

SUSTAINABLE INVESTING—BEYOND THE GREEN BOND

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Sustainability is increasingly becoming a more material topic for governments, businesses, and investors. Issuing green, social, and sustainability bonds provides an opportunity for corporations to demonstrate the integration of sustainability into their decision-making process, strategy, and operations. Sustainable investing provides an opportunity for investors to make long-lasting and positive financial, social, and environmental impacts.

Sustainable bonds can be issued by governments, international organizations, and corporations through a variety of instruments including senior unsecured debt, asset-backed securities, mortgage-backed securities, and covered bonds. Their structure, risk, and returns are similar to traditional bonds, except that sustainable bond proceeds are invested in projects that generate environmental and/or social benefits.¹

Key drivers of Sustainable Investing

- Bond issuers’ increased awareness and intent
- Investors’ increased interest in contributing to positive change
- Improved ability to invest in increasingly more sustainable bond offerings
- Pandemic that heightened the focus on global ESG considerations
- Increased government attention and policies globally

¹ <http://www.undp.org/content/sdfinance/en/home/solutions/green-bonds.html>

Collaboration among policymakers, corporations, and investors will result in continued growth of this movement. CIBC Asset Management (CAM) is committed to responsible investing by embedding consideration of ESG factors in our processes and investment strategy,² leveraging the expertise of diverse professionals and using active management. CAM is focusing on long-term value creation and is committed to encouraging investee companies to establish suitable ESG targets and appropriate disclosure.

Understanding Green, Social, and Sustainability Bonds

Ethical financing is devoted to the financing or refinancing of new or existing eligible environmental projects (green bonds), social projects (social bonds), or a combination of both green and social projects (sustainability bonds). Sustainability bonds are aligned with the core components of either one or both Green Bond Principles (GBP) and/or Social Bond Principles (SBP) based on their classification.³

The GBP and SBP have four core components

1. Use of proceeds
2. Process for project evaluation and selection
3. Management of proceeds
4. Reporting

² <https://www.cibc.com/en/asset-management/investment-solutions/responsible-investment.html>
³ <https://www.icmagroup.org>

Market size

Global issuance of green, social and sustainability bonds hit another record in 2020, with U.S.\$491 billion of bonds issued. As a result of the pandemic and the disruption that exacerbated inequalities and social issues, social bond issuance set a record high of U.S.\$148 billion in 2020. Green bond volumes rose 13%, to a record U.S.\$305 billion.⁴

Moody's Investors Service expects continuous growth across all segments in 2021, with U.S.\$650 billion of issuance, a 32% increase over 2020. Moody's forecasts approximately U.S.\$375 billion of green bonds, U.S.\$150 billion of social bonds, and U.S.\$125 billion of sustainability bonds for the full year,⁵ with a broader focus on environmental issues such as clean water, biodiversity, ocean projects, waste, and pollution.

Potential opportunities

Investing in green, social, and sustainability-related bonds provides numerous opportunities for investors to incorporate sustainability into their investment portfolios, while supporting global efforts towards creating a sustainable future. Sustainable investing enables asset managers to fulfill mandates related to socially responsible investments—strategies such as low carbon, fossil-fuel-free, or other environmental or sustainable objectives, while generating long-term value and creating a positive impact.

By attracting capital to finance environmentally friendly projects, green bonds can directly generate positive, climate-friendly results such as reducing air or plastic pollution. They can also be a tool to help investors better manage the overall risk to climate change in a traditional fixed-income portfolio. Many green bonds have a good degree of transparency, limiting the risk of “greenwashing”—the disinformation disseminated by an organization that presents an environmentally responsible public image that’s unwarranted. Green bonds enable investors to monitor, quantify, and report on some of their benefits, such as the amount of clean energy that is being produced (in GW/h) or the reduction of CO² emissions achieved.

