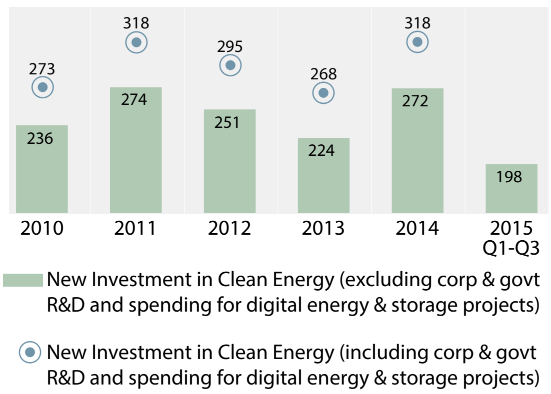
PAINTING THE CAPITAL MARKETS GREEN

BACKGROUND

In December 2015, the participating 195 countries of the 2015 United Nations Climate Change Conference agreed, by consensus, in 'the Paris Agreement' to reduce emission with the aim of keeping global warming below 2°C.

However, in the years preceding this conference, we have seen the fallout from the Global Financial Crisis (GFC), Euro Crisis and ongoing market uncertainty making it more difficult for governments to budget for infrastructure investment, green or otherwise. Likewise utilities stocks have been hit hard by falling equity valuations, while bank asset financing has shifted away from long-dated capital intensive infrastructure exposures.

FIGURE 1
New Investment in Clean Energy – falling short of requirements



Source: Bloomberg New Energy Finance (Q3, 2015)

Over 2014, roughly US$318bn flowed to new clean energy investment (US$188bn to asset finance)[2], falling well short of the incremental investment needs of $1trn per annum estimated by the International Energy Agency[3].

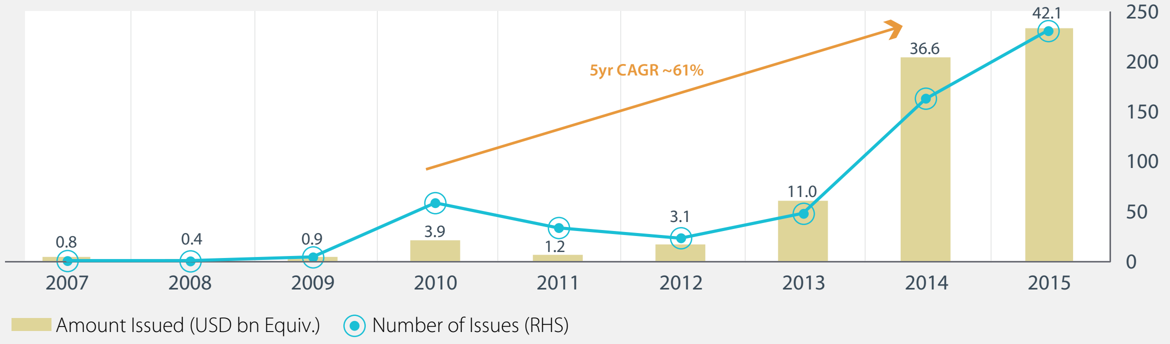
WHO IS PLUGGING THE SHORTFALL?

In our last edition of Issues that Matter, ANZ's Financial Institutions Group highlighted that infrastructure as an asset class is best suited to multigenerational investors, such as pension funds and sovereign wealth funds. These investors have the long term mandate and financial wherewithal to withstand intermittent periods of turbulence as well as regulatory, accounting or restrictive investment policies that can disincentivise long-term investment. However, to encourage a broader range of investors and fill the near US$700m shortfall, financial innovation is vital with all eyes on capital markets.

2 Bloomberg New Energy Finance (Oct 2015 'Global Trends in Clean Energy Investment)
3 International Energy Agency (www.iea.org)

FIGURE 2
Green Bond Issuance

Green bonds represent a new hope for clean energy infrastructure funding, with 5 year CAGR over 60% in this burgeoning new market.



Source: Climate Bonds Initiative (www.climatebonds.net)

WHAT ARE GREEN BONDS?

