YOUR GOALS,
OUR COMMITMENT.

Realigning fixed income with purpose

By the Nikko AM Green Bond Team
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History may not repeat itself, but it does rhyme.

The concept of fixed income dates back thousands of years when cattle and grain were used to make loans. The more modern interpretation was born in 12th-century Venice and was commonly used to fund wars and support state initiatives, and it was later used to fund infrastructure development, such as Dutch dykes.

The common thread of these early bonds was their sense of purpose—money was being loaned to finance a specific objective.

Fast forward to this century, and while fixed income issuance has become a standard mechanism for governments and companies to raise finance, it often lacks a defined purpose. However, the growing trend of responsible investing is changing that. The need to tackle our planet's many climate, environmental and societal challenges is reuniting fixed income with its sense of purpose.

Sustainable Bonds—the collective name for a growing array of Green, Social, Sustainability and Sustainability-Linked Bonds—are defined by their proceeds being exclusively applied to eligible environmental and social projects or a combination of both.[1]

Pioneering multilateral development banks

The concept of sustainable bonds was developed in 2008 by the World Bank in recognition of the risks posed by climate change, and the need to help stimulate and coordinate public and private sector activity to combat this risk. Alongside the World Bank, Nikko AM launched the world's first dedicated World Bank Green Bond Fund in 2010.

By pioneering lending to eligible projects seeking to mitigate climate change or help affected people adapt to it, the World Bank showed it was possible to deliver high-quality fixed income products that would deliver impact as well as profits. Since 2008, it has issued USD 20 billion equivalent in Green Bonds via more than 200 bonds in 25 currencies.[2]

Yet, this figure is a mere drop in the ocean of the funding required to necessitate the changes needed to achieve a more sustainable world. According to McKinsey, addressing the energy transition alone will require an additional global investment of US dollar (USD) 3-3.5 trillion per year between now and 2050.[3]

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[1] The-GBP-Guidance-Handbook-January-2022.pdf (icmagroup.org)
[2] Green Bonds (worldbank.org)
[3] The net-zero transition: Its cost and benefits | Sustainability | McKinsey & Company

In the intervening years, issuers of sustainable finance have widened to include other multilateral development banks, governments and companies in both the developed and developing world. And growth has been rapid. Sustainable Bonds are expected to represent around 15% of the total global fixed income market issuance for 2023[4] —underlying the strong demand for these assets.

Policy and regulatory drivers

Apart from the need to fix the world's poly-crisis driving appetite for Sustainable Bonds, policy and regulation are rapidly becoming other key factors behind the growth of these assets.

While many governments have issued net zero commitments, not so many have followed through with specific legislation and, most importantly, funding. Last year, the Biden administration changed this with the passing of the Inflation Reduction Act (IRA). At USD 369 billion, this landmark bill has sought to move the goalpost for many climate initiatives in the US, including the clean energy transition and the uptake of electric cars, and has already been linked to an increase in sustainable bond issuance.

The EU's response to the IRA—the Green Deal Industrial Plan—as well as other pre-existing initiatives such as the EU Taxonomy and the EU Green Bond Standard will also be instrumental in driving sustainable fixed income flows.

The regulators are also continuing to raise their game. The EU's Sustainable Finance Disclosure Regulation (SFDR) is raising the bar for what constitutes sustainable investment across all asset classes, as well as demanding credible reporting requirements for investors. This is expected to expand further in the coming years, with regulations becoming more stringent in an effort to eliminate greenwashing, and other international regulatory bodies are already following this example.

Asset owners themselves are also demanding more transparency, standardisation and guidance on what sustainable fixed income should be expected to both offer and deliver—hence the growing voluntary adherence by issuers to initiatives such as the ICMA principles already mentioned.

Fixed income for the future

The growing call for action on climate change, the environment and important social issues has seen Sustainability Bonds promoted to the forefront of fixed income investment.

The asset class's transition away from specialist investment and into the mainstream lies in its dual potential to deliver real impact and ongoing returns on a par with other comparable fixed income investments, which can be attributed to greater diversity issue type as well as the growing breadth of geographic issuers.

Added to these attractions, better regulation and guidance from initiatives, such as the International Capital Market Association, are helping to allay greenwashing concerns through the provision of clear definitions and rules, as well as advocating for greater transparency.

These factors underpin why momentum for this developing asset class will resume its prior heady trajectory and make Sustainable Bonds the fixed income choice for the future.

[4] https://www.spglobal.com/esg/insights/featured/special-editorial/sustainable-bond-issuance-will-return-to-growth-in-2023

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