Volksbanken Raiffeisenbanken
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DZ BANK Spotlight:

Update Sustainable Bond Market Forecast

Green Bond segment

Compared to 2019, the Green Bond segment has cooled down noticeably. The global new issuance volume in the first half of 2020 fell by approximately 28% compared with the same period of the previous year and amounted to around USD 84.5 billion (H1/2019: USD 117.8 billion).

In March in particular, the market took a strong breather with a new issuance volume of USD 4.3 billion. This represents a decline of around 72% compared to the same period of the previous year (Q3/2019: USD 15.6 billion) and is the lowest new issuance volume since December 2015.

Fortunately, the market began to recover noticeably as early as April, and the volume of new issues stabilised in the following months compared with the sharp slump in March. We expect a further „normalisation" in the coming six months. In the medium to long term, we believe that the segment for Green Bonds remains intact.

For 2020 as a whole, we forecast a new issuance volume of USD 200 billion, a decline of 22% compared with the previous year.

Content


Marcus Pratsch


David Marques Pereira

Dear Reader,

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

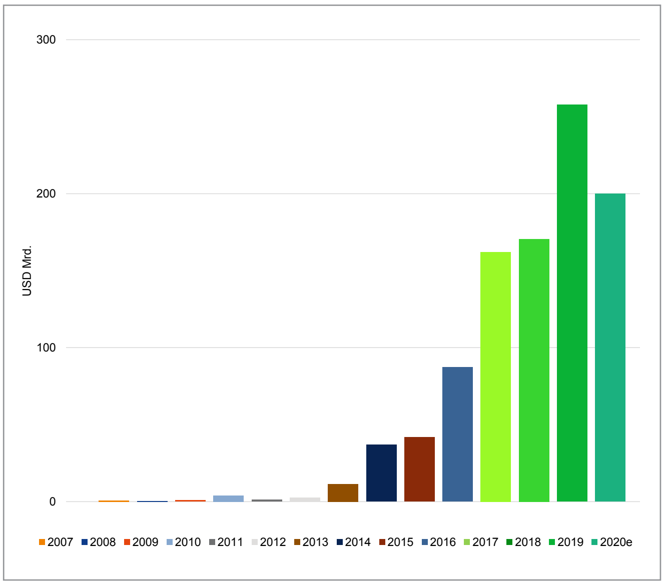
Even though the Green Bond segment took a breather in the first quarter, investor interest in Sustainable Bonds is unbroken. The Social Bond and Sustainability Bond segments in particular are continuing their strong growth from the previous year and are receiving additional tailwind from the corona pandemic. COVID-19-related funding is on everyone's lips and has been extremely successful, as evidenced by the issue of the world's first COVID-19 covered bond. In addition, target-linked issues are becoming increasingly popular, especially in the non-financial corporate segment, and should receive a further boost from the recently published Sustainabilty-Linked Bond Principles.

Enjoy reading! Stay healthy!

Marcus Pratsch
Head of Sustainable Bonds & Finance

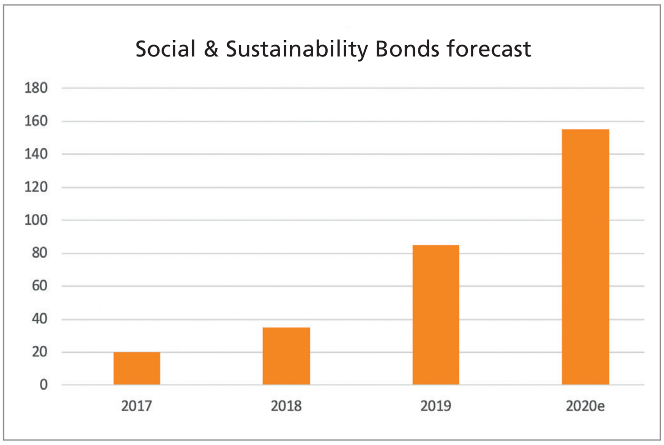
David Marques Pereira
ESG Originator

DZ BANK



Development of Green Bonds Source: DZ BANK, CBI, Moodys (2020)

We forecast that the new issuance volume of Social and Sustainability Bonds will increase by more than 75% compared to the previous year, exceeding the USD 150 billion mark.



