Helaba

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European bank bonds: Supervision wearing green-tinted spectacles

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The volume of bond issues with a socially-responsible or green focus is steadily increasing. Although their share is still low when measured against the overall bond market, in certain sub-segments they already account for a relatively significant proportion of issuance - such as euro-denominated senior unsecured benchmark bank bonds, in which they most recently accounted for 6.5 %. Meanwhile, having a focus on sustainability is considered an important factor for issuers' success that investors pay close attention to. This particularly reflects the fact that voluntary standards carry increasing weight on the green bond market. The introduction of the EU taxonomy for green activities and rising pressure from regulators for financial institutions to take account of climate risks are both likely to dominate the scene in 2021.

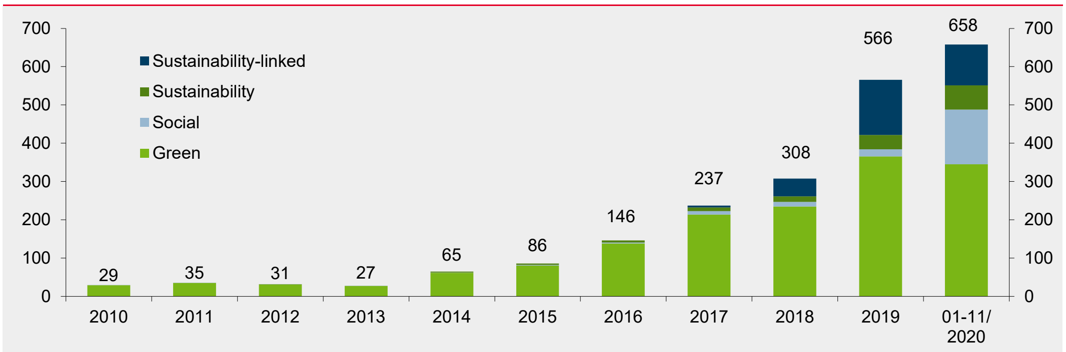
Growth in sustainable finance undiminished

Since our Credit Special entitled "Europäische Banken: Nachhaltigkeit rückt in den Fokus" (*"European Banks: Focus on Sustainability"),* published on 4 July 2019, the importance of environmental, social and corporate governance (ESG) factors has continued to grow on the credit and capital markets. In the period from January to November 2020, the volume of new sustainable finance raised had already reached as much as USD 658 billion, almost 33 % more than in the same period last year - and this despite adverse market conditions as a result of the crisis. For the first time, the largest increase was recorded for loans related to social projects and activities. This was primarily driven by government programmes to support the economy during the Covid-19 pandemic, most notably the EU-SURE programme. Green financing, with a volume of nearly USD 345 billion, still accounted for 52 % of total new ESG issuance.

Sustainable finance – upward trend continues unabated

Volume of new issuance in USD (billions)

USD (billions)



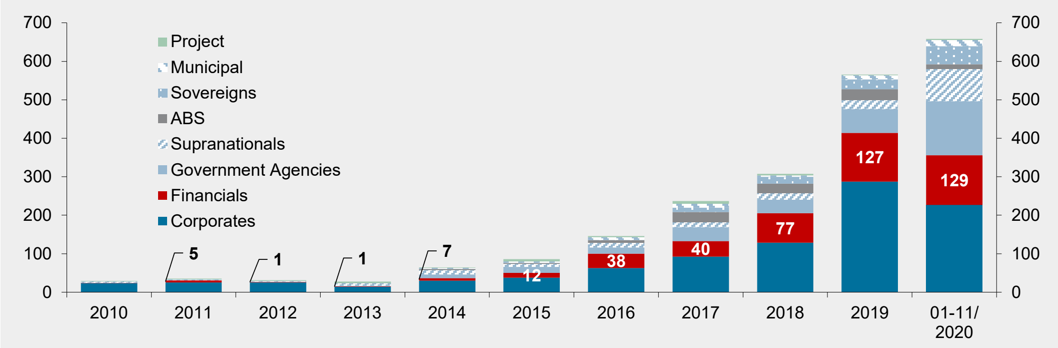
Sources: Bloomberg, Helaba Research

Sustainable bank bonds also on course for a record year

Approximately USD 129 billion of the ESG bonds placed between January and November 2020 were issued by financial institutions, a year-on-year increase of 9 % by our calculations. For 2020 as a whole, the sector can therefore be expected to see yet another marked increase in the volume of ESG issuance compared to the previous year.

