The Green Deal - 03/23 (EN) #responsiblebanking

March 8, 2023 12:37 CET

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On the secondary market, our Green Index outperformed its non-green counterpart and a greenium for corporates is emerging again, especially at the long end of the curve. The significant sell-off in government bonds has meanwhile resulted in negative ytd total returns, while we do not see a significant change in the greenium for German twin bonds. In 2023, the EUR ESG primary market had its best year-to-date start in their history. As in 2022, this is primarily driven by Financials. Green bonds account for the largest share while SLBs are rather disappointing. Since March, the ECB has also only been buying green corporate bonds & bonds from issuers with a better climate score on the primary market. However, it is not only the ECB that is pushing the green issue, but also the EU. For example, a preliminary agreement was reached on a green bond standard and, perhaps more importantly, there is a draft paper, among other things, on securing the location of green tech in the EU, which we consider crucial in terms of global competition.

- Green bonds outperform in February with greenium reemerging at the longer end of the curve
- Total returns turn negative for global ESG bonds amid rising govie yields
- EU reaches provisional agreement on EU Green Bond Standard
- The global fight for green technology and -companies gains momentum
- EU adopts position on EU wide reporting database for companies (ESAP)
- Nokia concludes journey back to IG with SLB
- US senate´s vote to overturn federal rule on ESG investing highlights long-standing debate and political disunity

Primary market

The ESG primary market — relative to the overall market — performed even better than in the previous year. In the first two months of 2022 (before the outbreak of the war), EUR 50.5 bn in ESG issues were placed. This year, we are already at EUR 91 bn, almost doubling the volume. In February, EUR 36.3 bn of EUR ESG issues were placed. This led to February 2023 being the strongest ESG February historically. The distribution among the ESG segments is interesting. In 2023, green bonds clearly dominate at 61% (2022: 48%). In addition to green bonds, sustainability bonds also improved - both in terms of volume and share (14% ytd). The "losers" at the start of the year include social bonds and also SLBs. Both lost ground in terms of share compared to the start of 2022, and SLBs even face a yoy decline in volume. On a country basis, issues from Germany, the Netherlands and SNAT in particular are below average compared with previous years. On the other hand, Austria and Italy, among others, issued significantly more compared to previous years.

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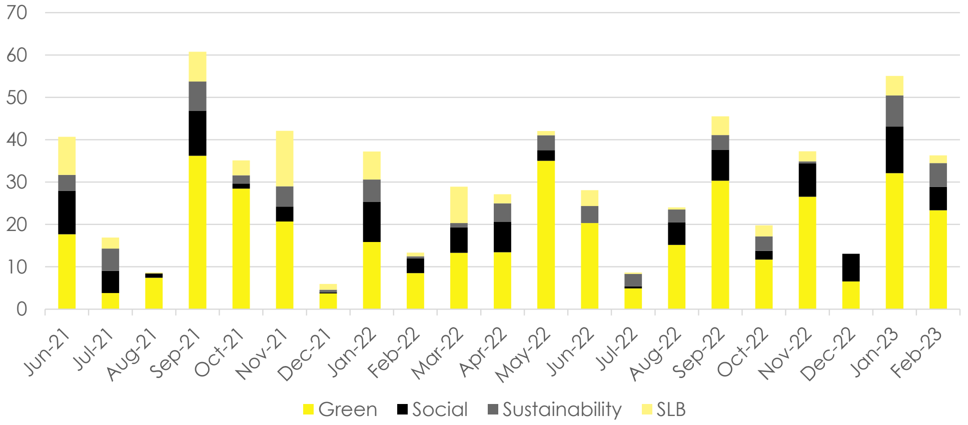
Chart 1 - Monthly Issuance Volume - EUR ESG Market (EUR bn)

