**IMPACT STORY #2**

**LEVERAGING THE POWER OF DEBT CAPITAL MARKETS TO HELP SAVE THE PLANET**

From billions to trillions: fixed-income investments that take into account environmental, social and governance (ESG) criteria have moved from ‘niche’ to mainstream debt capital markets in the last five years, potentially reaching US$ 11 trillion in 2025. Diverting just a small part of that capital flow towards biodiversity could have a massive impact on Planet. What would happen if investors acted?

**IMPACT**

Global debt capital markets are – by far – the largest and deepest pool of global capital. Over the past five years WWF has worked with private and public sector standards-setters to nurture and develop effective and credible environmental standards for so-called “green bonds”, “ESG bonds” or “sustainability bonds”, which exclusively finance projects with specific environmental, social or sustainability benefits in mind.

ESG bonds represented more than 13% of global bond issuances in 2022 and their market share is forecast to reach 14-16 globally in 2023. And these ‘green’ fixed-income securities traded on international markets now exceed US$ 3 trillion and could potentially reach US$ 11 trillion by 2025.

And the size of these markets matters: The US$ 900 billion raised through ESG bonds in 2022 alone represent more than 100-times the total amount of annual conservation funding mobilised by NGOs globally on average (US$ 2 billion per year). And while biodiversity still is a ‘niche use case’ for these markets and most financing has been carbon-related, ESG bond that make some kind of reference to biodiversity (among others) represented US$ 274 billion.

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1 Sustainable Bond Issuance Will Return To Growth In 2023, S&P Global Sustainability Insights, Feb. 7, 2023. Even recently reaching 15% of global total issuance, the highest quarterly market share on record in the second quarter of 2022, see: Sustainable bond volumes resilient in Q2 despite tighter financial conditions, Moody’s Investors ESG Solutions, 28 July 2022.
4 HSBC research *Biodiversity begins to bloom*, 31 August 2022. But this does not mean all of these funds have been allocated to biodiversity, as in many cases biodiversity is competing with other uses of proceeds.
OUR STORY

Exponential growth driven by investor demand for debt securities labelled as green

With more than US$ 126+ trillion in outstanding finance and investment⁵, global debt capital markets are – by far – the largest pool of global capital. Around US$ 1 trillion change hands on these markets every day and the people who control these transactions, including market practitioners, financial regulators, supervisors and central bankers, have a critical role to play to help save the planet.

But with a narrow and exclusive focus on financial risk- and return profiles of the securities traded on global debt capital markets, environmental performance criteria have been largely absent from the information provided to bond investors. This changed in 2014, when a group of investment bankers founded the Green Bond Principles⁶ to develop market guidance for companies to raise money on capital markets through debt securities that are self-labelled as green, social and sustainable.

Two years later, in 2016, WWF started to work on global debt capital markets, seeking to leverage the power of these markets by shaping and nurturing the thriving markets for fixed-income investments labelled as ‘green’ or ‘sustainable’. These labelled bonds, also referred to as “ESG bonds”, exclusively finance projects with specific environmental, social or sustainability benefits in mind.

Controversy: while market growth may be a necessary condition, is it enough to have environmental impact?

The question whether markets labelled as ‘green’ could actually have a positive impact on the environment was controversial from the very beginning: the thorny question of these markets’ ‘additionality’, and the risk of ‘greenwashing’ has haunted the market ever since⁷. Stakeholder views at that time were opposing: while for some, it was a clear success story, others felt that green bonds were doomed to failure from the start!

For its proponents, green bonds are an essential tool and strong growth, moving “from millions to trillions”⁸ and entering mainstream markets, was perceived as a fundamental, and necessary condition for impact. As Philippe Zaouati, one of the leading sustainability-minded asset managers, put it in 2018: “if we want the market to really have an impact on sustainability, we need this market to grow much more ...”⁹.

The critics, however, felt that green bonds were flawed by design: “Projects were going to get built anyway, the bonds were going to get issued anyway, so what has the market achieved?”. Green bonds were perceived, at best, as ‘shooting for the moon in a hot balloon’⁴⁰ and were criticised as “a distraction from meaningful activities” that lack evidence to conclude that green bonds contributed to scaling up the investments in green project¹⁰.