Financial institutions closing the gap

Volume of new issuance in USD (billions) USD (billions)

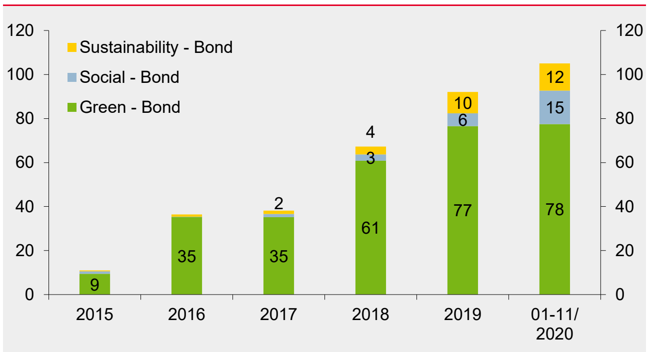


Sources: Bloomberg, Helaba Research

At USD 25 billion, loans only made up a comparatively small proportion of new ESG-related finance for companies between January and November 2020, with bonds accounting for the largest share at USD 105 billion. 19 % of new finance originated from the United States, followed by Spain at 8 %. Although lower, Germany nevertheless accounted for 7 % of new business.

Financials: preference for green bonds

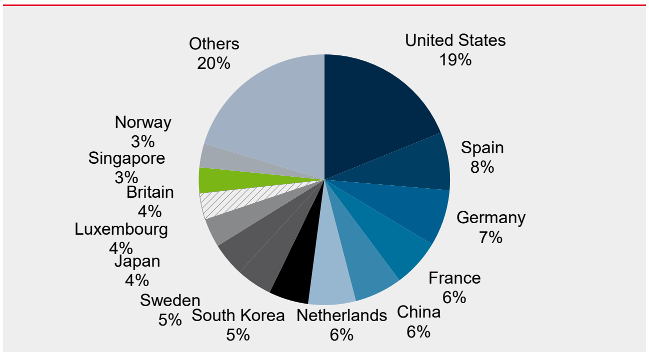
Volume of new issuance by financial institutions in USD (billions)



Sources: Bloomberg, Helaba Research

Financials: United States in pole position

Share of new issuance, Jan-Nov 2020 in %



Sources: Bloomberg, Helaba Research

Accordingly, USD-denominated issues represent a rather substantial share, though the euro remained the most popular issuance currency.

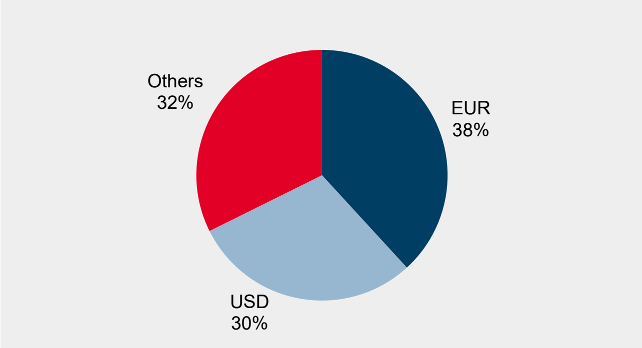
Bonds whose coupon payments are linked to sustainability indicators or issuer ratings by sustainability agencies - and not to the sustainable use of funds - have not been of any relevance to banks as yet. However, some initial ideas for so-called sustainability-linked ESG bonds have already been developed.

Senior unsecured bank bond segment with relatively strong green element

Despite the strong growth, the share of green bonds as a proportion of the financial sector's total primary market volume remains low at less than 2 %. However, depending on the definition, green bonds already play a rather significant role in individual segments. From January to November 2020, as much as 6.5 % of the primary market for euro-denominated benchmark senior unsecured bank bonds with a volume of EUR 500 million or more and a fixed coupon of around EUR 85 billion had a green focus.