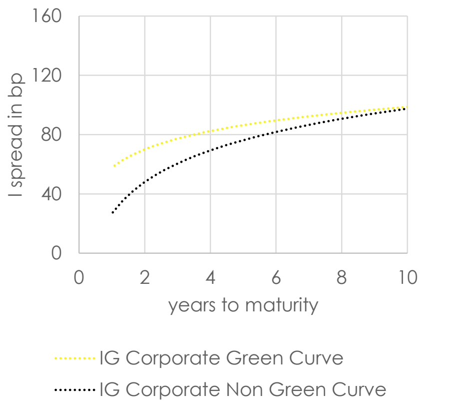


Source: Refinitiv, RBI/Raiffeisen Research

Secondary market

Our BBB green index outperformed the non-green pendant in February as credit risk premia tightened somewhat, while the non-green index remained flat. The greenium therefore declined to 9.5bp moving closer to what it should be — which is negative. While Real Estate is still skewing the overall greenium for the corporate curve, at least for the 10y term we do see a greenium of roughly -4bp again. Maybe this is a result of Isabel Schnabels remarks on an active reshuffling of the CSPP portfolio towards greener issuers, as investors try to get ahead of the ECB impact. Otherwise, it seems markets have finally listened to hawkish ECB statements and repriced interest rate hike expectations drastically. The resulting bear flattening move for the bund curve over the month of February resulted in the 2y bund yielding 3.13% (+45bp) and the inversion increasing to close to -50bp. Meanwhile, the 2y bund yield rose to 3.32% and the inversion stood at roughly -60bp. It follows that the positive total return we have seen to the start of the year has been diminished and actually turned negative for both asset classes — global ESG bonds and global non ESG bonds. In context of the rising bund yields, only the greenium for the 2027 German twin bond widened by around 2bp over February indicating it was sold-off less compared to the non-green counterpart. Overall, however, we do not see a significant change in the greenium for twin bonds.

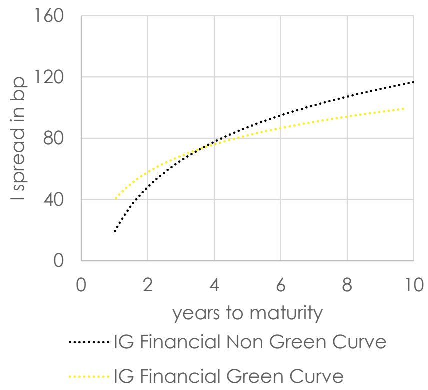
Chart 2 - Corporate Green vs Non Green*



**EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon*

Source: Refinitiv, RBI/Raiffeisen Research

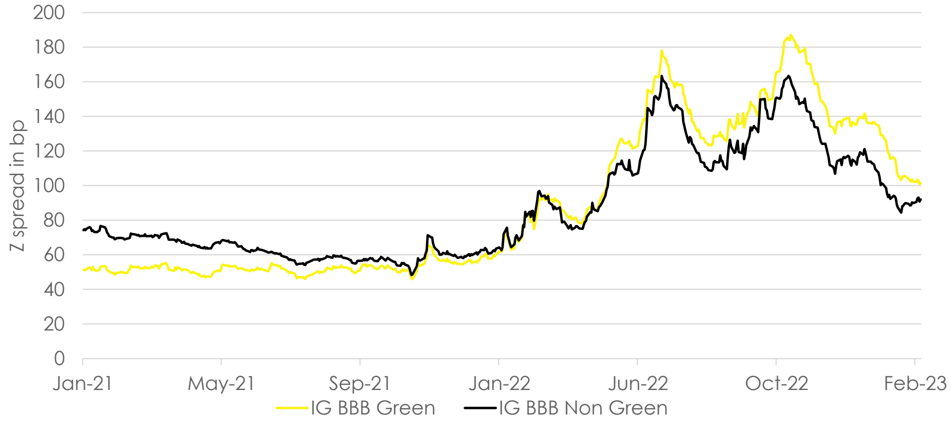
Chart 3 - Financials Green vs Non Green*



**EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon*

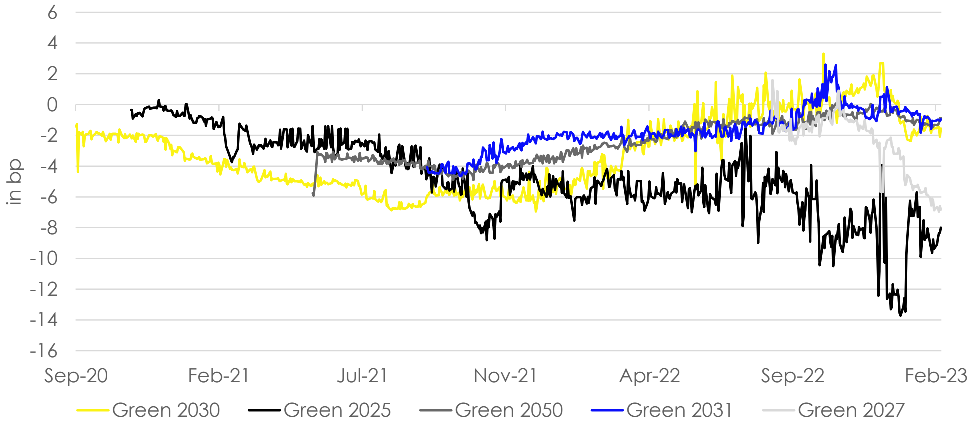
Source: Refinitiv, RBI/Raiffeisen Research

