy and energy efficiency.

The World Bank, first to label it. Subsequently, the World Bank became first in the world to issue a specifically labelled "Green bond" in 2008, which followed a conventional vanilla bond structure. Arranged by Swedish SEB, it was a SEK2.325b (circa USD370m) bond with 6-year maturity at a coupon rate of 3.5%.

Popularity jumped in 2013. The popularity of Green bonds issuance was muted for the next 6 years since it was first issued by EIB. The issuer of Green bonds from 2007 to 2009 had been supranational agencies. However, issuance suddenly started to gather steam in 2013 jumping to USD10.1b from USD2.7b in the previous year. Corporate issuer had also started to come into the scene that year. Issuance then tripled in 2014 to USD32.4b.

Graph 1 : Trend of Green Bond/Sukuk Issuance 2007 – March 2019



USD 'm	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019*	Grand Total
Corporate						280	1,212	13,646	19,308	48,458	73,932	91,861	14,986	263,682
Government				116	19	1,018	1,640	10,513	15,913	24,918	74,026	54,997	8,338	191,497
Supranational	682	370	806	2,679	975	1,396	7,262	8,230	9,230	12,103	9,600	12,451	1,620	67,403
Grand Total	**682**	**370**	**806**	**2,794**	**994**	**2,693**	**10,113**	**32,389**	**44,451**	**85,479**	**157,558**	**159,308**	**24,943**	**522,582**

** = up to March 2019*

Source: Climate Bond Initiative, USD equivalence estimated by MIDF Research

Corporates getting in on the act. We believe that the sudden spike in Green bonds were due to the combination of increasing new source of demand and supply. On the demand side, there was growing demand from investors for sustainable financial instruments. This stems from more investors subscribing to the Principles of Responsible Investing (PRI), where the signatories had grown to more than 1,000 by 2013. There were also new sources of supply as municipalities and corporations started issuing Green bonds. For example, Commonwealth of Massachusetts' USD100m 20-year notes and solar-backed bonds pioneered by SolarCity in late 2013.

COMPARATIVE ANALYSIS BETWEEN GREEN BONDS AND VANILLA BONDS

No difference with vanilla bonds. Green bonds are not much different from traditional or "plain vanilla" bonds. It has the same structure, risk and return as the traditional bonds. Similarly, Green bonds are also risk weighted and credit rated as per traditional bonds and is based on the creditworthiness of the issuer, with most being tradable in international secondary bond markets. These instruments can theoretically be issued at all levels of the fixed income market, from sovereigns to corporate.

No difference between issuers as well. In terms of corporate Green bonds, it functions as similar as international and supranational bonds in that the proceeds are used to fund green activities. However, the repayments are from general corporate funds. Here, we have to note that issuers have not been able to realise pricing advantages through the "green" labelling as investors are unwilling to take lower than expected coupons despite subscribing to PRI.

Except for need to adhere to Green Bond Principles. One difference between vanilla bonds and Green bonds is the need for the latter to adhere to the "Green Bond Principles (GBP)". Although the best practice guidelines are voluntary, issuer needs to observe to it to lend credence for its issuance. It suggests a concrete process for issuers to use, so that investors, banks and others have the necessary tools to understand any given Green bond. It was established in 2014 by a consortium of investment banks which were Bank of America Merrill Lynch, Citi, Crédit Agricole Corporate and Investment Bank, JPMorgan Chase, BNP Paribas, Daiwa, Deutsche Bank, Goldman Sachs, HSBC, Mizuho Securities, Morgan Stanley, Rabobank and SEB.

