Transcripts of the interview with Adriana Cruz Felix (Vice President and Sustainable Finance Manager of second party opinions for the EMEA region at Moody's Rating)

Melina London:

Good morning everyone and welcome to our new interview for the Sustainable Finance Research Forum of the European Commission. My name is Melina London and I am an economist working on sustainable finance at the Joint Research Centre of the European Commission.
Today, as part of our interview series of scholars and practitioners in the field of sustainable finance, I'm very happy to welcome Adriana Cruz Felix, who is Vice President and Sustainable Finance Manager of second party opinions for the EMEA region at Moodys Rating.
So good morning. Adriana, thanks a lot for coming.

Adriana Cruz Felix:

Thank you. Good morning and thank you for the invitation, Melina.

Melina London:

So in your capacity at Moodys Rating, you oversee a team of analysts in the region to produce second party opinions. You have been involved in the sustainable development sector for over 10 years now, with the last seven years focused on analysing the potential environmental social benefits of financial instruments. You are also one of the main authors of the Moodys Rating SPO assessment framework and you actively participate in the ICMA Sustainable Finance Working Groups and Task Force.
Your sectors of expertise are energy and transition, green building, biodiversity and social projects. So as we can see, a lot of very interesting background and expertise. So thanks a lot for taking the time to join us today to discuss a bit the sustainable finance perspective, like the stable finance topics through the perspective of second party opinion providers, which is something we haven't analysed that much in our former interviews, so thanks a lot for being here today.

Adriana Cruz Felix:

Thank you Melina and thank you also to the Sustainable Finance Research Forum for the invitation. It's really an honour to be here with you and also share a bit of the market perspective on thematic bonds. So thank you very much.

Melina London:

So that brings me directly to my first question, which would be: could you please share Moody's ratings projections in terms of evolution of the suitable sustainable insurance, both in Europe and globally? Because we are interested obviously in the EU, but I think what is really great is that at Moody's rating you also have this global view.

Adriana Cruz Felix:

Yes, so I'll share my screen to give a bit of, I think it's nicer to talk about trends when we have a bit of graphs. Uh, so can you check? Can you see my screen now? I'll try to put it in full.

Can you see it as a full mode or not? No, because it goes to my other screen when I put it on full mode, so I'll try. Let me see again. Yeah, it puts it on the other screen.

Melina London:

OK. Maybe we you can put it a bit bigger and we can see directly?

And there we share for our audience, we'll share the graphs also in the web.

Adriana Cruz Felix:

Yeah. But what I can do also, uh, well, yeah, it's true. I can just put it big. So it's OK. That's good. Is it OK? No, it's a bit too big like there is like this. Yeah, Yeah. OK.

So, you know, throughout the years, I think we can see from the graph that this sustainable bonds market has proven to be resilient, right? It is true that the market may not achieve the exponential growth that was achieved in, you know, in 2020 and 2021. But we do expect to see a steady growth over the next following years. Uh, you know, to hold steady and withstanding during high interest rates and slowing economic growth, right?

In our latest published reporting of May 2024, you know, despite the strength of the first quarter volumes, we are maintaining the same projections for 2024. So we're saying that the volumes of sustainable bonds will stay around 950 billion in 2024, which is little change from the 946 billion achieved in 2023, you know as macroeconomic conditions remain relatively soft. Uh, from the graph, we can see that green bonds will continue to be the main share of the sustainable bonds market. They will continue to lead. In terms of market share, we expect the share to stay steady at 14%.

So we see that, you know, the overall share of sustainable bonds out of the overall global issuance is expected to stabilize with a multi-year increase. You know there will be kind of a remain multi-year increase, but as you can see for the graph the growth will stay, will come, will start to be steady.