Chart 4 - Corporate green vs non green index spread development*



**BBB rating bucket; EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon*
Source: Refinitiv, RBI/Raiffeisen Research

Chart 5 - Greenium German twin bonds



Source: Refinitiv, RBI/Raiffeisen Research

Chart 6 - Global ESG Market Total Return 2022 vs 2023 ytd

Source: Bloomberg Finance L.P., RBI/Raiffeisen Research

Hot Topic I: EU reaches provisional agreement on EU Green Bond Standard

The EU parliament and the Council reached a provisional political agreement on the proposed **EU Green Bond Regulation**, paving the way for a harmonized EU wide Green Bond Standard (EUGBS). Issuers deciding to follow the EUGBS, will have to ensure that at **least 85% of the green bond proceeds** will be **aligned** with **EU Taxonomy** activities if the sector is not yet fully covered by the EU Taxonomy. For all other issuers, 100% of the proceeds will have to be aligned. This, in turn, provides investors with assurance that investments will be used for green projects (as defined by the EU Taxonomy), which are comparable across issuers as it's a unified classification system and therefore should **prevent green-washing**. The use of the EUGBS is voluntary and bonds issued under the framework will be classified as European green bond (EuGB).

The Regulation also addresses the supervision of external reviewers. Issuers applying the EUGBS will be required to employ external reviewers for assessing the alignment of the bond with the framework over the bond´s lifecycle. The draft regulation was presented by the EU commission already in July 2021 as part of the EU Green Deal. The provisional agreement, that was just reached based on the draft version, still needs to be confirmed and adopted by both the Council and the Parliament, after which the regulation will come into force with a 12 month lag.

Currently, under the APP, the ECB continues to purchase corporate bonds on the primary market only for issuer with a better climate score (based on the ECBs own score) and green corporate bonds. It will be **interesting to see if the ECB, once the EUGBS is in force**, will **only purchase** corporate green **bonds that classify as EuGB** (in addition to bonds from issuers with better climate score) for potential future bond purchases / reinvestments or continues to consider all corporate green bonds.

Hot Topic II: The global fight for green technology and companies gains momentum

This article was already almost finished, with a conclusion that Europe urgently needs to react to the developments in China, but especially in the US (keyword IRA). This is because in both countries there is a broad incentive system (taxes, subsidies, punitive tariffs, favorable refinancing, etc.) towards green technologies with a focus on CO_2 reduction. The EU's response now appears to be more rapid than one might have expected. Over the weekend, the **EU draft (EU Clean Tech)** became known in advance, which appears to be a clear **response to the US Inflation Reduction Act (IRA)**, with which the US is trying to achieve competitive advantages, especially in the area of green energy, and thus to secure its energy independence and, in the medium term, to be able to gain ground in the global competition for production locations with cheap energy.

The EU´s reaction now seems to be prompt. For example, the EU has set the lower limit for production capacity for clean technologies within the EU at 40% of its own needs, and perhaps more importantly, EU governments are to be allowed to override environmental concerns in order to push ahead with key projects. Approval procedures should be a maximum of 18 months in the future. This could ensure that the eternal approval process is shortened and that the EU can at least make up ground on one of its main weaknesses, namely the time component, compared to its competitors (US, China). The at least 40% rule applies to the following five key sectors:

- Solar energy
- Wind energy
- Heat pumps
- Batteries
- Electrolyser

The draft also makes it clear where the EU Commission sees the focus. For example, the baseline for **wind energy and heat pumps are as high as 85%**, while some topics have been left out. For example, alternative fuels for airplanes or automobiles are not mentioned. On the other hand, geothermal energy, green hydrogen, biomethane, nuclear power, etc. are also considered worthy of support, but without a lower limit.

The draft also describes so-called "Net Zero Resilience Projects" - these are projects that are intended to strengthen the autonomy of the EU in sectors where the EU is currently more than 80% dependent on other third countries.

For industries deemed worthy of support, there will be a facilitation of easier processes to reach permissions as well as regulatory support and easier access to public and private funding for certain strategic green technologies.

