Environmental policy performance bonds

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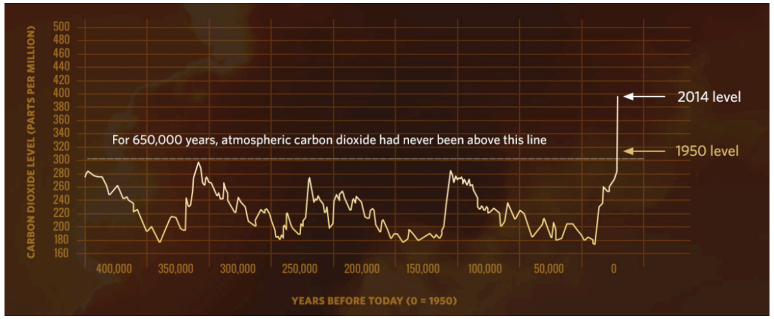
The problem



Are COP21 government promises enough? Especially to renew investment in a low-carbon future and given the dangerous milestone of 400 PPM we just crossed?

"*Les promesses n'engagent que ceux qui les écoutent*" (promises bind only those who listen to them) declared Henri Queuille, a French politician. Even if 188 countries engaged 'politically' to reduce their GHG emissions, no country seems to have clearly aligned financial incentives with environmental ones.

In addition, according to McKinsey, building sustainable infrastructure over the next 15 years will require an additional $4.7 trillion!

To win climate change fight, we need more than government promises!

The idea

CO2 government bonds are one of the tools that can move from promises to commitments.

We propose the creation of environmental policy performance bonds – call them CO2 government bonds.

The interest rates on these new bond types would be linked to CO2 reduction targets.

For example, governments could set a rate of return on their bonds that pays investors more when the proportion of renewable energy over a year drops below a target percentage. Alternatively, the more a government reduces CO2 emissions the less interest the government pays.

ISSUERS AND INVESTORS OF A CO_2 GOVERNMENT BOND

ISSUERS	INVESTORS
Governments • Governments willing to signal the credibility of their green programmes **International financial guarantors and co-investors** • World Bank • European Investment Bank • International Finance Corporation • European Bank for Reconstruction and Development	**Long-term investors** • State pension funds • Private pension funds • Insurance companies • Impact investors (philanthropists, family offices) • Sovereign funds • Endowment funds, e.g. universities • Asset managers with a green focus **Leading corporate buyers** • Renewable energy firms • Companies with a green focus

Investor perspective

CO2 government bonds could allow long-term investors, such as insurance companies or pension funds, to hedge their climate risk and eventually profit from opportunities linked to low-carbon markets.

Many long-term investors, such as public pension funds or university endowments, face public pressure to divest from fossil fuels and invest in more green products. However, they also have a duty to provide returns. CO2 government bonds would allow them to decarbonise their portfolios and support public policy hedged against government policies changing.

Issuer perspective

Issuing a CO2 bond is a simple and effective way for governments to enhance their funding, provided they engage in reducing their own CO2 emissions or increase renewable energy generation.

ADVANTAGES FOR CO_2 GOVERNMENT BOND INVESTORS

INVESTOR TYPE	BENEFIT FOR INVESTOR
Insurance companies	Hedging climate risk
State pension funds	Portfolio diversification
Development banks	Environmental return
Sovereign funds	Impact investing

Global winners

For such products to be successful, CO2 measurements need to be trusted. Fortunately, there are reliable numbers from the International Energy Agency, national statistics offices and regional agencies such as Eurostat.

Total energy usage is well monitored. Global CO2 levels are well monitored. For the closest comparable bonds, inflation-linked bonds, investors trust governments not to lie about inflation statistics (much).

On a case-by-case basis, scientists, rating agencies or other external auditors could provide additional guarantees on governments meeting, or not, their targets.

Such bonds in water or forestry might help with other environmental targets.

Even the automotive industry could issue Nox bonds to rebuild trust!