What is pushing this steady growth and this resilience of the market? From one side, we have all the interest in green technologies that it's growing. There's also a growing focus on transition finance that's also a driver of sustainable bonds. And then we're also seeing a gradual shift from voluntary to regulatory issuance. So these will all these drivers will play together to push the market forward. And then if we go to the next slide that it's more focusing on the differences between the regions. We can see that Europe will continue to be the main, let's say, the main issuer or the biggest issuer across the different regions, but we also see really like an exponential growth from 2 regions. The first one is Latin America where here the share of sustainable bonds, so meaning like green, social sustainable and sustainability linked is representing 39% of the share of issuance in the region. And then in the in Asia Pacific also, we see an interesting growth and in the Middle East and Africa, we're also seeing that there's a lot of movement in terms of sustainable issuance. So I would say that that would be the main trends, the main drivers that we're seeing in the region.

Melina London:

Thanks a lot. I think it's really great to see the graphs and see how like green bonds is really the over like the dominant instrument on the market. But it's still like you also have a much larger shares in the last few years on the sustainability-linked and the social bonds also. So that's interesting to see. And of course like seeing, OK, EU is the dominant market, let's say, but then you have this growing trends in other regions and yeah, we'll looking forward to see what will happen for the Latin American market. And well, I think that the idea of just trying to develop a bit more the market, also globally.

Adriana Cruz Felix:

Yeah, but as you can see in in the graph, it's also Middle East and Africa, you know, uh, with reaching higher, you know. Last year there was an all-time high with 23 billion issued and then there's a 21% share of the market of the regional, like sustainable bonds represent 21% which is also higher than the average that we have at 14. So we also see that and obviously also in Asia Pacific, it's very active with all the development of taxonomies in different jurisdictions. So I think the three regions will continue to push forward significantly and we will see a lot of a lot of growth in these in these markets.

Melina London:

OK, great. Well you made the perfect transition for my second question mentioning tax on the development of taxonomies in the Asia Pacific. So maybe I would like to ask you what has been the impact of EU regulation and development of order taxonomies around the world on your work and particularly in providing second party opinions?

Adriana Cruz Felix:

Yeah, you know the biggest achievement of the EU taxonomy was the creation of a common language, right? It was necessary to identify the activities that had a substantial positive contribution. It was mainly as a as a response from the market to address greenwashing concerns.

And I think the taxonomy has achieved this, right. It has achieved the creation of a common language. Now the market, it's always comparing whether their activities less or more ambitious than the criteria that substantial contribution criteria or as a whole, the technical screening criteria in, in the taxonomy. And this conversation is very useful in the market. It's very useful for the growth of the European market, but it has also been a, let's say, a driver of the development of other taxonomies in other in other jurisdictions. When it comes to our SPO, we provide opinions that go beyond the alignment with the principles right, the green or the social Bond or the sustainability linked bond principles.

We provide a granular view on the contribution sustainability, so if you can see in the taxonomy we have a list of economic activities, right? But there is no difference between which one, well, like which one has a high contribution? Which one has a lower contribution?

And this is where our assessments in the opinion in particular for the substantial contribution assessment comes into play and it provides an added value to the market from different aspects, from the aspects of differentiating the different quality of projects. So for example, our assessment is giving on a 5 level scale from poor to high. So it's poor, limited, moderate, significant and high, where obviously the high projects are those that are adopting the best available technologies or the most strict stringent thresholds in the market where negative impact it's avoided and even locating emission, there's no locked in greenhouse gas emissions and when there is minor environmental or social externalities that are correctly managed. So you see it's like the best quality that you can find in the market as of the time being. The taxonomy doesn't do this, so you could find certain economic activities that are, you know, for which there's even more strict thresholds in the market. An example is the renovation of green buildings that requires a primary energy demand of 30%. We know that in the market there's even more ambitious standards, right, that are asking for a 50% or 60%. So this is where we provide these granularity. And then, on the other side, we provide a view that it's consistent across regions.
So that also allows the interoperability of the different taxonomies, right? The market it's also speaking, let's say different languages and that's where our SPO comes and helps with the interoperability of the different taxonomies. Our assessment takes into account the local context, local characteristics, that actually play a crucial role right in the development of different technologies.

