NORD/LB

Fixed Income Special

ESG Update

Markets Strategy & Floor Research

Finanzgruppe

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Please see important disclosures on the last pages of this study.

NORD/LB
Fixed Income Special
ESG Update

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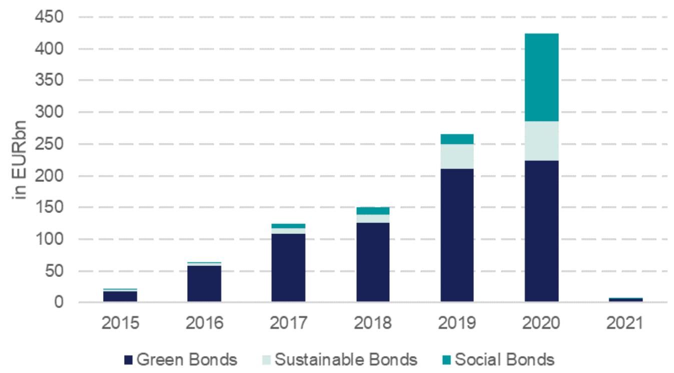
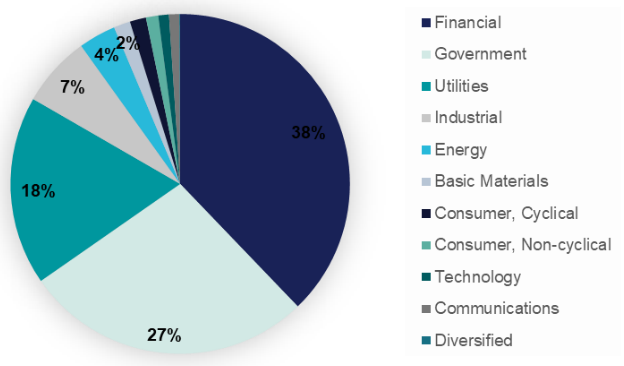
Total issuance volumes for ESG Bonds (EUR)



Total sector distribution of ESG bonds



Source: Bloomberg, NORD/Markets Strategy & Floor Research

Research portal:
nordlb.com/en/research/

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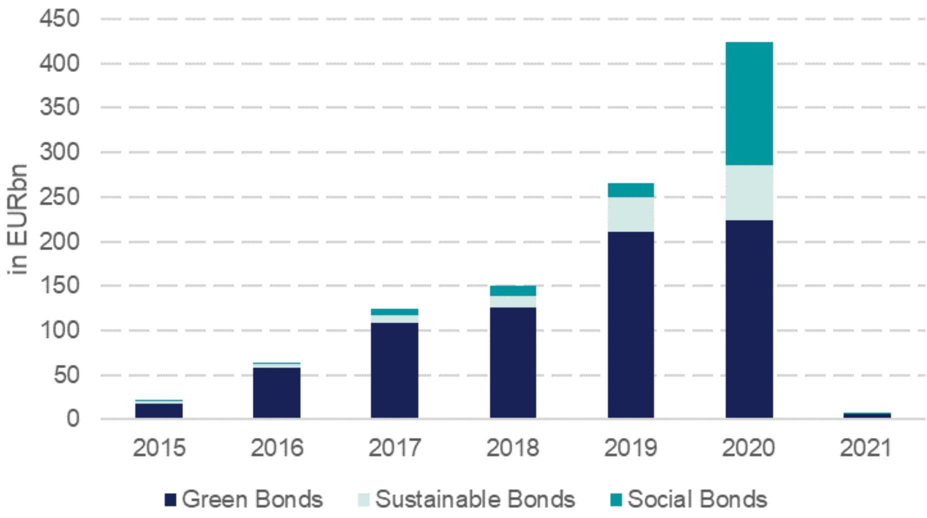
The market for ESG bonds

Social bonds stimulate further ESG growth

The market for ESG bonds recorded significant growth again last year. After a cumulative new issuance volume of EUR 266bn across all three asset classes, in 2020 the volume of all bonds newly brought to market in this segment rose to around EUR 425bn. In this context, green bonds again formed the largest sub-segment, with a volume of EUR 244bn (previous year: EUR 211bn). However, social bonds accounted for the strongest growth in comparison with the previous calendar year, rising from EUR 16bn in 2019 to a total of EUR 138bn as at the end of December 2020. The new issuance volume of sustainable bonds increased to EUR 63bn, which equates to substantial growth of 62% year on year. Due to the strong growth in the social bonds sub-segment, there were changes in the relative market shares. At 53% (previous year: 79%), green bonds continue to make up the largest share here. Social bonds are now in second place, accounting for an increased share of 33% (previous year: 6%). Although the relative market share of sustainable bonds remained constant at around 15%, this asset class has now slipped to third place overall.