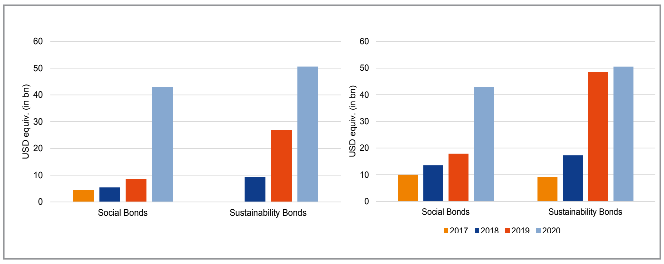
Forecast Social and Sustainability Bonds Source: DZ BANK, CBI (2020)

Social Bond segment and Sustainability Bond segment

The labelled market for Sustainable Bonds has become more colourful for some time now, i.e. it increasingly goes beyond Green Bonds. With a doubling respectively tripling of new issuance volume, Social Bonds and Sustainability Bonds have already proven to be growth drivers for the market as a whole in 2019.

In times of COVID-19 they receive additional tailwind. Only recently, the International Capital Markets Association (ICMA) published an update of its Social Bond Principles (SBP), which extends the eligible project categories of Social Bonds and the definition of the target population to the global population, in line with the latest guidelines for Social Bonds to tackle the coronavirus crisis.

Already in June, the new issuance volume of both Social Bonds and Sustainability Bonds exceeded the new issuance volume of the entire previous year.

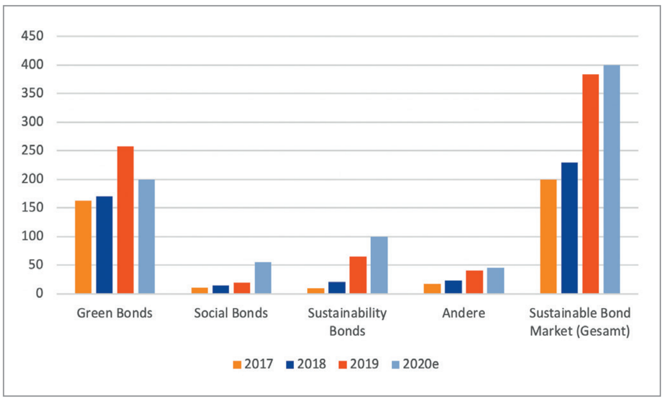


YTD development Social & Sustainability Bonds

Total Sustainable Bond market

Despite the noticeable cooling of the Green Bond segment in the first half of the year, we expect the overall Sustainable Bond market to grow by around 4% and thus exceed the USD 400 billion mark.

In addition to the rally in the Social Bond and Sustainability Bond segment, both the Sustainability-linked and Transition agendas are making great strides forward. We also expect a further boost for sovereign Sustainable Bonds. Germany will issue the first Green Bond in September. Other countries that are likely to join the club of sovereign Green Bond issuers this year include Denmark, Spain and Sweden. Furthermore, the segment of sustainable sovereign bonds is also likely to become more colourful in future. In January 2020 Ecuador became the first country in the world to issue a Social Bond. Mexico presented an SDG Bond framework as part of a roadshow in March.



Sustainable Bond market 2017–2020e Source: DZ BANK, CBI (2020)

Guest Commentary:

The issuer view: COVID-19-response Bonds

Ralf Berninger,
Head of Investor Relations & Sustainability, SFIL

The COVID-19 pandemic has created an important need for investments and additional expenditures across many sectors of the economy including :

- Health care and medical research
- SME financing
- Social security expenditures

As the fight against the pandemic has become a key priority across the globe, many issuers have set up dedicated issuance programs to raise funding for finance investments and expenditures related to the Pandemic. Issuers have used one of the three alternative options to set up such an issuance program:

- Issuers may use an existing social bond program if some or all of the project categories are aligned with the fight against the COVID pandemic

- Alternatively, issuers may set-up a dedicated COVID related issuance program. Such a program may not be fully aligned with all ICMA guidelines for social bond issuance. For example, issuers may choose to go ahead without a second party opinion given the urgency of financing measures against the COVID pandemic

- Finally, issuers may have additional funding needs that are clearly related to the fight against the COVID pandemic. However – given the nature of their activity - they may not at all be in a position earmark the proceeds for specific COVID investments or expenditures. In that case, issuers have chosen to go ahead with transactions without any specific definition use of proceeds

At the end of March this year, ICMA has provided some guidance to the market with a Q&A for Social Bonds related to COVID-19. In particular, ICMA has:

