Morgan Stanley

INSTITUTE FOR SUSTAINABLE INVESTING

Blue Bonds:

The Next Wave of Sustainable Bonds

In April 2019, Morgan Stanley became the first financial services firm to commit to developing systemic solutions to help address the growing challenge of plastic waste. Through the speed, scale and innovation of the capital markets, and by partnering with our clients, employees and non-profits, the Morgan Stanley Plastic Waste Resolution aims to prevent, reduce and remove 50 million metric tons of plastic waste from entering rivers, oceans, landscapes and landfills by 2030.

50 million metric tons

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As investors show growing interest in committing capital to solve environmental challenges, blue bonds have emerged as the latest financing instrument to help protect the world's oceans and the economies that rely on their health. Navindu Katugampola, Head of Green, Social and Sustainability Bonds at Morgan Stanley's Global Capital Markets, spoke with Matthew Slovik, Head of Global Sustainable Finance, to explain this new credit asset and how it can further boost sustainable investing.

Matthew Slovik
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Head of Global
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Sustainability Bonds,
Global Capital Markets

MATTHEW SLOVIK:

Navindu, green bonds have steadily grown across the global market in the past decade, but we understand that blue bonds are starting to break ground as well. What can you tell us about them?

NAVINDU KATUGAMPOLA:

Blue bonds are a relatively new type of sustainability bond which finance projects related to ocean conservation. Like green bonds, blue bonds operate similarly to any other debt instrument by providing capital to issuers who repay the debt with interest over time. The main difference is that blue bonds dedicate use of proceeds to marine projects, such as promoting biodiversity and supporting economies reliant upon healthy and sustainable fisheries.

They gained attention in October 2018, after the World Bank facilitated a bond agreement to offload a small portion of the Republic of Seychelles' debt in exchange for marine protection.[1] It served the dual purpose of stabilizing the country's credit rating and investing in its economy, which is closely tied to the ocean.

Sustainable Bond Principles

While there is not specific guidance for blue bonds at this early stage, the widely accepted guidelines for green, social and sustainability bonds are defined by the Green Bond Principles, the Social Bond Principles and the Sustainability Bonds Guidelines, set out by the International Capital Market Association (ICMA)—a trade association of major lenders, investors, law firms and other capital market stakeholders. While not legally binding, these approaches are intended for broad use by issuers to help attract investment in projects with environmental, social and sustainability benefits, and to lend credibility and transparency to their bonds.

THESE PRINCIPLES HAVE FOUR CORE COMPONENTS:

1. Use of Proceeds
2. Process for Project Evaluation and Selection
3. Management of Proceeds
4. Reporting

Rating agencies and third-party verifications have also established standards in order to assess how the bond's proceeds will be used in a sustainable manner. Adhering to or adopting similar measures will be important for the long-term legitimacy and market viability of blue bonds.

Green bonds raise capital for projects with dedicated environmental benefits.
FIRST ISSUED IN **2007**

Social bonds raise capital for projects with dedicated social benefits.
FIRST ISSUED IN **2010**

Sustainability bonds raise capital for projects with a mix of social and environmental benefits.
FIRST ISSUED IN **2012**

Blue bonds raise capital for projects with marine or ocean-based benefits.
FIRST ISSUED IN **2018**

MS

What is suddenly driving so much interest in blue bonds?

NK

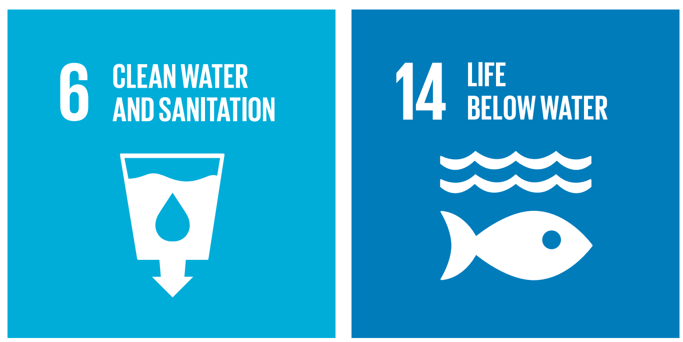
As the Seychelles' blue bond demonstrated, this is not purely an environmental issue; it's an economic one.[2] In part, the broader emergence of aligning business practices with the United Nations Sustainable Development Goals (SDGs) has catalyzed this conversation.[3]

Blue bonds are emerging as an instrument to finance solutions at scale. As concerns grow about the millions of tons of plastic waste added annually to the oceans, blue bonds serve as one example of how the capital markets can focus on reducing plastic waste, in this case marine plastic waste. Investors have taken notice, and are seeking new ways to generate economically competitive solutions.