In simple terms, Green Bonds are bonds whose proceeds are used to finance or refinance climate-friendly or environmentally-friendly projects. There are three broad guidelines which most Issuers have relied on:

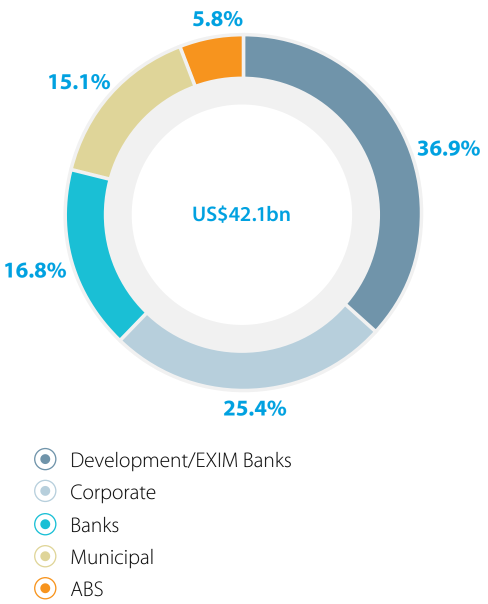
1. **World Bank –** World Bank Green Bond Project Selection Criteria with projects to be selected by World Bank environmental specialists
2. **Climate Bonds Initiative (CBI) –** Climate Bonds Standard
3. **International Capital Markets Association (ICMA) –** Green Bonds Principles

SUITABILITY FOR COMMERCIAL BANKS

Initially the domain of development banks only, Green Bonds have become a staple of ANZ DCM discussions with commercial banks. Net proceeds are used to finance projects with environmental benefits such as renewable energy, energy efficiency, sustainable transport, sustainable water management, sustainable waste management and sustainable land use. Such projects may not typically be prioritised by the bank due to the long-term and capital intensive nature of infrastructure funding, which has been disincentivised under Basel Committee of Banking Supervision's (BCBS) regulatory reforms.

FIGURE 3
2015 Green Bonds by Issuer Type

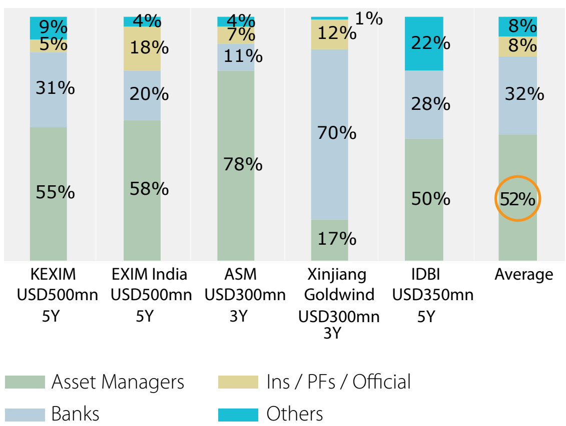
"Green bonds allow banks to sell bonds beyond their traditional investor base. We haven't seen lower borrowing costs, but there is certainly an increase in volume as a broader investor set participates", says Bhavik Pandya, Director, DCM.



Source: Climate Bonds Initiative (www.climatebonds.net)

FIGURE 4
2015 Green Bonds by Investor Type

Asset managers have been the core buyers of recent Asian green bonds.



Source: Dealogic

In 2015, ANZ self-led an AUD600m 5 year green bond in Australian domestic markets as well as a USD350m 5 year green bond debut issue for IDBI – the first USD green bond from an Indian commercial bank.

Both issuers developed a framework using the Green Bond Principles, developed by ICMA, although the approach diverged. ANZ's green bond was certified pre-issuance by the Climate Bonds Initiative, following successful verification by Ernst & Young, while IDBI issued on the basis of a Green Framework developed using Green Bond Principles with the intention to seek third party verification for their reports on use of proceeds going forward.

"Using the Climate Bonds criteria enabled us to leverage our position as a leading financier to the renewables and commercial buildings sector in Australia in order to successfully issue a green bond. Not only was feedback positive during our roadshow particularly with regards to use of criteria and the disclosure obligations that flow from that, but also our customers, whose assets are included in the bond were very supportive" says Katharine Tapley, Director, Sustainable Finance Solutions at ANZ.

SHARING OUR INDUSTRY INTELLIGENCE WITH CLIENTS

ANZ's Financial Institutions Group, together with the Capital Markets team, works with bank issuers to structure green bonds that meet the high standards demanded by green bond investors. "One of the positive impacts of both green bond issuances was the visibility and press for both IDBI and ANZ. I think demonstrating being able to deliver into the green agenda by issuing green bonds has really added to their reputations globally", comments Arshad Khan, Director, FIG India.

ANZ's Group Treasurer, Rick Moscati commented at the time of ANZ's issuance that "We have developed the bond in response to investor demand and to deliver on our commitment to deploy capital for the transition to a low-carbon economy". ANZ's order book attracted investors who had never before participated in bond issues from ANZ, resulting in a highly successful, oversubscribed and granular order book.

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