Volksbanken Raiffeisenbanken
cooperative financial network

Sustainable Finance Bulletin 04

DZ BANK Spotlight:

The impact of COVID-19 on the global sustainability agenda

The COVID-19 crisis has profound implications for the global sustainability agenda. It knows no borders, stopping neither before low-income nor high-income countries. The economic and social consequences in many countries are likely to be more far-reaching than those of the financial crisis of 2008. Especially in less and least developed countries, the already fragile macroeconomic and social situation is likely to be weakened even further. This makes it all the more important in times like these to steer financial flows in the right direction. Public capital alone is not enough. The financial market has a special role to play in mobilising private capital in the fight against coronavirus and its consequences. This also requires good governance. And even if the COVID-19 crisis provides „short relief" for the climate, it must not be used to ignore the environmental challenges still facing our blue marble in the medium to long term. At the same time, we must not risk economic death for fear of virological death. It is therefore important to create an exit scenario from the lockdown that encompasses all four dimensions of sustainability, with the aim to build a more sustainable tomorrow rather than simply rebuilding yesterday.

Content

Dear Reader,

Welcome to the decade of Sustainable Finance.

We are pleased to present the latest edition of our Sustainable Finance Bulletin.

Even in times of the current pandemic, sustainable finance is proving a suitable means of combating and mitigating the negative economic and social impact of the COVID-19 outbreak. Social and Sustainability Bonds from supranational issuers for example help to support countries, economic sectors and population groups that are particularly hard hit by coronavirus and its consequences.

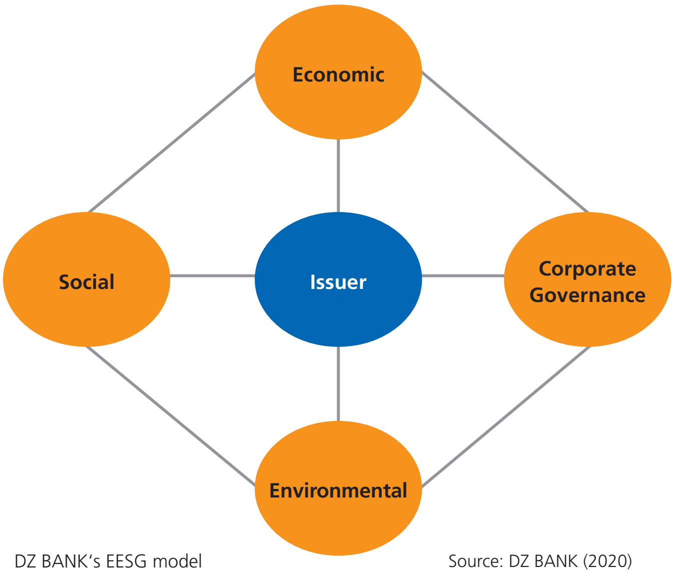
Enjoy reading! Stay healthy!

Marcus Pratsch
Head of Sustainable Bonds & Finance

DZ BANK

COVID-19 affects all four dimensions of sustainability

The COVID-19 pandemic affects all four sustainability dimensions in our EESG model.



DZ BANK's EESG model Source: DZ BANK (2020)

A few examples here:

E = Economic sustainability dimension: The coronavirus is taking a heavy toll on the global economy. Many experts fear a severe global recession, which will hit the poorest countries hardest. For many companies, the corona crisis is a race against time. For example, the Association of German Chambers of Industry and Commerce assumes that more than one in ten medium-sized companies in Germany is threatened with insolvency.

E = Environmental sustainability dimension: As life in many major economies is currently at a standstill, the climate is currently experiencing a period of „short relief". The crucial question is how sustainable this positive trend will be. Indeed, it can be strongly assumed that there will be a „rebound effect" after the end of the „lockdown" as there was after the financial crisis in 2008. Therefore, even in the current situation, it should be ensured that we do not neglect the urgent challenge of tackling of climate change.

