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Financial solutions for our planet

This paper discusses the importance of finance and how exactly could lead our world into a better situation.

Let me ask you this; Have you ever given a thought about how green bonds work?

We should start answering this question: “What are green bonds?” Green Bonds are fixed income instruments in which issuers raise money to climate, social and environmental projects backed typically by an asset-link endorsement.

In recent years they have taken huge amount of capital around the world, the amount issued in the current year at Abril 25 is $203,791,228,743USD without taking into consideration the previous years. We are talking about a $2,398,996,339,424USD market.

These types of funds have some pros and cons for the issuer and borrower; as time goes by, we have observed a phenomenon called “greenium”, that is a reference to the amount by which the yield on the green instrument is lower, compared with the conventional instrument. One explanation for the greenium is that investors are willing to pay more - reflected in a reduced investment yield - for the perceived benefits of investing in the green instrument. In other words, investors are willing to lend cheaper money for climate and social projects and at the same time incentivizing issuers to fund their projects by these instruments. Green bonds are usually very liquid bonds, which can compensate a premium for investors who are willing to accept lower rates of return.

The average greenium for technology market is 2bp, for utilities 3bp and for industrials 4bp.

Even though it seems like a great investment option, there is still work to do to eradicate some problems with the issuers. Despite efforts, there is no universally recognized standard for determining the environmental impact of a bond to be considered as a green bond. In some cases, these debt instruments may be marketed to investors as “green” even if their positive environmental impact is not clear at best.

Another great financial development that could lead to a great environmental impact it is one less known by the community because of his youth and have not taken the necessarily attention and regulation; we are talking about the “Cap and Trade” market.

As the routine on this paper goes by let’s start answering this question; “What is a Cap and Trade market?” It is a market/system, in which a government sets the emissions cap and issues a quantity of emission allowances consistent with that cap. Emitters must hold allowances for every ton of greenhouse gas they emit. Companies may buy and sell allowances, and this market establishes an emissions price. Companies that can reduce their emissions at a lower cost may sell any excess allowances for companies facing higher costs to buy.

Canada is an early adopter of this system, as the Canadian government states, “Putting a price on carbon pollution is widely recognized as the most efficient means to reduce greenhouse gas emissions while also driving innovation. Since 2019, every jurisdiction in Canada has had a price on carbon pollution. Canada’s approach is flexible: any province or territory can design its own pricing system tailored to local needs or can choose the federal pricing system. The federal government sets minimum national stringency standards (the federal ‘benchmark’), that all systems must meet to ensure they are comparable and effective in reducing greenhouse gas emissions.”

Here we have an innovative and well driven solution that can help reduce our greenhouse gas emission abruptly. Unfortunately, not all governments are implementing the system.

As usually occurs, the problems carry themselves the solutions. Opponents of cap and trade are against for four main purposes.

1. It could lead to an overproduction of pollutants up to the maximum levels set by the government each year, since allowable levels may be set too generously. The solutions is simple, don’t be too generously and state lower limits.
2. Emission credits are cheaper than converting to cleaner technologies and resources. The solution is again simple, increase the price of emission credits. We all know why this isn’t happening, nobody wants to generate less income. The

best practice to implement this system must be aligned with governments to subsidize clean technologies so that companies can implement them easily and at the same time give tax incentives.

3. Failure on the trade mechanisms, it is not always followed, and some emission credits are sold at auction to the highest bidder or just given away as a gift. We need to have a market regulator, or it will be a joke market.
4. Lastly, most industries do not have devices to determine their number of emissions. We must design a formula for every industry to be easier to calculate the number of emissions they create and finally execute the task. It could be like an EV/EBITDA multiple contrasted with the amount spent on green technologies or just something similar along the way. But it is a priority to standardize the process as we have done in other topics.

To sum up, I believe finance are our biggest force to win against this killing rate of ourselves. It is not a light problem, and we must address it properly. I would love to help and see one day all these instruments working as they should be, because they are great ideas.