This document is scheduled to be presented on March 14, 2023, and the timely response to the US IRA is definitely welcome. It is to be hoped that the support measures will be targeted, sufficient in volume and, in particular, implemented quickly and without bureaucracy. Because here ecological and economic interests unite perfectly. Only cheap, sustainable energy produced in Europe can secure and strengthen the EU as a business location in the long term. Therefore, a political steering effect for all EU citizens seems desirable. More about this hopefully in our next issue of the Green Deal.

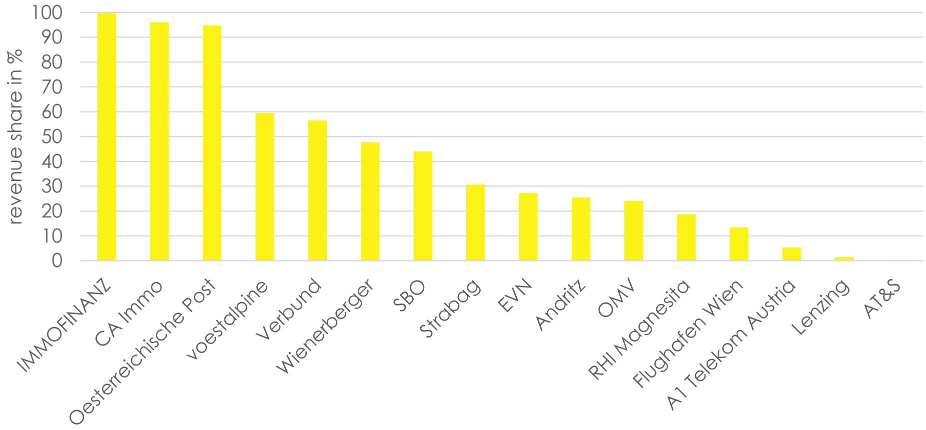
Hot Topic III: EU adopts position on EU wide reporting database for companies (ESAP)

The European Single Access Point (ESAP) will be a centralized & public database, where financial- and non-financial information (including ESG data) of EU entities will be disclosed. This in turn should help companies to attract funding as investors can easily access all the available information efficiently to conduct a well informed investment decision. The ESAP does not impose additional reporting requirements, but pools already existing disclosures. Non-listed companies, including non-listed SME´s will be able to provide information on a voluntary basis.

While the legislative proposal for the ESAP dates back to November 2021, the **EU parliament just recently adopted its position** on the topic after agreeing on its position in June of last year. Information shall be collected by national competent authorities and include data such as financial statements, management reports, audit reports, and reports on government payments. The **platform will be rolled out gradually between 2026 to 2030.**

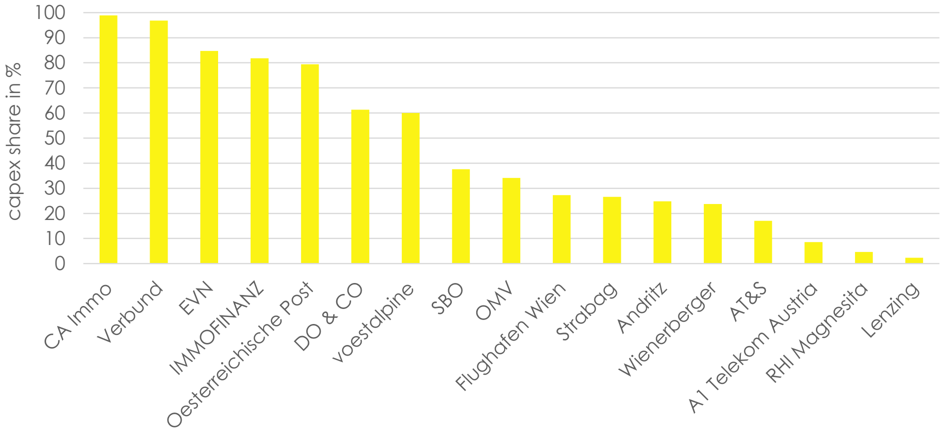
From an ESG perspective we **welcome the development** of an **ESAP** as it should help to **overcome the lack of data availability** and **transparency**. While data comparability, on the other hand, is not addressed through the ESAP, this issue should anyway be improved through the **EU Taxonomy** (which will be included in the reporting that is made available on the ESAP). Starting January 2023, the mandatory reporting requirement for the last four out of the six environmental objectives within the EU Taxonomy have to be disclosed by entities falling under the NFRD. Those objectives are sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control and the protection and restoration of biodiversity and ecosystems. Climate change mitigation and climate change adaptation were already applicable from January 2022 onwards. The EU Taxonomy aims at tackling the "green washing" issues as it provides a classification system of what is considered sustainable and therefore offers a unified decision-making basis for investors.

