INVESTORS FOR PURPOSE

Green bonds: opportunities, challenges and future priorities

COMMISSIONED BY *BNP PARIBAS ASSET MANAGEMENT*

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Published by *Investors for Purpose,* August 2026.

Introduction from *BNP Paribas Asset Management*

We have teamed up with *Investors for Purpose* to dig into the topic of how investors are approaching green bond investment and what barriers there are to a greater investment in the asset class.

In the more than 10 years since the first green bond was issued, the asset class has become progressively stronger. Including social and sustainability bonds, they have grown into a $4tn market, offering depth and liquidity to rival the conventional bonds market.

As it stands in 2026, there is much more clarity as to what a 'good' green bond should look like, thanks to standard setting bodies such as the *International Capital Markets Association*, the *European Green Bond Standard* and *Climate Bonds Initiative*, among others. Market participants have listened and issuers have fully adopted these best practices.

The birth of green taxonomies, notably in the EU but also globally, has also brought additional clarity to what constitutes green projects, facilitating flows towards projects the market will readily accept.

The evidence is clear – green bonds work

With over a decade of history, there is now ample evidence that green bonds help issuers decarbonise portfolios. Studies from the *Bank of International Settlements*[1] and the *London Stock Exchange Group*[2] confirm the link between green bond issuance and decarbonisation, highlighting how green bond issuers have decarbonised faster than non-green issuers. This presents a strong argument to strengthen the credibility of green bonds for net-zero investments.

But it is not just about portfolios. There is widespread recognition that green bonds are a way to finance the low carbon transition. The *Institutional Investors Group on Climate Change* has affirmed the importance of green bonds in an investor's net-zero strategy[3], positioning them as a possible climate solution to enable the transition and deliver real-world decarbonisation.

While climate is a dominant allocation, new themes have continued to emerge. Blue bonds, biodiversity bonds, resilience bonds and thematic bonds that have emerged in recent years showcase in their versatility the ways they can be used to address evolving sustainability concerns.

Green bonds work for investors too

From a fundamental perspective, green and sustainability bonds have also shown their worth. After 10 years of growth in the market, there is no more 'greenium': investors can choose to invest sustainably at no additional cost.

In fact, green bonds have recently outperformed conventional bonds. Over the past three years, the green, social and sustainability (GSS) universe has delivered a better return than the global bond market, close to that of the global corporate market and with a lower volatility profile than both universes.

The market has developed to the point where there are a wide variety of green bond strategies available today to meet a range of investor needs. Whether it is liquidity management, portfolio diversification or long-term risk management, there is sufficient depth in the market to meet a wide array of investment objectives.

The allocation conundrum

Given all this, the question remains – why have investors been slow to adopt green bonds at scale? Flows into Sustainable Financial Disclosure Regulation (SFDR) Article 9 green bond mutual funds have declined in recent years. In the UK, our UK-domiciled fund has not grown appreciably in assets under management, despite the adoption of the 'sustainability impact' label under the *Financial Conduct Authority*'s sustainability disclosure requirements.