Financial institutions: EUR and USD dominate

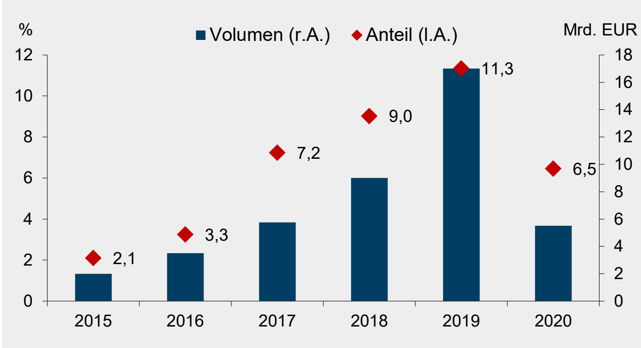
Volume of new issuance by financial institutions, Jan-Nov 2020 in USD (billions)



Sources: Bloomberg, Helaba Research

Green notes already play key role in sub-segments

Issuance of euro-denominated benchmark-size senior unsecured bank bonds*



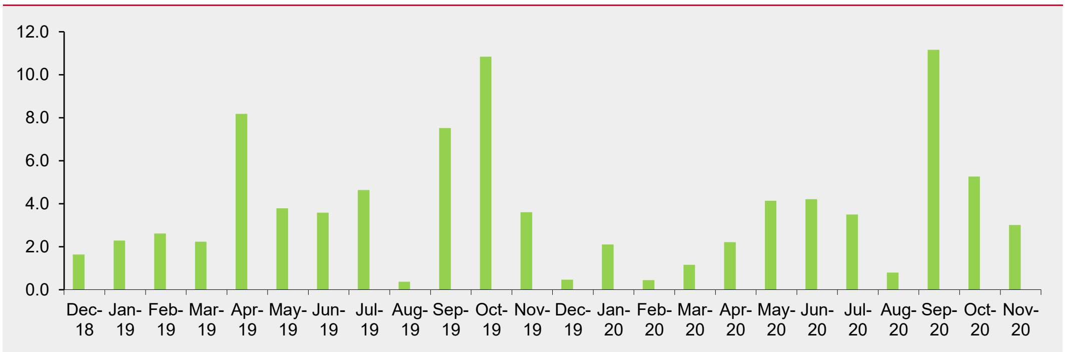
* Bloomberg search criteria: issue size >= EUR 500 m, bullet, banks or commercial finance or consumer finance or diversified banks or financial services
Sources: Bloomberg, Helaba Research

Recent crisis-plagued environment weighs on green bond issues by banks

The combined primary market volume of green bank bonds has so far amounted to around USD 38 billion this year, a decline of 24 % compared to the same period in 2019 that we mainly attribute to the crisis-hit environment in the summer months due to Covid-19. After the summer break, it picked up strongly in a generally more benign market environment, reaching a peak of USD 11.2 billion in September 2020. In the following two months, it declined again after many issuers had already taken advantage of the favourable market window in September to launch transactions. However, in our view it has remained on a relatively stable level in a long-term comparison.

Green bank bonds – uninterrupted growth

Green bonds issued by banks* in USD (billions) USD (billions)



* Banks, diversified banks, commercial finance, financial services
Sources: Bloomberg, Helaba Research

Green Bond Principles provide essential framework

The use of funds raised by green bank bonds is typically based on the UN Sustainable Development Goals. The ICMA's[1] Green Bond Principles (GBP) have become the standard for issuing green bonds and consist of process guidelines that govern (1) the use of funds, (2) the process of assessing and selecting projects for which the proceeds are to be used, (3) managing the use of funds and (4) reporting requirements.

The terms and conditions of the bonds regularly refer to the issuers' respective Green Bond Framework, in which they set out their sustainability strategy, the objectives they pursue and their compliance with the four GBPs. In addition, a second party opinion by a sustainability agency on the issuer's Green Bond Framework and compliance with the GBPs is also a customary feature.

[1] International Capital Markets Association

From a purely legal standpoint, this has no bearing on the insolvency ranking of the respective bond; it is solely an indication of the (voluntary) use of the funds raised from issuing the bond. Investors in senior unsecured notes will continue to have no recourse to certain assets in the event of insolvency or restructuring.