Protecting Marine Resources through the Sustainable Development Goals

The United Nations Sustainable Development Goals (SDGs) are increasingly gaining traction as an organizing framework for many investors, particularly those looking for a thematic investment approach. The SDGs are a set of 17 global goals focused on sustainable-development themes ranging from poverty, equality, education, climate change, infrastructure, land and water, and production/consumption, with a target of 2030. Within the context of thematic investing, the SDGs are both a framework for thinking about and pursuing impact. A number of companies, organizations and government entities have committed to addressing SDG 6 (Clean Water and Sanitation) and SDG 14 (Life Below Water).

SUSTAINABLE DEVELOPMENT GOALS



Blue bonds are emerging as an instrument to finance solutions at scale.

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How is Morgan Stanley's Global Capital Markets group addressing ocean conservation? Can you give us an example of a blue bond the firm has participated in?

NK

Earlier this year, Morgan Stanley served as sole underwriter of a blue bond for the World Bank. The $10 million in proceeds focused attention on plastic waste reduction efforts in oceans, and the promotion of the sustainable use of marine resources in developing countries including scientific research, policy and regulatory reform and cross-sector collaboration. The bond helps to highlight the growing need to protect the world's oceans and the economies that rely upon their health and resilience. This issuance is part of a larger, thematic bond initiative from the World Bank to support the Sustainable Development Goals.

$10 million

Morgan Stanley served as sole underwriter of a $10 million blue bond for the World Bank. The bond helps **to highlight the growing need to protect the world's oceans as well as the economies that rely upon their health and resilience**.

MS

Where do blue bonds go from here?

NK

We've seen significant progress across sustainable investing in recent years. It's no longer viewed as the niche market it once was. Sustainable investing assets now total more than $30 trillion globally—up 34% over the last two years.[4] In the United States alone, one in four dollars—$12 trillion—is sustainably invested.[5] In 2016, the Paris Agreement heightened interest in green bonds; in the years since, we've seen a spike in companies, municipalities, sovereigns and banks issuing green bonds.

It's too early to tell whether the blue bond market will grow with the speed of green bonds or if current interest will, in fact, spur future investment. However, the momentum seems high.