So we do see that moving forward, that moving from a voluntary to a more regulatory environment, it's going to be good. It's going to create more opportunities. It's going to push for best practices in the market. You know, we see that the application of the EU green bond standard, in December 2024, will really push the different issuers to adopt the best practices in the market. However, we have also seen that issuers are finding challenging to adopt the EU taxonomy criteria.
And this is true for many different types of issuers, right, not just the ones that just entering the market. So these challenges may create a, let's say some slowing down in the wide adoption of all of the taxonomy across the globe.

So and even in Europe, right, I think for more the wide adoption of the taxonomy.
The challenges of moving from theory to practice are going to, there's where the devil in the details is, and that's where issues may take time and also since now issuers are more exposed to scrutiny from the market, they may also take it slower, right. They may say, OK, I'll wait a little bit I'll make sure that I have it better structure that I have everything in place before I move forward. So there's this part of, yeah, their secretion of opportunities, but also there's, there's challenging in the conversion from theory to practice.

Melina London:

Oh, yeah, definitely. Yes. There are a lot of challenges in the implementation, but so maybe it was some question I would like to ask you would be like to provide examples maybe on how the issues are using the EU taxonomy and how they are trying to overcome those challenges. Would you have some examples to share?

Adriana Cruz Felix:

Yes, you know, and then we have been working with issues that have started to introduce or start using the EU taxonomy criteria in their green bond frameworks. And one of the things that we have seen very clearly is that there is, as I was saying before, there's a significant learning curve for them in all the aspects, right, in terms of data collection processes, all the different elements that they need to put in place in order to be able to demonstrate alignment with the EU taxonomy. So in particular if I give you a couple of examples, if they do not significant harm, right, I think maybe the substantial contribution we have seen some challenges, but in the biggest ones are in the do no significant harm.

And in terms of examples, I won't be giving names of issuers, but just to give you the context. For example, we have a Nordic bank that has historically specialised in green buildings, right? That's their main. And they're in the provision of loans to green buildings has been their one of their biggest sectors of activity. And when they decided to integrate the taxonomy they initially thought that it was all going to be demonstrating alignment because they believe that the Norwegian regulation for buildings was covering most of the items. And then they realise that, for example, in the “do no significant harm” for sustainable use and protection of water and marine resources, the Norwegian regulation has provisions to prevent damages to the building from water leakages, but there's a specific item that talks about the water flow and the flush volumes in the toilets that is not covered by their Norwegian regulation. In the bank didn't have something additional to cover it, so they are not aligning to that one.
A similar one was in the transition to circular economy. The taxonomy requires a 70% reuse on construction waste. The Norwegian building regulation requires a 60%. So you see, they're not really following it.

So what we do in our assessment is that yes, we have, let's say, a binary opinion that says they appear, they don't adhere to the to the EU taxonomy. And we use the word adhere in particular not to confuse the market on the fact that we're doing a verification on alignment, right. It's just a decision from Moody's ratings to be specific on the wording and to clarify that we are not external verifiers or auditors against the EU taxonomy. So we see either adheres or does not adhere, but we also provide kind of a summary of what's happening, right because maybe in this case for this Norwegian bank they're not adhering to these two items that I just mentioned. But it's not a clear no, right? It's just they have something. It's just that it's not exactly what it's supposed to be there.

Then we have other examples from, for example energy utilities from one of the issuers that I think is one of the most active issuers in the market and most mature issuers in the market.
And for the category of low carbon hydrogen, for example, in the substantial contribution criteria for climate change mitigation, the taxonomy requires that life cycle assessments are conducted.
And the company is conducting life cycle assessment, but not using their specific ISO that is referenced in the taxonomy. So again, it's not, you know, they don't fulfil. It's again, all these type of, of examples that show that, OK, we do have something, it's just not exactly what, what the criteria is, is presenting.