Chart 7 - EU taxonomy eligible revenue share of AT corporates



Source: Bloomberg Finance L.P., RBI/Raiffeisen Research

Chart 8 - EU taxonomy eligible capex share of AT corporates



Source: Bloomberg Finance L.P., RBI/Raiffeisen Research

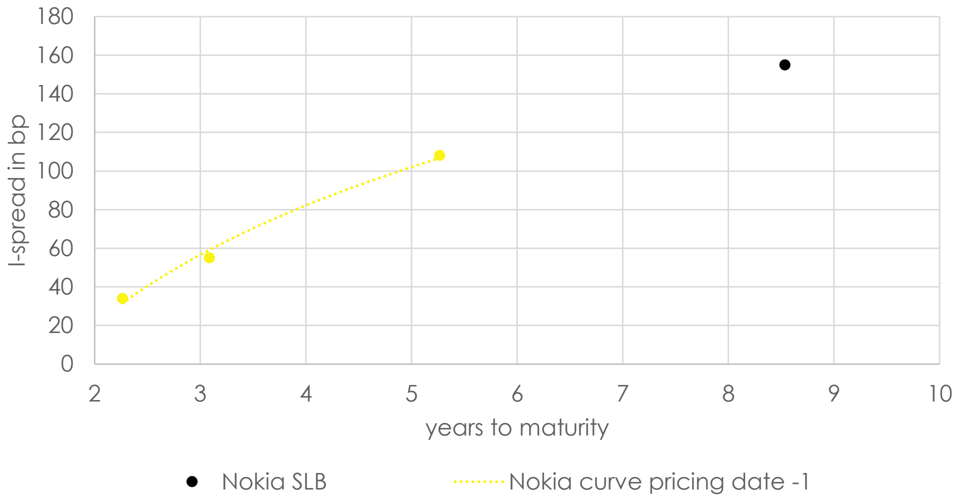
Deals of the month

- **Intesa** showed how financials can currently successfully use "green assets". The issuer placed a **dual-tranche SNP** issue (A: 5NC4; B: 10y) at the end of the month (February). Especially the longer tranche appeared to be complex for an Italian issuer in the current yield environment (inverse). Nevertheless, both tranches were able to significantly tighten their IPTs during the pricing process. The short tranche achieved a final order book of EUR 2.7 bn (for EUR 1.5 bn) and the long tranche came in at an order book of EUR 1.8 bn with a bond volume of EUR 750 mn and thus solidly oversubscribed. Even though the new issue premium for the long tranche was significant at ~ 35bp, we see the green format as the key to the fast order book build-up for this issue. (**Jörg Bayer**)

- After securing a BBB- rating from S&P on 7th of February and therefore successfully completing the 11-year-long journey back to IG (composite with BBB- from Fitch), **Nokia** wasted no time and was three days later on the market with an 8y EUR 500 mn SLB. Investor welcomed the rising star with arms (or check books) wide open filling the order book at the peak at EUR 2.7 bn and final for EUR 2 bn (4x book to cover). The pricing was tightened substantially to ms+155bp from IPTs of 190/200bp over mid swaps, however, still offering a roughly 5bp NIP. Proceeds are used to actively manage the debt maturity profile as Nokia also issued tender offers for their 2024, 2025 and 2026 bonds for a maximum of EUR 700 mn which was fully exhausted by investors. While this extends the maturity profile, interest burden is set to rise as the tendered bonds carried coupons of 2-2.375% vs 4.375% for the new paper. The redemption premium for the SLB is linked to the 2030 CO_2 reduction target of -50% vs

2019 baseline. We think the target is, despite being absolute, ambitious as emissions stood at 37.6 mn tons in 2021 vs the target of 17.5 mn tons by 2030 and as it includes scope 3 emissions which account for 99% of Nokia´s emissions in 2021 and are the most difficult to reduce. However, in terms of financial impact / negative implications for Nokia, we view those as limited as there will only be a one time 75bp redemption premium once the bond matures in August 2031, as the target observation date is the 31.12.2030. (Georg Zaccaria)

Chart 9 - Nokia SLB bond pricing*



**EUR denom. plain vanilla fixed coupon senior unsecured bonds*
Source: Refinitiv, RBI/Raiffeisen Research

Good to know

US senate´s vote to overturn federal rule on ESG investing shows political disunity

Early March, the US Senate **voted to overturn** a Labor Department **rule** that **permitted fiduciary retirement fund managers to consider ESG factors** in their investment decisions. The rule, which was put in place by President Biden, was voluntary — meaning it allowed them to consider such factors, but they did not have to. On the contrary, under the previous rules by the Trump administration, fund managers were required to limit their investment decision making process to financial factors — therefore effectively restricting them to consider other factors such as ESG. The vote gained support from all Republicans (and two Democrats) who call ESG part of "**woke capitalism**" and argue that the Labor Department´s rule potentially disadvantages retirement fund participants if managers decide to favor ideological issues such as climate change over higher investment returns.