New issuance volume of EUR bonds in the ESG segment



Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Coronavirus pandemic supports market growth

Refinancing operations in connection with promised coronavirus aid were conducted in the social bonds segment to a significant extent. Both governments and sub-sovereign issuers as well as promotional banks were all active in this bond segment. In 2020, the European Union (EU) even established itself as one of the largest players and looks set to dominate this asset class with its corona bonds in the near future. The aim is to raise more than EUR 750bn on the capital market over the coming years, with the majority of this volume attributable to the social bond segment. Moreover, German Bundeslaender in addition to national and multinational development banks are included in the circle of social bond issuers.

Banks and public issuers continue to provide largest new issuance volumes
Around 65% of the ESG bonds currently outstanding can be allocated to the Financials (38%) and Public Sector (27%) segments. In comparison with the previous year, there was a slight decline here amounting to 5 percentage points. A look at the industrial sectors shows that utilities play an important role in the ESG universe. In 2021, an outstanding volume of EUR 138bn was attributable to this issuer group, which takes third place with a relative market share of 18%.

Taxonomy plays important role for the green bond segment
In November 2020, the European Commission underpinned the first two climate goals with technical screening criteria (TSC). These will become binding in 2021 and therefore represent an important basis for the further development of the green bond market. The four environmental targets still outstanding (sustainable use of water resources, transition to a circular economy, avoidance of pollution and protection of ecosystems and biodiversity) in addition to the addition of further corporate sectors will follow by the end of 2022. Many issuers have already established green bond issuance programmes and are waiting for further specifications with regard to regulatory requirements. As soon as this is provided, the market segment should experience increased activity in the form of new issuances.

ESG new issuance volume will exceed the EUR 500bn mark in 2021
In the first few weeks of the new year, new bond issuance activity was certainly on the restrained side overall, although issuers were busy in the segment of ESG bonds. With a share of 89%, green bonds are presently leading the way, although we are expecting social bonds to become far more popular over the course of the year. For 2021 as a whole, green bonds and sustainable bonds are likely to largely remain at levels similar to those seen in the previous year, while a significant increase in social bonds definitely appears to be on the cards. Working on the assumption that the level recorded last year will double, the total volume in the ESG segment will increase by around EUR 470bn. However, this forecast is based on pandemic bonds being assigned to this segment and issuers sticking to current targets for their funding plans.

Taxonomy update: financial market expected to present in 2021

Analyst: Michael Schulz, CIIA

Taxonomy overview

Within the framework of the EU Green Deal and the Paris Agreement, the European Commission will introduce a uniform market standard for sustainable economic activities in the form of the EU Taxonomy. The Taxonomy is designed to be a dynamic framework, which will be subject to evaluation and amendment every three years. Specifically, it provides a classification system, which is expected to help boost growth by defragmenting the sustainable investment landscape and by reducing distrust on the market for sustainable finance (NORD/LB study April 2020).

Changes in the taxonomy over time

Source: European Commission, NORD/LB Markets Strategy & Floor Research

New criteria for two of six environmental objectives already in force in 2021

Of the six environmental objectives of the Taxonomy Regulation adopted in total, the first two (climate change mitigation and climate change adaptation) were underpinned by the European Commission in November 2020 with a draft detailing the technical screening criteria (TSC) to be applied. Following agreement from the European Parliament within four months, they will therefore be mandatory in the course of 2021, starting with financial market players (in accordance with Regulation 2019/2088). This period may be extended by a further two months by the European Parliament. The four outstanding environmental targets (sustainable use and protection of water/marine resources, transition to a circular economy, pollution prevention and control, protection/restoration of biodiversity and ecosystems) are to be underpinned with criteria and enshrined in law in a second Delegated Act by the end of 2022. The European Commission's subsequent schedule envisages including other corporate sectors in the course of 2022.