And then one last example comes from a European sovereign, right?
There's a “do no significant harm” for the pollution and prevention control for the category 6.5 that it's the one on, you know, motorbikes and passenger cars and light commercial vehicles, there's a specific items on the characteristics of tyres and noise control. The sovereign said we don't have access to this level of data, you know, at our level as a sovereign issuer. They replied saying, we consider that these criterion does not apply to us because we are a sovereign issuer and we don't even have access to that level of data on the vehicles that we that we finance. However, as of today

us as external reviewers we have not receive, let's say guidance on whether there's some exceptions or there's some. Let's say we can say that there are certain things that are not applicable. So as of today, it's like, OK, it doesn't adhere, but we also explain what's happening. So as a summary, this is to show how issuers, even issuers that have been there in the market since the sustainable bonds market has started our finding challenging to adopt the whole the whole EU taxonomy criteria.

Melina London:

No, thanks a lot for this, those are very telling examples. And I would say it also comes back to something you mentioned earlier, like we need standardization and we need standardization between like regional taxonomy, like the EU taxonomy and then national laws. Also, no, Norway is not part of the EU, but like how can you align and how like, in a global world, companies know which terms to follow. And I think, yeah, that's it.

Adriana Cruz Felix:

I have heard of several market participants and issuers say that they need more guidance in terms of proxies, right? What are the proxies that they can use to demonstrate alignment? And it's true that that's still the part that's still to be seen. But I think there's good developments, you know, there's, a lot of work that has been done and I think we also need to recognize how much the market has grown and how far we have come from how it was a couple of years ago, right? Right now we have taxonomies and, I don't see it just to finalise, I don't see it as a, as a negative point. No, it's just the challenge of putting into practice something that it's very well constructed, and there is a good and environmental logic behind it, right. And it's just helping the market adopted, it's more than that part. So we do see, we do expect to see growth, but then maybe will be a slow growth thing like due to the learning curve that needs to happen. But yeah.

Melina London:

Well, thanks for being optimistic. We actually need that and we need to highlight that indeed we like we've come a long way and yes, there are still some stuff to be done to have like perfect market, but already we've done a lot. So no, yes, for pointing that out.

OK, Maybe my next question would be the topic of transition, which is like really on the highlight lately because it's yeah, it's the next question of ok whether you are green, but how can you become green is being the objective. How can you become green? How can you transition toward the even so, my question would be, how is the policy landscape helping provide transparency around carbon transition risk and opportunities also?

Adriana Cruz Felix:

Yeah. You know, the last couple of years we have seen a proliferation of policies across the different regions, North America, Europe, Asia Pacific that are really trying to support the development of these green transition or transition technologies and really putting pressure on companies to decarbonized right. So, there's a lot of there, all these pressure is starting to reshape both investment strategies and also the carbon transition risk for issuers.

In some heart to evade sectors right like oil and gas, autos manufacturing and empower generation. We see a lot of support in technologies like green hydrogen, biofuels, carbon capture and storage and this is fuelling growth in private and in public investments. So we do see that this is likely to improve the cost competitiveness of these technologies and contribute to the acceleration of green investments, which eventually could be financed with the sustainable bond issuance, right. We have, for example, in the US the Inflation Reduction Act that it's mainly focusing on this right? It is really trying to rapidly reduce cost and demonstrate the scalability of these technologies. In the EU, we see the Green Deal industrial plan that it's also trying to improve the climate, the investment climate for strategic clean technologies. The UK just launched in April this year, you know, the transition plan taskforce, which is trying to unlock financing for businesses so that they can finance their net zero emissions plans and so on.

And in particular in Asia Pacific, we see a significant scale up in low carbon investments and also kind of, how to mitigate the transition risk exposure? And just to give you an example, for example, the Japanese GX transition green transformation plan, which is aiming to accelerate sustainable finance, It's estimated to be equivalent to 60%, sorry, 26% of the GDP of the country. And then also the country was one of the first ones that launched at the beginning of this year, the first in the world's climate transition bond.

So you see that there's all these, I would say all these policy support that is trying to generate the scalability of the technologies.

Melina London:

OK, thanks. Very, very insightful. And maybe my last question would be how you can, how do you think sustainable finance issuance can support this transition also?