S = Social sustainability dimension: The coronavirus is putting healthcare systems in many countries to the test. In many countries, hospitals are working close to their capacity limits. There is a lack of intensive care beds, personal protective equipment and staff. The pandemic is also putting enormous pressure on the labour market. In many countries, short-time work reaches new highs in record time, and the number of unemployed has exploded. Loss of purchasing power is inevitable. COVID-19 will therefore inevitably lead to greater income inequality in many countries. The education system is also severely affected by the COVID-19 pandemic.

G = governance: The corona crisis also highlights the need for good governance and corporate governance in particular. More than ever before, cooperation and partnerships are required across both country and company borders.

COVID-19 and the Sustainable Development Goals (SDGs)

The impact of the corona pandemic on the various dimensions of sustainability is also evident when looking at the Sustainable Development Goals (SDGs).

Source: UNSESA

Sustainable Development Goals (SDGs)

DZ BANK Spotlight:

Social and Sustainability Bonds in the time of corona

Over recent weeks, Sustainable Bonds have proved themselves a suitable financial instrument in the fight against or mitigation of the negative economic and social impact of the COVID-19 outbreak. For example, a number of supranational issuers such as the Council of Europe Development Bank (CEB), the European Investment Bank (EIB), and the International Finance Corporation (IFC), with the help of DZ BANK and other syndicate banks, have successfully issued Social and Sustainability Bonds to support countries, industries, and population groups that are particularly hard hit by coronavirus and its fallout.

The development of the Social Bond and Sustainability Bond segment

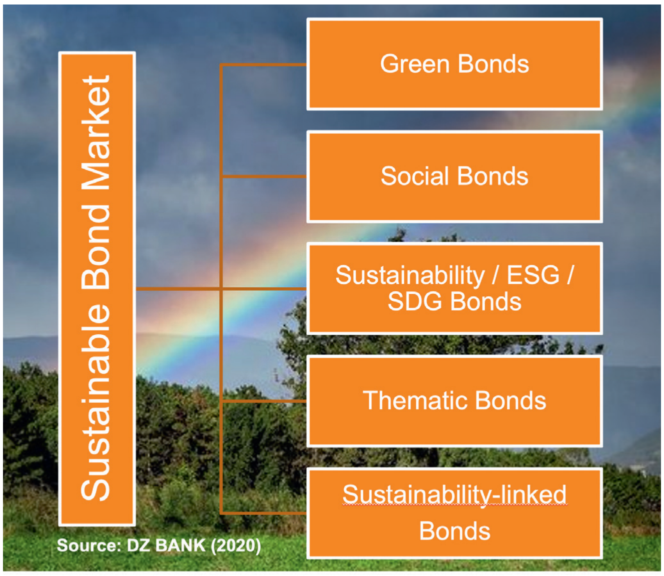
Within the Sustainable Bond Market, Social and Sustainability Bonds are among the comparatively younger financing instruments. While the Green Bond segment, born thanks to issuers such as the European Investment Bank (EIB) and the World Bank, is already approaching its 13th birthday this year, Social or Sustainability Bonds appeared on the market for the first time around five to six years later. In the absence of applicable guidelines, they existed mainly in the shadows in spite of their importance.

The first bonds officially labelled as Social Bond or Sustainability bond were issued around three years ago, after the International Capital Markets Association (ICMA) launched the Social Bond Principles (SBP) and the Sustainability Bond Guidelines (SBG) on 2 June 2017.

According to the voluntary guidelines of the ICMA, Social Bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance in part or in full new and/or existing eligible Social Projects and which are aligned with the four core components of the SBP.

Sustainability Bonds are bonds where the proceeds will be exclusively applied to finance or re-finance a combination of both Green and Social Projects. Sustainability Bonds are aligned with the four core components of both the GBP and SBP with the former being especially relevant to underlying Green Projects and the latter to underlying Social Projects.