ICMA Green Bond Principles established as standard

Key figures on Green Bond Frameworks of various issuers

Issuer	Use of funds	SPO*	Senior unsecured bonds**	ISIN	Ranking***	An-nounced
Commerzbank	Solar, wind	Sustainalytics	CMZB 1.25 % 10/23	DE000CZ40NG4	NPS	02.10.2018
LBBW	Solar, wind	ISS ESG	LBBW 0.375 % 07/26	DE000LB2CLH7	NPS	17.07.2019
			LBBW 0.375 % 05/24	DE000LB2CHW4	NPS	15.05.2019
			LBBW 0.2 % 12/21	DE000LB1M214	NPS	05.12.2017
Berlin Hyp	Energy efficiency	ISS ESG	BHH 1.5 % 04/28	DE000BHY0GB5	NPS	09.04.2018
			BHH 1.125 % 10/27	DE000BHY0GS9	NPS	17.10.2017
			BHH 0.5 % 09/23	DE000BHY0GU5	NPS	19.09.2016
			BHH 0.5 % 09/23	DE000BHY0GU5	NPS	19.09.2016
Deutsche Kreditbank	Solar, wind	ISS ESG	DKRED 0.75 % 09/24	DE000GRN0016	NPS	11.09.2017
			DKRED 0.625 % 06/21	DE000GRN0008	NPS	01.06.2016
Raiffeisen Bank International	Renewables	Sustainalytics	RBIAV 0.375 % 09/26	XS2055627538	PS	17.09.2019
	Energy efficiency		RBIAV 0.25 % 07/21	XS1852213930	PS	18.06.2018
BNP Paribas	Renewables	ISS-Oekom	BNP 1.125 % 08/24	FR0013405537	NPS	21.02.2019
	Transport		BNP 1 % 04/24	XS1808338542	NPS	10.04.2018
	Energy efficiency		BNP 0.5 % 06/22	XS1527753187	PS	24.11.2016
	Green buildings					
	Water management					
Société Générale	Renewables	ISS ESG	SOCGEN 0.125 % 10/21	XS1500337644	PS	28.09.2016
	Green buildings	EY report	SOCGEN 0.75 % 11/20	XS1324923520	PS	18.11.2015
	Transportation					
	Water management					
	Air pollution					
	Circular economy					
Banco Santander	Wind, solar	Vigeo Eiris	SANTAN 1.125 % 06/27	XS2194370727	NPS	18.06.2020
		Independent report	SANTAN 0.3 % 10/26	XS2063247915	PS	01.10.2019
BBVA	Energy efficiency	Sustainalytics	BBVASM 1 % 06/26	XS2013745703	NPS	12.06.2019
	Transportation	DNV-GL	BBVASM 1.375 % 05/25	XS1820037270	NPS	03.05.2018
	Water management					
	Waste management					
Coöperative Rabobank	Renewables (wind, solar, others)	Sustainalytics	RABOBK 0.25 % 10/26	XS2068969067	NPS	22.10.2019
		PwC report	RABOBK 0.125 % 10/21	XS1502438820	PS	04.10.2016
ABN AMRO Bank	Solar, wind	ISS-Oekom	ABNANV 0.5 % 04/26	XS1982037696	PS	08.04.2019
	Real estate	KPMG report	ABNANV 0.875 % 04/25	XS1808739459	PS	11.04.2018
			ABNANV 0.625 % 05/22	XS1422841202	PS	23.05.2016

*Second Party Opinion by sustainability agency ** euro-denominated benchmark-size *** PS: preferred senior, NPS: non-preferred senior
Sources: Information provided by companies, Bloomberg, Helaba Research

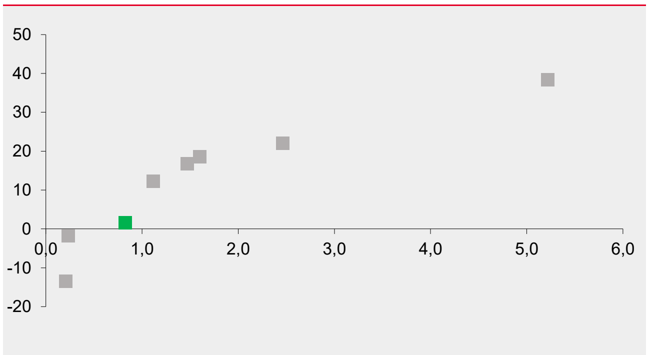
Credit quality advantages for sustainable companies

To date, we have not observed any significant spread divergence between issuers' green and non-green bonds, at least in the secondary market. In our view, the fact that there are narrower spreads on the primary market in some cases is more a reflection of the relative scarcity of green bonds. S&P

describes the potential impact of ESG factors on their ratings as being dependent on whether they are material and relevant to the capacity and willingness of the respective issuer to meet its financial targets.[2] However, issuers are increasingly integrating ESG factors into their corporate strategies, which we believe has an overall positive impact on their credit quality. From our perspective, a sustainable approach has a disciplining effect and contributes to greater transparency, more efficient corporate processes and strict risk management.

