

# FI Strategy Denmark

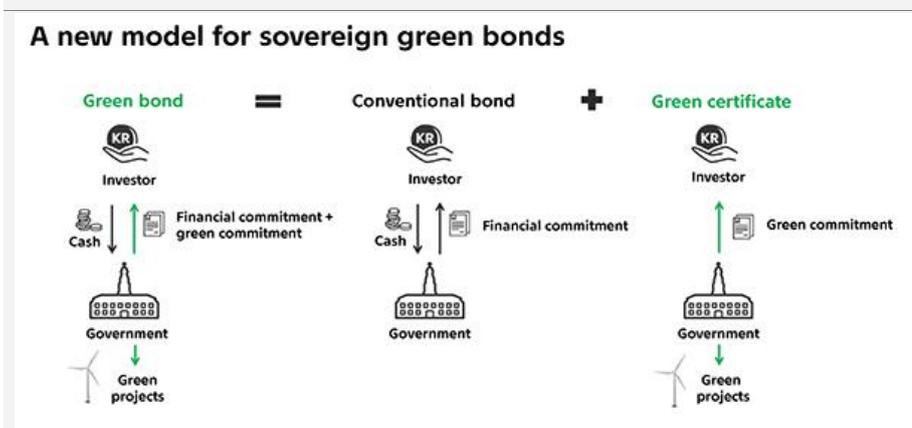
## The Danish sovereign green bond model

The Danish Debt Management Office (DMO) has published a short note regarding the issuance of green bonds. The key challenge for the Danish Central Bank is that the funding need in coming years continues to be modest, given solid public finances, with a small deficit or even a surplus. Hence, the DMO has been working on a model *‘that will enable small sovereign issuers like Denmark, with limited funding needs, to access the green bond market without compromising liquidity’*. See more on the DMO website *Green issuance*. The DMO sees the conventional green bond as comprising two components.

- A traditional government bond.
- A commitment that the expenditures for green projects will be financed through the proceeds of selling government green bonds.

In the Danish government’s green bond model these components are split into two separate parts – a traditional government bond and a green certificate attached to the specific government bond as shown in the chart below.

Figure 1. Green bonds – the Danish alternative



Source: Nationalbanken, Danske Bank

According to the DMO, then *‘the green certificates constitute a commitment by the Kingdom of Denmark, that the green expenditures at least match the proceeds from selling a package of a conventional government bond and a green certificate’*. Hence, in this model the DMO will sell certificates attached to a traditional Danish government bond such as DGB 0.5% 11/29.

It is still ‘work in progress’ for the DMO on how to issue green bonds. However, given that the DMO is working on the above model, we expect that this will be the most likely solution for the Danish government’s green bond framework. Hence, the DMO will not supplement the current issuance of traditional government bonds with a new green bond such as we have seen in Ireland, Belgium, France and Netherlands. It is worried that this would ‘dilute’ the liquidity in Danish government bonds.

### Key points

- The Danish DMO has published a note on future green bond issuance.
- The Danish DMO proposes a different model from the traditional green bond model, where sovereign issuers add green bonds to the existing non-green government bonds.
- The Danish DMO is worried about the liquidity of both the traditional DGBs as well as new green bonds if it just adds green bonds to the current portfolio of DGBs.
- Instead, the DMO has split the green bond into a traditional non-green bond and a green certificate. The green premium becomes very transparent as investors bid for the entire package at auctions.
- The green certificates are attached to a traditional DGB such as DGB 0.5% '29 and will have their own ISIN code, such that there can be secondary trading in the green certificates.

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However, there are a number of outstanding points, such as the secondary trading in green certificates, whether the DMO will take part in buying and selling green certificates and whether or not there will be a repo market for the them, etc.

This model makes the green premium (*'greenium'*) very transparent relative to the traditional model, where issuers have both green bonds and non-green bonds and the green premium can be difficult to differentiate from the non-green bonds.

There are pros and cons for the Danish green bond model. Firstly, we expect there will be a larger investor base as the green bond investor base is rapidly expanding. However, there may be a lower free float of DGBs as green bond investors are seen to be more buy-and-hold investors. Finally, we do not know the funding need for green projects going forward. Currently, the Danish government has set DKK25bn aside for green projects, but we do not know if it will be financed entirely by the issuance of new green bonds. Hence, we do not expect that green bond issuance will start before autumn 2020 or spring 2021.

How should these green certificates be priced? If we look at the current pricing of green bonds from France, Ireland and Belgium there is a premium (*'greenium'*) of 1-2bp, while for the Dutch green bond there is actually a discount of 3-4bp relative to the traditional non-green government bonds. This discount is mainly due to the expected issuance in 2020. Hence, we would expect that the green certificate will have a positive price.

We have the following details regarding the green certificates from the DMO.

- Green certificates and conventional government bonds are sold as a package at auctions – i.e. the investor bids for the total package at the auction.
- The certificate is associated with a specific government bond.
- The green certificates have their own ISIN code and can be traded separately in a secondary market.
- The certificate expires at the same time as the government bond and will be a zero-coupon bond with zero redemptions at maturity.

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**Report completed:** 5 December 2019, 14:07 CET

**Report first disseminated:** 5 December 2019, 16:20 CET