Issue Your Greens

Green halo 2.0

It has been rewarding to see that the "Green Halo effect", which we at NatWest Markets first introduced in early 2018 has become part of common market parlance.

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At the time, after analysing green issuances and corporate performance thereafter, we argued that this halo effect of a green bond issuance is created by attracting a broader sustainability-focused investor base to the company's debt as a whole, thereby putting downward pressure on the entire curve.

And the green halo effect seems to reach even further: recent research by Professor Caroline Flammer in the US suggests that the externalities of issuing a green bond go even beyond a company's outstanding (non-green) bond curve and extend into its share price and operating performance.

Green bonds, amongst other positive effects, improve operating performance two years post issuance

After looking at the 217 corporate green bonds issued by public companies globally from January 1, 2013 to December 31, 2017, Flammer found that green bond issuances lead to four major effects:

1. The share price outperforms following the market announcement, indicating that investors expect the green bonds to contribute to shareholder value. Interesting fact: the stock price increase is about twice as large for green bonds that have been certified by independent third parties.
2. The operating performance (as measured by Return on Assets) improves two years post issuance: while green bond offerings are associated with a 2.4% increase in long-term value, Flammer's analysis showed that issuers of green bonds can expect an increase of their ROA by 0.6 percentage points after two years.
3. The environmental performance of the issuer improves, with their environmental score rising on average 6.1 percentage points on the Thomson Reuters' ASSET4 scale. This scale is based on more than 250 key performance indicators such as CO^2 emissions, hazardous waste, recycling, and so on. Moreover, green issuers increased their green innovations measured by the ratio of the number of "green" patents filed to the total number of patents they filed in a given year by 2.1 percentage points.
4. Corporate green bonds help attract investors who care about the long term and the environment. The sample of 217 bonds showed that the share of long-term investors increased from 7.1% to 8.6% (a 21% increase), and the share of green investors from 3% to 7% (a 133% increase).

Flammer's results have generated a lot of interest amongst the issuer and investor community, with a number of those issuers and investors having previously considered ESG-labelled debt as too much of a "gimmick".

This impact is driven by a greater corporate focus on sustainability metrics as enhanced investor interest in the firm

From an issuer perspective, the process of establishing a green bond framework often leads to a better collaboration between the sustainability and the finance division in a firm, which helps to direct the focus on longer-term sustainability targets and performance and not just the next quarterly report. A comment we often hear is: "Now that the CFO cares, business sustainability metrics are looked at more seriously."

From an investors' angle, a green bond is a good opportunity to re-evaluate a company's ESG performance and attractiveness as an investment. With investors increasingly aligning their ESG strategy across debt and equity holdings, but large firms on the other hand quite rarely raising new equity funding, a green bond is a welcomed opportunity to get a foot in the door of a company that is transitioning to a sustainable business model.

While on the road meeting clients, a few ESG quotes I heard sum up perfectly how ESG investing and green finance have come a long way: "I started as an ESG analyst 9 years ago. Today, people no longer look puzzled when I talk about my job at dinner parties." This peppered with a healthy dose of realism: "When everyone claims to be green, someone is a hypocrite."

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