T. Rowe Price

Blue bonds: The next frontier in climate investing

Oceans play a vital role in the global climate. They capture around 30 percent of the CO_2 produced by humans, making them essential in achieving global climate goals. This absorption capacity, however, is rapidly declining due to pollution and ocean acidification, exacerbated by rising global temperatures. "We must start investing in healthy oceans, by boosting maritime biodiversity, sustainable fishing, and shipping. The investment potential for positive climate impact is immense," states Willem Visser, associate portfolio manager at T. Rowe Price.

Many institutional investors have geared their investment strategies toward combating global warming. By redirecting investments to renewable energy, they are playing a key role in the energy transition and advancing the path to a carbon-neutral economy. Green bonds have proved to be one of their most important sustainable investment vehicles, financing climate projects all over the world.

The green bond market has grown rapidly over the last few years, as more and more investors flock to these bonds. According to the Climate Bonds Initiative, governments and corporations have issued US$385 billion in green bonds in the first half of 2024, bringing the total issuance to US$3.2 trillion[1] since 2006.

However, green bonds have largely neglected the vital role that healthy oceans play in combating climate change, instead focusing predominantly on renewable energy investments, argues Visser. "It's time for us as investors to acknowledge the critical role of oceans and to act accordingly. Oceans play a key role in regulating the global climate by absorbing CO2. The potential for climate impact in this emerging area of climate investing is, therefore, truly impressive."

Climate impact through healthy oceans

The United Nations has recognized the importance of healthy oceans by incorporating the theme into the Sustainable Development Goals (SDGs), specifically SDG 14: 'Life below water'. Many institutional investors have adopted these goals as a framework for their sustainable and climate investment strategies. However, Visser points out, "SDG 14 is the most underfunded of all the SDGs. It's estimated that US$175 billion is needed annually to meet UN targets by 2030, yet only US$10 billion has been invested over the past five years, leaving a significant funding gap."

The underfunding is worrisome, Visser states. "If we don't invest in healthy oceans, we won't achieve our climate goals. Oceans are absorbing roughly 30 percent of human-generated CO_2 emissions, making them one of the planet's most effective carbon sinks. Additionally, oceans generate 50% of the world's oxygen, with phytoplankton – tiny, microscopic plants that absorb CO_2 and generate oxygen – playing a key role in both processes."

Breaking the downward spiral

However, pollution and rising temperatures are severely impacting the ocean's ability to maintain these critical functions. Ocean acidification, driven by increased CO_2 levels, is weakening the capacity of oceans to absorb carbon. Global warming is causing a downward spiral.

Visser: "Since industrialization, oceans have absorbed 90% of the excess heat from human-driven climate change, but global warming is reducing this cooling capacity and the capacity to store CO_2. The dual role of oceans in absorbing both carbon and heat is critical for achieving net-zero targets."

Increasingly, pollution is harming marine ecosystems. Plastic pollution is especially damaging. Plastic debris not only kills fish and other animals but also disrupts the ocean's ability to function as a carbon sink by blocking sunlight from reaching the phytoplankton and algae. Visser: "Investing in projects that address plastic pollution, acidification, and the warming of seas is crucial for maintaining the oceans' role in climate regulation and is beneficial for biodiversity as well."

[1] https://www.climatebonds.net/files/reports/cbi_mr_h1_2024_02e_1.pdf

Blue bond: a new dedicated funding vehicle

Investors have an opportunity to address environmental challenges through the growing green bond market, Visser acknowledges. However, water-related issues still remain significantly underfunded. This funding gap has led T. Rowe Price to advocate for blue bonds, an asset class dedicated to the water-related sectors of the Blue Economy.

Blue bonds build on the success of green bonds by specifically targeting water-related projects. These use-of-proceeds bonds aim to finance initiatives that support ocean health, such as reducing maritime industry emissions, combating plastic pollution, and promoting offshore wind energy. By funding these projects, blue bonds seek to restore and protect marine ecosystems and can play a critical role in mitigating climate change.

