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Green Bond Pricing and Greenwashing under Asymmetric Information

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Green Bond Pricing and Greenwashing under Asymmetric Information
Prepared by Yun Gao and Jochen M. Schmittmann*

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ABSTRACT: We analyze the corporate green bond market under a rational framework without an innate green preference, using a simple adverse selection model. Firms can use green bonds to signal their green credentials to investors. Transition risk stems from uncertainty over the introduction of carbon pricing. We show that green bonds have a price premium over conventional bonds when there are information asymmetry, transition risk, and it is costly to engage in greenwashing, that is, false or exaggerated claims of being green. The extent of greenwashing in the market is a function of the green bond premium. A swift and gradual implementation of carbon pricing generates a small green bond premium and a low level of greenwashing, while delayed and large carbon pricing has an ambiguous effect on both. The model provides a rich set of policy implications, notably the need for swift action on carbon pricing and strong information disclosures and regulations to ensure the integrity of green bonds.

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