Tabular overview of the EU Taxonomy Regulation

Article	Description	Content / remarks
1	Subject matter and addressee group	▪ Uniform set of criteria for determining whether an economic activity qualifies as environmentally sustainable (percentage) ▪ Applies to European financial market participants and companies under NFRD
2	Definition	▪ Environmentally sustainable investment and associated environmental terms ▪ Financial market participants and financial product
3	Criteria	▪ Criteria for environmentally sustainable investment
4	Usage of criteria in national policy	▪ Member States shall apply criteria to financial market and to participants
5	Transparency of investments	▪ General disclosure obligations for financial products that qualify as environmentally sustainable
6	Transparency of qualified financial products	▪ Disclosure to what extent DNSH criterion applies and proportions of investments which are not taxonomy aligned
7	Transparency of other financial products	▪ Mandatory disclaimer for financial products not covered by Taxonomy
8	Transparency in non-financial statements	▪ Undertakings subject to NFRD 2013/34 required to include information on extent to which activities apply to taxonomy in their non-financial statement ▪ Disclose aligned proportions of turnover, capital/operational expenditure
9	Environmental objectives	**1)** Climate change mitigation **2)** Climate change adaptation **3)** Sustainable use and protection of water/marine resources **4)** Transition to a circular economy **5)** Pollution prevention and control **6)** Protection/restoration of biodiversity and ecosystems
10	Substantial contribution to 1)	▪ Definition of type of process or product innovation which an aligned economic activity has to be accompanied by ▪ Definition of transitional activities to support climate-neutrality ▪ European Commission to adopt delegated act to supplement art. 10
11	Substantial contribution to 2)	▪ Definition of when activity substantially reduces risk of adverse impacts on climate without adverse impact on people, nature and assets or provides corresponding adaptation solution ▪ European Commission to adopt delegated act to supplement art. 11 with technical screening criteria for application in January 2022
12	Substantial contribution to 3)	▪ Definition of substantial contribution to good status of bodies of water (fresh- and saltwater, surface- and groundwater) and definition of deterioration of waters with already good status ▪ Delegated Act for supplementation to follow end of 2021
13	Substantial contribution to 4)	▪ Prerequisites under which economic activity substantially contributes to the transition to a circular economy ▪ Delegated to follow end of 2021 to applicate in January 2023
14	Substantial contribution to 5)	▪ Definition of substantial pollution prevention and control of air, water, land and human health ▪ Delegated Act for supplementation to follow end of 2021 with a view to applicate in January 2023

Source: European Commission Draft DA on Taxonomy Regulation, NORD/LB Markets Strategy & Floor Research

Tabular overview of the EU Taxonomy Regulation

Article	Description	Content / remarks
15	Substantial contribution to 6)	▪ Conditions under which economic activity protects, conserves or restores biodiversity and achieves good status of ecosystems ▪ Delegated Act for supplementation to follow end of 2021 with a view to applicate in January 2023
16	Enabling activities	▪ Criteria for when economic activity qualifies as enabling activity through directly enabling a substantial contribution as per art. 9
17	Significant harm	▪ Situations in which environmental objectives are significantly harmed by economic activities including life cycle assessment
18	Minimum safeguards	▪ Enumeration of intercontinental guidelines from the OECD, UN and other institutions as minimum safeguards concerning conduct of business, human rights and labour ▪ Implementation in alignment with the DNSH principle
19	Requirements for technical screening criteria	▪ Specifications of technical screening criteria which are to be adopted for environmental objectives laid out in art. 10-15 ▪ Commission to review and amend technical screening criteria at least every three years taking into account the outcome of previous applications in financial markets
20	Platform on sustainable finance	▪ Commission shall establish a Platform on Sustainable Finance composed of representatives of European agencies, banks, private stakeholders, civil society and academia ▪ Platform is tasked with advisory, analysis, monitoring and reporting in matters concerning the EU Taxonomy
21	Competent authorities	▪ National authorities of member states are required to monitor the compliance of financial market participants with transparency obligations laid out in art. 5, 6, 7
22	Measures and penalties	▪ Member States shall lay down the effective, proportionate and dissuasive rules on measures and penalties applicable to infringements of Articles 5, 6 and 7
23	Exercise of delegation	▪ The power to adopt a delegated act is conferred on the Commission for an indeterminate period from 12 July 2020 ▪ European Parliament and Council have a veto right and four-month response period before delegated acts enter into force and can revoke power on any time ▪ Response period can be extended by two months
24	Member State Expert Group on Sustainable Finance	▪ Establishment of advisory group to assess the appropriateness of the technical screening criteria and the approach by the Platform ▪ Tasked with exchange of view across member states
25	Amendments	▪ European Supervisory Authorities to develop draft regulatory technical standards in Joint Committee until 30 December 2020 ▪ Draft for art. 9 environmental objectives 1) and 2) by 1 June 2021 ▪ Draft for objectives 3) to 6) by 1 June 2022 ▪ Further amendments for art. 8,9,11,20
26	Review	▪ From 13 July 2022 onwards every three years the Commission shall publish a report on the taxonomy application ▪ By 31 December 2021 Commission shall publish a report concerning provisions needed to extent scope of this regulation ▪ By 13 July 2022 Commission shall assess the effectiveness of the advisory procedures
27	Entry into force and application	▪ Application of art. 4-8 for environmental objectives 1) and 2) in January 2022 ▪ Application for environmental objectives 3) - 6) in January 2023

Source: European Commission Draft DA on Taxonomy Regulation, NORD/LB Markets Strategy & Floor Research

Technical screening standards: what's new?

The TSC are expected to allow financial market players to determine the degree to which their activities are compliant with the Taxonomy. If, having assessed their activities, they are compatible with the minimum safeguards and the Do No Significant Harm (DNSH) principle, their sustainability can be indicated on the market using the prescribed reporting practices. Financial products that currently qualify as sustainable are also affected by the latest regulatory developments as they must now undergo another review. Financial market players are obliged to report on the (pro rata) compliance of their activities with the Taxonomy at the end of 2021 for the first time and henceforth every year as well as in response to particular events. Since November 2020, the European Commission has been asking for feedback on the Draft Delegated Act from industry associations, in particular, as part of a public consultation process. In the process, far-reaching problems have been revealed, the majority of which point to criteria that are too ambitious and insufficiently justified, which threaten to choke the growth market for sustainable finance products before its breakthrough. There is also a consensus that EU Member States are being given too much leeway in transposing the rules into national law. This approach could prove to be a challenge in safeguarding a fair competitive environment in the European Union.

