

As the green bond market approaches its twentieth anniversary, it's timely to reflect not just on the growth of the market, but on the evolving narrative around green finance. The sector has matured from a niche innovation into a cornerstone of sustainable finance, and one question continues to dominate: should green bonds be judged by their additionality? In a world of evolving reporting regimes, regulatory scrutiny, and practical financing constraints, it may be time to rethink whether additionality should remain the yardstick for credibility.

DEFINING ADDITIONALITY

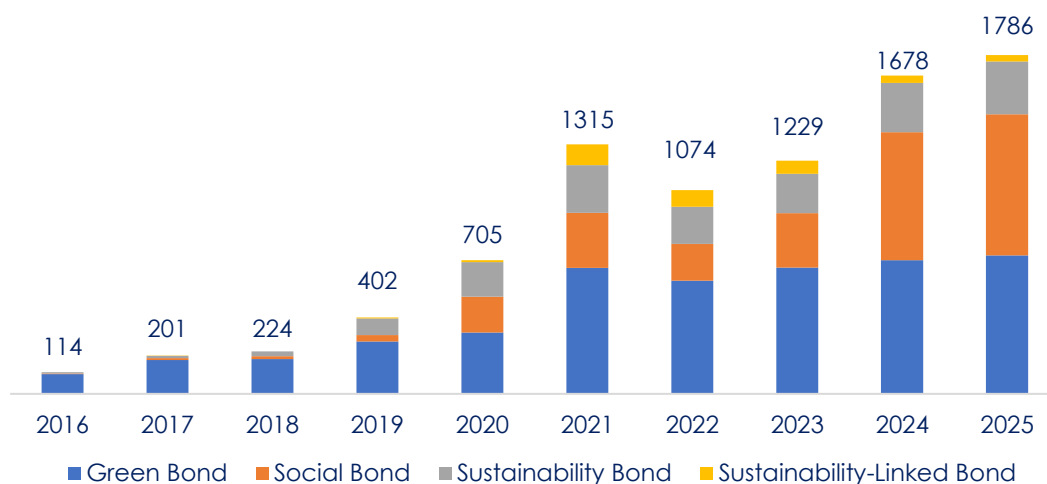
Let's start first by defining the concept of additionality. In sustainable finance, additionality refers to the principle that the proceeds from a green, social or sustainable bond should be directed only to projects that would otherwise not have been financed, thereby creating incremental positive impacts beyond an issuer's business-as-usual (BAU) activities. In short: the capital must fund something new, not simply relabel existing projects.

The International Capital Markets Association ("ICMA") Green Bond Principles - broadly considered the market's gold standard framework that facilitates the issuance of green bonds - doesn't explicitly require additionality. Rather, it emphasises four core pillars:

1. Use of proceeds
2. Project evaluation & selection
3. Management of proceeds, and
4. Reporting.

The chart below illustrates the rapid growth and changing composition of labelled bond issuance since 2016, highlighting the increasing scale of green, social, sustainability and sustainability-linked bonds within the bond market.

Labelled Bond Issuance (US\$ billion)



Source: Bloomberg

For reference, ICMA estimates that 97% of sustainable bonds issued in 2024 were aligned with one of the four ICMA labelled bond principles¹.

Despite there being no mention of additionality as a requirement for a green (or otherwise labelled) bond in the ICMA Principles, market and investor expectations continue to hone in on additionality, or the perceived lack thereof. This is as a means to measure whether a bond deserves the green label and any potential pricing benefits associated with that label.

WHERE ADDITIONALITY BREAKS DOWN

Let's walk through how market expectations around additionality can play out in practice, using the example of a renewable energy utility or generator. The business of renewable energy generation is inherently critical for global decarbonisation and aligned with the core tenets of sustainability. However, since generating renewable capacity is part of the issuer's BAU, then viewed through a strict additionality lens, it could be seen to fail the test for an impactful green bond. But that's not a practical outcome, especially for utilities that are capital-intensive and where financing alignment is crucial.

In our view, a renewable energy generator's financing needs should be aligned with that of their assets. A pool of green assets can and should be matched with "green liabilities". The burden of additionality can be a deterrent for issuers who have the right assets and the right sustainability strategy from issuing in green (or otherwise labelled) format. They might prefer conventional debt to avoid the reputational or disclosure scrutiny.



A similar tension arises with government issuers, who have become some of the largest and most consistent participants in the labelled bond market. Their programs typically finance broad categories of public infrastructure: transport networks, water systems, schools, hospitals, or social housing. By design, many of these projects are core public services – activities the governments would almost certainly fund regardless of whether a labelled bond was issued. From a strict additionality lens, this can appear problematic: is the bond actually enabling new green or social outcomes, or just rebadging BAU public expenditure?