- provided examples of eligible project categories including healthcare services and equipment, medical research or SME loans supporting employment generation in affected small businesses

- clarified that it is possible to issue a COVID-19 Social Bond even if not all the proceeds are directed towards COVID-19 Projects, with issuers ideally providing information concerning the percentage of proceeds earmarked for dedicated COVID-19 investments

For SFIL Group, we made the choice to use our existing social bond framework to raise funding for COVID-19 related investments. This framework has been set up in 2018 to finance investments by French public hospitals. The French public hospital sector has a strong social policy mission as defined under the **French public health act** ('Code de la Santé Publique'):

- Mission to provide **public health services for the whole population** regardless of the income, social or financial status, at any time, and for all medical and surgical specialties, all diagnostic and therapeutic possibilities, including rare diseases or extremely expensive, complex and long-term treatments (art. L1110-1)

- Mission to reduce **social inequalities, gender inequality and regional inequalities** is defined as key objective (art. L1411-1) – healthcare services are available across the country including **the most isolated areas** (art. L6112-2)

- Medical treatment is available to each and every person, including people in a situation of hardship (the elderly, poor, homeless), services are free of charge in the **absence of health insurance** cover, any kind of discrimination is prohibited (art. L1110-3)

- **No advances in cash** are required for treatment by public hospitals, **administrative help** is made available to ensure full access to public services (art. L6111-1-1)

The credit process at SFIL includes an extra-financial analysis of each public hospital that focuses on the importance of the hospital in the overall healthcare offer – the so-called **Healthcare Added Value** of a public hospital.

Public hospitals in France have played key role in treating COVID-19 patients in France. A large investment program will further strengthen the hospital sector to be able to deal with any potential future pandemic outbreaks. One of the lessons learned from the pandemic, is that the required investments go well beyond investments in medical equipment. For example, the structure of hospital buildings may need to be adapted to deal with any highly contagious pandemic outbreaks. Separate entrances and separate elevator systems would ensure that contagious patients remain separated from other hospital patients.

As leading lender to the public hospital system, SFIL will play an important role in financing future investments to strengthen the public hospital system. Our first COVID-19 related social bond transaction was launched as a covered bond by CAFFIL in late April with a five year maturity and a volume of EUR 1 billion. The market reception was exceptionally strong with an order book above EUR 4.5 billion and the participation of 130 different investors. This was the first „COVID 19" related covered bond aimed at directly or indirectly funding sectors affected by the pandemic. It was also at the date of issuance the covered bond with the tightest spread since the start of the COVID19 crisis and the largest order book for a covered bond transaction in 2020 with a rate of oversubscription of 4.5.

Looking ahead, we plan to make regular use of our Social Bond Program to finance these investments, either under covered bond format issued by CAFFIL or in the agency market via SFIL.

Supporting local investment and export

Société de Financement Locale (SFIL) is a public development bank created on February 1, 2013, with the aim of guaranteeing stability in local public sector financing in France. It is a 100% publicly-owned bank, having obtained approval from the French Prudential Supervision and Resolution Authority (ACPR). The French government is the principal shareholder, with a 75% stake in its capital, the remainder being owned by Caisse des Dépôts et Consignations (20%) and La Banque Postale (5%).

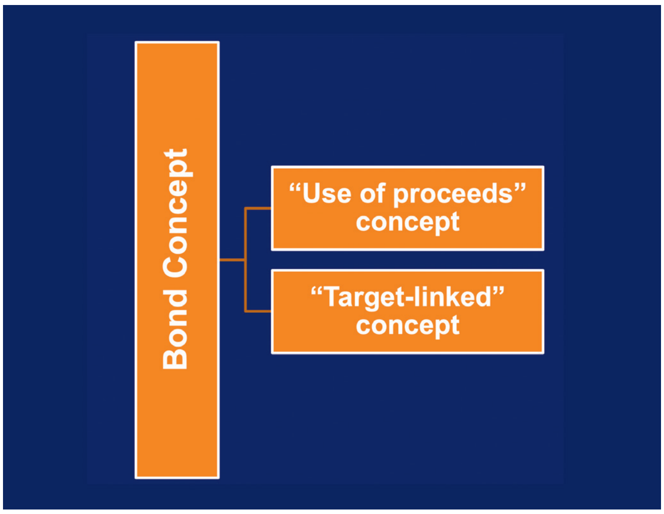
Caisse Française de Financement Local (CAFFIL), a wholly-owned subsidiary of SFIL, is a société de crédit foncier which refinances loans to public sector authorities through the issue of obligations foncières (covered bonds)

DZ BANK Spotlight:

The Sustainability-Linked Bond Principles of the ICMA

Target-linked issues are becoming increasingly important, especially in the non-financial corporate segment. Whereas in the case of „use of proceeds" solutions, the proceeds of the issue may only be used to finance eligible green, social or sustainable projects in part or in full, sustainability-linked constructions do not limit the use of the proceeds of the issue.

