UK

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UK issues first green gilt

The UK government has demonstrated their ambition to tackle environmental issues by issuing the UK's first "green gilt".

The proceeds raised will fund green projects across the country.

Exposure to green gilts will improve a pension scheme's environmental, social and governance (ESG) position.

Background

On Tuesday 21 September 2021, the Debt Management Office (DMO) issued the UK's first "green gilt" and raised £10 billion for "Eligible Green Expenditures" that aim to accelerate the UK towards their target of net zero emissions by 2050.

The proceeds will be distributed across six "Green Categories" that focus on: Clean Transportation, Renewable Energy, Energy Efficiency, Pollution Prevention and Control, Living and Natural Resources, and Climate Change Adaptation. Hence, the money from the issuance will help finance initiatives such as: Zero-Emission Buses, Flood Defence Programmes and the Renewable Heat Incentive Scheme, whilst also creating jobs in the process. More information can be found in the Green Financing Framework published by the UK government in June 2021.

The issuance

The UK's inaugural green gilt is due to mature in July 2033 and pays a coupon of 0.875% (0.875% Green Gilt 2033). The £10bn gilt issuance was over-subscribed by 10 times at £100bn, demonstrating once again the demand for gilts continues to far outstrip supply.

It was priced at a gross redemption yield of 0.87% which is 7.5bps higher than its nearest conventional non-green gilt, the UK Treasury 4.25% 2032 gilt. However, yield comparisons between the two gilts are difficult due to the differing coupon rates and maturity dates. Instead, it is expected that a green gilt would trade at a lower yield relative to a directly equivalent non-green gilt. This discrepancy in yields is known as a ‘greenium’ and reflects demand exceeding supply for green bonds.

Future issuance

The DMO announced they will issue a second green gilt later in October as they are committed to raise at least £15bn for green government projects during the 2021-22 fiscal year. This gilt will have a maturity date within 20-30 years which helps to build out the ‘green’ curve and fulfil the demand for UK green debt from LDI funds and other investors as they seek to include longer dated green bonds within their portfolios.

A growing green sovereign bond market increases the ability of investment managers to successfully integrate ESG factors into their funds. As a result, investors can make better ESG specific investment decisions when faced with a wider pool of available options.

What is the impact on defined benefit pension schemes?

UK green gilts are not different to ordinary gilts, but the funds raised must be used for specific ‘green’ purposes which are defined in the Green Financing Framework. Pension schemes which are hedging their liabilities may well be exposed to these green gilts which will serve to improve the scheme’s overall green scores.

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