Even though President Biden said he will veto the bill (overturning a veto would require a 2/3 majority in both houses of Congress), it highlights once again the long-standing debate and **political back and forth** in the US towards **ESG investing**. Basically, Republicans and Democrats take turns in negating rules put in place by each other´s predecessor. For example, in 2020 the Trump administration overturned the rules put in place by the Obama administration, which promoted the use of environmental, social and governance funds for retirement funds as long as the investments is appropriate for the fund and with respect to objectives, return and risk economically and financially comparably to alternatives. The rules under the Trump administrations forced retirement fund managers to focus purely on financial factors (to put economic interest ahead of "non-pecuniary" goals). Even though the proposal acknowledged that ESG factors can be pecuniary, it would have required investment managers to basically proof that they pose a material economic consideration.

But even the rules under Obama were basically offsetting the changes made under President Bush, which were offsetting what President Clinton put in place. According to the changes under the Bush administration, economically targeted investments were prohibited unless the fiduciary has first come to the conclusion that alternatives are truly economically equal. President Obama´s rules basically overturned those set by Bush and went back to IB 94-1 issued under the Clinton administration.

In our view, considering ESG factors within **the investment decision making process** clearly **does not contradict** with the **fiduciary duty** by retirement fund managers. In general the long-standing argument is based on the fact that retirement fund managers have to act in the best interest of the beneficiaries, which is strictly speaking achieving the highest possible (risk adj.) returns in line with the stipulated objectives to provide the beneficiaries with the most funds possible for retirement, hence fulfilling their fiduciary duty to their clients. Even though it can be argued that e.g. for green bonds, the greenium effectively means a lower compensation for investors despite taking on the same risk vs a comparable non-green bond only to support e.g. investments in green technology via issue proceeds (such an investment would most likely be prohibited if the Biden rule remains overturned), not all ESG factors have a direct negative implication on returns.

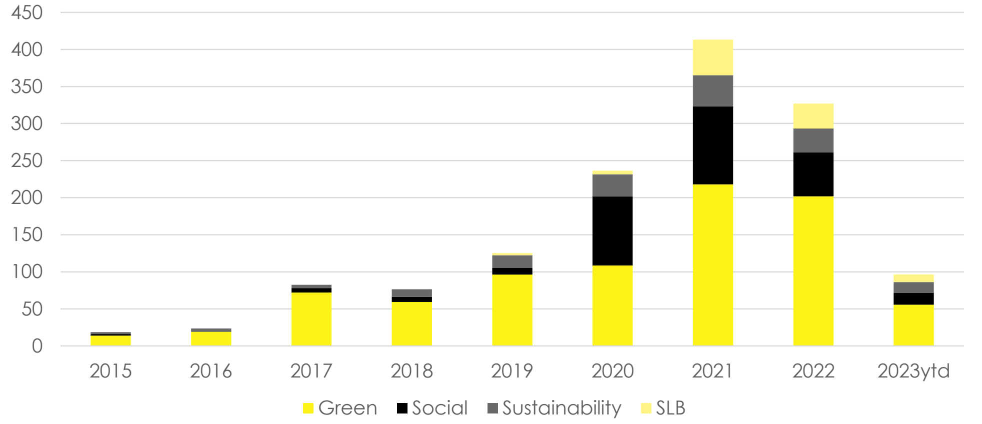
On the contrary, investing in green bonds which support the development of technologies or assets that are in line with climate change mitigation could reduce the risk of stranded assets for the issuer or mitigate the risk of the issuer becoming obsolete and losing market share, hence generating lower cash flow, in the future as end markets will demand e.g. lower carbon products. This consideration should play a role in particular for funds with a longer term investment horizon such as pension funds which invest in longer dated bonds and should therefore be in particular concerned with the future cash generation potential of their investment. Not investing in green bonds because of losing out on a few basis points, therefore fails to consider a more holistic view.

