

SDG BONDS, THEIR ROLE IN THE INVESTMENT CAPITAL MARKET

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Abstract:

This thesis examines the concept and essence of bonds, debt securities issued by the issuer, and the role of bonds in the development of the capital market. In addition, the prospects for the development of the banking system of the Republic of Uzbekistan are considered, as well as scientific proposals for improving the capital market with the help of SDG bonds are presented.

Keywords: Bond, donation, credit resources, international financial institution, sustainable development goal, securities market.

Many people know what bonds are. These are debt securities issued by the issuer, the state or an organization to raise funds for certain purposes, which may be the implementation of a project, business development, construction of a large facility, solving social problems. For sure, many people do not know about sustainable bonds, which are steadily gaining popularity in global securities markets. The origin of the concept of sustainable bonds, which were preceded by green bonds, the growth of their volume on the market is associated with three main events, this is the UN General Assembly in 2015, where global sustainable development goals were defined in 17 directions (poverty reduction, food security, affordable healthcare, quality education, gender equality, etc.), the Paris Agreement Climate Change Agreement, regulatory measures to reduce greenhouse gas emissions into the atmosphere and an Action Plan on Climate Change developed and adopted in 2016 by the World Bank Group (WBG).

Sustainable bonds represent a new financial instrument in achieving global climate improvement goals and sustainable development goals through financing green and social projects. The issuer of such bonds pays coupons when certain results are achieved for one or more SDGs. Sustainable bonds are issued in accordance with the guidelines and principles of ICMA, the International Capital Market Association. There are several types of sustainable bonds: green, social, SDG (SDG) bonds, SLB (Sustainability-linked Bonds) bonds related to sustainability. Green bonds finance

projects aimed directly at improving the environment, such as renewable energy sources, energy efficiency projects, green buildings, wastewater management, etc. The first green bonds were issued in 2007 by the European Investment Fund. The largest issuer of green bonds is the World Bank. From 2008 to 2020, green bonds collected \$14.4 billion in 111 projects.

Social bonds are issued to raise funds for projects aimed at solving social problems and achieving positive social impact. Examples include food security, socio-economic progress, affordable housing, or affordable healthcare.

A Sustainability-linked Bond is a borrowing instrument whose financial and structural characteristics are based on whether the issuer achieves sustainability indicators or ESG indicators (environmental, social, managerial) indicators within a given period of time. Failure by the organization to meet the established sustainability goals means that the issuer pays investors a higher coupon rate. The issuance of SLB bonds in accordance with international requirements gives measurability to the company's goals. The company's obligations and responsibilities, expressed in specific measurable indicators, allow investors to make choices and regulators to evaluate their activities. As with green bonds, companies must provide investors with an annual report on the productivity of the organization. Investors make sure that the deadlines are met and that the results achieved correspond to future and current goals.

Sustainable development bonds attract financing for projects that combine both environmental and social goals. The SDG bond financing mechanism is based on the regulatory framework (SDG Bond Framework), which defines a management structure that ensures transparency, planning and monitoring of the process. The issue of bonds is carried out in accordance with international practice and the principles of ICMA (Association of the International Capital Market).

Mexico became the first country in the world to issue SDG bonds. On September 14, 2020, the Mexican federal government successfully issued SDG bonds worth 750 million euros with a term of 7 years. Less than a year later, in July 2021, the Mexican government issued a second series of CDO bonds in the amount of 1,250 million euros for a period of 15 years. One of the largest French investment banks, Natixis Bank, acted as the organizer of both transactions. This innovative approach was an example of Mexico's commitment to global sustainable growth goals. According to the report on the implementation of the program, the most significant



amounts were allocated to health (SDG 3), education (SDG 4) and food security (SDG 2). In total, 3.8 million people received direct assistance¹.

In July 2021, Uzbekistan, the second country in the world, and the first in the CIS and the EBWA region (Central Europe, Middle East and Africa), issued SDG bonds in the amount of \$ 235 million with a coupon rate of 14%, for a period of 3 years to improve and develop the sectors of education, water supply, health, and eco-transport, waste management². In November 2022, the first report on the results and distribution of funds raised was published. According to the report, the bulk of the revenue was spent on the construction and reconstruction of highways and roads (50%), loans to women entrepreneurs (18%), construction and reconstruction of schools (16%)³.

