INVESTING IN *Green Bonds*

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RELIABLE "GREEN" INVESTING

Sustainable investing is on the rise, as evidenced by the growing number of investors looking for solutions that not only generate potential returns, but also support projects that have a tangible and lasting impact on the environment. Above all, environmentally responsible investors want to know exactly what is happening with their money.

When it comes to transparency, green bonds occupy a special place in the world of sustainable investing, as they are governed by specific principles (Green Bond Principles, GBP), a common standard established in 2014 by member issuers of the International Capital Markets Association (ICMA). Green bonds are securities whose proceeds are used exclusively to finance or refinance new or existing eligible green projects.

AN ESTABLISHED REGULATORY FRAMEWORK

The Green Bond Principles are transparency and reporting guidelines voluntarily adopted by issuers to promote the integrity of this market. They provide a clear framework for green bond issuance. The GBPs are based on four key principles:

1. Use of proceeds
2. The project evaluation and selection process
3. Management of funds raised
4. Reporting

Eligible green project categories include renewable energy, energy efficiency, pollution prevention and control, sustainable management of living natural resources and soils, conservation of terrestrial and aquatic biodiversity, clean transport, sustainable management of water resources, adaptation to climate change, green buildings and products, and production technologies and processes adapted to the circular economy.

Since then, the European Commission has established the first legal framework for this fast-growing asset class by adopting the European Union Green Bond Standard (EUGBS), with the intention of making it a global benchmark.

HUGE FINANCING NEEDS

The transformation necessary to meet the climate goals of the Paris Agreement will require huge investments over the coming decades. Bonds are an essential asset class to secure the financing of such large-scale projects, while providing investors with a measurable return. Sustainable bonds thus offer investors the opportunity to directly finance specific projects that can help transform the economy.

The market for sustainable bonds in the broadest sense, which includes not only green bonds but also social bonds (aimed at fighting poverty or promoting social housing) and sustainable bonds (addressing both environmental and social objectives), is growing rapidly. The volume of current issues has increased fivefold between 2000 (€250 billion) and today (around €1,400 billion)[1]. Almost three-quarters of these are green bonds.

This is a welcome development for investors. The growing number of issuers not only improves diversification opportunities but also market liquidity. In addition, sustainable bonds carry relatively lower credit risk. As the market is dominated by semi-public institutions and non-cyclical companies, our analysis shows that they have solid ratings and a defensive profile. However, as with all bonds, a thorough credit risk analysis is essential in the selection process. This asset class is exposed to capital loss risk, interest rate risk and credit risk.

AN INNOVATIVE INVESTMENT APPROACH

While some fund managers are increasingly using fixed maturity strategies in the management of traditional bond portfolios, this is not yet common practice for green and sustainability bonds. However, the broadening issuer base and increasing issuance activity could change this. As a result, investors can pursue multiple objectives at the same time. In addition to the diversification offered by traditional investment funds and the active selection of securities based on credit risk analysis, fixed maturity funds offer the characteristic advantages of individual bonds: the volatility and default risk of the securities decrease as the remaining maturity increases. Fixed maturity funds therefore offer investors greater visibility of the expected target return, though it has to be recognized that the fund is exposed to the risk of capital loss.

What's more, sustainable bonds offer a high degree of transparency, as they are required to publish detailed documentation on the use of invested funds. Investors can then consult the reporting documents to find out how their money has been used.

The opinions expressed in this document correspond to our market expectations at the time this document is published. They are subject to change with market conditions, and under no circumstances do they incur the contractual liability of ODDO BHF AM SAS.

(1) Source: Bloomberg Global Aggregate EUR Green Social Sustainability Bond Index, data as of 12/08/2023