While governments have already been issuing blue bonds, corporate issuance remains limited, leaving untapped potential in the private sector. For climate-focused portfolios, assessing the additionality – the tangible impact that each investment generates – is crucial. Corporate blue bonds often provide greater transparency than government-issued counterparts, facilitating clearer tracking of environmental and social impact. Visser: "This explains why we focus on corporate blue bonds in emerging markets, driving growth in areas where the need for climate resilience is arguably most urgent."

A good fit for climate portfolios

Visser explains: "Blue bonds seamlessly integrate into institutional investors' climate portfolios and align with emerging investment themes like biodiversity. Their exclusive focus on the Blue Economy boosts their visibility. As a new asset class, blue bonds can serve as a rallying point for both issuers and investors, building momentum. However, the challenge remains to scale up issuance. Currently, the global assets under management in this category are only valued at between US$6 to US$8 billion, depending on how self-labeled blue bonds are categorized."

To drive growth in this market, T. Rowe Price has partnered with the International Finance Corporation (IFC), the largest global development institution focused on the private sector in emerging markets.

Investment projects offering impact and financial returns

There are several sectors within the Blue Economy where investors can make a meaningful difference, with potential for financial return.

Firstly, sustainable shipping presents a key opportunity. Investing in this sector helps combat climate change in two important ways. Not only does it reduce CO2 emissions, but, as Visser points out, it also plays a vital role in preserving ocean health. Cleaner ships not only cut carbon emissions but also prevent oil and other harmful substances from polluting the seas.

With 80% of global trade transported by sea, the International Maritime Organization (IMO) has set a target for climate-neutral shipping by 2040. Blue bonds can be instrumental in financing the electrification of harbors, funding the shift to zero-emission vessels, and reducing both CO2 emissions and ocean pollution.

Reducing the flow of plastic in our waters

Another critical area is tackling plastic waste. An estimated 171 trillion pieces of plastic currently float in the world's oceans, posing a grave threat to marine life and ecosystems. Blue bonds can provide the funding needed to support recycling initiatives and the production of recycled plastics, helping reduce the flow of plastic into our waters.

Sustainable fishing is another promising investment theme. Oceans are an essential source of protein for millions of people, but the exploitation of these resources must be managed sustainably. Investments in sustainable fishing practices can protect marine biodiversity while ensuring the long-term viability of the ocean as a food source.

The transition to renewable energy is also essential, given that fossil fuels are responsible for over 75% of global greenhouse gas emissions. Offshore renewable energy, particularly wind and solar, holds great potential in ocean environments. Blue bonds can help finance offshore wind and solar projects, which benefit from consistent wind patterns and minimal competition for space. These projects, if properly managed, can deliver environmental and financial returns while minimizing their impact on marine ecosystems.

Transforming the lives of people

Projects within the Blue Economy not only benefit the environment but can also transform the daily lives of people, especially those in coastal communities. Many of these communities are already grappling with the effects of ocean pollution and face the long-term threat of rising sea levels. By focusing on clean oceans and promoting biodiversity, these investments help preserve the ecosystems that coastal populations rely on for their livelihoods.

Furthermore, such investments can strengthen local industries like fishing, tourism, and transport, providing much-needed economic opportunities. For example, supporting sustainable fishing practices ensures stable, long-term incomes for communities dependent on marine resources. Similarly, promoting eco-tourism creates new jobs and drives revenue, enabling communities to flourish in tandem with a healthier, more sustainable environment.

A long-term impact

The long-term impact of these investments is even more significant. As climate change accelerates and sea levels rise, coastal communities face increasing existential threats. A well-protected ocean plays a vital role in mitigating these risks by enhancing its ability to absorb CO2, which helps counter the effects of rising sea levels.

Climate change poses an urgent challenge for humanity. Investors have a critical role to play in financing the right projects. “Until now, blue bonds have mainly been issued by sovereign entities and development banks. For the blue bond market to grow, it will be crucial for corporations to begin issuing them, much like what occurred in the early stages of the green bond market. At T. Rowe Price, we are therefore actively seeking companies with projects that can be funded through blue bonds. To help expand this funding channel, we offer partial financing for projects, encouraging companies to issue blue bonds and other investors to follow,” says Visser.

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