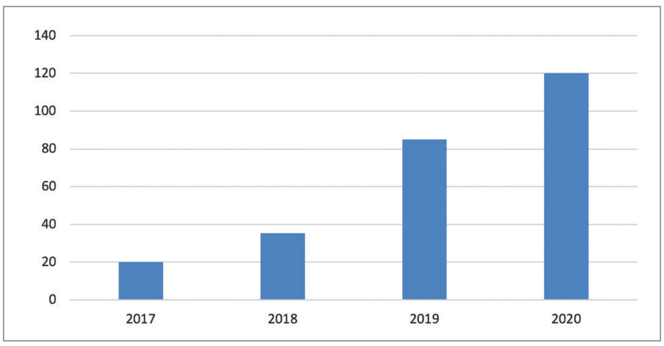
In 2018 an increasing market diversification began, described by us as the „green goes rainbow" trend, and which continues now. Issuers and investors are increasingly looking beyond the purely environmental perspective. Social Bonds and Sustainability / ESG / SDG Bonds are gaining in importance. The market is becoming „more colourful".



"Green goes rainbow": Sustainable Bond Classification

The increasing importance of Social and Sustainability Bonds is also evident when looking at growth rates. The new issue volume of Social Nonds rose by around 41% to USD 20 billion in 2019 (2018: USD 14.2 billion). Sustainability, ESG and SDG bonds even tripled the volume of new issues to USD 65.2 billion (2018: USD 21 billion).

For the current year, we assume - not least due to the COVID-19 crisis – that the disproportionately high growth of the Social Bond and Sustainability / ESG / SDG bond segments will continue. Within the segments, there will also be further diversification in terms of issuers. In January 2020, for example, Ecuador became the first country in the world to issue a Social Bond. Mexico recently presented an SDG Bond framework during a roadshow. In view of the Sustainable Development Goals, we see enormous potential for the corporate Sustainable Bond market in German-speaking Europe, for example. In Germany, for instance, there has not yet been a company that has issued a benchmark Social Bond or Sustainability Bond.



Social & Sustainability Bonds (USD bn) Source: CBI, DZ BANK (2020)

Eligible projects in the time of corona

As described at the beginning of this bulletin, the COVID-19 pandemic affects all four sustainability dimensions in our EESG model, with the economic and social dimensions being particularly affected.

The proceeds from the issue of Social or Sustainability Bonds should therefore be allocated to projects that are directly aimed at combating or mitigating economic and social problems resulting from the COVID-19 crisis. According to the Social Bond Principles, these include, for example, access to essential social services (health, education and vocational training, healthcare, financing and financial services, etc.) and and employment generation and protection including through the potential effect of SME financing and microfinance.

Successful transactions:

Supranational issuers such as the Council of Europe Development Bank (CEB), the European Investment Bank (EIB) and the International Finance Corporation (IFC) have set a good example in recent weeks by issuing Sustainable Bonds, whose proceeds will be used to combat or mitigate the negative economic and social consequences of the COVID-19 outbreak. DZ BANK is proud to have supported these issuers in their capital market transactions.

COUNCIL OF EUROPE DEVELOPMENT BANK (CEB)

On 2 April 2020 the Council of Europe Development Bank (CEB) issued a EUR 1 billion 7-year maturity COVID-19 Response Social Inclusion Bond. The funding will be used to support CEB member countries in mitigating the social and economic impact of the ongoing COVID-19 crisis.

The COVID-19 Response Bond is issued within the CEB Social Inclusion Bond framework, which is being adapted so that financing can be extended to the health sector, where countries have increased needs because of the pandemic.

In line with the Social Inclusion Bond framework, the proceeds raised will also finance new or existing social projects which support micro, small and medium-sized enterprises (MSMEs) in order to create and preserve jobs. The MSME sector has been hit particularly hard by the coronavirus outbreak across Europe.

The CEB has an exclusively social mandate and a strong track record of promoting social investments in Europe. This is the fourth Social Bond issued by the Bank since 2017 and is further strengthening its leading position in the Social Bond market.

Investor interest in the COVID-19 Response Social Inclusion Bond was impressive. Following the announcement of the transaction, the order book reached more than EUR 3.9 billion in just over an hour. The deal also gathered the largest order book of any CEB benchmark to date, with final books standing in excess of EUR 4.5 billion. This allowed the CEB to set the deal's size at EUR 1 billion, making it the largest ever Social Inclusion Bond for the Bank.

