GREEN BONDS: INTRODUCTION & OUTLOOK; FAB'S ROLE IN THE MARKET

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Introduction

The 2015 Paris climate agreement emphasized the key role of mobilizing public and private finance to fight the adverse impacts of climate change, and included the commitment to align financial flows with a pathway towards low greenhouse gas emissions and climate-resilient development.

The required transformation aims to limit global warming to 1.5°C. Including a target of reaching net-zero emissions by 2050, huge investments will need to be made to achieve these goals. Capital needs to be mobilized across the priority sectors of the global economy to ensure this transition is successful and equitable, and this is especially true across sectors that account for global emissions such as power, mobility, buildings, agriculture, forestry, and waste management. These key activities will all need to see substantial transformation to achieve net-zero emissions.

According to a new report from McKinsey, the transition to net-zero will cost USD275 trillion globally by 2050 as low-emission activities are ramped up and high-emission activities decrease. While the scale of the investment needed is widely known, what is less clear is just how this huge investment is going to happen. This is where sustainable finance comes into play.

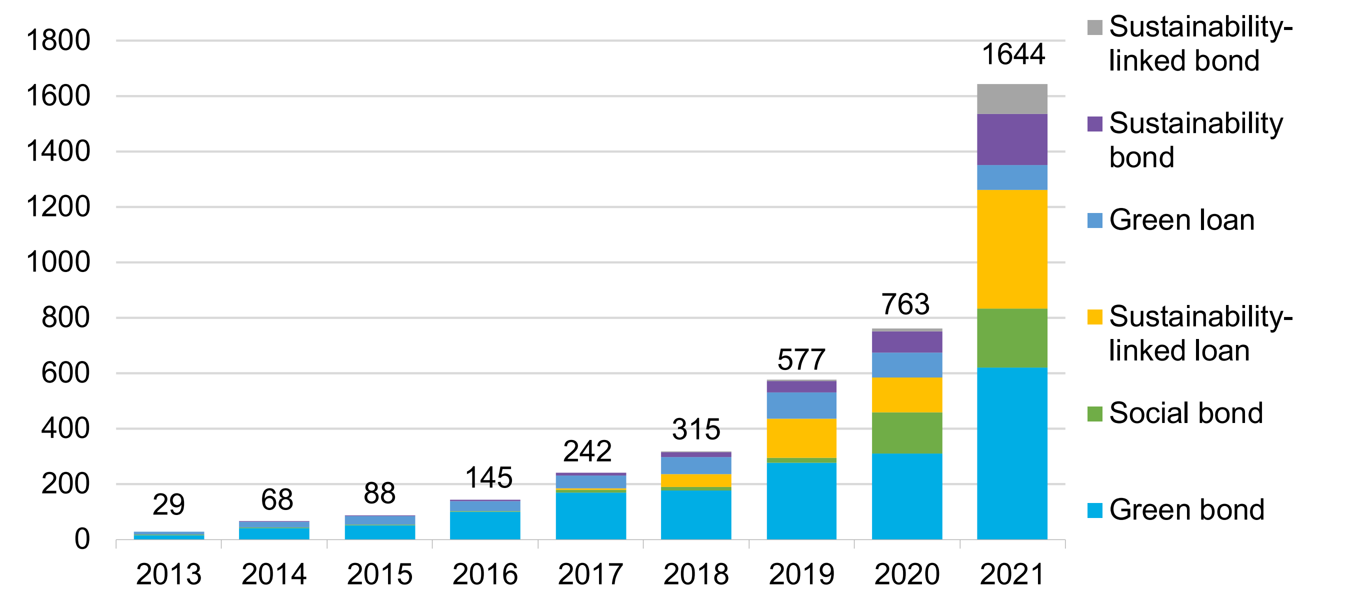
What is sustainable finance?

Sustainable finance is defined as investment decisions that take into account the environmental, social, and governance (ESG) factors of an economic activity or project. Sustainable financing can be split into two main categories:

1- Activity-based products: financing projects or businesses with an intended environmental or social outcome. This includes Green bonds & loans (activities with an environmental benefit), Social bonds (activities with a social benefit) and Sustainability bonds (activities with environmental and social benefits). In 2021, activity-based debt totaled $1.1 trillion (see chart 1).

2- Behaviour-based products: such as Sustainability-linked bonds & loans, where the financial component of the bond is linked to a sustainability target. This could be a greenhouse gas emission reduction goal, a quota for diversity in the workforce, or many other types of behavior. In 2021, USD537 billion of behavioural-based instruments were issued (see chart 1).

Chart 1: Sustainable debt issuance ($ billion)



Source: Bloomberg

Focus on Green bonds

Green bonds were created to fund projects that have positive environmental and/or climate benefits. They have identical financial characteristics to conventional bonds from the same issuer, including credit quality, yield, and price at which they are issued. The only difference relates to their use of proceeds - they are exclusively used towards financing or refinancing green assets, projects or business activities, such as to develop renewable energy technologies, or to mitigate climate changes.

The funds raised from green bonds must be used exclusively for these activities, which can be used to provide environmental benefits, social benefits, or both.

The eligible activities should contribute to at least one of the United Nations' Sustainable Development Goals (SDGs), and covers a range of activities, from financing green energy projects and clean transportation, to projects that demonstrate positive social impacts such as employment generation and social inclusion.

