

Green structured products are likely to proliferate

As carbon emission themes and alternative energy sources such as biofuels and wind power make global headlines, governments and the business sector are focusing on climate change policies.

Investment products providing a rational economic contribution to climate change problems are gaining momentum. Eco-friendly products and climate change thematic indices are being launched by financial institutions keen to take advantage of growth in this market.

A political determination to address climate change has resulted in policies that are laying the economic foundations for the steady growth of the market. Emission credit trading under the EU

Comment

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scheme on and off stock exchanges and other environmentally-linked projects are growing. The US is also joining in with the country's Climate Security Act, which is designed to cut greenhouse gas emissions.

Securitisation techniques are being applied to renewable energy projects and in particular to wind energy projects. Various refinancing have emerged involving the refinancing of wind farms. New

structures involving aggregations of diversified portfolios of wind farm assets combined with ABS structuring technology and forward selling of CER emissions credits to generate additional collateral are being actively considered. Future flow securitisation structures in the context of sound environmental projects in developing countries – the pooling of rights to credits from environmental projects – may provide highly innovative instruments.

Merrill Lynch and Standard & Poor's have launched biofuels, renewable energy and forestry indices. The S&P Global Timber & Forestry Index includes "25 of the largest publicly-traded companies engaged in the ownership, management or the upstream supply chain of forests and timberlands". The ML Renewable Energy Index provides exposure to stocks in each of the largest renewable energy sub-sectors, such as biofuels, solar and wind power based on certain criteria: market cap, liquidity and country of listing. As with all indices, a wide range of structured products can be based on them and marketed to institutional clients.

Numerous climate change funds

have been or will be launched with an investment focus on companies that contribute to eco-energy, pollution control, clean water and benefit from efforts to adapt and control climate change.

Among the products being launched are tracked notes, which are designed to give direct exposure to the indices and funds, as well as leveraged notes, principal protected notes and constant proportion portfolio insurance.

Although this market has strong potential, there are also significant challenges such as the lack of global uniformity in emission trading; the US and Australian refusal to ratify the Kyoto Protocol, although the new Australian prime minister has

confirmed that the country will change its position, and the lack of empirical data supporting the indices. However, credit index trading went through similar growing pains in the early part of the decade but is regarded as a mature market with a wide range of respected indices and related products under the iTraxx mark.

Climate change financial products, with political and legislative capital behind them, might well become as firmly established and in a shorter time frame.

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