KPMG

Green Bonds

The Process

March 2016

Eight years ago, 'green bonds' did not exist. Fast forward to 2015, and the total issuance of green bonds during the year stood at USD 42 billion[1]. Green bonds are fast becoming an attractive option for organisations seeking to raise capital for projects, assets or other activities that benefit the economy, environment and society. Interest has reached new heights in recent years, with governments starting to promote the development of the green bond market, and investors flocking to 'green' investments. This has resulted in green bonds being constantly over-subscribed.

As green bond issuances continue to gain momentum, a growing number of businesses are asking: **"Are green bonds suitable for my business? How do you issue green bonds?"**

WHAT

WHAT is a green bond?

A green bond, like any other bond, is a fixed-income financial instrument for raising capital through the debt capital market. The key difference between a 'green' bond and a regular bond is that the issuer publicly states it is raising capital to fund 'green' projects, assets or business activities with an environmental benefit, such as renewable energy, low carbon transport or forestry projects.

Market[2] Highlights

- Size **tripled** between 2013 and 2014[3]
- **2015** issuance amount: **USD 42 billion**
- A number of emerging countries, including **China**, kicked off their market in 2015

WHY

WHY issue green bonds?

Many regular bonds have raised money for climate-aligned assets that would qualify as green without labelling them as such. In terms of pricing, most green bonds currently in the market bear similar financial characteristics to regular bonds from the same issuer since repayment is tied to the issuer. Green bonds, however, offer some **potential benefits** to issuers:

- Investor diversification and demand
- Closer engagement with investors
- Corporate reputation and awareness
- Improved internal awareness of sustainability
- Government support and incentives

WHO

WHO can issue green bonds?

There is no restriction on the type of organisation that can issue green bonds. The 'greenness' of a company does not matter, although this could be a concern for some investors and may attract accusations of 'greenwashing'.

Issuers may be supranational institutions, private corporates, banks or governments.

1 Climate Bonds Initiative (2016). Year 2015 Green Bonds Final Report.
2 Refers to the labelled green bond market, i.e. where the issuers and/or indices label the bond as green.
3 Climate Bonds Initiative (2015). Year 2014 Green Bonds Final Report.

Issuance life cycle

The green bond issuance process is similar to that of a regular bond, with an added emphasis on **governance**, **traceability** and **transparency** designed to increase investors' confidence in the green credential of the bond, and prevent accusations of 'greenwashing' to the issuer. Below is a simple outline of a generic green bond issuance process, which may be different depending on the jurisdiction. Guidance is given below on the steps that require extra attention from issuers of a green bond compared to a regular bond:

1. **Review funding options**
2. Choose underwriter
3. **Design green bond criteria and project selection process**
4. Registration/application
5. **Processes and controls for use/management of proceeds**
6. Information disclosure
7. Get credit rating
8. Issue bond
9. Allocation of proceeds
10. **Ongoing reporting**

Review funding options

Issuers should review the business case for green bond issuance, consider how it matches with their financing objectives and sustainability strategy, and weigh the benefits against the specific challenges, which may include:

- Issuance and ongoing tracking, monitoring and reporting costs
- Keeping a 'closeness' to conventional bonds, including returns
- Reputational risks associated with 'greenwashing' accusations
- Heightened scrutiny of environmental credentials
- Penalties for green default (whereby a bond is paid in full but the issuer breaks agreed green clauses)

Design green bond criteria and project selection process

There is no universally agreed standard for a green bond and the kind of activities that can be funded. Issuers can look to several evolving guidelines and sources such as the **Green Bond Principles**, the **Climate Bonds Standard**, national guidelines, green bond indices and sector-specific standards for guidance in defining their green bond and the process used to determine the eligibility of projects.

In China, guidelines have been issued by the People's Bank of China and the National Development and Reform Commission in December 2015.

Processes and controls for use/management of proceeds

Setting up robust management and controls for tracking and allocation of proceeds is recommended to ensure the proceeds are used in line with the terms of the bond. The following areas should be considered while designing the tracking mechanisms and processes:

- **Tracking of proceeds**
- **Management of proceeds**
- **Management of unallocated proceeds**
- **Assurance**

Ongoing reporting

Reporting on the allocation of proceeds and the environmental and/or social outcomes of the investments regularly during the life of the bond or projects invested in is increasingly expected by investors. In preparing for the disclosure of the green impact of the underlying assets or investments, issuers are recommended to consider:

- Designing monitoring and evaluation processes in advance
- Implementing key performance indicators (KPIs) and data collection systems to monitor environmental outcomes of projects over time
- Seeking third-party assurance to reduce data quality risks and raise stakeholder confidence in disclosures

KPMG's support throughout the life of a green bond

Review funding options
- Review financing objectives and options
- Determine a funding route
- Act as a sounding board for management

Choose underwriter

Issuance Support
- Provide advice on selecting bond underwriter

Design green bond criteria and project selection process
- Develop 'green' criteria and management of proceeds criteria
- Review processes and controls
- Benchmark green bond framework

Processes and controls for use/management of proceeds
- Assurance over bond criteria, processes and controls

Information disclosure/Get credit rating

Issuance Support
- Provide advice on the credit rating process, presentation to investors, commercial terms and reaching financial close

Ongoing reporting

Monitoring and Reporting
- Develop monitoring and reporting processes/KPIs
- Support internal/external reporting

Third-party Independence Assurance
- On processes and controls for selecting projects, managing proceeds and on progress reports

Financial Advisory
- Ongoing financial advisory assistance
- Support investor management

Outlook

While the green bond market is still in its nascent stage, **the growth potential is enormous** as both developed and emerging countries transition to more eco-friendly economies, and the range of issuers and investors, as well as the variety of bonds offered, continues to widen.

However, **KPMG predicts that guidance and requirements may be tightened over the next two to three years**. For the green bond market to mature, issuers should take a rigorous approach to effectively monitor and manage their green bond proceeds, uphold transparency and communicate regularly with stakeholders in order to preserve market integrity.

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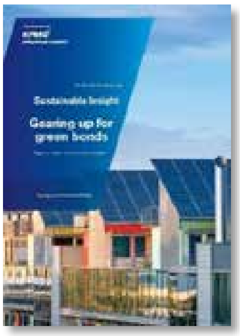
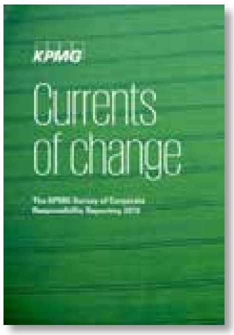


Sustainable Insights: Gearing up for green bonds



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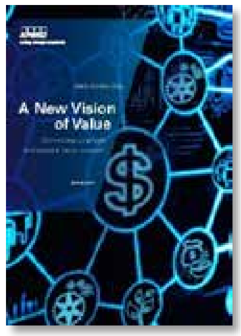

A New Vision of Value: Connecting corporate and societal value creation

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