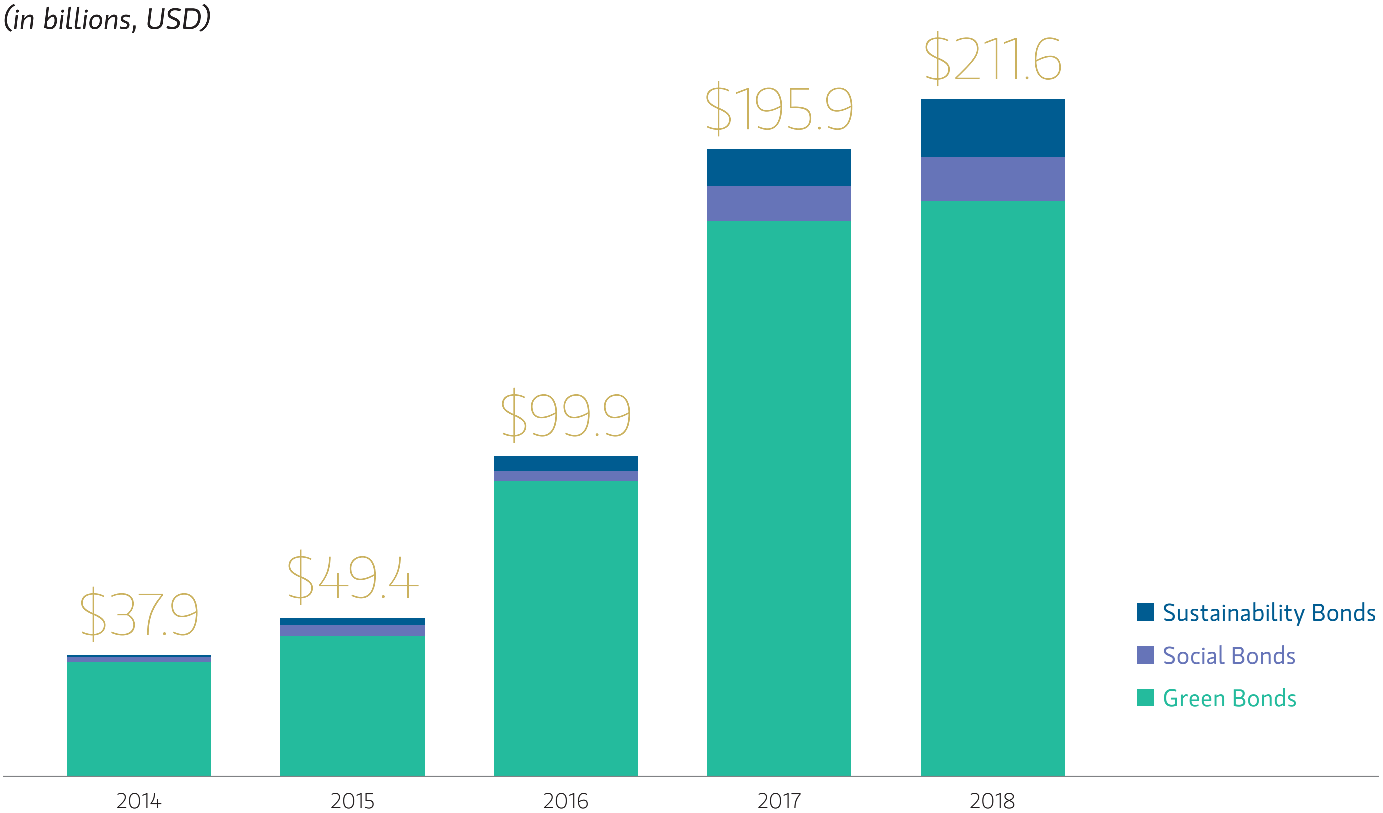
In May, the Asian Development Bank (ADB) committed $5 billion over the next five years to promoting more sustainable oceans through the Action Plan for Healthy Oceans and Sustainable Blue Economies. This commitment stands to infuse even more funding into a topic already atop public consciousness, and seeks to accelerate such investments by coupling technical assistance grants and funding with private capital through instruments like blue bonds.[6]

However, there remains a great deal of uncertainty surrounding how such approaches fit within a larger investment strategy. Even with 180 nations recently agreeing to a UN accord on plastic waste, it's unlikely that any one event will trigger an uptick in demand for blue bonds, as the number of offerings remains, at least at the moment, very limited.[7]

Given the existing framework set forth by green, social and sustainable bonds, the lag time between scale-up and wider adoption could conceivably be shorter. Still, it's reasonable to expect that blue bonds will encounter some of the early hurdles green bonds faced. Here, the expertise and diligence of organizations like the ADB can play an important role in navigating investor uncertainty. What's clear though is that if these instruments are to gain traction, developing standards, measuring data and sharing success stories will be critical. Thinking broadly about the adoption and application of blue bonds can direct the forces of the private sector and, in turn, better aid the oceans we share.

Global Sustainable Bond Issuance

(in billions, USD)



Source: Environmental Finance Database, 2019.

Notes

1 "Sovereign Blue Bond Issuance: Frequently Asked Questions." The World Bank, October 29, 2019.

2 "Out of the Blue." International Financial Law Review, February 2019.

3 "About the Sustainable Development Goals." The United Nations.

4 "Global Sustainable Investments Rise 34 Percent to $30.7 Trillion." Bloomberg, April 1, 2019.

5 "US SIF Foundation Releases 2018 Biennial Report On US Sustainable, Responsible And Impact Investing Trends." The US SIF Foundation, October 31, 2018.

6 "ADB Launches $5 Billion Healthy Oceans Action Plan." Asian Development Bank, May 2, 2019.

7 "U.N. clinches deal to stop plastic waste ending up in the sea." Reuters, May 10, 2019.

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Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Income generated from an investment in a municipal bond is generally exempt from federal income taxes. Some income may be subject to state and local taxes and to the federal alternative minimum tax. Capital gains, if any, are subject to tax.

Please note that there is currently no standard definition of blue or green bond. Without limiting any of the statements contained herein, Morgan Stanley makes no representation or warranty as to whether these bonds constitute a blue or green bond or conforms to investor expectations or objectives for investing in blue or green bonds. For information on characteristics of the bonds, use of proceeds, a description of applicable project(s), and/or any other relevant information about the bonds, please reference the offering documents for the bonds.

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