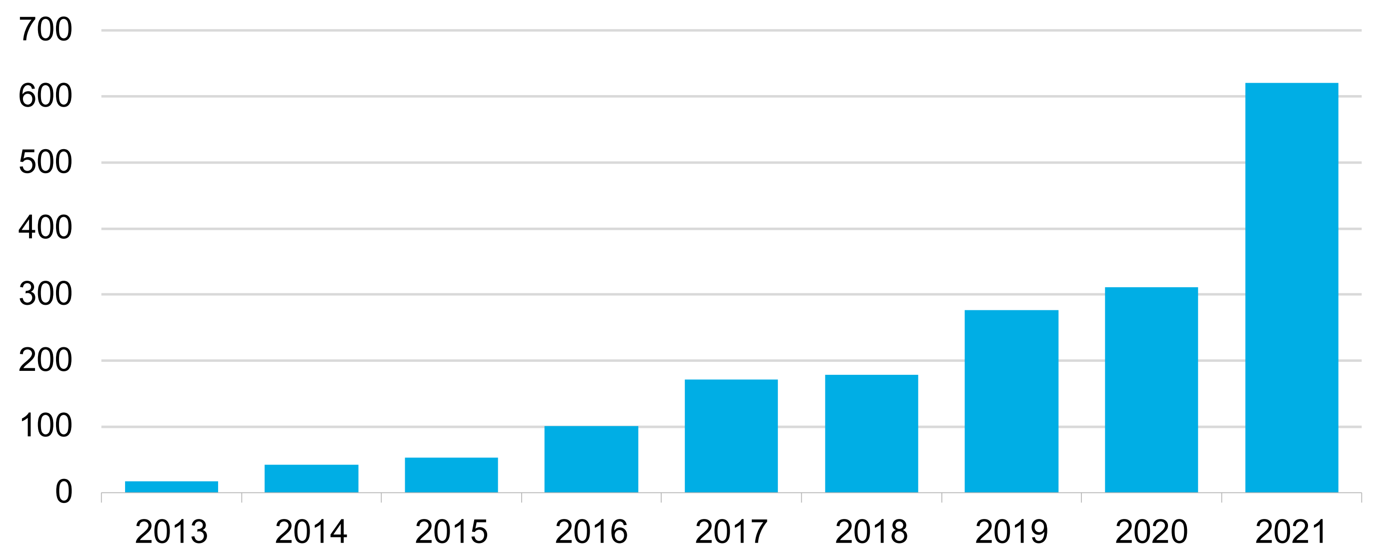
It is highly recommended that green bond issuers comply with the following core components of International Capital Markets Association (ICMA) Green Bonds Principles:

- Use of proceeds: explain which project the proceeds are going to be used in, and the expected green and/or social impact
- Process for project evaluation and selection: the issuer must provide details about the internal process to select the eligible green project

- Management of proceeds: explain how to track the allocation of green proceeds, and the use of unallocated funds
- Reporting: at least annually publish a report including a list of the projects financed by the green bond proceeds, and the expected environmental impacts of these projects

Since the first ever labelled green bond issued by the European Investment bank in 2007, the green bonds market has grown exponentially, especially in recent years. In 2021, total green bonds issued amounted to USD621 billion, double the issuance of the previous year, and close to 15 times the amount issued in 2014 (see chart 2). The global market in green bonds exceeded USD1.8 trillion in 2021, and is expected to continue growing significantly during the years to come. This record growth underlines the growing popularity of green bonds as a funding concept.

Chart 2: Green bonds issuance ($ billion)



Source: Bloomberg

FAB is one of the leaders in Sustainable Financing

Green bonds are a key tool that FAB employs to support the bank's sustainability policy. As mentioned above, they work like regular bonds, with one main difference: the money raised from investors is used exclusively to finance projects that have a positive environmental impact. In 2017, FAB became the first bank in MENA to issue a green bond, and have since become a market leader in this relatively new asset class.

The origination of green bonds and green private placement products are particularly important to FAB's sustainability strategy, as they are linked to projects the bank is actively involved in.

FAB has also expanded its Green Bond Framework to a Sustainable Finance Framework to incorporate the ICMA's green, social, and sustainable bond guidelines. FAB was the first bank from the United Arab Emirates and the Gulf Cooperation Council to join the UN's Net-Zero Banking Alliance in 2021 and was given an ESG rating upgrade by MSCI from "A" to "AA", identifying FAB as a true ESG leader. FAB's commitment to ESG has led to a number of major transactions for the bank this year, with more than half of the bonds issued in a green format ($1.5 billion), including three public benchmark transactions:

- EUR500m 5-year, the first-ever green issuance in euros from the MENA region;
- CHF 200m 4-year, where FAB remains the only issuer from MENA with green CHF outstanding; and -
- USD700m 5-year, the largest-ever green issuance from a MENA-based bank.

Despite challenging market conditions last year, FAB was able to attract high-quality investors, including large central banks and asset managers, in addition to several large green dedicated funds in Europe, Asia, and the US.

As mentioned, in 2017 FAB pioneered green bond issuance in the MENA region - by issuing a USD587 million, five-year green bond. Since then, the bank has continued to focus on its green and sustainability-linked funding activity, by issuing over USD2.8 billion equivalent in green formats in both public and private transactions, of which over USD2.25 billion are outstanding from 13 transactions, and in five different currencies.

So, what is the positive impact of these? FAB has created positive outcomes from many of the sustainable projects it has financed. These include 1,989,000 tons of carbon emissions avoided every year (in total) from three solar projects. Additionally, seven green buildings the bank has financed have an 'Estidama 2 Pearl Rating' (*) for design. Lastly, a wastewater plant FAB has financed treats 430,000 m3 of wastewater per day.

Note: (*) 'Estidama' is the Arabic word for sustainability. The Pearl Building Rating System (PBRS) is used to evaluate sustainable building development practices in Abu Dhabi. The PBRS encourages water, energy, and waste minimization, and the use of local materials to improve supply chains for sustainable and recycled materials and products.