Green bond proponents responded that they felt it was unfair to ask the green bond market to be ‘additional’ and argued that bonds are principally a refinancing tool. This would make it near-to-impossible to prove whether a project would or would not have happened without ‘green labelling being available’. Moreover, while environmentally-minded investors recognised the critical role of standards to set a high bar for integrity of the green bond market, others feared that stringent standards would stifle innovation and eventually ‘kill the green bond market’¹¹.

“Green bonds are an interesting tool to reconnect the dots between finance and the real economy. ..If we want this market to really have an impact on sustainability, we need this market, really, to grow much more than that...

Philippe Zaouati, CEO of Mirova (Natixis Group), an asset management company offering investment solutions that combine financial performance with environmental and social impact

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⁵ Global Fixed Income Outstanding stood at US$126.9 Trillion at the end of 2021, see: SIFMA Capital Markets Fact Book, 12 July 2022.
⁶ Green and Social Bond Principles, convened by the International Capital Markets Association (ICMA).
⁸ Green bond comment, August 2018: Upgrading the hot air balloon, Environmental Finance, 1 August 2018.
⁹ "Shooting for the Moon in a Hot Air Balloon", 2 Degrees Investing Initiative, May 2018.
¹⁰ A bond for the planet: 10 years of EIB’s Climate Awareness Bonds, European Investment Bank, 25 October 2018.
With impact in focus WWF worked to set effective and credible standards to protect market integrity

In the middle of this controversy, in early 2018, WWF decided to launch a global initiative on ‘green debt capital markets’, focusing on effective & credible standards, with two key knock-on effects for the financial sector in mind: financial instruments with measurable environmental impacts (i.e. the ‘quality’ of green bonds and loans available in the market) and increased transparency in non-green bonds (i.e., ‘quantity’ to reach ‘tipping point’ market share, exceeding 20%).

Over the past 5 years WWF has been working with all leading international standard-setters, including the International Capital Markets Association (ICMA), the International Standards Organisation (ISO), the European Commission and the Chinese government, to clearly define what can be deemed a ‘green investment’ through robust investment frameworks, including sector-specific investment criteria, metrics and thresholds (also called ‘taxonomies’).

Today, there are very encouraging signs that the market is developing and that the mainstream financial market infrastructure now delivers more, and better environmental information to investors.

Green and sustainable debt capital markets have reached ‘tipping point’ market share, exceeding 20% in Europe, and 13% globally in 2022

Investor demand for these securities has been strong and markets have grown exponentially in the last 5 years. These markets represented more than 13% of global bond issuances in 2022 and their market share is forecast to reach 14-16% globally in 2023.

And, more importantly, in some regional or national markets, these ESG bonds have already reached a ‘tipping point’ market share, moving from a ‘niche market’ to mainstream fixed-income markets. In Europe, for example, more than 20% of the money raised on European debt capital markets in 2022 was labelled as green, social or sustainable and in Mexico the market share of these securities even exceeded 30%.

Public sector issuers have played an important role in the creation of the market and issuances from sovereign green bond issuers, a market segment that WWF has helped kick-start in 2017. They have played an important role in amplifying and accelerating market growth and tightening standards through signalling effects (See: WWF’s impact story #3 Greening Sovereign Debt Capital Markets).

Source: Data compiled by WWF from various sources, including S&P Global Sustainability Insights (2023) and AFME Finance for Europe (2023).

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Green debt capital markets have not only grown in quantity, but also in quality: the EU’s plan to design international ‘gold standard’ with WWF input

Green debt capital markets have not only grown in quantity but also in quality: international standards for these markets have shifted from relatively lax, principle-based process guidelines available since 2015 (i.e., ICMA Green Bond Principles) to more prescriptive taxonomy-based standards in 2022.\(^\text{26}\)

For example: the European Green Bond Standard (EU-GBS), a voluntary standard designed with WWF input\(^\text{27}\) and agreed in March 2023,\(^\text{28}\), ambitions to become the ‘gold standard’ for international bonds markets. The standard goes well beyond the market’s predominantly narrow, and sometimes exclusive focus on climate\(^\text{29}\) and is based on a comprehensive investment framework (also referred to as the “EU-taxonomy”)\(^\text{30}\) covering six environmental objectives including the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems.

The EU-taxonomy includes, among others, sector-specific criteria for positive impacts on biodiversity and ecosystems protection, as well as ‘do-no-significant harm criteria (DNSH)’ aiming to avoid unintended negative side effects of investments resulting in negative impacts on biodiversity and/or ecosystems, in particular in Key-Biodiversity Areas or UNESCO World Heritage sites.

