Greeniums and “Halo” effect – green bonds make financial sense

I took part in a panel at this year’s Climate Bonds conference, discussing the latest evidence around green bond pricing in the primary and secondary markets. Joined by other practitioners and researchers - including representatives from the World Bank and the European Commission - the very engaging discussion brought up several takeaways, which I want to share here.

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Greeniums – opportunities and limits

Green bonds pricing tighter than similar vanilla bonds have made the headlines over the past years. Unmet demand for green debt is helping green issuers to achieve such greeniums, with the average final pricing of USD and EUR green bonds around two basis points tighter - relative to initial pricing thoughts - than that of “vanilla” bonds1. However, a green bond pricing benefit is mostly found in only smaller and niche markets such as the green US Municipal market.

During our panel we also discussed whether FIs could achieve larger greeniums if they guaranteed to pass on the pricing benefit to customers, for example by offering cheaper green mortgages. Consensus was, however, that such a strategy would not translate into meaningful price improvements at this current stage, but could still help winning new customers.

Finally, there was also a word of caution: investors as well as issuers face additional costs when assessing green risks or preparing to raise green funds respectively, so an excessive focus solely on a pricing benefit – which comes with higher costs – is not helpful. Equally, we questioned whether investors could argue to be compensated for the comparatively reduced liquidity of green bonds and therefore in fact demand a pricing benefit for themselves.

ESG credentials have “Halo” effect for corporate debt

Several studies in the past years have identified a link between a corporate ESG focus and lower costs of corporate financing. A Hermes study2 found, that companies with the weakest ESG credentials tend to trade with the widest CDS spreads, indicating that a corporate focus on ESG reduces a firm’s risk and therefore its cost of debt capital. And the “Halo” effect of green bonds – improving the trading of regular bonds of the same issuer – is now also moving into equities. Research is showing that an ESG focus and green issuances as a result, lead to share price
outperformance as well as (longer term) RoA and ESG metric outperformance.

**More incentives can help boost the market**

To further develop the green bonds market, market actors are already working together to introduce common standards and incentives. Our panel welcomed initiatives such as the EU taxonomy to help create a common language of green projects.

Looking at incentives, green bonds tax exemptions are a powerful tool to help speed up the adoption of green thinking amongst corporates. Municipal authorities in the US for example can access the Clean and Renewable Energy Bond (CREB) tax-credit program for funds used to finance projects that reduce greenhouse gas emission. Issuers using this program can theoretically pay 0% interest rate with investors receiving federal tax credit instead of interest payment. Such initiatives also translate into green pricing benefits.

**Green bonds increase staff satisfaction and customer retention**

Green bonds can help to make sustainability part of a company's DNA, changing corporate thinking and improving stakeholder relationships far beyond the investment community.

Brand perception, customer loyalty, staff satisfaction and successful recruitment are all linked to the ESG credibility of a company: in the search for talent and customers amongst the Millennial generation with a much higher sensibility for climate change and a desire to make a difference, corporates with a green agenda will score higher. Equally, a green focus positively affects staff satisfaction with many studies showing that there is a strong correlation between staff wellbeing and positive corporate performance.