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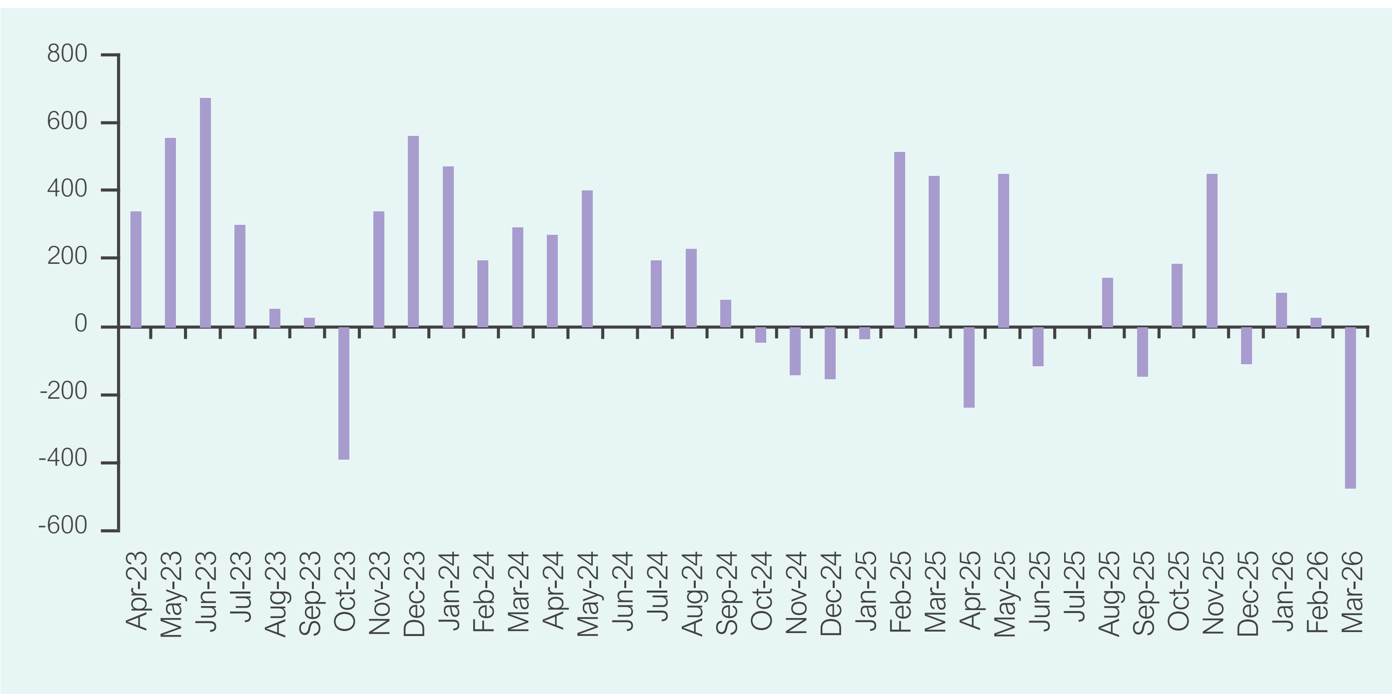
Fig 1: Monthly flows into SFDR Article 9 GSS bond funds (active mutual funds only)



Source: *BNP Paribas Asset Management, Broadridge, Morningstar Direct (as of 31/03/2026).*

At a time when fixed income has become increasingly attractive, and climate and nature financing needs seem to be larger than ever, are we missing out on a prime impact and investment opportunity to allocate to green bonds?

About the research

This research paper seeks to provide insights into demand-side hurdles to allocating to green bonds. Based on five interviews with UK institutional investors, this research examines green bonds' role in portfolios. Interviews followed a structured questionnaire covering motivations and barriers for green bond allocation, impact and transition goals, and market development.

The evolution of the green, social and sustainability (GSS) bond market

A snapshot of the market's breadth, including sector composition and key characteristics, highlighting the scale and diversification available to investors.

Fig 2: GSS bond universe: composition by sector

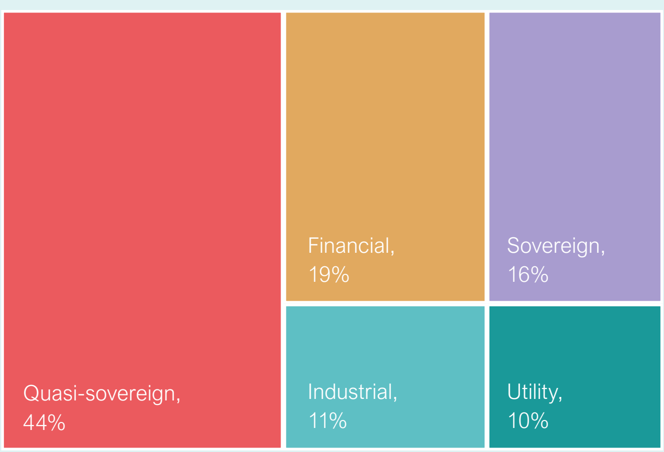


Table 1: Key characteristics

	GSS bond universe	Global Broad Index
Market size	$4tn	$61tn
Yield (GBP-hedged)	4.95%	4.59%
Duration (years)	5.4	6.0
Average rating	AA	AA-
Issuers	+1100	+3400

Source: *BNP Paribas Asset Management, Bloomberg (as of 29 May 2026).* For illustrative purposes only.

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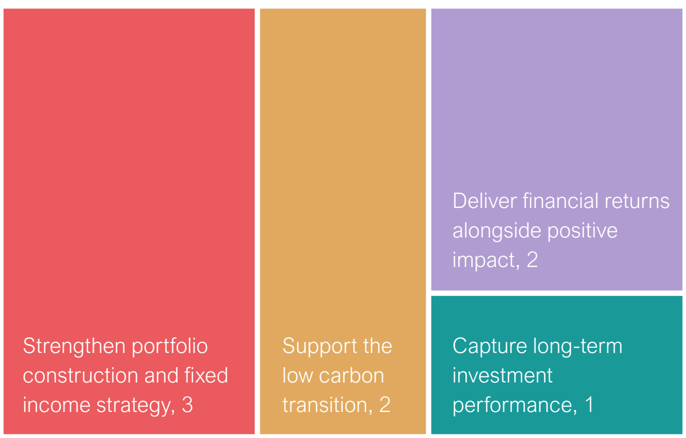
Why institutional investors are allocating to green bonds

Institutional investors described green bonds as an important component of portfolio construction, supporting diversification, liquidity and risk management, alongside sustainability objectives across both public and private markets.