What are the trends in the development of the global sustainable bond market? Since 2007, green bonds have dominated the market. In the five years from 2016 to 2021, the volume of green bonds increased 5-fold, from \$100 billion to more than \$500 billion (Fig. 1). Later, social bonds and sustainable development bonds appeared. These three types of reporting bonds are often combined into one group of GS (green, social, sustainable, SLB) bonds. Their volume increased from \$200 billion in 2017 to more than \$1 trillion in 2021, i.e. more than 5 times in just 4 years (Fig. 1). 2022 was a very difficult year for the capital market and for sustainable bonds. According to Environmental Finance Data, the volume of GSS bonds in 2022 decreased by 15%, from \$1.05 trillion in 2021 to \$899 billion in 2022. Stable annual growth has fallen sharply under the influence of geopolitical conflicts and high inflation in the world.

According to Moody's Investor Service forecast, GSSS bonds are expected to grow to \$950 billion in 2023, an approximately 10% increase from last year's figures. The main growth is expected in green bonds, which is due to the global focus of issuers and investors on environmental goals. The growth in social bonds will not be so significant, mainly due to a decrease in government funding for projects related to COVID-19. Moody's forecasts the growth of sustainable bonds to \$175 billion, as many issuers combine environmental and social projects well into one, in

¹ <https://gsh.cib.natixis.com/our-center-of-expertise/articles/the-federal-government-of-mexico-released-its-first-sdg-bond-allocation-and-impact-report>

² <https://www.undp.org/ru/uzbekistan/publications/pervyy-otchyot-uzbekistana-o-razmeschenii-i-vozdeystvii-obligatsiy-cur>

³ <https://www.uzdaily.uz/ru/post/68497>



accordance with the recommendations and requirements of regulatory rules. Finally, the market for SLB bonds (sustainability linked bonds - linked to sustainable goals) is just beginning to take shape, SLB issuers continue to build trust in SLB labeling and work to standardize best practices. A small increase is expected here compared to last year, up to \$ 75 billion. However, despite the fact that the projected rise will not exceed the amount of more than \$ 1 trillion achieved in 2021, stable and long-term growth is still expected due to the acceleration of corporate decarbonization, increased public interest in financing the SDGs and increased investor pressure on companies to provide reporting and transparency of information on the achieved SDGs⁴.

In 2022, the largest issuers of sustainable development bonds were the IBRD bond issue worth \$ 20.2 billion, the Republic of Chile – \$ 7.1 billion, BNG Bank Netherlands – \$ 4.7 billion, AFD French Development Agency – \$ 4.2 billion. Of the private corporations, the largest volume of SLB bonds was issued by the Italian company Enel, an electricity producer, in the amount of 12.5 billion dollars, the French retail company Carrefour - in the amount of 2.5 billion dollars, the Dutch company Vodafone Ziggo – telecommunications services, in the amount of 2.4 billion dollars and the French wine company Pernod Ricard in the amount of 1.9 billion dollars⁵.

What is the attractiveness of sustainable growth bonds for investors, what is the reason for the growth of their volume in the market? First, there is a global trend of changing the approach of "investments for income" into "investments in value" or "responsible investments". Secondly, according to established international rules and guidelines, clearly defined goals, transparency of information, measurability of results, and annual reporting are mandatory conditions for financing. Thus, the changing trend in investing and clear rules of the game affect the demand for sustainable bonds.

Uzbekistan is one of the pioneers in using new financial instruments to attract foreign capital. This experience is important and valuable for further development of cooperation with international financial institutions and building trust. It is also a manifestation of the country's commitment to global development goals, the

⁴ <https://www.environmental-finance.com/assets/files/research/sustainable-bonds-insight-2023.pdf>

⁵ <https://www.environmental-finance.com/assets/files/research/sustainable-bonds-insight-2023.pdf>

implementation of strategic goals for building a sustainable economy and a healthy society.

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