

# What Financial Institutions Can Do for CSR

## A New Financial Product to Promote the Development of the Emissions Trading Market



**Kunihiro Nishikawa**

Deputy General Manager  
Private Equity Investment Dept. &  
Carbon Finance Business  
Daiwa Securities SMBC Principal Investments Co. Ltd.

**Daishu Nagata**

Deputy General Manager  
Corporate Planning Dept.  
Daiwa Securities SMBC Co. Ltd.

**Teruaki Kashiwabara**

General Manager  
Head of Structured Products  
Fixed Income Dept.  
Daiwa Securities SMBC Co. Ltd.

**Masahisa Uryu**

General Manager,  
Structured Products Department  
Daiwa Securities SMBC Co. Ltd.

**Mariko Kawaguchi**

Senior Analyst, Management Strategy  
Research Department  
Daiwa Institute of Research Ltd.

### Cool Bonds: Raising awareness about the importance of CO<sub>2</sub> emissions reduction and curbing global warming

#### The birth of Cool Bonds

**Nishikawa:** Daiwa Securities SMBC Principal Investments Co. Ltd. invests in companies with the Daiwa Securities Group's own investment funds. Since the effort to reduce CO<sub>2</sub> emissions affects the operations of many companies, we thought that it would very likely impact our corporate investment operations as well. However, we also realized that the emissions targets from the Kyoto Protocol are in line with economic rationality, and hence, new business opportunities would arise. Thus, the right conditions for the Cool Bond initiative were created.

We began our investigations two years prior to the implementation of the Kyoto Protocol. Initially, we invested in the Community Development Carbon Fund\*<sup>1</sup>. At that time, the predicted scale of the emissions trading market was fairly large, ranging between 300 billion yen and 30 trillion yen, and we could see that there was potential for development due to the unpredictability of the market. We became more firmly convinced that the concept could be commercialized; hence, we consulted with the Structured Products Department on the creation of a new financial product based on emissions trading.

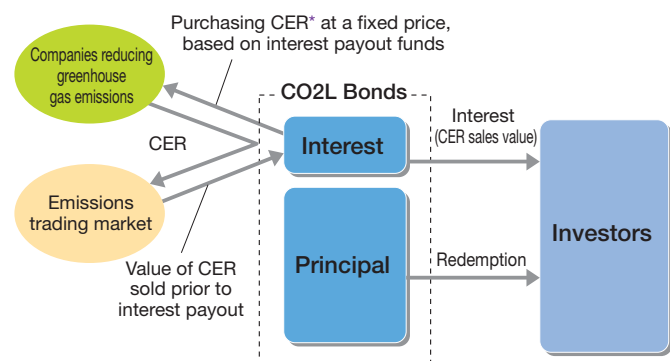
**Uryu:** The role of the Structured Products Department is to develop

#### What are Cool Bonds?

Cool Bonds have a mechanism to return to investors as interest payment the value of emissions credits sold, as established by the Kyoto Protocol. For example, emissions credits obtained through greenhouse gas reduction in China are sold in the market for emissions credit transactions, and the sales proceeds are returned to the bond investors as interest payment. Based on this method, individual investors that normally would not be able to participate at all in emissions trading are now able to participate in these transactions indirectly. Cool Bonds are also expected to provide stable earnings for the greenhouse gas reduction business.

▶▶ For more details on the website, visit:  
<http://www.daiwasmbcpi.co.jp/news/060216/060216.html> (in Japanese only)

#### Cool Bond mechanism



\* CER: Certified Emissions Reduction

In February 2006, Daiwa Securities SMBC Co. Ltd. and Daiwa Securities SMBC Principal Investments Co. Ltd. Developed "CO2L Bonds" (Cool Bonds), a financial instrument whose interest is linked to the market value of greenhouse gas emissions credits.

The persons involved in the development, sales, and marketing of this financial product were brought together recently to discuss the development objective behind Cool Bonds, the future of the emissions credits business, and what financial institutions should do to help resolve environmental problems. (Discussion date: May 25, 2006)

the new financial products. When I first heard the words "emissions trading", "Kyoto Protocol", and "clean development mechanism (CDM)"\*2, I had no idea what it was all about. However, if there was a market involved, I knew that financial products could be made. Moreover, at that time, a graph I saw showed emissions trading values on the rise, and my intuition told me that interesting investment products could be made.

