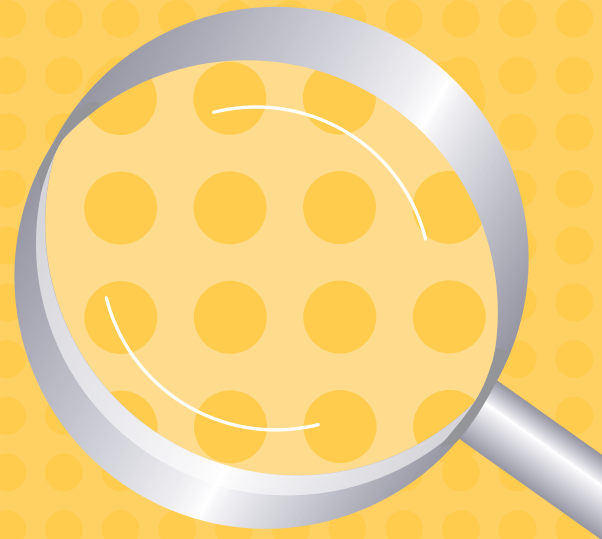


# MARKET INTEGRITY:

## 3 in every 4 dollars from green bonds meet best practice climate standards



### Introduction

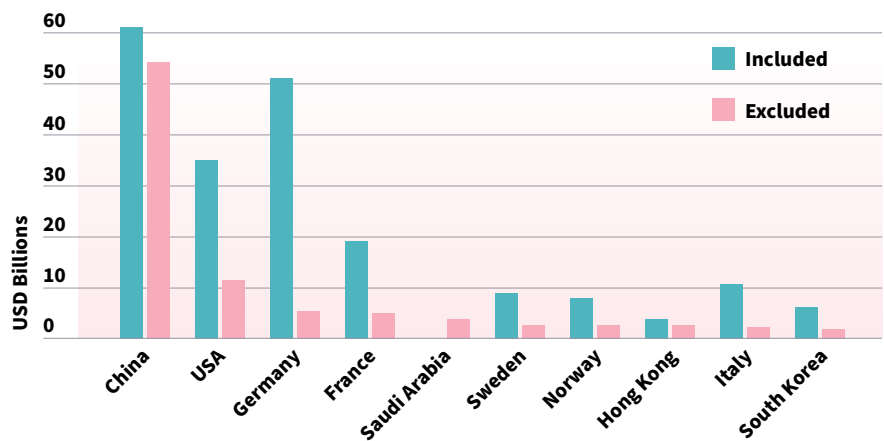
Consistent, transparent labelling of green, social, and sustainability debt is crucial to reinforcing the credible growth of the market. The Climate Bonds Initiative (Climate Bonds) maintains databases to capture green, social, and sustainability bond issuance. Rules for inclusion in the Climate Bonds' Green Bond Database (GBDB) are described in the *Climate Bonds Green Bond Database Methodology*.<sup>1</sup> The Climate Bonds Social and Sustainability Bond Database (SSBDB) includes bonds whose proceeds are dedicated to social, or green and social (sustainability) projects. The rules for inclusion are described in the *Climate Bonds Social and Sustainability Bond Database Methodology*.<sup>2</sup>

The Climate Bonds databases inform inclusion in major thematic bond indices including but not limited to those constructed by FTSE Russell, IHS Markit, ICE, S&P Global, MSCI, Solactive, and CCDC (China). Therefore, to scale the market it is critical that as many thematic bonds as possible are in alignment with the relevant Climate Bonds methodology. For the issuer, inclusion in a Climate Bonds database reinforces the thematic credentials of the deal and for the investor it extends the still relatively limited investable opportunity set.

*Most issuance meets the standards for inclusion in Climate Bonds databases and crucially, therefore, contributes to the climate and social causes for which it is earmarked*

However, one out of every four dollars of labelled debt priced in 2022 is excluded from the Climate Bonds GBDB and one in 17 is excluded from the Climate Bonds SSBDB. Bonds are excluded either because of insufficient information from the issuer, or because the Use of Proceeds (UoP) lack the required ambition.