EUROPEAN INVESTMENT BANK (EIB)

On 2 April 2020, the European Investment Bank (EIB) issued a Sustainability Awareness Bond (SAB) with a volume of EUR 1 billion due 15 May 2028.

The use of proceeds contribute among other things to Sustainable Development Goal 3 „Good Health and Well-Being" by being used to support the health sector in the wake of the COVID-19 pandemic. The EIB intends to support emergency measures to finance urgent infrastructure improvements and equipment needs in the health sector. In addition, the EIB Group will use existing financial instruments shared with the European Commission, primarily the InnovFin 'Infectious Disease Finance Facility', to finance projects that work towards halting the spread of, finding a cure for, and developing a vaccine against coronavirus.

Sustainability Awareness Bonds (SAB) have been issued since 2018 under the SAB framework of EIB, which initially focused on water projects and was extended to health projects at the end of 2019. Proceeds are allocated to EIB's lending activities contributing to environmental and social sustainability objectives in line with the evolving EU sustainable finance legislation, which has taken the SDGs on board at the outset.

SAB-eligibilities are now being extended to other areas of EIB's financing directly related to the fight against Covid-19 pandemic, in line with a national / international health emergency response or preparedness plan (based on technical screening criteria aligned with the logic of the upcoming EU Sustainability Taxonomy).

These include support to national health authorities and hospitals, laboratory facilities and networks with regard to:

– Medical and non-medical equipment (including ventilators, beds, home care equipment);

– Works to convert facilities into emergency and intensive care units (installation of medical gases, power supply, water/sewage, waste management, etc.);

– Mobile units (container hospitals, mobile diagnostics and sterilisation units);

– Reconfiguration of healthcare services (temporary single specialty facilities for COVID-19 treatment, removal cost etc.);

– Supplies and consumables of all kinds (single and multi-use);

– Staff costs: User training and salaries for researchers;

– Vehicles and transport equipment, and transport costs;

– Emergency maintenance and repairs of equipment and buildings;

– IT and telecommunication systems and equipment (surveillance, diagnostics, modelling);

– Fees/payments for contracting-in of private hospital facilities and service providers for epidemiological, clinical and support services (e.g. private hospital beds, equipment rental, diagnostic services);

– Supply chain management and warehousing / storage facilities (including OPEX, e.g. rent).

The transaction met with overwhelming market response, with more than 150 investors participating and final orders at EUR 7.3bn, excluding JLM interest. The bond could thus be priced at a spread of 6bps over midswaps, 4 basis points tighter than per initial guidance.

INTERNATIONAL FINANCE CORPORATION (IFC)
On 11 March 2020 – in face of the current COVID-19 pandemic – the IFC has issued a USD 1bn 3y Social Bond being the first issuer to offer a coordinated and global response to the pandemic.

This issuance is part of the IFC's Social Bond programme, which aligns with the Social Bond Principles published by the International Capital Market Association (IMCA). It is the first public dollar deal in the format since 2017 and IFC's largest Social Bond ever. The IFC is a pioneer in Social Bond issuances.

The transaction follows the recent announcement of a COVID-19 support package by the World Bank Group to support countries affected by the global outbreak of Covid-19. The financial package, with financing drawn from across IDA, IBRD and IFC, will be globally coordinated to support country-based responses. It will make available initial crisis resources of up to USD 12 billion in financing – USD 8 billion of which is new – on a fast track basis. There is a USD 6 billion contribution from IFC, including USD 2 billion from existing trade facilities.

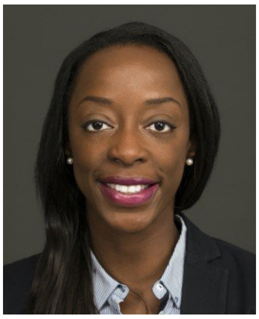
Through this new fast track package, the World Bank Group will help developing countries strengthen health systems, including better access to health services to safeguard people from the epidemic, strengthen disease surveillance, bolster public health interventions, and work with the private sector to reduce the impact on economies. It will also include policy advice and technical assistance drawing on global expertise and country-level knowledge.

