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Sustainable finance instruments: green bonds

Over the last decade, considering global warming and climate change issues, one of the most significant financial innovations in the sustainable finance area has been the development of green bonds. The demand for green bonds, to a large extent, is attributable to the growing prominence of climate issues. As public and private institutions around the world are necessarily more attentive in terms of adoption of sustainable and socially responsible policies, the investors and shareholders are now more aware of the risks of climate change. Likewise, corporates are considering alternatives to create economic value while also contributing to safeguard of the future. Therefore, although sustainable financing methods were already on the rise prior to the pandemic, they are now even more significant instruments for raising funds for green and sustainable recovery projects.

European Investment Bank (EIB) and the World Bank pioneered the first green bonds, with EIB issuing its Climate Awareness Bond in 2007, as a structured bond with proceeds dedicated to renewable energy and energy efficiency projects and the World Bank issuing its first green bond in 2008 to raise funds from fixed-income investors to support lending for eligible climate-focused projects. Since then, the market for green bonds has grown considerably. According to a report by Climate Bonds Initiative, annual green bond issuance topped half a trillion in 2021 for the first time, which represented a 75% increase on prior year volumes. Recently, green bonds have been issued by issuers in more than 50 countries and the United States of America has the largest source of green bonds.

In terms of rising trend in sustainable finance and green bond issuances in Türkiye, the first green/sustainable bond in Türkiye was issued by the Industrial Development Bank of Türkiye (TSKB) in 2016. The TSKB's five-year green bonds with a value of US$300m reportedly attracted 13 times the demand than the issue size from both green and conventional investors. This was also the first green/sustainable bond issuance in Central and Eastern Europe, Middle East and Africa which proves that Türkiye has a leading position regarding green bonds in the region.

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PRINCIPLES OF GREEN BONDS

Green bonds offer the investors and shareholders a chance to impact the business strategy of bond issuers to adopt better environmental and social governance policies while achieving similar returns on their investment. Green bonds are structured the same way as conventional bonds with the exception that their proceeds are dedicated to raise capital to support climate related or environmental projects. Thus, specific use of the funds raised to support the financing of green projects distinguishes green bonds from conventional bonds.

Green bonds can be divided into (i) green labelled bonds and (ii) green unlabelled bonds, depending on whether they are labelled as 'green' by the issuer. Additionally, different types of green bonds exist in the market such as green revenue bond, green securitised bond and green project bond. It is important to note that there is no legal definition of a green bond, as it is the issuers who determine whether their bonds are green. In the absence of uniform standards, certain principles and certification programmes have been developed, out of which the most widely accepted is the Green Bond Principles of the International Capital Market Association (ICMA). The Green Bond Principles are designed to provide issuers with guidance on the key components involved in the issuance of green bonds in order to encourage transparency and disclosure, and to promote integrity in the development of the green bond market.

According to the ICMA, green bonds are any type of bond instruments the proceeds of which must be exclusively applied to partially or fully finance or refinance to new or existing green projects that contribute to environmental sustainability (eg, renewable energy, energy efficiency, pollution prevention and control, clean transportation and waste water management projects) and which are aligned with the four core components stated in the following:

- **Use of proceeds:** Description of the utilisation of proceeds including a distinction between new project financing and refinancing, achievement of expected environmental benefits and contribution to environmental objectives.
- **Process for project evaluation and selection:** Description of the process used to determine how the project fits into the eligible green project categories, eligibility criteria and use of existing standard or certification; recommendation to appoint an agent to provide an external review to confirm alignment with the Green Bond Principles;
- **Management of proceeds:** Tracking of net proceeds allocated to eligible green projects and of temporary placement for unallocated funds, recommendation to use a third party (eg, auditor) for verification purposes;
- **Reporting:** Annual reporting on proceed allocation until funds are exhausted including list of projects and expected impact.

The Green Bond Principles also recommend that issuers use an external review provider to confirm that the funds are used to finance the projects eligible for funds under the Green Bond Principles. Such review might include third-party reviews and consultations, audits, third-party certifications and ratings. However, it should be noted that such principles are voluntary process guidelines and there is no penalty mechanism for the incompliance with the principles. Therefore, if the bond proceeds are misallocated or the projects are not green, the issuers of green bonds may face several consequences together with the reputational effects.

LEGAL FRAMEWORK IN TÜRKIYE

In parallel with the increased demand for sustainable debt instruments, the green bond framework in Türkiye has marked significant development in the recent years. Reportedly, Türkiye aims to promote the issuance of more green bonds by preparing a legal framework that is expected to increase investments in clean energy, electric and hybrid vehicles and reduce carbon emissions. In February 2022, the Capital Markets Board of Türkiye (CMB) has published a guideline on green debt instruments, sustainable debt instruments, green lease certificates and sustainable lease certificates (Guideline) following the basis of the Green Bond Principles of ICMA. The Guideline aims to ensure that green debt instruments are issued in accordance with best practices and standards in international financial markets and to protect investors in the financing of green projects that can contribute to environmental sustainability, and to increase transparency, consistency and comparability.

Similar to the Green Bond Principles of ICMA, the Guideline stipulates that green debt instruments are debt instruments whose proceeds will be used exclusively for partial or total financing or re-financing of new or existing green projects in conformity with the eligible green project definition. As per the Guideline, the issuer will be permitted to use the term 'green debt instrument' if the following conditions are met:

- The issuer shall confirm that the issues covered by the framework document will be conducted in accordance with the principles set out in the Guidelines, which are aligned with the four core components (eg, use of proceeds, process for project evaluation and selection, management of proceeds and reporting) stated above.
- Proceeds from the issue as specified in the framework document shall be used exclusively to finance or refinance, partially or wholly, new or existing green projects that meet the definition of green projects under the Guideline.
- The compliance of the green debt instrument framework document with the Guideline shall be reviewed and evaluated by an institution providing external review services (eg, second-party opinion, verification, certification and green debt instrument rating).

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TÜRKIYE'S GREEN BOND PRACTICE

The green bonds are mostly used for private sector investments in renewable energy, energy efficiency, and other activities/projects that reduce greenhouse gas emissions in Türkiye. The first green bond issue from the TSKB was followed by a series of green bond issues by Turkish companies, banks and financial institutions in increasing volumes:

- In 2019, Garanti BBVA and İş Bankası issued green bonds in the total amount of US$100m.
- In 2020, Akbank, Garanti BBVA and Yapı Kredi issued green bonds in the total amount of US$150m.
- In 2021, QNB Finansbank, Arçelik, TSKB and İş Bankası issued green bonds in the total amount of US$413m and €350m.

CONCLUSION

Green bonds are among the options available for market participants committed to supporting climate-friendly and environmentally sustainable investments. However, the evolving green bond market faces a range of specific challenges and barriers such as underdeveloped domestic bond markets, insufficient pipelines of bankable and standardised green projects and a lack of commonly accepted green standards. In addition, there remains a question as to whether green bonds bring clear environmental benefits, as there exists an ambiguity around what qualifies as 'green'. The development of globally accepted standards such as the Green Bond Principles of ICMA and the local standards stipulated under the Guideline have brought a degree of transparency and standardisation to the market. However, the risk of corporate greenwashing, which can be defined as use of the proceeds of green bonds in projects that in reality have a negligible impact on the environment, still remains due to the growing number of firms issuing green bonds and high demand for these instruments. Considering the above, since green bonds are themselves a relatively new concept, the relevant authorities are expected to regulate green bonds in detail in the near future.

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