The core components. With the need to continuously monitor and develop the guidelines, the International Capital Market Association (ICMA) became host to an independent secretariat on the GBP. The GBP emphasise the required transparency, accuracy and integrity of information that will be disclosed and reported by issuers to stakeholders. It has four core components, which are:

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

Broad project categories. We have to note there is no specific definition of a green bond that is uniformly agreed upon to this date. While the World Bank has its own criteria or definitions of eligible green projects, the GBP do not provide details on how a project can be defined as "green". It is left to be determined by the issuer. However, broad green project categories suggested by the principles include:

- Energy
- Buildings
- Transport
- Water management
- Waste management & pollution control
- Nature-based assets including land use, agriculture and forestry
- Industry & energy-intensive commercial
- Information technology & communications (ICT)

Some additional cost to Green bonds. Nevertheless, the labelling of Green bonds does have an added cost to when compared to issuance of vanilla bonds. Additional cost can range from circa USD10,000 to USD100,000 due to requirement of external reviews. To mitigate this, come governments have launched grant schemes to incentivise corporates to raise Green bonds. For example, the Hong Kong Government launched the Green Bond Grant Scheme (GBGS) in June 2018 to subsidise eligible green bond issuers in obtaining certification under the GFCS. Eligibility criteria include a minimum issue size of HKD500m and that the bond is to be issued in Hong Kong and to be listed on the Hong Kong Stock Exchange and/or the Central Money markets.

TREND ANALYSIS of GLOBAL GREEN BONDS

In terms of the Green bond market, 2018 has been a consolidation year. Good progress has been made in the development of taxonomies and harmonisation efforts. As such there is a possibility of greater alignment of future deals to the Climate Bonds Taxonomy. In broader terms, clearer definitions of what is considered "green" and improved disclosure can help investors assess the market and individual bonds.

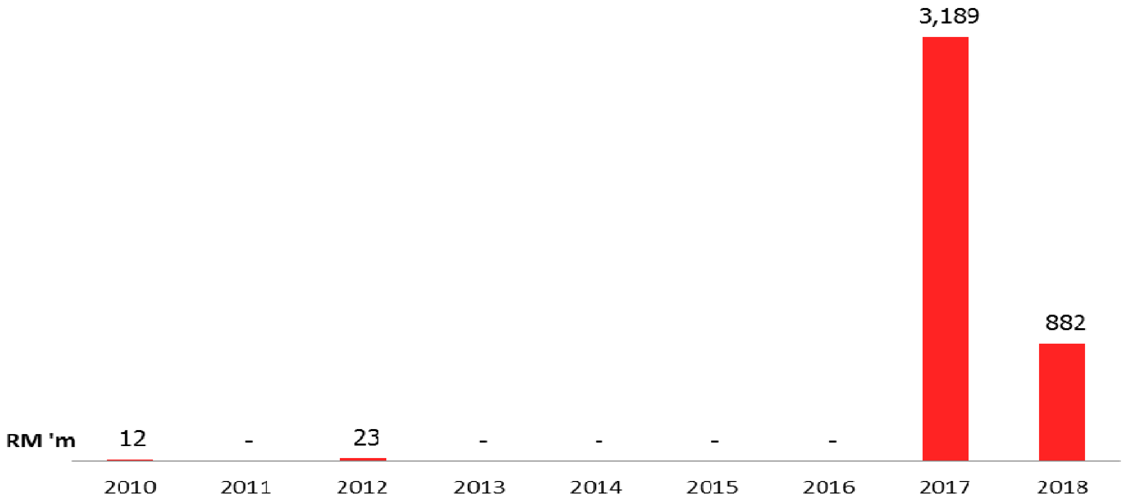
Green labelled bonds issuance had been particularly strong in the past couple of years. It breached the USD150b mark in both 2017 and 2018. The leading bond issuer in terms of size have been the USA (20%) followed by China (18%) and France (8%). Meanwhile, Germany (5%) and Netherlands (4%) makes it the top 5. The cumulative green bond issuance since 2007 until March 2019 amounted to USD522b.

Becoming more popular with corporates. Increasingly, Green bonds have been raised by corporates. Issuance by corporates neared the USD100b mark in 2018. We also noted an increasing number of global financial institutions have been aggressively raising Green bonds. South African Nedbank first entered the market in August 2012 with a green retail offering. A variety of institutions have issued green bonds with 127 as of the end of 2018. Most issuance has been senior unsecured with covered bonds being the second most issued bond type. For example, Credit Agricole CIB used a synthetic ABS to the transfer risk of a mixed loan portfolio (including green project finance) and to create capital capacity for green lending.