But also considering social factors within the supply chain like human rights and labor standards or environmental factors like biodiversity and water pollution can prevent negative monetary implications from lawsuits or reputational risk that in turn lower revenues and profits of bond issuers. Moreover, taking into account risks from e.g. flooding and/or earthquakes (generally termed **physical risk**) via assessing the proximity to the coastline or elevation could prevent substantial harm to production assets (which would again reduce cash generation via production stops and require substantial investments to rebuild). For insurers such events could result in higher insurance claims and therefore reduce profitability.

So based on these examples, **not considering ESG factors**, especially for asset manager / owner with a long term and low risk investment horizon such as pension funds, in the investment decision-making process **could also be considered a breach of fiduciary duty?**

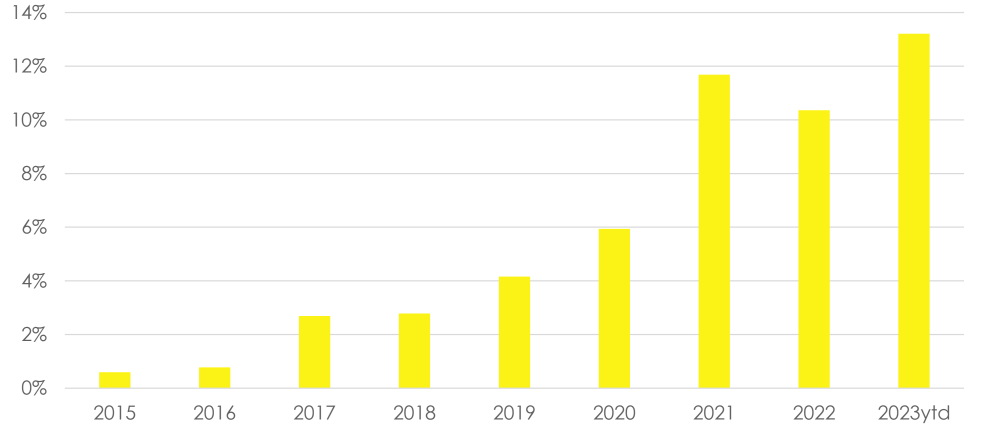
Appendix

Chart 10 - Yearly Issuance Volume - EUR ESG Market (EUR bn)



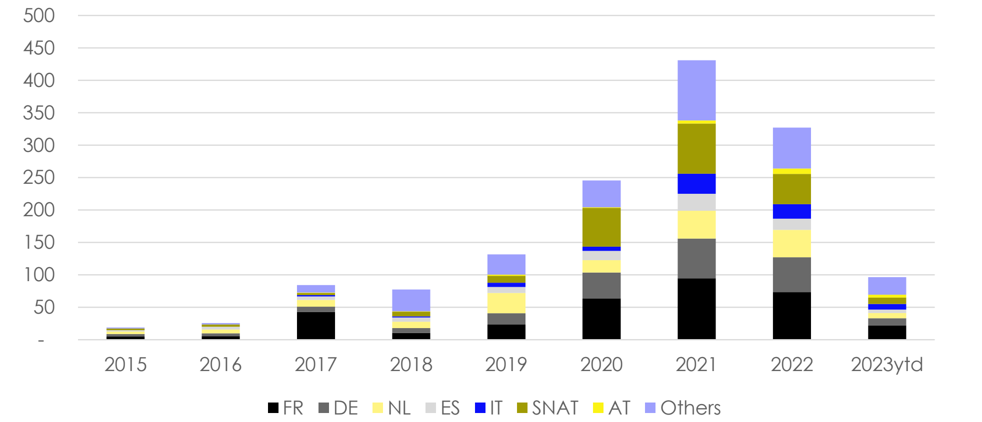
Source: Refinitiv, RBI/Raiffeisen Research