Real estate sector battling with classification standards

The aggregate primary energy requirement for building stock in the EU is responsible for more than a third of Europe's total CO_2 emission balance. To achieve the ambitious climate targets, the European Commission is focusing on the financial market, which has close links with the real estate sector, with the first Delegated Act. Following the European statistical classification of economic activities (NACE), the EU Taxonomy makes demands on the real estate sector in terms of acquisition, renovation and new construction. The new technical screening criteria envisage selection thresholds for the point at which a financing can actually be certified as making a significant contribution to a climate objective. No distinction is envisaged between residential and commercial property. Following the European Commission's call for evidence, many industry associations criticised the stringent requirements for sustainable properties. The Energy Efficient Mortgage Initiative (EEMI) created by the European Covered Bond Council highlighted the considerable impact on the critical mass of assets in the market in its consultation paper, use of which would be significantly reduced (up to 95%). Eligible mortgages and green bonds are also affected. There is an additional challenge with regard to the EPC rating-based approach. In principle, only buildings constructed after 2010 have such a rating, whereas 90% of the European building stock was actually constructed before 2001 – meaning that underpinning with EPC ratings is not an option for most buildings. A proposal by the EEMI therefore suggests that a dynamic approach should also be applied beyond the static consideration of the rating class. Following the example of the technical expert group (TEG) commissioned by the European Commission, this could be designed in the form of local benchmarking. The requirements would therefore be more realistically calibrated to local circumstances. However, the proposal by the TEG was not implemented in the current version of the Taxonomy.

Sustainability criteria in the real estate sector – an overview

	New build	Renovation	Acquisition
Assessment basis / threshold	A new build qualifies if the primary energy requirement (net) is 20% less than the existing NZEB requirements for low energy buildings prescribe. For buildings with more than 5000 m^2 floor space, a national standardised report must be prepared and published.	A renovation qualifies if one of the two conditions is met: 1.) It is a fundamental renovation according to Art. 2 EPBD 2.) Relative energy savings of 30% are achieved (measured in kWh pro m^2 per annum). The renovation must be accepted by an independent inspection body accredited by the regulator.	For properties constructed *after 2021,* the same criteria apply as to a new build. For properties constructed *before 2021,* they must have an EPC A rating at least.
	Minimum safeguards and DNSH principle are met.		

Source: European Commission Draft DA on Taxonomy Regulation, NORD/LB Markets Strategy & Floor Research

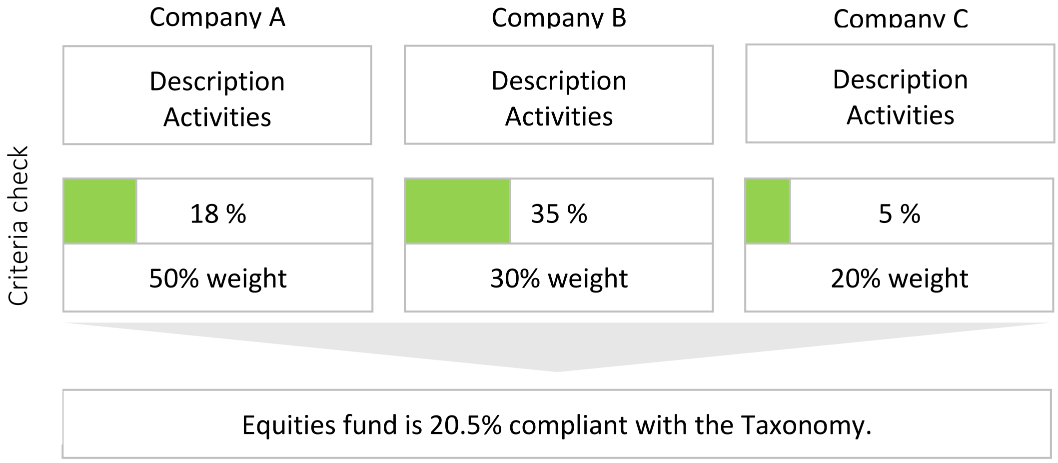
Investments in renovation projects reveal to be mostly unattractive

The EEMI also views the requirements for renovation as problematic. The immense cost of renovating inefficient buildings to comply with low energy standards is not appealing to investors, as it is much easier to implement sustainable financing projects with the new regulatory requirements in new builds. Consequently, there will be a growing stock of inefficient buildings requiring more and more investment. The International Capital Market Association (ICMA) questions the EPC A rating barrier outright in its consultation paper. It cites the fact that the current legal basis provided by the Energy Performance of Buildings Directive (EPBD) only constitutes general requirements, with the specifics being left to the EU Member States. The resultant flexibility allowed in implementing the requirements is detrimental to a level playing field and will make it more difficult to implement climate policy objectives anyway. Looking at the market for green bonds, the ICMA confirmed the fact that in most EU countries, including regions where green bonds are popular such as northern Europe, less than 1% of the building stock is Taxonomy-compliant. Given the evidence base, there is consensus among the industry associations that if the draft of the technical screening criteria is implemented in full, it is unlikely that the forecast economic benefits resulting from sustainable economic activities will materialise.