Despite a difficult market backdrop, the IFC transaction was very well received by investors from Asia, Europe and the Americas. The IFC went out with a guidance of ms +17bps area and a size language of USD 1bn "no grow". After just one hour, the order book exceeded the targeted issuance volume. On the back of a strong orderbook, IFC was able to tighten the pricing by 4bps to ms +13bps. The spread over Treasuries was the tightest ever achieved for a 3-year bond in recent SSA history. The final orderbook closed above USD 3.4 bn. In total, 59 investors participated in the transaction. DZ BANK coordinated the SRI assessment of investors based on its expertise from past transactions. The allocation was increased for investors with a high SRI score.

Please more about the transaction and IFC's Social Bond program in the guest commentary below.

Guest Commentary: Social Bonds

Commentary by the IFC on Social Bonds



Esohe Denise Odaro,
Head of Investor Relations/ Treasury, IFC

The question "what is a social issue eligible for social bond funding?" is often one that leads to extensive debate. Ideas differ as to what constitutes a social problem and in particular the location of the said social issue only further fuels the debate. For instance, a project considered to alleviate a social issue in a developing country would too often not be accepted as a social project in a developed country.

Social bonds require two key facets: exclusive use of proceeds to projects aiming to address a social issue and that these social projects target a specific subset of the populace identified as underserved or vulnerable. There are certain social matters that arguably affect the entire populace and public health is a good example of such. Child mortality owing to a lack of access to vaccines is undoubtedly a social issue. IFC's Social Bond Program finances projects that aim to resolve social issues and boost shared prosperity through the provision or increase of access to essential services to such as healthcare, water, finance etc. for underserved populations in developing countries. In 2017, IFC's social bonds supported a US$60 million loan to BioE to fund R&D to develop new vaccines and scale up its manufacturing facilities for new vaccines. BioE produces Pentavalent, one of the most used vaccines in the world, which safely combines five antigens that will prevent catastrophic illness, disability, and death from Diphtheria, Tetanus, Pertussis, Hepatitis B, and Haemophilus influenzae type B (Hib), which causes meningitis and pneumonia. By reducing the number of shots needed, children are more likely to receive the entire regimen and be fully protected over their lifetime. Fewer doses also helps governments to reduce the overall cost of vaccination. Through large-scale production of vaccines at lower costs, life-saving vaccines can reach the most disadvantaged children in the world.

IFC's Social Bond Program incorporates the four core components of the Social Bond Principles (SBP), namely use of proceeds, process for project evaluation and selection, management of proceeds, and reporting. In FY17, IFC merged the two existing products into a single Social Bond Program: IFC's Banking on Women (BOW) Bond Program set up in 2013 was the first bond program of its kind focused on creating opportunities for women entrepreneurs in emerging markets. Subsequently, in October 2014, IFC's Inclusive Business (IB) Bond Program was launched, the first debt offering to exclusively support businesses which include low income communities into their supply chains. Both BOW and IB bonds were sold to Japanese retail investors in the uridashi market. Subsequently, we created IFC's Social Bond Program to not only support these pre-existing eligible projects but also expand the use of proceeds to categories of projects as stipulated within the SBP. One of the intended outcomes of the resulting larger pipeline, has been the scope to issue more social bonds in the public market as well as accommodate private placements. An asset manager in Europe, a retail investor in Japan, a central bank can effectively support the provision of access to essential services to those who are less likely to get it. We launched the new program in 2017 with a benchmark-sized US$500m issuance in 2017 and 20 percent of the investors in the book were first-timer investors in IFC bonds.

IFC International Finance Corporation WORLD BANK GROUP

Thereafter, recognizing the importance of transparency in this market, IFC was the first social bond issuer to produce comprehensive impact reports for investors to quickly access information on funded projects. This reporting was significant leap forward for the nascent social bond market. For each proposed investment – and in accordance with IFC's disclosure policy – we disclose relevant financial information, the project's environmental and social implications, its expected development impact and alignments with the SDGs. These efforts were recognized by investors who voted IFC's 2018 Social Bond Impact Report as "Best Impact Report of the Year" as awarded by Environmental Finance.