Fig 3: Why are institutional investors allocating to green bonds?



1. Green bonds were usually integrated into diversified fixed income allocations, helping to strengthen portfolio construction and fixed income strategy. Some investors noted specific opportunities in private debt and emerging markets, where climate finance may offer returns alongside measurable impact.

"Our private markets bond sleeve has a targeted emerging market focus, partly because it is higher returning, but also because it has greater measurable impact."

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Investors also described bonds and green bonds as part of their broader approach to managing portfolio risk. One investor explained that maintaining an allocation to bonds alongside growth assets could help manage overall portfolio risk and allow members to remain exposed to growth assets for longer, rather than de-risking the portfolio too early.

"We wanted to shorten the de-risking period by keeping investment risk in retirement for longer. Our allocation to bonds and green bonds helps to manage overall portfolio risk, while allowing members to remain exposed to growth assets for longer."

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2. Investors also saw green bonds as an opportunity to support the low-carbon transition, recognising the scale of capital needed to decarbonise the economy. This included investing in new green technologies as well as supporting the decarbonisation of existing high-emitting sectors.

"We invest in issuers that are high emitters but have credible decarbonisation trajectories, helping to finance those key players in the low-carbon transition."

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3. Environmental benefits were expected to complement, rather than replace, financial returns. Pension funds emphasised their duty to deliver competitive long-term risk-adjusted returns while also addressing systemic risks such as climate change.

"Our members want us to do good with their money. If we can achieve a market-rate return while delivering positive outcomes, why wouldn't we? Sustainable investing creates and protects long-term value."

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"There is growing polarisation and a perception that sustainability drags on returns, whereas our experience has been positive. We have generated good returns and are happy to be transparent."

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4. Finally, institutional investors' long-term horizons were seen as well aligned with the opportunity to capture long-term investment performance. Funds must assess risks and opportunities that will materialise over decades, and interviewees viewed climate change as both a financial risk and an environmental challenge. For pension funds, allocating to decarbonisation was therefore seen as prudent long-term risk management for members' retirement outcomes.

"Pension funds are long-term investors. It's not just about short-term returns; we still need to pay pensions to members who are 18 today."

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Table 2: Market insight: examples of green bonds solutions

Sector	Challenges	Examples of green bond solutions
Energy	The energy sector represents 34% of global greenhouse gas (GHG) emissions.	Renewable energy generation, grid infrastructure upgrades and energy efficiency projects.
Transport	The transport sector represents 15% of global GHG emissions.	Vehicle electrification, electric charging infrastructure and low-carbon public transport projects.
Buildings	Buildings represent 6% of global GHG emissions.	Green buildings, energy-efficient upgrades, retrofitting projects and sustainable construction solutions.
Nature	Around 50% of global gross domestic product (GDP) depends on nature and biodiversity.	Ecosystem restoration, pollution prevention, sustainable water management and biodiversity conservation projects.

Why investors remain cautious

Despite support for green bonds, wider adoption depends on whether they can meet conventional fixed income expectations on risk-adjusted returns, governance and reporting.

Investors will allocate only where green bonds compete financially within fixed income strategies and deliver environmental impact.

Fig 4: Why investors remain cautious (n=5)

1. Some interviewees raised concerns around **performance considerations, particularly whether green bonds could reduce returns during the growth phase,** when long-term member outcomes are most important.

"These assets have tended to underperform in a highly competitive market. From a member outcomes perspective, higher-returning assets may be more appropriate, particularly during the growth phase."

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2. Investors also highlighted **challenges balancing fiduciary responsibility with environmental objectives.** Some saw transition investment as protecting long-term value; others wanted clearer evidence of direct financial benefits.

"Ultimately, fiduciary duty and financial returns always supersede positive environmental characteristics in the short-term."

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3. **Difficulty measuring impact outcomes was another concern.** Investors increasingly expect evidence of meaningful outcomes, but reporting quality varies significantly between issuers and managers. Additionality also remains difficult to assess, with investors questioning whether projects deliver benefits beyond what would have happened anyway.