Portfolio structure of insurance companies is scarcely relevant to the Taxonomy
As providers of insurance-based investment products (IBIPs Regulation), German insurance companies are also directly affected by the obligation to disclose sustainable economic activities. To be able to declare sustainable activities, insurance companies must in future provide comprehensive details of their sustainable strategy and how it is geared to the Taxonomy. Specifically, the definition of quantifiable indicators on which sustainable and Taxonomy-focused investment is to be based, is envisaged. For example, pro rata Taxonomy-compliant fund units can be shown (for example (?): 20% of the fund invests in companies generating more than 50% of their revenue from Taxonomy-focused activities). The strategy to achieve the goals set is also to be disclosed. For example, the EU Taxonomy suggests addressing the future structure of portfolios through targeted commitments here. Annual reports (ICMA Resource Centre) are also expected to keep investors, policyholders and stakeholders up to date with the realisation and practical implementation of strategies. This also includes details of how much activities and investments comply with the Taxonomy at a given time. In its study dated July 2020, the European Insurance and Occupational Pensions Supervisory Authority (EIOPA) revealed that of its investment volume of EUR 11.4 trillion, the EU-wide insurance industry can only report 5% of all its direct investments as being Taxonomy-compliant on average. In the area of equities, 13% of the assets qualify, while 6% of corporate bonds are eligible. The German Insurance Association (GDV) also highlighted reasons for this in its position paper. The assessment basis for sustainability in insurance companies' portfolios currently only captures a small section of the fundamental investment universe for insurance companies. Government bonds and securities issued by financial institutions and banks are currently viewed as mainly climate-neutral and are therefore outside the focus of the Taxonomy. Consequently, there is a fear of misinterpretations on the market by investors, policyholders and stakeholders. The GDV also believes that it is within the realms of possibility that regulators could restrict the freedom of investment stipulated in the Solvency II Directive if the Taxonomy does not evolve with regard to insurance companies' fundamental portfolio structures.

Asset managers are required to disclose a comprehensive sustainability strategy
Demand for funds focusing on ESG investments from private customers has been booming for years and asset managers have responded by launching new ESG funds. According to a report produced by BlackRock in September 2020, at the moment 25% of the global potential in green bonds which have at least an investment-grade rating meet the requirements of the EU Taxonomy. Starting this year, European asset managers will also be obliged to provide details as to how they include sustainability risks in their own investment decisions and how the environmental objectives of the EU Taxonomy are specifically affected as a result. Key figures (e.g., revenue, capex, opex) are prescribed as the assessment basis for individual exposures. These figures help to determine and aggregate the degree of sustainability of individual portfolio elements. The target variable represents an overview of the percentage of investments that qualify for Taxonomy purposes at a specific point in time and is presented as a diagram below.

Determining compliance with the Taxonomy using the example of an equities fund



Source: European Commission Draft DA on Taxonomy Regulation, NORD/LB Markets Strategy & Floor Research

Asset managers see problems with green covered bonds

The European Fund and Asset Management Association (EFAMA) initially sees challenges for European asset managers with covered bonds and green mortgage bonds. In its consultation paper on the Delegated Act, it explains that the new TSC, in their current draft, are more likely to harm the European market for sustainable real estate than benefit it. The EFAMA believes that this is mainly due to the uneven implementation of EPBD guidelines, which are regulated at national level. These constitute the respective national policy for energy efficiency in buildings. EU countries, which already impose strict energy efficiency standards for their buildings, are likely to have more difficulty raising efficiency by the required 20% than EU States with less ambitious standards. Similarly to the consultation paper produced by the ECBC, the EFAMA also sees an urgent need for the European Commission to improve the measures relating to renovation. It claims that the first version of the incentive system in the Taxonomy is too weak to make a start on the target mass of core renovation projects. This will mean that mortgage financing, as the traditional financing vehicle, comes under pressure particularly. According to the current rules, renovation that has been financed sustainably can be shown to be compliant with the Taxonomy but not the value of the (consequently sustainable) building in its entirety. This will result in any financing being separated into sustainable and traditional parts, which is likely to complicate matters in future.