Obtaining an external review of the sustainability bond framework prior to issuing a sustainability bond is recommended by the sustainability bond guidelines.⁶ With the growing availability of sustainability bonds, the popularity of second-party opinion (SPO) is increasing. According to Environmental Finance, greater than 85% of green, social, or sustainability bond issuers obtained SPOs in 2019.⁷ Sustainalytics' Sustainable Finance Solutions team hit a key milestone, delivering 500 SPOs for the sustainable bond framework as of October 2020.⁸

4 <https://www.bloomberg.com/news/articles/2021-01-11/social-bonds-propel-esg-issuance-to-record-732-billion-in-2020>

5 https://www.moody.com/research/Moodys-Sustainable-bond-issuance-to-hit-a-record-650-billion-PBC_1263479

6 <https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-bond-guidelines-sbg/>

7 <https://www.lw.com/thoughtLeadership/green-bond-second-party-opinions-legal-practice-considerations>

8 <https://www.sustainalytics.com/sustainable-finance/sustainalytics-500th-spo/>

New classes of bonds

These are potential opportunities for Canadian businesses to access funding to reduce or mitigate their negative environmental impact.

Sustainability-Linked bonds (SLBs)

One of the most promising sustainability-related instruments is the SLB. SLBs are a forward-looking performance-based instrument. Any type of bond instrument for which the characteristics (coupon, amount, or maturity) depend on the issuers' achievement of pre-defined environmental, social, and governance (ESG) goals within an established timeline can be included in this category. The proceeds of the bond are not allocated to specific projects and can be used for general corporate purposes, unlike other labeled bonds (green, social, and sustainability bonds).⁹ Because of their flexibility in use of proceeds, which allows a much wider set of corporations to tap the sustainable finance market as part of their sustainability strategy, we expect to see these types of instruments in a broad range of industries.¹⁰

Transition Bonds (not yet available in Canada)

Transition bonds enable companies that would not generally be able to issue green bonds to obtain financing to shift to greener business activities. For example, companies that have a high carbon footprint are given an opportunity to become more sustainable by using the proceeds for climate-transition activities. The proceeds should be used exclusively to finance new and/or current qualified transition projects and support a shift to more sustainable business practices.¹¹ The need for transition bonds is a result of growing societal and governmental pressures to limit global warming. They provide a valuable opportunity for a wider range of corporations to shift their business activities towards a more sustainable path and support the transition to a low-carbon economy.¹²

CIBC Asset Management's approach

CAM takes a thoughtful approach towards integrating ESG factors into every step of the decision-making and investment process. We conduct in-depth due diligence and analysis of companies considering ESG-related developments, while combining both financial and ESG risk analysis. We actively incorporate ESG issues into our policies and practices and seek appropriate disclosure on ESG issues by the entities in which we invest. We continuously strive to enhance our effectiveness in implementing ESG strategies into our business and we regularly report on our activities and progress.

9 <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Sustainability-Linked-Bond-Principles-June-2020-171120.pdf>

10 <https://www.oecd.org/daf/Sustainable-and-Resilient-Finance.pdf>

11 <https://smith.queensu.ca/index.php>

12 <https://www.theedgemarkets.com/article/intheknow-transition-bonds>

An example of green bond investing—Algonquin Power Co.

We invested in a green bond issued by Algonquin Power Co., a company committed to generating clean, renewable energy.

Algonquin Power's green bond framework was credible, impactful, and fully aligned with our eligibility criteria. The proceeds were used to finance the construction of the Amherst Island wind facility in Ontario, in operation since June 2018. The project has a total of 26 turbines with 75 MW installed capacity,¹³ which comprises about 0.2% of the current installed capacity on Ontario's transmission system (38,944 MW according to IESO as of March 2021), and 1.6% of current installed capacity of wind energy in the province.¹⁴

Wind energy is one of the lowest-cost sources of new electricity generation in Ontario, a leading province in clean wind energy in Canada, producing approximately 40% of the country's wind generation as of year-end 2019. Wind energy is currently generating enough power to meet the needs of over three million Canadian homes. Ontario's wind industry has created thousands of jobs in manufacturing, construction and local services, and is expected to generate billions in earnings and add significantly to provincial GDP.¹⁵

Our investment illustrates our commitment to supporting and financing sustainable developments while receiving a fair return on our investment. Investing in renewable energy diminishes air pollution. This, in turn, strengthens the well-being of communities, reduces economic and infrastructure vulnerability, and creates long-term value for our clients.

¹³ http://amherstislandwindproject.com/site_main/

¹⁴ <https://www.ieso.ca/en/learn/ontario-supply-mix/ontario-energy-capacity>

¹⁵ <https://canwea.ca/wind-facts/why-wind-works/>

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