Top ten country sources of excluded green bonds priced in 2022



### The scope of the issue

At the end of the third quarter (30 September 2022), Climate Bonds had recorded green bonds priced in 2022 with cumulative volume of USD332.52bn, and a further USD236.3bn of social and sustainability debt.<sup>3</sup> Beyond this, is an additional USD106.2bn worth of green bonds, and USD14.4bn of social and sustainability (S&S) bonds that have been assessed for inclusion but did not meet the criteria. Climate Bonds classifies these bonds as excluded.

As the market matures, expectations have been raised, and investors expect precise definitions and reporting of eligible project categories. Climate Bonds encourages high levels of ambition, innovation, and materiality of a bond's UoP that result in positive, long-lasting climate or social benefits.

Labelled thematic bonds are excluded for one of two reasons.

**1. Insufficient information.** Disclosure surrounding the UoP is not detailed or clear enough, and efforts to obtain the required clarity from the issuer have been unsuccessful.

**2. UoP not aligned.** The UoP do not meet the standards described in the GBDB/SSBDB methodology either because:

**a. the projects/assets do not meet the green or social criteria** – e.g., a building is LEED Silver certified when the criteria state a minimum of Gold

**b. the project/asset type is not yet listed in the GBDB/SSBDB methodology** – e.g., very complex technologies/processes such as industrial energy efficiency that are not covered in global taxonomies or the Climate Bonds Taxonomy are difficult to assess.

**c. the proceeds are directed to general working capital.** This issue is almost entirely unique to China where some bonds allow up to 50% of funds raised to go to general working capital (see below).

## Excluded green bonds

The 643 bonds excluded from the GBDB in the first nine months of 2022 originate from 40 countries, with the largest volumes coming from China, the USA, and Germany.



The main reason for excluding Chinese green bonds, was UoP allocations to general working capital (USD11.3bn) which has, for some time, been allowed by the regulator although not accepted internationally. In July, however, China's National Association of Financial Market Institutional Investors (NAFMII) published updated *China Green Bond Principles*, which stated that 100% of green bonds UoP must be earmarked for green projects. As a result, we do not expect this to be an issue in the future. The second most common reason was bonds with fossil fuels including liquid natural gas (LNG) among the eligible project categories (USD9.0bn). Eligible project categories for Chinese bonds are defined by the Green Bond Endorsed Project Catalogue (2021 Edition) which permits LNG, and the Common Ground Taxonomy (for overseas issuers), which does not.

More than half of the excluded bonds originating from the USA cited buildings that were not aligned to sufficiently ambitious standards in the UoP (USD5.5bn). 70% of the excluded volumes originating from Germany (USD3.9) were also related to inadequate levels of ambition in building standards. Two green bonds originating from Saudi Arabia were both excluded due to insufficient disclosure of the UoP.

### Country sources of excluded green bonds priced in 2022

Country	Included	Excluded
China	61.4	54.3
USA	34.9	11.4
Germany	51.3	5.6
France	19.1	5.0
Saudi Arabia	0.0	3.8
Sweden	8.5	2.6
Norway	7.8	2.6
Hong Kong	4.1	2.5
Italy	10.7	2.4
South Korea	6.2	2.0
Rest of world	128.5	14.0
<b>Totals</b>	<b>332.5</b>	<b>106.2</b>

## Issuer type sources of excluded green bonds priced in 2022

Green issuer type	Insufficient information		UoP not aligned		Total	
	USD bn	Number of deals	USD bn	Number of deals	USD bn	Number of deals
Development Bank	0.1	1	1.7	7	1.7	8
Financial Corporate	16.2	129	24.6	139	40.8	268
Government-Backed Entity	6.0	55	9.8	64	15.8	119
Local Government	0.1	4	0.8	13	0.9	17
Non-Financial Corporate	18.2	100	28.9	131	47.1	231
<b>Total</b>	<b>40.5</b>	<b>289</b>	<b>65.8</b>	<b>354</b>	<b>106.2</b>	<b>643</b>

The private sector is the source of the largest number of excluded green bonds. Within this, non-financial corporates are responsible for almost half of the excluded deals with non-aligned UoP including things like minimum thresholds not being met, or the inclusion of fossil fuels as eligible expenditures. Issuers could avoid these pitfalls by aligning their UoP with the guidelines described in the *Climate Bonds Green Bond Database Methodology* mentioned above.

