RBC Global Asset Management

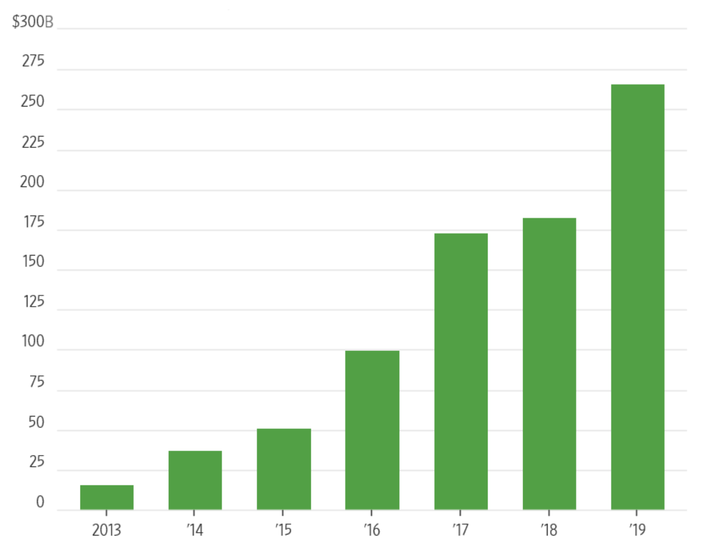
Are All Green Bonds Actually Green?

Growth of an asset class

Climate change is a global challenge that will have wide-ranging and significant impacts on economies, markets and societies worldwide for years to come. Investors are increasingly interested in addressing the very real threat of climate change by pursuing investment strategies that not only limit negative environmental impacts, but also take a proactive approach in supporting positive environmental outcomes. The growth of such interest has subsequently fueled a remarkable increase in green bond issuance over the past several years, with issuance of $15.69 billion USD in 2013 climbing to a staggering $266.54 billion USD in 2019.[1]

However, we believe a large swath of corporate-labeled "green" bonds qualify as greenwashed. Proceeds of corporate bonds are fungible – they are not project-specific. Investment grade corporates also have no financial need to issue a green bond, as they have no trouble tapping the bond market. While we applaud companies for working toward transition, they could do so without raising capital under the "green bond" label.

Exhibit 1: Growth in Green Bond Issuance



Source: Bloomberg New Energy Finance

The importance of impact measurement

At RBC Global Asset Management, we seek to mitigate risk and invest in high impact climate solutions to create resilient portfolios over the long term. To do this, we invest in projects that promote the health of the environment, including renewable energy, clean air and water, land preservation, efficient resource use, and environmental remediation projects. These investments can be guided by focusing on a subset of the United Nations Sustainable Development Goals, a global agenda to end poverty, protect the planet, and ensure prosperity for all by the year 2030.

Similar to how our investment philosophy informs our investment decisions, our corresponding impact philosophy informs our decisions around social and environmental impact. It is through that lens that we evaluate the impact of bonds labeled "green".

[1] https://www.wsj.com/articles/green-bonds-need-the-right-filter-11593509402

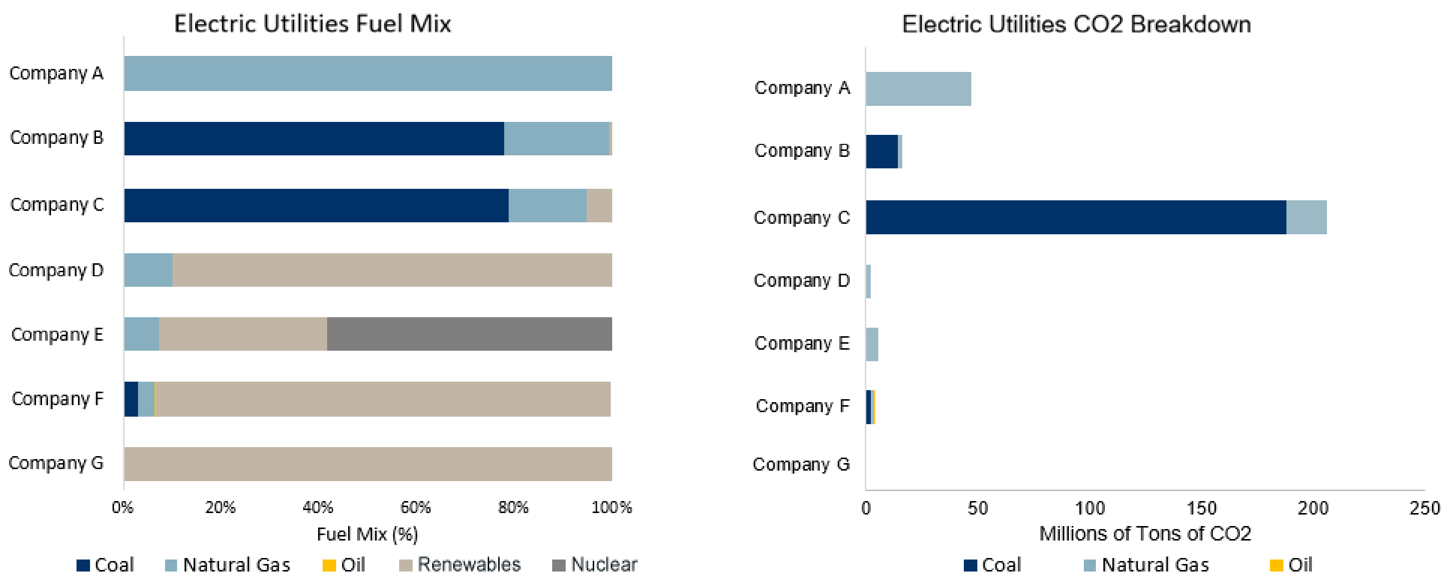
Our impact philosophy is guided by the belief that every investment has both positive and negative environmental effects, and that impact measurement is key in understanding the environmental footprint of your portfolio. All investments have the potential for negative environmental impacts, including greenhouse gas emissions, excess water usage, pollution and the loss of biodiversity, as well as positive environmental impacts, such as investments in renewable energy. Without a process to properly measure these impacts, there is no way of knowing if and by how much the good outweigh the bad. With good measurement comes an ability to optimize the positive and minimize the negative environmental impacts in a portfolio.