These new legal requirements will trigger more extensive investor due-diligence on biodiversity and ecosystems across the financial services value chain (see: Impact story #1: Do-no-significant harm criteria to avoid unintended side-effects).

However, the actual impact of these regulated standards will hinge upon their credibility and their level of ambition, which currently is a source of serious concern. In some instances, for example, technical proposals with solid scientific evidence made by WWF and others have been overruled to suit vested national or industry interests (e.g., inclusion of gas and nuclear in the EU taxonomy\(^\text{31,32}\) or weak criteria for certain activities\(^\text{33}\) such as forestry or bioenergy). This will significantly tarnish the reputation of the standard that the EU had initially intended as the world’s leading “gold standard” for green finance.

A common language is emerging, defining what is green and what is not

While market growth is certainly not an end in itself, it certainly is a necessary condition for impact at scale. Analysts estimate that the debt market could potentially grow 4-times in the next 3 years to reach US$4.5 trillion in annual issuances by 2025, on course towards a global market share of up to 17%\(^\text{34}\).

More importantly, the underlying standards, definitions, and taxonomies are now beginning to create a ‘common language’ for responsible and sustainable investments globally, becoming a universal set of definitions of what qualifies as a ‘green investment’. This will help create credible platforms and relevant market infrastructure for environmentally friendly investment options to be developed, thus enabling a meaningful shift in financing towards a sustainable economy.

Success or failure? Whether green bonds have failed or have helped to save the Planet is yet to be seen!

But was the green bond market a failure or a success? A recent academic study tried to answer the question whether the proponents or the critics of green bonds were right, but concluded that “...it [was] still too early to speak of ‘success’ or ‘failure’ of the green bond market”\(^\text{35}\).

Indeed, it seems that the broader contribution of debt capital markets in mitigating climate change still remains unclear and robust scientific evidence is scarce: A study by the Bank for International Settlements\(^\text{26}\) did not find conclusive evidence that green bond issuance is associated with any reduction

\(^{\text{26}}\) See: chapter 4 (pages 48-55) in the WWF publication Can debt capital markets save the planet, September 2021.
\(^{\text{27}}\) WWF was a member of the EC mandated technical expert group, which developed the European green bond standard, released in March 2020.
\(^{\text{28}}\) EU agrees on long-awaited rulebook for ‘green’ bonds in an attempt to fight greenwashing, March 2023.
\(^{\text{29}}\) Such as, for example, the Climate Bond Standard, developed and purveyed by the Climate Bonds Initiative (CBI), a UK-based international NGO.
\(^{\text{30}}\) EU taxonomy for sustainable activities, European Commission website, accessed in August 2022.
\(^{\text{31}}\) This is not to say... WWF will not rest until the Taxonomy is right, WWF Europe, July 2022.
\(^{\text{32}}\) EU Lawmakers Remove Last Hurdle to Label Gas, Nuclear as Green, Bloomberg News, 6 July 2022.
\(^{\text{33}}\) Open Letter to the Commission Asking for Removal of Forestry and Bioenergy from the Current Climate Taxonomy: Delegated Act, Brussels, 9 April 2022.
\(^{\text{34}}\) E.g. assuming US$4.5trillion of annual issuances in 2025, under IIF’s ‘bull market’ scenario, see: Bonds that build back better, Pictet Asset Management in partnership with the Institute for International Finance (IIF) January 2022.
in firms’ overall carbon intensity, highlighting that issuers may be (and often are) heavily engaged in carbon intensive activities elsewhere. In contrast, a study by the European Commission’s Joint Research Center\(^27\) found that, compared to conventional bond issuers with similar financial characteristics and environmental ratings, firms borrowing in the green segment witnessed a larger decrease in the carbon intensity of their assets, up to 2 years after the bond issuance. And the European Securities and Markets Authority\(^28\) concluded that energy firms, utilities and banks that issued a green bond [...] have on average reduced their carbon intensity to a larger extent than other firms confirming the view that green bonds act as a signal of firms’ climate-related commitments.

Anyway, it already becomes clear that green bonds have significantly contributed to raising investor awareness about environmental issues, more prescriptive taxonomy- based standards developed with input from WWF failed to ‘kill the market’ and exponential growth of the green bonds market is likely to continue.