**Kashiwabara:** The Fixed Income Department's job is specifically to create the bond. To be honest, I thought it would take quite a lot of time to commercialize the concept, as there were so many types of related contracts and provisions that needed to be included. It was decided that the whole Group would start marketing and selling this new product on the first anniversary of the implementation of the Kyoto Protocol. As such, we worked with the lawyers at a feverish pace to complete the necessary preparations, and eventually, the product was ready for sale by the target deadline.

## Huge response from the media and individual investors

**Nagata:** The Corporate Planning Department is in charge of the media strategy. There was a tremendous interest in Cool Bonds at the time of its launch, since they had been covered by more than ten newspapers and television programs in Japan. There have also been a lot of inquiries from environmental magazines, and I think this can showcase the Daiwa Securities Group's environmental initiatives.

**Uryu:** The team members that created the product are also in charge of sales. Whenever I explain Cool Bonds to customers, I always begin with an explanation about the Kyoto Protocol. I tell them that Japan needs to meet its Kyoto Protocol obligations, and since companies generally incur heavy costs to reduce their CO<sub>2</sub> emissions, it is expected that there will be strong demand for emissions credits from the companies that cannot stay within their emissions quota. I then go on to explain that there is already an active market for emissions credits in North America and Europe, and the price of these credits is on the rise.

**Nagata:** Some individual customers see an article about Cool Bonds in newspapers or elsewhere, and then call us to learn more about purchasing them. However, since this product is a private placement issue\*3 sold in minimum units of 500,000 dollars, it is not affordable for most individual investors at this time.

**Uryu:** While learning about environmental issues during the development of this product, I became keenly aware that environmental protection both offers a business opportunity for financial institutions, as well as poses a business risk. I also developed a greater awareness and concern for the environment as a result. Unfortunately, however, it has not quite reached the point where I've changed my own eating habits or other daily behavior.

**Kashiwabara:** That's true. As a result of this work, I now pay more

attention to articles in the newspaper about environmental issues. Once I started paying attention, I realized that there are actually a surprising number of articles about the environment.

## A financial institution's mission is to raise funds for global warming prevention projects

**Uryu:** Although Cool Bonds do not directly contribute to the reduction of greenhouse gas emissions, emissions trading will grow as the number of participants increase, and public awareness is expected to follow suit as a result.

**Kawaguchi:** Certainly, Cool Bonds will not directly reduce CO<sub>2</sub> emissions. But by increasing participation in emissions trading, I think there will be an increase in the awareness of costs related to CO<sub>2</sub> in our environment. As a result, there will be more done to control global warming.

**Nishikawa:** Currently, only international institutions and a limited number of professionals are able to provide funds for CDM projects. As the sources of funding increases, projects in developing countries will become more diversified. One of the Daiwa Securities Group's missions as a financial intermediary is to directly connect individuals, companies and global environmental projects.

**Nagata:** In the future, we would like to have a wider range of investors purchase Cool Bonds through public offering, and hence, greatly increase the number of people involved in emissions trading.

**Nishikawa:** Next, we'd like to increase the range of emissions trading-related instruments available by finding more opportunities to participate in similar green house gas reduction projects. At the same time, we'd like to continue telling our staff and the public that the creation of financial products based on emissions trading is contributing towards measures to prevent global warming.



\*1 Community Development Carbon Fund: A World Bank fund that provides funding to projects to curtail emissions of greenhouse gases in developing countries. The fund investors receive portions of the emissions credits according to the resulting reduction in greenhouse gases.

\*2 Clean development mechanism (CDM): One of the mechanisms established by the Kyoto Protocol. Developed countries provide funding, as well as other types of support, for projects to reduce emissions in developing countries, and then part of the reduction achieved can be counted as a reduction in the developed countries concerned.

\*3 Private placement: Bonds that are issued for less than 50 purchasers. Issued mainly for institutional investors.