## Excluded social and sustainability bonds

The 116 deals priced in the first nine months of 2022 and excluded from the S&S database originate from nine countries plus supranational issuers. Japan is the source of 56% of the excluded volumes, mainly because the deals specify roads as an eligible UoP. The issuers of the excluded supranational deals did provide adequate disclosure around the label or the UoP.



Government-backed entities appear the most frequently among excluded S&S deals. The main reason for non-alignment is again the inclusion of roads in the eligible project categories listed in the frameworks. Climate Bonds does not consider roads to be a climate friendly UoP, and therefore bonds whose proceeds go towards development of road infrastructure are excluded, although the Social and Sustainability Bond Database Methodology does allow for possible exceptions for roads if they are in emerging market territories.

### Sources of excluded S&S bonds priced in 2022.

Country	Included	Excluded
Japan	10.28	8.12
Supranational	57.85	3.03
China	33.44	0.86
Saudi Arabia	0.75	0.75
USA	37.07	0.68
South Korea	19.10	0.33
Canada	5.23	0.28
Germany	11.11	0.27
Argentina	0.02	0.05
Colombia	0.03	0.001
<b>Totals</b>	<b>174.9</b>	<b>14.4</b>

## Issuer type sources of excluded S&S bonds priced in 2022

S&S issuer type	Insufficient information		UoP not aligned		Total	
	USD bn	Number of deals	USD bn	Number of deals	USD bn	Number of deals
Development bank	0.0	0	3.3	3	3.3	3
Financial Corporate	0.8	15	0.2	1	1.0	16
Government-Backed Entity	0.3	2	8.3	41	8.6	43
Local Government	0.0	0	0.8	50	0.8	50
Non-Financial Corporate	0.2	1	0.4	3	0.6	4
<b>Total</b>	<b>1.4</b>	<b>18</b>	<b>13.0</b>	<b>98</b>	<b>14.4</b>	<b>116</b>

### Endnotes

1. Climate Bonds Green Bond Database Methodology 2022, <https://www.climatebonds.net/market/green-bond-database-methodology>
2. Climate Bonds Social and Sustainability Database Methodology 2022, <https://www.climatebonds.net/market/social-sustainability-bond-database-methodology>
3. Climate Bonds Initiative, *Sustainable Debt Market Summary Q3 2022*, [https://www.climatebonds.net/files/reports/cbi\\_susdebtsum\\_highlq32022\\_final.pdf](https://www.climatebonds.net/files/reports/cbi_susdebtsum_highlq32022_final.pdf)

## Aligning thematic deals with market standards will reinforce credibility

Climate Bonds has a market leading Standard scheme in place which offers guidance to issuers on elements of green bond issuance including frameworks, reporting, disclosure, and verification. The Standard is complemented by individual Sector Criteria that set climate change benchmarks for each sector and are used to screen UoP. This is being continually expanded, and in 2022, criteria were introduced to define acceptable UoP for Cement, Basic Chemicals, Steel, and Hydrogen Production. Issuers can follow this guidance to ensure they are meeting the highest levels of ambition, and Climate Bonds offers a Certification scheme through which issuers can verify that their UoP is in alignment.

Transparency and completeness of information from issuers are essential to determine a bond's alignment with market standards and green taxonomies (a social taxonomy is yet to materialise) but the level of disclosure is often inadequate.

To achieve best practice, Climate Bonds recommends that issuers should:

- 1. Consult** local/international taxonomies to see what is accepted as green
- 2. Seek advice** to assess compliance with a taxonomy from external experts
- 3. Seek public external certification/review**
- 4. Be precise** by stating what will be included and how it meets the green definitions/standards/taxonomy
- 5. Disclose more information** - particularly on controversial areas which will be scrutinised more closely by international investors.

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