Adriana Cruz Felix:

Umm, yeah. And you know, the use of sustainable bonds by issuers in high exposure sectors with high exposure to carbon, carbon risk is not a new phenomenon. We have seen it already, right. But what we see is that there will be a grow in interest in transition finance as the policy support comes as I was just saying before. So we will see, we think that we will see more and more label bonds from issues that are trying to finance their decarbonisation plans, and this includes both, you know, issuers from sectors that have already viable solutions in terms of transition, so for example, like the energy utilities or the automotive sectors, but we will also see other. We think that we will see more and more insurers from other sectors that may not have already like a scalable solutions such as aviation, airport, oil and gas.

In 2023 we see that, you know, the volumes from non financial for non financial corporate represented 43% of the market. So we see a clear opportunity for growth. And then when we look at other data, for example, according to our estimates at the end of last year, transition sectors have a total of 4.9 trillion of Moody's rated debt outstanding.

Pointing to the significant increase that can happen here, right and it's interesting also to see that they share of the non financial corporate sustainable bonds issuance stay steady as the corporate volumes fell. So it also showing that these sectors are kind of also resisting more and also the interest of issuers on these sectors is growing. Uh, we see more like low, low carbon hydrogen, low carbon fuels. We see more and more issues including this in their frameworks.

Although it is slow, right, we don't see it as an exponential integration of these technologies in frameworks. But we are seeing little by little more and more of this and also other emerging green technologies like you know like steel, cement, shipping. I already mentioned aviation. We will see them more, but I guess that they will also face let's say the quality risks, right that hard to evict sectors have always faced in this market is this idea of OK, let's bring forward the emerging green technologies such as low carbon hydrogen, carbon capture and storage utilization and storage. But there is also the risk of OK, are these projects really pushing? How are issuers demonstrating that these projects are really moving towards a greener environment and how they actually will support, right? Because there's I would say, based on the science and all, there's also a lot of question marks regarding how these technologies will push right, but we do expect to see more and more movement on that area and having more issuers look for sustainable bonds to finance their decarbonisation plans. So we expect to see more activity in the sustainable finance world coming from transition sectors.

Melina London:

Maybe like a complementary question, would you expect to have like more labelled bond as transition or using the already available financial instrument like the green systemic sustainability linked and so on?

Adriana Cruz Felix:

Um, you know, historically there has been a conversation of this transition label in the market for a long time and the signals show that the market doesn't really want to go that way. The main desire is for assurance to stay, you know, stay in the existing labels and then that's why ICMA published the Climate Finance Transition Handbook. That is kind of the additional item that issuers will need to put to umm to demonstrate how it all, you know how the overall strategy of the company it's in line with the Paris agreement goals. ICMA also recently published more guidelines for green enabling activities and all. So I think the market won't necessarily go into transition labels, but will continue to use the labels that we have and then push them forward.

However, I also have to say that in our case, as second party opinion providers, we don't provide an opinion on the label because we actually ask this against the principles so whether an issuer decides to call their bond, I don't know, sometimes you know they used to call them like SDG bond or ESG bond.

The reality is that we're looking at the green and the social bond principles. So for us the standards that we follow are the ones that are currently in the market and the different guidelines that we have in the market.

Melina London:

OK. Well, super, super interesting. Thanks a lot.

I think it's the time to conclude the interview. So thank you so much for taking the time to join us today despite the busy period of like prior holiday everything. So and thanks so much for providing all those details on the global market, EU, and comparing the different taxonomies, the challenges with concrete examples because I think like, as a platform to which is trying to join the perspective of practitioners and researchers, this is extremely useful.

So thanks a lot. We will continue to follow your work with a lot of interest and for our audience, this July interview will close the first season of interviews. And so please stay tuned in September for the launch of the second season of interviews.

Thanks so much, Adriana.

Adriana Cruz Felix:

Thank you very much, Melina. And it was a pleasure to be part of this initiative. So thank you very much for the invitation again.

Melina London:

Bye everyone.

Adriana Cruz Felix:

Bye.