Regular amendment of the Taxonomy: an element of uncertainty

The regular amendment of the EU Taxonomy every three years is also associated with a systematic element of uncertainty. The general expectation from the market is that the European Commission will regularly make adjustments to the Taxonomy in future to achieve its ambitious long-term climate objectives. It is therefore uncertain which rules will apply precisely in three years. Specifically, the EFAMA warns that this uncertainty could flare up on the market for sustainable finance, especially in the areas of green bonds, loans, mortgages and the sustainable use of proceeds. To reduce this uncertainty, its suggestion for the final version of the TSC is that, for example, covered bond issuers should be allowed to invoke the case law applicable in each case at the time of the report.

ICMA Bond Principles update

Analyst: Michael Schulz, CIIA

Green Bond Principles update expected for Q1

Up to the end of 2018, the year in which the Green Bond Principles (GBP) were last revised, the Climate Bonds Initiative (CBI) estimated the cumulative global issuance volume of green bonds at the equivalent of over USD 500bn. Over the past two years, this has doubled meaning that the threshold of the equivalent of USD 1 trillion was exceeded in December 2020. Following updates of the Social Bond Principles (SBP) and Sustainability-Linked Bond Principles (SLBP) in 2020, an update of the GBPs, as the unit of the ICMA Bond Principles family with the largest number of issues, can be expected in the near future. The GBPs are voluntary guidelines for financial market participants for the issue of green bonds. The issuance proceeds may only be used pro rata or entirely to finance and refinance projects that generate added social value. The core structure is divided into four areas (use of proceeds, process for project evaluation and selection, management of proceeds and reporting), allowing the bond's sustainability and integrity to be clearly indicated to investors. In the run-up to the update of the GBPs expected this year, the ICMA consulted its members and stakeholders in November last year. The survey focused on the core areas of governance, green bonds and sustainability-linked bonds, impact reporting and the Guidance Handbook. As things stand currently, the consultation has not yet been followed by a new publication. The update of the GBPs is therefore expected in the current quarter.

Social Bond Principles extended in terms of project categories and target groups

The ICMA published the extension to the SBPs in June 2020 – barely two years after its last update. By providing the SBPs, its aim is to support issuers of bonds whose purpose is to raise funds for social projects and consequently drive growth in the market for social bonds. The basic structure of social bonds based on the model of the SBPs is, in principle, identical to the GBPs. The difference lies in the areas on which the project categories focus, namely those that produce a positive socioeconomic benefit in the case of the SBPs. In the updated version, two items were added to the social project categories, namely food security (sustainable nutrition systems) and socioeconomic development/empowerment. The target groups were also extended to include women and/or gender minorities as well as the aging population/vulnerable young people. To actively help tackle the COVID-19 crisis, the updated SBPs also provide amended guidelines for crisis management. Interested parties can also have recourse to an updated collection of Social und Sustainability Bond Case Studies.

Sustainability-Linked Bond Principles

Previously, green issues were largely based on the Green Bond Principles, where proceeds have to be used to finance projects that have been defined ex ante as sustainable. In contrast to this, issuance proceeds from the latest family member of the ICMA, the Sustainability-Linked Bond Principles (SLBP), can be used for general corporate purposes, which are focused on individually defined sustainability data and corporate objectives. These are also voluntary process guidelines aimed at promoting the development of the market for sustainable finance. Here, the financial and structural features of SLBs may vary depending on whether the issuer achieves his pre-defined sustainability performance targets or not. Surveys carried out by the ICMA refer emphatically to the demand on the market for bond instruments that are linked dynamically with an issuer's sustainability objectives beyond referring to a project. Accordingly, as a financial product that is deemed to be sustainable, SLBs could become established as a useful alternative for issuers that cannot issue green bonds or social bonds. They could also be used for transitional funding where the underlying investments could not previously be certified under established sustainable labels. This would allow transformations to a sustainable business model to be accomplished with sustainable financial instruments.

EU Green Bond Standard

Analyst: Michael Schulz, CIIA

EU Green Bond Standard to be introduced shortly

As part of the "Financing Sustainable Growth" action plan, the European Commission plans to introduce a European Green Bond Standard (GBS). It is also expected to be consistent with the EU Taxonomy. Specifically, the new standard is made up of four core areas, which are to introduce a common language for investors, issuers and legislators. To this end, the European Commission conducted a public and a closed consultation process in the first and second half of 2020 respectively as well as carrying out further bilateral stakeholder discussions. A decision in relation to the GBS based on the results was expected in Q4 2020 but, as at today's date, there has still been nothing published regarding this. It is expected that a statement will be published in connection with the update of the action plan to finance sustainable growth.