But here too, the additionality test can be misleading. The credibility of a semi-government green bond framework rests not on whether the projects would have happened anyway, but on:

- Transparency and ringfencing: proceeds are clearly allocated to a defined pool of eligible assets (e.g. low-carbon transport, water efficiency, renewable power offtake).
- Reporting and accountability: semi-government issuers often provide some of the most detailed post-issuance reporting in the market, setting a standard for corporate issuers to aim for.
- Market signalling: labelling their financing as "green" or "sustainable" signals policy alignment and long-term commitment, reinforcing confidence in the jurisdiction's sustainability agenda.

In this context, additionality should not be the sole measure of credibility. Local and semi-government issuers play a critical role in scaling the market, mobilising investor capital toward low-carbon infrastructure, and anchoring liquidity. Penalising them for a lack of "extra" beyond public policy imperatives risks ignoring the essential role public entities play in decarbonisation. In contrast, ambition and additionality are core tenets of sustainability-linked financing, where bond proceeds are used for general corporate purposes and environmental or social outcomes are driven through issuer-level performance targets rather than asset ring-fencing, making the risk of greenwashing more acute.

Accordingly, additionality is and should be front and centre in the design of sustainability-linked bonds. However, with use-of-proceeds (UoP) bonds, where capital is explicitly allocated to pre-defined, ring-fenced eligible assets or projects, the risk of misalignment or greenwashing is inherently reduced by directly linking financing to funded activities.

In practice, many green bond frameworks allow proceeds to refinance existing green assets, often within a “look-back period” of 24 to 36 months. That means a portion of funding can go to projects already in operation or recently financed. If strict additionality were required, those refinancings would be disallowed, but investors have accepted that as a legitimate use. Refinancing is too often derided, but it can have value: lower-cost capital for existing green projects, extension of green liability matching, and freeing up alternative capital lines. The existence of look-back windows in many green bond frameworks subtly acknowledges that additionality is not always achievable or necessary for credible green financing.

THE ROLE OF REGULATION

Increasing regulatory pressure and enforcement amplify the issue. In Australia, the corporate regulator ASIC has increasingly flagged concerns not only about greenwashing, but also about “greenhushing”, the phenomenon whereby companies opt to remain silent about sustainability initiatives for fear of scrutiny or litigation. This idea was first publicised in Australia during ASIC Chair Joe Longo’s speech at the AFR ESG Summit in June 2023² where he noted “in response to ASIC’s scrutiny of greenwashing, some companies may be tempted to cease all voluntary disclosure, chasing greenwashing with a little ‘greenhushing’”. He described this response as just another form of greenwashing.

Failure to disclose for fear of regulatory scrutiny is increasingly unacceptable and we encourage issuers to be transparent with the market on their sustainability strategies and to signal alignment with their strategies and their financing through accessing labelled bond markets.

THE ROAD AHEAD FOR ISSUERS

We regularly hear from corporates that labelled bond issuance is challenging, due to the complexity, cost, and internal demands of maintaining reporting, governance, assurance, and data collection. In Australia, upcoming mandatory climate disclosure obligations will require many of the same data points issuers already needed for green bond reporting. This means the incremental cost of disclosure for labelled debt will generally decline. We encourage bond issuers to move early and show leadership in their reporting and financing structures and believe the market will reward ESG leadership. Issuing in labelled format has the potential to open up access to greater demand and diversified investor pools, strengthen issuer reputation through credible signalling, and position early movers ahead of peers in a market where transparency and accountability are quickly becoming baseline expectations.

Ultimately, the evolution of the green bond market calls for a more nuanced understanding of additionality. While additionality remains a critical test of credibility in certain financing structures, particularly where proceeds are not ring-fenced, it should not be treated as a universal litmus test for all labelled debt. As the market matures, credibility should be assessed through the alignment between assets and liabilities, the robustness of governance and reporting, and the transparency with which issuers articulate their sustainability strategies. Reframing the debate in this way allows green bonds to fulfil their core purpose: efficiently mobilising capital at scale toward the transition.

REFERENCES

¹ <https://www.icmagroup.org/assets/documents/Sustainable-finance/ICMA-Principles-infographic-2024-050325.pdf>

² <https://www.asic.gov.au/about-asic/news-centre/speeches/asic-chair-s-af-r-esg-summit-speech/>

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