



# Beyond Green Bonds: Innovations in Sustainable Investing

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Environmentally minded investors, take note: we think a controversial new bond format that links a company's sustainability goals to its bottom line could be a game changer in building a more sustainable future—and a welcome complement to “labeled” green bonds, which are project-specific.

The new format is exciting because it does two things. First, it puts the focus on a company's sustainability goals. Second, it ensures that the company has skin in the game by penalizing it if it fails to meet those goals, which are explicitly written into the bond documentation.

Italian utility Enel, a major issuer of more traditional green bonds in the past, recently embraced this new approach when it issued a bond that pins the company's renewable energy goals to its bottom line. If Enel falls short of having 55% of its electricity generation capacity in clean energy by the end of 2021—up from 46%—the bond's coupon rises by 0.25%.

## Rewarding Sustainability

The way we see it, there's a lot to like here. Yes, it's true that funds raised from bonds structured in this way are directed toward a company's general operating expenses rather than a specific project, as is the case with green bonds. But buying a general-purpose bond is appealing because the bond is structured so that it effectively rewards companies for having a sustainable business model.

Enel's goals are based on some of the [United Nations' Sustainable Development Goals \(SDGs\)](#), such as providing access to affordable and sustainable energy and taking urgent action to combat climate change and its effects. We've written before that the SDGs provide a good road map for investors who want their investments to have an impact.

Overall, we consider this new structure a positive development and hope to see more issues—and innovations—like it.

## Where Do Green Bonds Fit In?

Not everyone agrees, though. Some worry that replacing green bonds with goal-linked deals will weaken accountability.

For instance, the terms of these new deals allow companies to spend the proceeds however they wish. A utility company might opt to spend some on coal-powered electricity generation even as it works toward achieving its sustainability goals. Labeled green bonds, in contrast, have a specific green use of proceeds.

Here's the thing: we don't look at this issue as an either/or proposition. Green bonds have been a great way for companies and investors to advance environmental goals, as have blue bonds, which are used to finance sustainable marine-based projects and protect the world's oceans. Indeed, funding specific projects makes a lot of sense and contributes to overall environmental sustainability.

But until now, there hasn't been a way to hold a company accountable for moving in the right direction when it comes to environmental sustainability. This new format changes that. The more companies design and issue bonds this way, the more likely they are to meet environmental, social and governance (ESG) standards, since doing so is aligned with their bottom line.

Enel has said it intends to stop issuing green bonds and focus only on this new goal-based approach. But there's no reason why other issuers couldn't choose to do both, as needed.

## Moving Beyond Labels

We think labeling will become less important as more companies embrace structures that link achieving green targets with the company's own financial health. Just as important, we think investing in issuers that are financially committing themselves to sustainability is likely to increase progress in combating climate change.

As we wrote in 2019, it's worthwhile, for example, to support automakers that have made commitments to building out their electric vehicle lines—even if these companies still rely heavily on sales of fuel-inefficient trucks and SUVs. By lending to them, investors can help to advance the transition to electric vehicles and the reduction of greenhouse gas emissions.

It's clear that sustainability is becoming a consideration for companies today—and for many bond investors. But there's room for improvement. In our view, bond structures that use an integrated, goal-based approach can help encourage companies to participate in building a greener world.

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