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To: Canadians Interested in Sustainable Finance

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Re: **Playing It Safe: Assessing the First Federal Green Bond Issue**

The Government of Canada recently issued its first green bond, fulfilling a commitment made in the 2021 Budget. This inaugural federal green bond offering, at $5 billion, is another milestone in the development of the green finance market in Canada.

Such federal support is intended to help advance green finance into the mainstream, not least by setting benchmarks for other green debt issuance.

My C.D. Howe Institute Commentary, identified some specific factors that remain relevant:

- Standards and processes: Acceptable green principles or standards are what make a bond "green." These standards include: defining what kind of projects and activities qualify; technical environmental standards; certification and verification practices; and reporting and accountability to investors and the public.
- Financial structure: The timing, proposed amount, term and pricing of the first green bond issue need to be determined. Ideally, the federal government would set the best possible price or yield benchmark for other Canadian green bond issuers to use as a reference point.
- Expanding green finance: Federal green bonds in the market can encourage international and Canadian institutional investors to hold green bonds and other low-emission assets.
- Related issues: These include development of common international green bond standards, and mobilizing transition finance.

In order to help build the government's knowledge base and operating capacity, TD Securities and HSBC were engaged as advisors on the inaugural green bond issuance and on the government's green bond framework.

The inaugural federal green bond issue was met with robust investor demand, covering the $5-billion issue twice over. The final order book reached more than $11 billion, a high for a Canadian dollar green bond offering. The bond's yield is 25 basis points higher than regular federal government debt with a similar maturity, a so-called "greenium" over other investments.

Setting a more attractive price benchmark for other Canadian issuers is a principal reason for federal green bond issues. The demonstrated market demand was strong. Moreover, a green bond is based on the federal government's credit rating and payment capacity. It's fair to conclude a green premium was not really necessary, except as a comfort blanket to ensure a successful launch. A green premium should therefore not be needed for future federal green bond issues.

In terms of standards, the government chose to use the Green Bond Principles (GBP) of the International Capital Markets Association to guide the development of its Green Bond Framework and the initial issue. This was another safe choice; the GBP provide a voluntary common denominator of good practice for green bond issuers globally. The nine areas specified by the feds for green bond funding – including renewable energy, climate change adaptation, and biodiversity – are also unquestionably green activities.

Verification and transparency help to build public confidence that green bonds really are green. To that end, an independent ESG group was engaged to confirm that the feds' Green Bond Framework is credible. The government also committed to release allocation and impact reports for each green bond issue. These are all welcome elements – but there is also room to enhance green bond practices with future issues, such as by working with the EU and other major countries to develop common and mandatory international standards and practices.

Another benefit of federal green bond issuance is to attract international and Canadian institutional investors to hold green bonds and to encourage the overall expansion of green finance. Finance Canada has reported a mix of Canadian institutional and international investors, with 72 percent of buyers being environmental and socially responsible investors.

Yet a number of related issues are still to be addressed, with climate transition finance at the top of the list. Many sectors of the Canadian economy, including oil and gas, petrochemicals, cement, and other heavy manufacturing will need access to sufficient financing if they are to invest in technologies and processes that materially reduce the GHG emissions from their operations. The recent federal budget highlighted the importance of green finance and the green bond issue, but was largely silent on the federal government's role in mobilizing transition finance.

Similarly, many jurisdictions globally and in Canada will be relying on nuclear energy to provide reliable electricity production with no related GHG emissions; innovations like small modular reactors are also in the works. The budget provided funding in support of zero emission nuclear power in a number of areas; including it on the green bond eligibility list would be another tangible step.

Overall, the feds played it safe by selecting an approach to issuing green bonds that did the job adequately. A good start – and one that can be improved upon in future bond issues.

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