Société Générale Preferred Senior Bonds

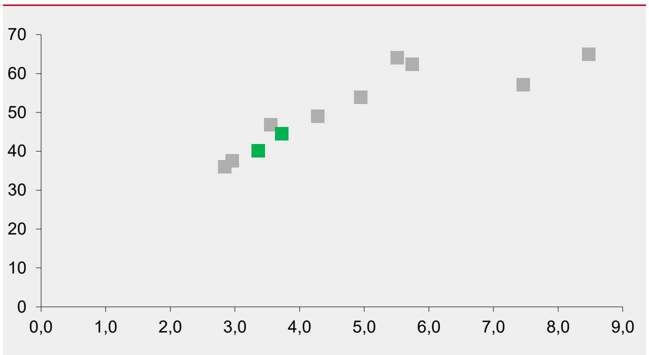
Z-spread in bps; as of 7 December 2020



Sources: Bloomberg, Helaba Research

BNP Paribas Non-preferred Senior Bonds

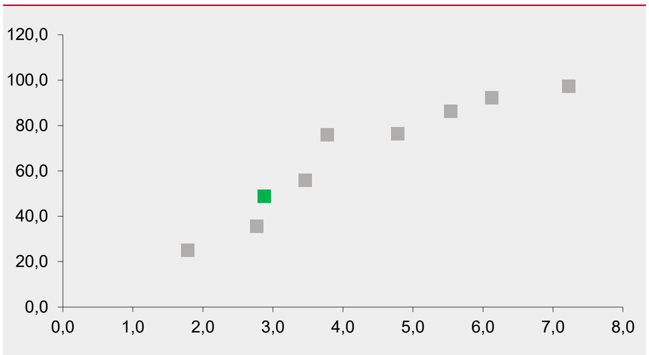
Z-spread in bps; as of 7 December 2020



Sources: Bloomberg, Helaba Research

Commerzbank Non-preferred Senior Bonds

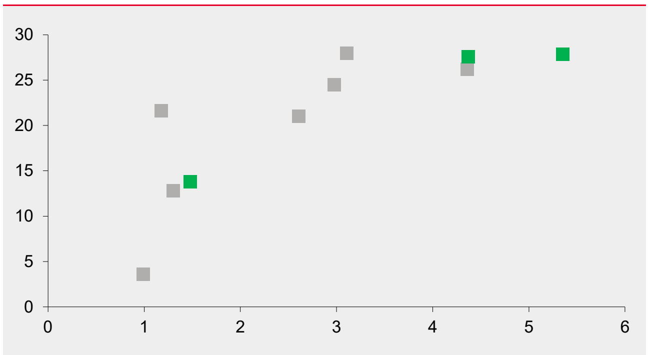
Z-spread in bps; as of 7 December 2020



Sources: Bloomberg, Helaba Research

ABN AMRO Bank Preferred Senior Bonds

Z-spread in bps; as of 7 December 2020



Sources: Bloomberg, Helaba Research

Pressure from European banking supervision

Pressure from policymakers and regulators to intensify efforts to promote sustainability also remains high (for more details, see our Credit Special "Europäische Banken: Nachhaltigkeit rückt in den Fokus" of 4 July 2019). Representatives of the banking supervisory authorities stress again and again that climate risks are also sources of financial risks. Recently, the Basle-based Financial Stability Board warned of unforeseen risks to the financial system as a result of climate change, e.g. due to sudden political changes. In addition, from 2022 onwards the ECB Banking Supervision intends to examine in greater detail how the banks it supervises manage climate and environmental risks. At the end of November 2020, it published a corresponding guide on climate-related and environmental risks for banks. The relevant institutions are expected to submit a self-assessment and a resulting action plan based on the aforementioned guidelines as soon as the beginning of 2021. Furthermore, the ECB wants to make climate risks the focus of its next stress test in 2022.