Blooming of Green bond fund and ETF. Presently, there are almost 50 dedicated Green bond funds that have been set up and this includes 10 in 2018. We believe this is to respond to the increasing demand from a wide pool of investors. A prime example is the Amundi Planet – Emerging Green One fund that was set up in 2018 by Amundi, a global asset manager. It is a USD2b Green bond fund specifically to invest in issuance from emerging markets financial institutions with the aim of supporting local bond market development. In turn, local banks are expected to engage in green lending across the real economy. Also, we need to point that there are 4 Green bond Exchange Traded Funds (ETF) in the market currently.

ASEAN is a growing market. Since the first Green bonds issued in 2016 in the Philippines and Vietnam, the ASEAN Green bond market have been robust. This culminated in the total issuance of USD5b as of the end of November 2018. Green bonds issued in ASEAN local currency terms amounted to USD3.2b lead by Singapore (40.7%), Malaysia (30.5%) and Philippines (18.5%). Green bonds issued in Thai baht, Indonesian rupiah and Vietnamese dong contributed to 4.7%, 4.6% and 0.8% respectively.

Graph 2 : Trend of Malaysia's Green Bond/Sukuk Issuance 2007 – 2018



Source: Climate Bond Initiative, USD equivalence estimated by MIDF Research

Malaysia not left behind. As for Malaysia, momentum of Green financing (either sukuk or bond) has been mirrored global past two year's trend. It peaked in 2017 with total issuance of RM3.2b, largest being Permodalan Nasional Bhd's RM1.87b issue. We understand that the majority of the issuer has been for solar related project.

WHY ISSUE OR INVEST IN GREEN BONDS

Advantages for issuer. There are many advantages to issue Green bonds or sukuk as an alternative to traditional sukuk/bonds. For an issuer these are:

1) Ability to attract environmentally-conscious investors who may not otherwise invest in the company
2) There is an ever-growing list of investor demanding for green/sustainable financial instruments
3) Increasing demands from stakeholders for responsible business practices
4) Ability to project the company as an environmentally-conscious organization, enhancing its brand
5) Economical and convenient financing model by project developers as there is no difference with traditional bonds in terms of structure
6) Almost all Green bonds issued in the past have been oversubscribed

For an investor, we believe below are some of the advantages in investing in the Green financial instruments:

1) Green bonds are becoming an important component of ESG investing
2) Demand for green bonds is surging. Hence, higher tradability potential for the bonds
3) Accessible and powerful instrument for financing a sustainable, low-carbon economy
4) As the global economy shifts to a low-carbon footprint, portfolios that have proactively reduced its carbon exposure may be better positioned to outperform the broad market
5) Transparency in reporting by issuer as they have to produce 'impact reports'
6) There is no difference in terms of risk-return profile of Green bonds with traditional bonds

CONCLUSION

We believe that there is no doubt that the demand for Green bonds and sukuk, whether from issuer or investor point of view, is real. Judging by the rapid pace of bond issuance especially in the past two years, we can dismiss Green bonds as a fad. Although, the Green bond market is relatively smaller than the traditional global bond market, we opine that it has tremendous potential as governments and investors become more environmentally conscious. With this, financial institutions will have opportunities to play a larger role especially given more issuance, in terms of number or size.

In our view, financial institutions have a unique position in the Green bond market. It can play the role in all or separately in the three section of the value chain. Of course, financial institutions will participate as an advisor of an issuer. However, it could also become an issuer or investor of Green bonds/sukuks. We have observed a number of global financial institutions such Credit Agricole and Citibank issuing Green bonds for green lending. Financial institutions' treasury could also invest and trade in Green bonds much like traditional bonds, especially with better proliferation of the Green bond market.

In conclusion, we expect to see the growth of the Green bond market to continue to gather steam. We believe that it is still an infant stage of the cycle. However, it is fast maturing and financial institutions, companies and investors will need to be quick to take advantage of this growing market.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.