Greenwashing is the labeling of bond issues as "green" when the proceeds are not used for strictly green purposes.

An Illustration

Corporate bond investors are lenders to corporations. Whether a corporate bond is labeled "green" or not, at the end of the day, the bond proceeds support the larger entity as a whole – not just its green activity. It is for that reason that when we consider a corporate green bond, we evaluate the entirety of a company's activities to determine the environmental impact it may have. A good example can be found when we look at the utilities sector, breaking down each company by its overall fuel mix and resulting CO2 production.

Exhibit 2: Utility sector example – Measuring and managing transition risk



Source: Company data as of 12.31.19 Source: Bloomberg with supplemental information from individual company annual reports.

Any one of these companies above could issue a green bond – including the coal heavy producers (B and C). However, if we utilize the United Nations Sustainable Development Goals (UN SDGs) as a guide (a key framework to our impact measurement process), we can see that it wouldn't make sense to finance a company with a fuel mix that is 80% coal as the best method to invest in sustainable energy. The goals shown below are the relevant SDGs that our team would consider when making decisions regarding security selection in the sustainable energy sector.

7 AFFORDABLE AND CLEAN ENERGY

Ensure access to affordable, reliable, sustainable and modern energy.

- **7.2 By 2030**, increase substantially the share of renewable energy in the global energy mix
- **7.a. By 2030**, enhance international cooperation to facilitate access to clean energy research and technology, including renewable energy, energy efficiency and advanced and cleaner fossil-fuel technology, and promote investment in energy infrastructure and clean energy technology

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

Ensure sustainable consumption and production patterns.

- **12.2 By 2030**, achieve the sustainable management and efficient use of natural resources

We find that investing in bonds simply because they are labeled "green" is a very inefficient way to support climate change solutions. What's more, we believe it contributes to the widespread issue of greenwashing, making it feel more like a marketing exercise than an actual desire to meaningfully move the needle toward environmental sustainability. With a focus on quantifying the degree of impact, we are less inclined to consider what a company communicates as its climate change policy than to evaluate how a company's operations and products affect the environmental and social ecosystems in which they function.

Making the greatest impact

Impactful green bonds are available in the marketplace but many with the label are not green. We are biased towards financing pure-play green bonds. Some corporate bonds certainly meet or come close to meeting that criteria (companies D through G in Exhibit 2 above would be more aligned), but we believe higher impact green projects can be found in other sectors. We consider the taxable municipal market to offer the most breadth of pure-play climate change solution bonds. Investments in this sector support a variety of environmentally sustainable projects, including energy-efficient affordable housing, clean water and sanitation, and renewable energy projects.

Ultimately, our goal is to align our investments with the UN SDGs. Our proprietary impact measurement framework enables us to conduct location-specific environmental stress testing and analysis to meet our clients' goals. We seek to maximize the positive social and environmental footprint of our impact investing portfolios. Heavy carbon footprint investments are prevalent but can be avoided. We believe that net negative carbon investment strategies are feasible and it is our goal to advance environmental sustainability for the health of our planet and the well-being and economic prosperity of the peoples that inhabit it.

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Learn more about RBC's Impact Investing strategies.
With a legacy of deep expertise in impact investing, the **RBC Impact Bond** strategy seeks to provide market returns on liquid fixed income investments while also producing measurable positive impacts on communities and the environment.

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