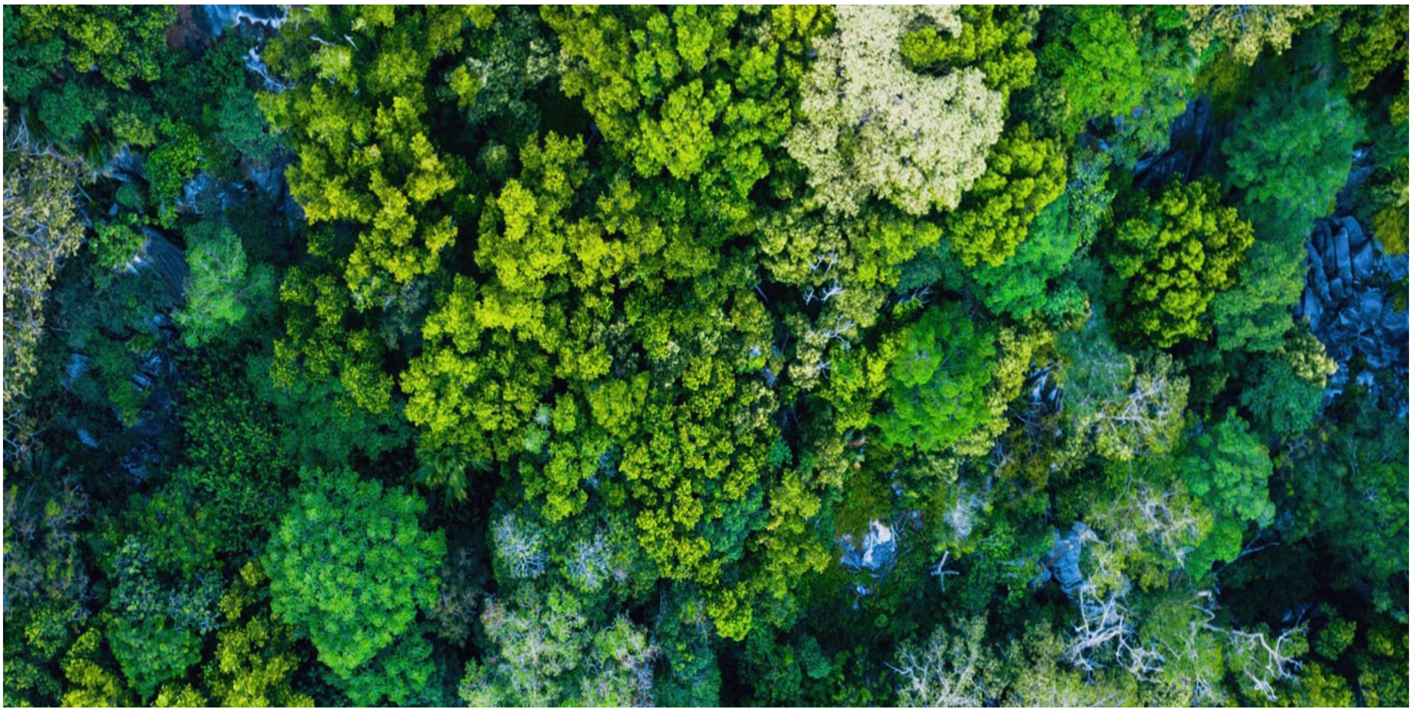

The Green Bond Potential in Emerging Markets

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Recently news broke that two Kenyan issuers are considering green bonds. Is this a portent of good things to come? Are other markets, not just in East Africa but more globally, likely to tap this new avenue of revenue? And how will it impact our evaluation of potential issuers, as investors in emerging markets debt?

Green bonds are much like traditional bonds, except they raise capital for sustainable projects—renewable energy, green transportation, and waste-water treatment, for example.

We have seen sharp growth in the issuance of not only green bonds but also sustainability bonds and social bonds, which are closely related. When thinking about issuance outside of the corporate space, sovereigns and state-owned enterprises in Latin America are leading in that respect, with Asia closely following. And there was recently a debut of a sustainability bond in Sub-Saharan Africa. The Republic of Benin issued a bond with a sustainability feature, making it one of the first in Sub-Saharan Africa to do so.

The latter provided a helpful framework for debt analysis in that it was very clear what the money was earmarked to do, and there was third-party opinion as to how it contributes to sustainable development goals and the achievement thereof.

But sustainability bonds are still a relatively new concept, and we think the effectiveness is yet to be tested. There clearly are transactional costs involved in designing a framework like that and ensuring that funds are used for intended purposes.

In comparison, proceeds raised through Eurobond issuance are intended for general budgetary purposes and this money is therefore fungible. But the proceeds of sustainable or green bonds can only be used for specific projects that meet strict guidelines in terms of meeting environmental objectives, and these frameworks have yet to be tested in terms of how they may be avoiding some of these fungibility issues.

Specifically, a country can develop a sustainable bond, but still fund other activities that are not green. A country may have a sustainable bond that is investing in renewable energy, but coal-fired power plants are being funded through other means. How do you think of a sovereign that is issuing money in that way? How green is the sovereign itself?

That said, bonds whose proceeds must be used for very specific purposes, and have very clear mapping to sustainable goals, in our minds can be very helpful in understanding the impact on environmental and social outcomes.

We definitely see scope for this across East Africa. There are issuers that are actively speaking to banks about designing these frameworks and ensuring that within the public money-raising system, earmarking processes are enacted that would allow for activities to be funded directly through a sustainable fund.

From an investor perspective, there is clearly a large pool of funds actively investing in sustainable activities, and sustainable funds are growing in size as allocators see this. We're seeing asset owners, particularly in Europe, focusing on sustainability. And in the context of European legislation, we're seeing a change in demand for sustainable products. That's filtering through to issuers, who are looking to issue an increased number of green and other labelled bonds.

There's a gap, in particular, for the lower-income countries and the single B-rated or lower-rated countries that don't necessarily have the frameworks in place to allow for that earmarking and have not yet completed the process of ensuring these frameworks are tested by third parties.

But we've found the development helpful in creating more transparency and specifically help in elevating the focus on sustainability within our own portfolios. Labelled bonds are helpful in mapping expenditure to objectives within environmental, social, and governance (ESG) factors and with sustainable outcomes.

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