

September 2022 Research # 135

Executive Summary

**Green, Social and Sustainable (GSS)
Bonds in Israel**

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About the Milken Innovation Center Fellows Program

The Milken Innovation Center Fellows Program accelerates Israel's economic growth through innovative, market-based solutions for long-term economic, social, and environmental challenges. Our goal is to accelerate Israel's transition from a Start-up Nation to a Global Nation with solutions that others can replicate.

The Program awards annual fellowships to outstanding Israeli graduate students. We train and deploy some of Israel's best and brightest young professionals to create pragmatic financing and economic policy solutions. Our applied research and Financial Innovations Labs® are a launching pad for transformative change, using innovative financing mechanisms, programs and policies to bridge social, regional, economic and productivity gaps within Israel and between Israel and the world.

In addition, Fellows craft their own projects during their internship aimed at barriers to job creation and capital formation in Israel. The Fellows' research, carried out under the guidance of an experienced academic and professional staff, support business and policy makers to shape economic reality in Israel. The program offers the ultimate training opportunity, combining real-life work experience with applied research.

Throughout the year, Fellows receive intensive training in economic and financial analysis, public policy and research methods. They acquire tools for communication and presentation, policy analysis, leadership and project management. The fellows participate in a weekly research training workshop where they work with senior economic and government professionals, business leaders, and top academic and financial practitioners from Israel and abroad. They also participate in an accredited MBA course, taught at the Hebrew University School of Business Administration by Prof. Glenn Yago.

Fellows Program alumni can be found in senior positions in the public and private sectors. Some serve in key positions in government ministries while others work at private-sector companies or go on to advanced graduates studies at leading universities in Israel, the United States and Great Britain.

The Fellows Program is a non-partisan. It is funded, in part, by the Milken Institute and other leading philanthropic organizations and individuals in the United States and Israel.

The financial sector has an increasing role in countries' path to achieving climate goals by developing, adopting, and assimilating relevant technologies and solutions. These actions demand large-scale investments while creating ways to stream capital towards research and development. The financial market constitutes a convenient and efficient platform for capital streaming on this scale.

A growing financial instrument in the financial sector in the previous years is GSSS (Green, Social, Sustainable, Sustainability-Linked) Bonds. GSSS Bonds are an innovative and unique instrument that has the potential to bridge investors and social or climate goals, thus providing a solution for the need for large-scale investments in the social and green spheres.

Four bonds are considered GSSS Bonds, divided into two groups separated by differing bond mechanisms:

1. Use of Proceeds
 - a. Green
 - b. Social
 - c. Sustainable
2. Sustainability-Linked (SLB): Tying the bond payment mechanism to green or social key performance indicators.

In the first group, the capital raised is uniquely designated for green or social (or both). The issuer cannot use the proceeds for any other cause (for example restructuring previous debts or paying salaries). In addition, the issuer reports on the use of proceeds. The payment mechanism is like that of a Plain Vanilla Bond.

In the second group, the issuer has the flexibility to use raised capital for any goal that he deems necessary. However, the payment mechanism varies from that of a Plain Vanilla Bond. During the negotiations on the Bond Issuing, the issuer and the investor agree upon at least one measurable goal, social or green (or both), that the issuer undertakes to complete by an agreed upon date – Key Performance Indicator (KPI). A third party measures the KPIs. Contingent upon the issuer failing to achieve the KPIs, he pays an extra "fine" to the bondholders, usually in the form of a higher coupon. If the issuer will achieve the KPIs in time, he can pay a lower coupon to the investors.

In contrast to the growing trend of GSSS worldwide, the Israeli financial market is lagging behind foreign financial markets. As of today, only three Israeli companies have issued GSSS Bonds: Teva Pharmaceuticals, Bank Hapoalim (both raised the capital abroad), and Ogen Group, while Ormat Technologies announced that they will issue a Green Convertible Bond in June 2022. All three

issuances took place during 2021-2022, while the first Green Bond was issued in 2007, and the total market cap of GSSS issuances surpassed \$2.5 trillion by May 2022.

In light of reviewing the risks and opportunities for the Israeli financial market, the research includes a survey of several policy incentives and recommendations to advance the GSSS Bond market in Israel. The policy recommendations are evaluated using three parameters: The potential for greenwashing, expected pushbacks from the industry and governmental institutions, and potential costs. Based on calculating the expected risk output for all three parameters for each policy recommendation, two policy tools for the short-term and two more for the long-term are proposed:

In the short-term period, recommendations include:

- A. Presenting investors and issuers with clear standards (preferably adopting existing international standards) for the issuance of GSSS Bonds
- B. Issuing a sovereign GSSS Bond (SLB or Use of proceeds)

The first group of recommendations (A) is the most crucial because as long as there are no clear standards for GSSS Bond issuances serves as the greatest barrier to the prosperity of a GSSS Bond market in Israel. The Israeli Securities Authority is recommended to adopt international standards to allow for better interoperability between the Israeli financial market and foreign financial markets and investors. Regarding the second group of policy tools (B), the government is recommended to consider issuing an SLB instead of a "use of proceeds" bond, although the Israeli market can highly benefit from both.

In the long-term period, conditioned on reassessment and preliminary growth of the GSSS Bond market in Israel, and to attract foreign investors, the following tax incentives based on Municipal Bonds tax relief in the USA are recommended:

- C. Providing bondholders with tax relief on GSSS Bonds' Coupon
- D. Providing bondholders (issuers) with a tax credit on GSSS bond holdings (issuing)

Tax incentives regarding bonds in the Israeli financial market, as they are practices in the US bond market, for example, are unprecedented in Israel. Both approaches must be examined for both policy and economic impact on the Israeli capital market and beneficiaries of the bond proceeds.



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