[2] S&P: "Thee Greening Of Financial Services: Challenges For Bank And Insurance Green And Sustainability Hybrids" of 12 August 2020

Disclosure requirements drive further progress

From the end of June 2022, major institutions will be required to set out their ESG risks in their disclosure reports. Moreover, the European Banking Authority (EBA) has been mandated to integrate ESG aspects into banking supervisory practices.[3] EBA guidelines on lending and risk management processes are due to be in place at the end of June 2021. On 3 November 2020, EBA launched a consultation process on the integration of ESG risks into corporate governance and risk management processes of credit institutions and investment companies. It has also published a consultation paper with proposals on how ESG factors and risks, including the regulatory framework, could be appropriately addressed. It is currently in the process of gathering feedback on these issues before preparing its final report. The consultation process is expected to be completed on 3 February 2021.

EU taxonomy to enhance transparency

EU institutions have taken additional steps to adapt the EU framework to the requirements of the Paris Agreement and the EU's climate targets and have continued with measures to implement the 2018 Action Plan on sustainable finance (see Credit Special "Europäische Banken: Nachhaltigkeit rückt in der Fokus" of 4 July 2019). In particular, there has been further progress on the classification (taxonomy) and labelling of financial products and corporate activities based on sustainability criteria. Both represent key elements in channelling capital flows into green and sustainable investments and should therefore contribute to achieving the goals of the European Green Deal.[4] The principal regulatory frameworks are the EU Regulation on sustainability-related disclosures in the financial services sector (Disclosure Regulation) of November 2019 and the EU Regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation) of June 2020.

The EU Taxonomy Regulation provides a general framework for the application of the taxonomy and corresponding disclosure obligations. It includes a requirement for financial market participants - such as issuers and investment companies[5] - to provide information on how and to what extent their activities and financial products can be classified as environmentally sustainable. So far, the taxonomy only covers environmental goals. It also defines abstract criteria for classifying an activity or product as sustainable.

It is envisaged that disclosure will be part of institutions' non-financial reporting. The disclosure requirements will apply from 1 January 2022 for the two environmental goals of protecting the climate and adapting to climate change. For the other goals[6], they will apply from 1 January 2023.

The specific and so-called technical criteria for classifying economic activities as environmentally sustainable are currently being defined by the EU Commission. It has the task of implementing the Taxonomy Regulation by adopting delegated acts. For the two goals of protecting the climate and adapting to climate change, it is under obligation to establish the final regulations by 31 December 2020, and it recently published a corresponding draft delegated act. An amendment to the criteria for sustainable activities with regard to real estate, in particular, raised eyebrows. According to this amendment, properties constructed before the end of 2021 should only qualify as sustainable if they possess a certificate for the highest energy efficiency class "A". This change is especially relevant for the cover pools of covered bonds. (see Covered Bond Special: "Green Covered Bonds: EU-Taxonomie als Klimakiller?" of 11 December 2020)

Classification for the remaining goals is expected to be implemented by 31 December 2021. The aim is to determine the content and format of the new information within the disclosure statements by 1 June 2021.

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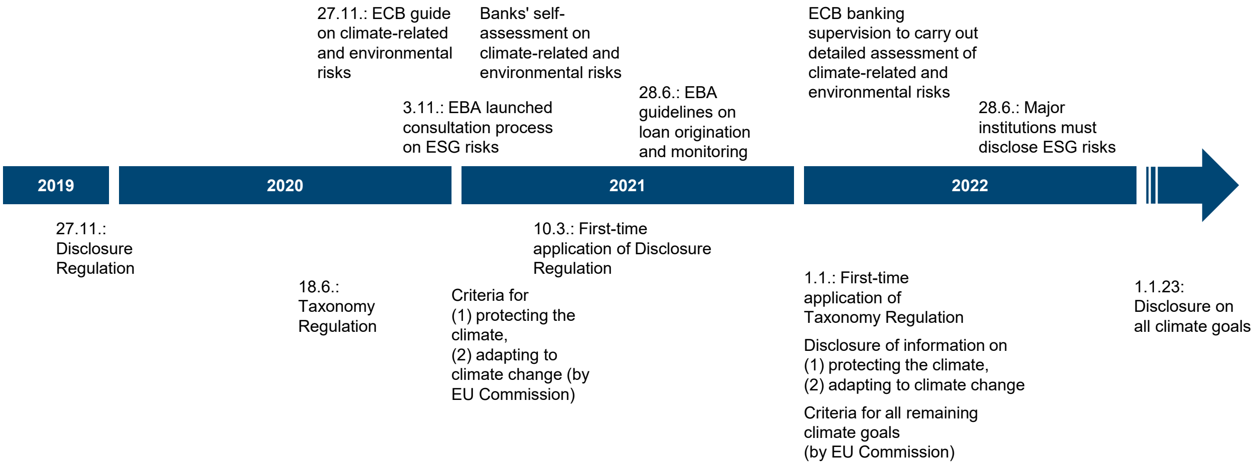
[3] CRRII/CRDV
[4] The aim of the European Green Deal is for the EU's economy to be fully climate-neutral and circular by 2050.
[5] This includes companies that are required to provide non-financial information under the CSR (corporate social responsibility) Directive
[6] Sustainable use and conservation of water and marine resources, transition to a circular economy, avoidance and reduction of environmental pollution as well as protection and restoration of biodiversity and ecosystems