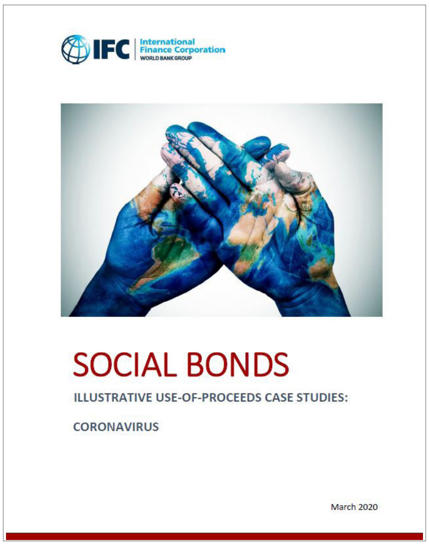
Our social bonds are a subcategory of IFC's core funding program and issuance is dictated by the volume of eligible commitments to projects. For this fiscal year ending June 30, 2020, our funding target remains up to US$14 billion in size, with US$ 10 billion already issued. The current coronavirus pandemic has given rise to the demand of social bonds. Following the announcement of a $14 billion financing package for COVID-19 by IFC and the larger World Bank Group, we issued our largest ever social bond a US$ 1 billion (no-grow) 3-year global bond. DZ bank acted as join bookrunner for this landmark transaction. The bond which pays a coupon of 0.5% priced with a spread of +13bps over mid-swaps, equivalent to +4.4bps over the UST 0.5% March 2023. The deal gathered exceptional investor interest of over US$ 3.4bn despite the volatility in the market and following the worst day in financial markets since the 2008 crisis which saw equities and oil tumble and US treasury yields trade lower than 1% across the curve for the first time. The success of the trade is testament to the fact that investors are keenly interested in supporting the alleviation of social issues. The trade attracted both new investors to IFC's Social Bond Program as well as loyal supporters of IFC's thematic bonds. We always carefully manage allocation to investors, and we were able to employ DZ Bank's systematic means of allocation based on the investors' commitment to ESG investing. To date, IFC has issued over US$2.8 billion through 33 social bonds in nine currencies.

The pandemic is causing extensive economic disruption in emerging markets and developing countries alike. The The priority today is to support the inundated health sector and the millions of employees and enterprises being hit by the crisis. IFC's experience from past shocks, including the global financial crisis in 2008, has taught us that keeping companies solvent is crucial to saving jobs and limiting the economic damage. We have also learned that speed is of the essence at such times. Supporting the private sector is critical to restoring economic stability and preserving jobs. Applying lessons learned from the previous crises in response to the global coronavirus pandemic, IFC is providing fast-track financial support of US$ 8 billion to private companies to sustain economies and protect jobs during this period of significant global uncertainty. We aim to support our clients to cushion the economic blow through financing that will help them continue to operate. The financing package will provide direct lending to companies affected by the outbreak, as well as support to financial institutions so they can continue lending to businesses.

Similar to the manner in which climate change became a topical issue and a call to action worldwide which then led to the growth of the green bond market, the current pandemic and its effect on public health and the global macro and political spheres may very well increase the awareness of social bonds. With no additional risk besides that of the issuer, social bonds offer investors access to support social issues including those emanating from COVID-19. In our capacity as a Chair of the Social Bond Working Group, IFC published illustrative case studies to highlight use-of-proceeds that may be considered by issuers evaluating social bonds as a financing option for COVID-19 impact alleviation projects. This has the potential to spur growth of the social bond market significantly. We need to combat the effects of the virus through fast action, while continuing to maintain high standards of integrity and transparency.