A Sustainability-linked Bond is a non-earmarked bond whose financing costs depend on the achievement of sustainability performance targets (SPTs) defined in advance of the issue. These targets measured by sustainability-related key performance indicators (KPIs). The SPTs can be of environmental or social nature. The issuer has various options: In the case of an SDG-linked bond, these targets are based on the United Nation's Sustainable Development Goals (SDGs). Another possibility is a structure where the financing costs are directly related to an external sustainability rating (ESG-rating).



Bond Concepts Source: DZ BANK, (2020)

A new product, albeit without one common standard or one common language – until now. The International Capital Market Association (ICMA) published the Sustainability-Linked Bond Principles (SLBP) in June 2020. These are voluntary process guidelines for issuers. Sustainability-linked bonds are defined as future-oriented and performance-/success-based debt instruments which consist of five core components:

1) Selection of Key Performance Indicators (KPIs)
The selection of KPIs determines the credibility of the transaction. The SLBP recommend the selection of indicators that fulfil the following requirements:
- Essentially and strategically important for the business model
- Quantifiable or measurable
- Externally verifiable
- Possibility of benchmarking (based on external references or standards)

2) Calibration of Sustainability Performance Targets (SPTs)
The issuer should determine in advance one or more SPTs that should be achieved within a defined time period, based on the KPIs defined in step 1). International initiatives such as the Paris Agreement and competitors' performance in the respective KPIs can serve as an orientation. The calibration of SPTs are to be in line with the issuer's overall sustainability strategy. The SLBP recommend an external expert review about the conformity of the process with the five core components as part of an independent Second Party Opinion (SPO).

3) Bond Characteristics
The cornerstone of a Sustainability-linked Bond is the variable nature of financial or structural elements which depend on the (non-)achievement of the goals defined in step 2). The most frequently used element here is a variable coupon: If the pre-defined SPT is achieved within the period of time, the coupon changes in favour of the issuer (step-down). The payment moves to the opposite direction in case of (non-)achievement – the issuer pays a higher coupon (step-up).

4) Reporting
The issuer is encouraged to report at least once a year on the development the KPIs defined in step 1). Furthermore, a verification assurance report relative to the SPT outlining the performance against the SPTs and the related impact is to be published as well.

5) Verification
The issuer should seek independent and external verification regarding the development of the KPIs against the background of the SPTs. This report is to be conducted at least once a year and to be made publicly available. In contrast to the recommended ex-ante SPO, this verification is a necessary element of the SLBP.

Although the ICMA SLBP are of voluntary nature, an adaptation by the market can be expected soon – this framework has the potential to become an established standard in the sustainability-linked bond market, parallel to the Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines. This type of bond is an attractive refinancing instrument, especially for non-financial corporates. For example, a number of companies such as Faber-Castell AG, Dürr AG, PORR AG and Aurubis AG have successfully entered the target-linked bond market with the help of DZ BANK and other syndicate banks.

In conclusion, the trend that has already been seen in recent months can be confirmed: The Sustainable Bond market is becoming more diversified and more colourful.

https://www.icmagroup.org/green-social-and-sustainability-bonds/sustainability-linked-bond-principles-slbp/

SAVE THE DATE:

DZ BANK Sustainability Day

This year's DZ BANK Sustainability Day will take place on **22 September 2020.** SAVE THE DATE to discuss with us current trends & drivers in the Sustainable Bond / SSD market, the impact of COVID-19 on Green, Social and Sustainability Bonds and the latest regulatory developments.

In view of the current situation, the event will be organized in a hybrid format. You can either attend on site (limited number of participants) or follow the discussion online as live broadcast.

Further details (such as the web link) will be announced after registration. The agenda will follow in the coming weeks.

If you can already foresee today that you will be attending our event in September, you can already register via the following link:

https://live.dzbank.de/sustainability-day

LEGAL REFERENCES

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