Development of the EU Green Bond Standard over time

Source: European Commission Draft DA on Taxonomy Regulation, NORD/LB Markets Strategy & Floor Research

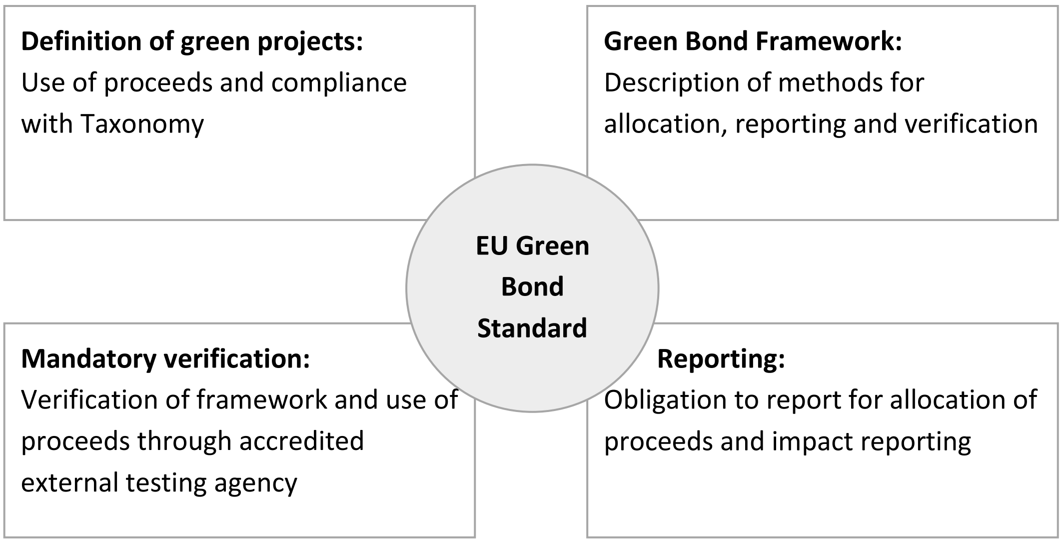
Introduction associated with substantial costs for issuers

As far as green bond issuers are concerned, the ICMA takes the view that implementation of the new GBS will impose disproportionately substantial costs on smaller issuers in the SME segment and on the retail segment as well as smaller financing projects in general. Issuers that wish to refinance their activities by issuing green bonds in accordance with the future GBS must check the project parameters individually for compliance with the minimum safeguards and the DNSH principle enshrined in the EU Taxonomy. In many cases, this process can be very time-consuming and expensive, especially as the industry associations have already reported that simply obtaining the relevant data is likely to become a problem. Some large issuers have already reacted by investing vast sums in IT and communication in anticipation of these requirements.

Industry associations insist on eased requirements for small issuers

To improve the market conditions for smaller financing projects, in its response to the consultation on the GBS, the ICMA suggests that the checks regarding minimum safeguards and the DNSH principle should not apply to this segment. EU regulations already in force, such as those relating to work, are sufficient for this purpose. Building on these problems, the ESMA sees the success of the EU GBS as being heavily dependent on whether it can establish itself as a reliable indicator for sustainability on the market. In its consultation paper, it therefore suggests establishing an EU-wide central unit for testing capacities, which will focus on future demand to guarantee that issues on the market are high quality. At this juncture, the ESMA also warns that market conditions for SMEs should not be overlooked. With regard to Europe's status as the current centre of global green bond issuance, the ICMA sees problems in transferring the GBS to other jurisdictions. The Taxonomy on which the GBS is based has been specially developed for European markets and jurisdictions. The wildly differing (in some cases) world regions in the global market for green bonds are also at different stages of development. If implementation in full of the EU Taxonomy is required for international issuers without guaranteeing the requisite degree of flexibility, this could significantly restrict international interest in the GBS label.

Target structure of the EU GBS



Source: European Commission, NORD/LB Markets Strategy & Floor Research

Rating agencies increase weighting of ESG factors

Analyst: Michael Schulz, CIIA

Moody's updates ESG assessment methodology

In its press release from December 2020, the rating agency Moody's announced that it would be updating its assessment methodology in relation to environmental, social and governance risks, which will replace the previous version from 9 January 2019. It stated that this will not affect existing ratings. Specifically, four key changes will be implemented in the update:

- Introduction of three new issuer profile scores for environmental (E), social (S) and governance (G) frameworks for government issuers in the first phase, with other sectors gradually being included
- Introduction of an ESG credit impact score (CIS), which, to start with, will also apply to government issuers and transactions as a means of illustrating the impact of ESG aspects on the rating compared with other key credit factors
- Publication of more detailed information on the framework of E, S and G profile scores
- Expansion of the general principles for assessing E, S and G risks

The inclusion of the new "E risk category" aims to depict environmental risks and international developments of environmental standards and disclosure agreements as well. The update preceded the "General Principles for Assessing Environmental, Social, and Governance Risks: Proposed Methodology Update" consultation in September 2020. The current version included the feedback from a total of 64 responses, of which 14 are available publicly.