"Understanding additionality takes resources, especially where transparency is weaker. Some second-party opinions are more useful than others. Greater consistency would help."

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4. **Some challenges relate to the structural characteristics of fixed income investing.** Unlike equity investors, bondholders do not have voting rights, limiting engagement opportunities. Secondary-market investments and shorter holding periods can further constrain the ability to engage directly with issuers.

"There is no meaningful engagement opportunity. These are secondary market investments and we do not hold them long enough to contact the company."

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5. **Greenwashing and credibility also remain concerns.** Investors want greater confidence that proceeds are being used as intended, and that reported environmental outcomes are credible and meaningful. The quality and usefulness of second-party opinions can vary, while stronger audit and reporting are seen as important to building investor confidence.

"Green bonds require stronger audit and reporting to confirm proceeds and outcomes. Investors need confidence they are not exposed to greenwashing."

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6. **Finally, investors highlighted market constraints, particularly the uneven distribution of green bonds across industries, regions and issuers.** The green bond universe is perceived to remain relatively narrow, making it harder to build well-diversified portfolios without creating unintended concentrations in specific sectors, geographies or risk profiles.

"Sector and regional concentration remains a challenge. Green bonds work better within broader mandates, because it is difficult to meet sustainability and investment objectives in standalone sleeves."

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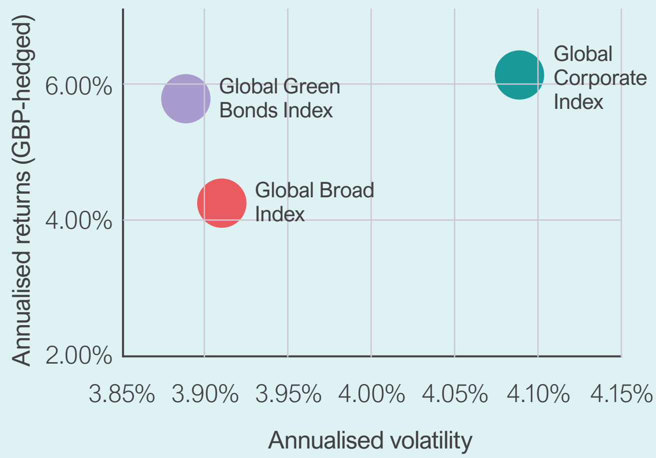
Market insight

Over the past three years, ICE BofA Green Bond Index has demonstrated competitive risk-adjusted returns. It has achieved comparable performance to the ICE BofA Global Corporate Index, while significantly outperforming the ICE BofA Global Broad Market Index, with the lowest volatility among the three.

Fig 5: Three-year returns versus volatility



Source: *BNP Paribas Asset Management; Broadridge; Morningstar Direct, Bloomberg (as of 29 May 2026)*. For illustrative purposes only.

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What could support wider adoption?

Interviewees were optimistic about the long-term development of the green bond market and identified four priorities that could support wider adoption. The recommendations below translate those priorities into practical actions for market participants and policymakers.

1. **The need for consistent, comparable reporting at both issuer and asset-manager portfolio level, covering use of proceeds, delivered impact and unintended consequences.** Interviewees also emphasised the value of reporting beyond emissions to include resilience, community benefits and lessons learned, while stressing that reporting should focus on information most useful to investors and avoid unnecessary burden.

Action to support wider adoption: develop clearer expectations and guidance for asset managers and issuers on decision-useful reporting, with a focus on consistency, comparability and avoiding unnecessary reporting burdens.

2. **Asset owners noted a perception that the market still lacks breadth across sectors, regions and credit qualities.** Larger, more diversified issuance would support mainstream fixed-income integration, particularly in global credit, high yield and transition finance.

Action to support wider adoption: strengthen investor education on the breadth of opportunities available and how green bonds can be integrated across conventional fixed-income universes.

3. **Interviewees called for stronger evidence that green bonds can deliver competitive financial performance, alongside measurable environmental outcomes.** Interviewees also valued accessible communication and practical examples of green bond integration:

"Education needs to be transparent and plain English, dispelling myths and showing green bonds are legitimate, non-concessionary investments."

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Action to support wider adoption: develop accessible, evidence-based investor education using practical examples and market data to demonstrate both financial characteristics and environmental outcomes of green bonds.

4. **A regulatory environment that supports long-term transition investment.**

"Policy instability makes it harder for companies to commit to greening core activities, especially where changes affect industrial processes. Asset managers and owners could do more together on policy engagement."

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Action to support wider adoption: strengthen coordinated public policy engagement to support stable, credible frameworks for long-term transition investment.

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Published by Investors for Purpose, August 2026