Link to the case study:
https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/SB-COVID-Case-Study-Final-30Mar2020-310320.pdf

Link to IFC's Social Bond Program:
www.ifc.org/socialbonds

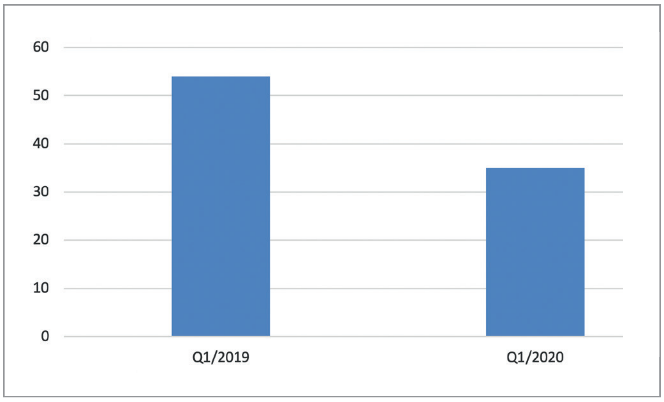


DZ BANK Spotlight:

Green Bonds in times of Corona – Quo vadis?

As life in many major economies is currently at a standstill, the climate is currently experiencing a period of „short relief" from human activity. The collapse of the world economy as a result of COVID-19 is likely to dampen the growth of global greenhouse gas emissions for the first time in years.

According to calculations by the Finnish Center for Research on Energy and Clean Air, greenhouse gas emissions in China fell by 25 percent in February, which corresponds to a saving of around 200 million tonnes of CO_2. For Germany, the think-tank Agora Energiewende has calculated that greenhouse gas emissions this year are likely to be around 40 to 45 percent below the comparable figure from 1990. This would put Germany on track to achieve its climate protection goal for 2020 (a 40 percent reduction in greenhouse gas emissions compared to 1990).



Green Bond market Q1/2019 vs. Q1/2020 (USD bn) Source: CBI, DZ BANK (2020)

The Green Bond market is also taking a "breather" at present. The global volume of new issues in the first quarter of 2020 amounted to around USD 35 billion. By way of comparison: In the first quarter of 2019, the Green Bond segment recorded a new issue volume of around USD 54 billion. In March 2020, the increase in the absolute volume of new issues was in single-digits for the first time since 2018.

The question therefore arises as to how badly the market for Green Bonds will be affected by the COVID-19 pandemic.

In the short to medium term, we expect the Green Bond market to cool significantly. Many issuers (especially potential first-time issuers) are reluctant and are postponing their funding plans until later in the year. Supranational issuers that are regularly active in the Green Bond segment as well as in the Social Bond and Sustainability Bond segment currently focus their issues predominantly in the latter.

In view of the situation described above and the uncertainties surrounding the further course of the COVID-19 pandemic, we do not expect the Green Bond market to return to „normality" before the second half of 2020 at the earliest. We will therefore adjust our forecast made at the beginning of the year that the global Green Bond market is likely to grow to around USD 375 billion in 2020 in the near future.

In the long term though, we believe that the market for Green Bonds is intact.

The positive trend in greenhouse gas emissions mentioned above will not be sustained. In fact, it can very well be assumed that there will be a "rebound effect" after the end of the "lockdown" as there was after the financial crisis in 2008. According to World Bank calculations, emissions of CO_2, methane and other greenhouse gases fell during the course of the financial crisis from around 50 gigatonnes in 2007 to 48.2 gigatonnes in 2009. Yet in 2010, emissions had already exceeded their pre-crisis level.

Therefore, even in the current situation, we should be careful to ensure that we do not neglect the urgent challenge of tackling climate change. Moreover, the COVID-19 crisis should be seen as an opportunity to allocate the investments required for reconstruction in a way that takes account of sustainability. Besides economic and social projects, climate and environmental protection must also be included. For example, climate- and environmentally friendly technologies could be specifically promoted.

Combating the COVID-19 pandemic and mitigating its economic and social consequences is urgent and has absolute priority. Nevertheless, in the long term, we must not ignore climate targets and risk a climate pandemic. This would have negative economic, environmental and social consequences that are far more serious than those resulting from the corona crisis and, moreover, most of them will be irreversible.

Green Bonds will therefore not lose importance in the long term. The race on the capital market for the trillions required for the transformation will continue.