Standard & Poor´s adds to its risk atlas

S&P Global Ratings will also adapt increasingly to the ESG trend in future. With this in mind, the in-house risk atlas, which forms the basis for ESG assessments, has been expanded. It compares global relative positionings with regard to environmental and social risks sector by sector. Regionally, the atlas provides analyses in relation to the risks of natural disasters, social standards and governance standards. To start with, an individual ESG profile is prepared that assesses the observable ESG risks and opportunities. Here, the important aspects are the way in which risks are mitigated and opportunities exploited though business activities. The next step is to assess an entity's ability to adapt to possible turbulence long term. The resulting scores are rated on a scale from "1" (low risk) to "6" (high risk).

Six new areas in the S&P risk atlas

The risk atlas has been amended to include public finances in the following areas. The aim is to improve comparability with the Global Industry Classification Standard (GICS).

- Supply networks
- Energy
- Real estate/public housing
- Services/education
- Transport infrastructure
- Healthcare

Existing scores have already been revised following the statement by S&P Global. The impact of the changes on issuers' ratings is likely to increase significantly, as the ESG rating is already at the root of the rating process. Looking forward to 2021, publication of Key Sustainability Factors for ESG Evaluations (KSFs) is planned, which are expected to provide more detailed information at sector level in principle. These in-depth analyses provide a summary of the relevant environmental and social topics per sector and provide ecological and social performance indicators (KPIs). The specific assessment and significance of the various environmental and social factors of the ESG assessment framework is also disclosed.

Fitch identifies governance as the most influential factor for ratings

In its trend report in January 2021, the rating service provider Fitch identifies trends that affect issuers' ratings across a variety of sectors studied. It established that ESG aspects will increasingly influence corporate strategies, financing and the operating environment with governance having the greatest direct influence on ratings. The results show that governance factors have the greatest impact on credit ratings in almost all rating groups among all ESG aspects. In the covered bonds and structured finance segment, Fitch has already reported 25 positive rating migrations. The assumption is that governance will remain the most significant driver for ESG ratings in the covered bonds and structured finance segment in future too. Growing interest in sustainability has sparked regular debates as to how corporate governance frameworks should be reformed in future to encourage responsible corporate conduct long term. In combination with more active participation by investors and the integration of defined sustainability objectives in sustainable financial instruments, Fitch expects ESG topics to exert an increasing influence on strategic and management decisions.

Outlook: Success of EU Taxonomy and GBS remains to be seen

Analyst: Michael Schulz, CIIA

Consistent consultation results call for relaxations

In 2021, key decisions regarding the future of the market for sustainable finance are taken through the finalisation of the TSC within the framework of the EU Taxonomy. The draft of the Delegated Act, which defines the first version of the TSC for sustainable economic activities, is causing concern in many respects among the industry associations. The biggest challenges are quite possibly those facing the market for green bonds because of its close links with the real estate sector. The consultation on the draft TSC carried out by the European Commission revealed that, from the perspective of the industry associations, there is a need for relaxation in many areas. Apparently, the core problem is that selection thresholds that are too strict or insufficiently justified could have a negative rather than a positive impact on the market. The counterproposals by the industry associations provide, above all, for a relaxation of the selection thresholds. Whether and to what extent the final version will differ from the current draft is a matter for the European Commission. The European Parliament has not given its consent following the publication of the draft TSC in November 2020. This must take place within four months. The deadline for a decision can, however, be extended by two months. In relation to the introduction of the EU GBS, which is planned for 2021, it remains to be seen how the new EU label will fare compared with the internationally established standards and frameworks. The key factors for the success of the EU GBS from an issuer perspective are practicability and the cost factor. Generally speaking, the European Commission's project was welcomed in the consultation papers produced by the industry associations and other stakeholders, who think the EU GBS will be beneficial. However, here too, concerns were highlighted especially because of its focus on the Taxonomy. In view of the global regulatory developments in the ESG field, rating agencies are also changing their approach. Accordingly, risks and opportunities arising from the ESG environment were already included in the existing assessment methodology or examined in greater depth. Some agencies have already revised existing ratings. Others are opting not to apply their more stringent assessment standards retrospectively. However, one thing is already certain: a company's sustainability strategy and implementation thereof has a major influence on its rating.

NORD/LB

Appendix
Publication overview

Covered Bonds:

- Issuer Guide Covered Bonds 2020
- Risk weights and LCR levels of covered bonds
- Transparency requirements §28 PfandBG
- Transparenzvorschrift §28 PfandBG Sparkassen **(German only)**

SSA/Public Issuers:

- Issuer Guide – Supranationals & Agencies 2019
- Issuer Guide – Canadian Provinces & Territories 2020
- Issuer Guide – German Bundeslaender 2020
- Issuer Guide – Down Under 2019

Fixed Income:

- ESG update
- Analysis of ESG reporting
- ECB holds course, but ups the ante – PEPP running until 2022
- ECB launches corona pandemic emergency
- ECB responds to corona risks

NORD/LB:
Markets Strategy & Floor Research

NORD/LB:
Covered Bond Research

NORD/LB:
SSA/Public Issuer Research

Bloomberg:
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Issuer / security	Date	Recommendation	Bond type	Cause