ESG bonds as a tool have entered mainstream financial markets. But it remains in the hands of those vested in global debt capital markets to pioneer a change in investment paradigm that can leverage the power of debt capital markets to “...help preserve, restore and protect the planet, rather than destroying it”\(^29\).

Whether debt capital markets will eventually play their part in saving the planet and shift to becoming ‘zero-carbon and nature positive’ will eventually depend on the people who control transactions on these markets, including market practitioners, financial regulators, supervisors and central bankers. Will they make the shift, and use the standardised data to inform their investment decisions, beyond the traditionally narrow and exclusive focus on financial risk and return profiles that still dominate mainstream financial markets? Will they “pass their investment decisions and priorities through a green screen in a not-too-distant future” so as to leverage the power of ‘green’ debt capital markets?

For that to happen we will certainly have to see more and stronger scientific evidence on the real-life impact of ‘green’ debt capital markets.

“I would like to think that at some point in the not-too-distant future issuers of all types of debt obligations pass their decisions and priorities through a green screen

John Shideler, convener of an International Standards Organisation (ISO) expert working group, tasked with developing the ISO 14030 standard for environmental performance evaluation of green debt instruments

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\(^{29}\) WWF’s scenarios for 2025 are described in the WWF publication Can debt capital markets save the planet, September 2021.
EVIDENCE

With sustained and exponential growth ESG bond surpassed US$ 3 trillion in assets, entering mainstream debt capital markets

In 2021, the volume of outstanding ESG-labelled debt securities traded on international debt capital markets surpassed $3 trillion³⁰ as both green and sustainability-linked debt markets expanded at an exponential rate. While 12 years were needed for the first US$1 trillion, it took another year to top US$2 trillion, and only six months this year to add the latest trillion.

With more than 20% market share in Europe, and more than 13% globally, ESG bonds are set to become the “new normal”

Annual issuances of ESG fixed-income securities exceeded 13% of global issuances in 2022³¹, a 5-fold increase in market share in less than 5 years. ESG bonds have reached ‘tipping point’ market share in Europe (> 20%³²), and in some other emerging markets, where sustainable bond markets have skyrocketed in 2021 (e.g., >30% in Mexico). This is a small, but important systemic change in debt capital markets. Going forward environmental performance information is set to become the “new normal” in these markets and can help inform investment decisions, beyond the narrow and exclusive focus on financial risk-return profiles that dominate mainstream capital markets.

ESG bonds valued almost US$ 275 billion earmarked funding towards biodiversity (among others) represents more than 10-times the amount of conservation funding mobilised by NGOs globally

While biodiversity still is a ‘niche use case’ for these markets and most financing has been carbon-related, ESG bond that make some kind of reference to biodiversity (among others) represent US$ 274 billion³³ (or approximately 1% of the global debt capital market³⁴). Of course, this does not mean that all these funds have been allocated to biodiversity, because biodiversity is competing for other purposes. But size matters: this already is more than 10-times the total amount of conservation funding raised by NGOs globally over the last 10 years³⁵.

Effective and credible, taxonomy-based standards with tighter definitions for ESG bonds are becoming available

International standards for green debt securities have shifted from relatively flexible, principle-based process guidelines available since 2016 to more prescriptive taxonomy-based standards. Two international standards with tighten green definitions developed with significant input from WWF are becoming available: the European green bond standard (or EU-GBS³⁶), which has the ambition to become the ‘gold’ standard for global markets was agreed in March 2023; and the ISO 14030 standard for environmental performance evaluation of green debt instruments mirrors the structure and content of the European standard to a large extent and was finalised in July 2022³⁷.

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³¹ Sustainable Bond Issuance Will Return To Growth In 2023, S&P Global Sustainability Insights, Feb. 7, 2023. Even recently reaching 15% of global total issuance, the highest quarterly market share on record in the second quarter of 2022, see: Sustainable bond volumes resilient in Q2 despite tighter financial conditions, Moody’s Investors ESG Solutions, 28 July 2022.
³³ HSBC research Biodiversity begins to bloom, 31 August 2022. But this does not mean all of these funds have been allocated to biodiversity, as in many cases biodiversity is competing with other uses of proceeds.
³⁴ Research by HSBC quoted in “HSBC COP7 will see more green bonds focus on biodiversity”, Environmental Finance, 2 September 2022.
³⁶ European Green Bond Standard, agreed by EU legislators in March 2023.