Chart 11 - Share of ESG bonds in the EUR primary market



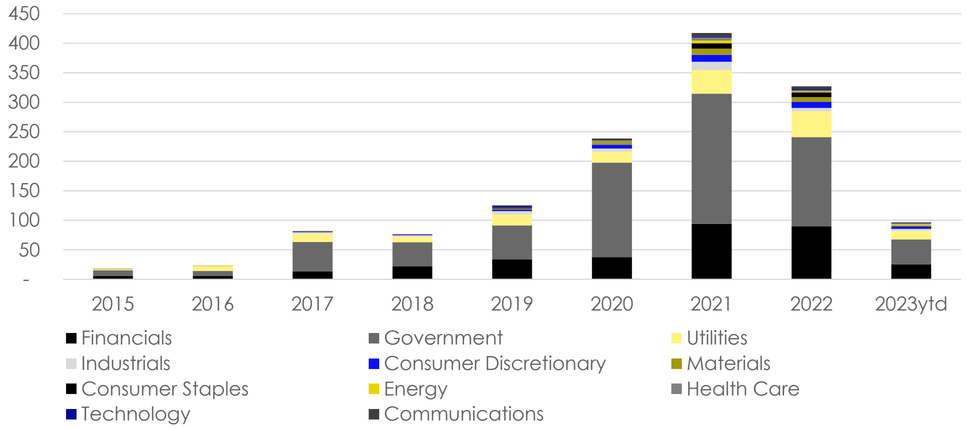
Source: Refinitiv, RBI/Raiffeisen Research

Chart 12 - Country Overview - EUR ESG Market (EUR bn)



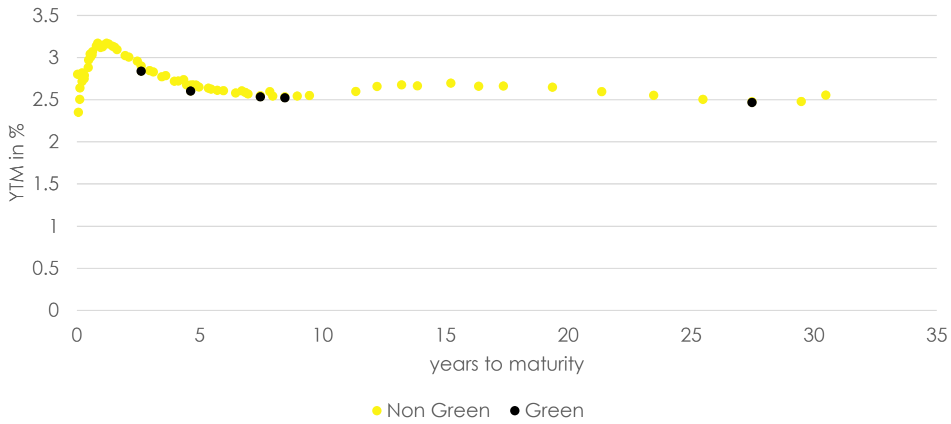
Source: Refinitiv, RBI/Raiffeisen Research

Chart 13 - Industry overview - EUR ESG primary market (EUR bn)



Source: Refinitiv, RBI/Raiffeisen Research

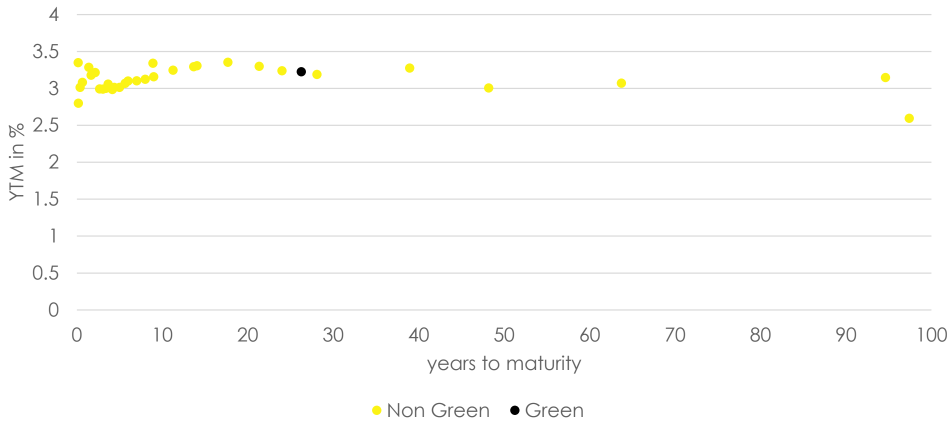
Chart 14 - Yields of German government bonds*



**EUR denom.; > EUR 250 mn; Plain vanilla fixed coupon*

Source: Refinitiv, RBI/Raiffeisen Research

Chart 15 - Yields of Austrian government bonds*



**EUR denom.; > EUR 250 mn; Plain vanilla fixed coupon*

Source: Refinitiv, RBI/Raiffeisen Research

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Creation time of this publication: 08/03/2023 12:37 P.M. (CET) ;

First Dissemination of this publication: 08/03/2023 12:37 P.M. (CET)