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# FREE Sustainability-linked green finance: a proposal to address greenwashing and enhance impact

We need an instrument that captures the advantages and minimises the limitations of existing sustainability finance structures



by: [Antonio Vives](#) Dec 21st, 2021



The explosion of sustainable financing: long on financing, short on sustainability, long on promise, short on impact. And this growth is not only in volume but also in modalities, now covering the whole spectrum from credit facilities and credit lines to bonds, to equity and securitizations.

In the rush to issue and particularly to refinance old liabilities in a favorable market (greenium is still positive, strong demand for socially responsible investors, and fashionable), many issuers are engaging in structures with little or no impact on the sustainability they are supposed to foster. Many take advantage of the loopholes in the existing principles for sustainable and sustainability-linked financing. The discussion of the sustainable finance market is driven and dominated by intermediaries, which have an interest in volume. But the gap between volume and impact can very wide.

## Limitations of the current structures

Most of the limitations derive from the existing voluntary principles that govern those issues, in particular from the most used ones, the International Capital Markets Association Principles (ICMA) for Green, Social and Sustainability bonds (GSSB) and for Sustainability-linked bonds, SLB (Principles for the corresponding loans have been developed by the Loan Syndications and Trading Association, LSTA).

The current system is akin to the limited assurance of sustainability reports, which are passive (“nothing has been called to our attention that ...”) and must be significantly more proactive and express a judgement.

The Principles for GSSB establish that the funds raised must be used in projects that have sustainability contributions, but the magnitude of the contribution is not specified. Those adhering to the principles must report on inputs and outputs (amounts invested in which project or activity), which then become the goals, but are not required to report on outcomes or impacts.

The Principles for SLB do require a linkage between the issue and some sustainability goals, but the use of the funds and the significance of the goals are not specified and could be something trivial compared to the sustainability impact of the issuer. In general, the achievement of the stated goals is either penalised or rewarded through the cost of the issue, which could, again, be trivial or significant. Neither of the two sets of principles address the sustainability of the issuer. Granted, responsible issuers will go beyond the minimum expectations and report on impact.

The framework that guides the issues is verified by an independent institution, normally a consultancy, that produces a second opinion regarding the compliance with the principles – which is non-binding, non-compliance can only damage the reputation of the issuer. But they do not address the significance of the goals, the resources used to achieve them, the significance of the impact and the overall sustainability of the issuer. This can lead to either greenwashing or to a reduced impact, or both.

### **A tighter modality**

What is needed is an instrument that captures the advantages and minimises the limitations of the two existing modalities. We propose Sustainability-linked Green, Social or Sustainability bonds (or facilities, or credit lines, or loans, or notes, or equity), SL-GSSB. These instruments would follow the following additional principles:

- Sustainability goals must be significant, commensurate with the issuer’s social and environmental impact.
- A significant portion must be used in achieving those goals, even if resources can be for general use,
- Significant impact over the status quo, i.e, additionality.
- Significant overall sustainability of the issuer

### **The way ahead**

The system of Principles and reporting will have to include a workable definition and requirements of what are (1) “significant” sustainability goals to be achieved; (2) “significant” use of the resources raised in achieving those goals; (3) significant impact; and (4) the overall sustainability of the issuer (for instance, a minimum rating average of 5 major raters), not only of the goals.

The issuers of Second Opinions and reports should analyse these issues and state their opinion on all three, and maybe including a rating for each (beyond light and dark green!). This will require changing the second opinion to a verification of the material compliance with the “significant” principles above. The current system is akin to the limited assurance of sustainability reports, which are passive (“nothing has been called to our attention that ...”) and must be significantly more proactive and express a judgement. They must include a judgement.

As this is implemented it may evolve to include sustainability covenants on the bonds that go beyond the penalties and rewards.

But the coordinated action of all responsible investors is fundamental, not just of some of them.

All of this is, of course, easier said than done. There are significant vested interests in the status quo, in both the issuers, that can access the market, and the sustainability industry (asset managers, raters, collectors and aggregators of information, second opinion institutions, consultants, promoters of sustainable finance, among others) that profit from it.

Industry opposition is to be expected to our proposed instrument, as the implementation of this financing modality could lead to a reduction in the volume of these instruments - but they would certainly enhance their impact. While it may not achieve universal application, any use will an improvement over the *status quo*.

As such, the intervention of regulatory agencies is urgently needed to force the disclosure of the relationship between intent and impact, not just seeking standardisation.

It is unlikely that the two traditional modalities will cease to exist, but at least the SL-GSSBs can create a submarket for really socially responsible instruments, issuers, investors and asset managers, hopefully not just a niche market.



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tagged with: ICMA, Green Bond Principles, Loan Syndications and Trading Association