The Disclosure Regulation comes into force on 10 March 2021 and is directed at insurance companies, investment firms, pension providers and credit institutions, among others. These types of companies will be required to disclose their strategies for integrating sustainability risks into the investment process.

To the best of our knowledge, the EU Commission intends to adapt its Sustainable Finance Strategy at the beginning of 2021. Among other things, it is expected to proposals on an EU Green Bond Standard and a revision of the CSR Directive. The purpose of Green Bond Standards is to ensure that such bonds are aligned with the EU taxonomy.



Outlook: focus on sustainability to become increasingly important for issuers

There is a growing recognition among market participants that companies whose business activities are geared towards sustainability are more efficient than their competitors. Some even claim that the Covid-19 pandemic over recent months has shown that they are more resilient to crises. We expect the proportion of capital market issues with a sustainable - and particularly green - focus to continue rising, even if it will take some time for them to fully penetrate the bank bond market. According to a recent survey of participants at the Luxembourg Sustainable Finance Forum, 55 % believe that it could take more than 10 years before capital markets are fully green and sustainable. Still, as many as 42 % of respondents believe that this could be the case in five to ten years. In addition to reputational risks, the financial risks arising from the impact of climate change are becoming increasingly significant.

This development is also being driven by political and regulatory interests. The expectations of banking supervisory authorities have become clearer since the recent publication of the ECB's guide on climate-related and environmental risks. In addition to that, the ESG bond market is likely to be characterised by the introduction of EU taxonomy and disclosure requirements in 2021.

The range of green and sustainable products will continue to grow. Meanwhile, for example, there is even talk of green equity instruments. In July, Spain's BBVA was the first bank to issue a green AT1 benchmark bond with a volume of EUR 1 billion. Shortly afterwards, the Dutch De Volksbank followed with the issue of a green subordinated tier 1 bond with a volume of EUR 500 million. In September, the AIB Group, Allied Irish Bank's holding company, issued a green Tier 2 bond. All of these innovative bond issues were successfully placed. We expect the green element to continue its success story across a whole variety of asset classes.

Additional Credit Specials:

Green Covered Bonds: EU-Taxonomie als Klimakiller?
11.12.2020

Unternehmens-Liquidität: Firmen machen aus der Not eine Tugend
24.11.2020

Europäische Banken: EBA sorgt für mehr Transparenz bei Kredit-Moratorien
23.11.2020

Hybridanleihen: Rechtzeitig Abwehrkräfte stärken
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EUR-Corporate Bonds: In ruhigeren Bahnen
06.10.2020

EUR-Benchmark Bankanleihen: Krisenbedingte Emissionsflaute
01.10.2020

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Primärmarktausblick: EU und Länder weit vor Corporates und Banken
07.09.2020

Ertragsstabilität europäischer Corporates: Vorsicht vor Pauschalurteilen
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24.06.2020

Europäische Banken: COVID-19 erhöht Kredit-Risikovorsorge drastisch
27.05.2020

Corporate Schuldscheindarlehen – ESG prägt den Markt nachhaltig
14.05.2020

Schuldschein nur mit milden Corona-Symptomen
08.04.2020

Europäische Bankanleihen: COVID-19 rückt Bilanzqualität in den Fokus
02.04.2020

Europäische Banken: EZB-Aufsicht legt mit weiteren Erleichterungen nach
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Europäische Banken: EZB mit Maßnahmen gegen Corona-Schock
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