EU's Bond Issuance programme a 'Game Changer' for European Sustainable Financing – APG Webinar

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The European Union's decision to finance a third of its €750 billion Pandemic Recovery Fund with the issuance of green bonds marks a transformational 'game changer' in the development of deep and liquid ESG investment financing in the EU, to fight climate change and boost societal fairness, and its effects will ripple out across global capital markets, speakers at a recent webinar, hosted by Dutch institutional investor APG, predicted.

The Covid-19 Recovery Fund will turbocharge the emergence of a true European fixed income investment market, eventually creating a benchmark yield curve up to 30 years for the bloc's debt and boost the euro's role as an international reserve currency. The fund will also lift the EU's projected GDP by 3% by 2027 compared with what it would otherwise have been after the pandemic, Gert Jan Koopman, Director General of the European Commission's Budget Directorate said.

The €225 billion green bond issuance in the package will play a critical part in linking the fund to the EU's 'Green Deal' ambition to make Europe climate neutral by 2050, he told at APG's: *EU Sustainable Recovery* webinar. The Director General also announced that the European Commission will issue up to €100 billion in social bonds, starting this month, under its EU SURE bonds programme aimed at financing member states' national short-time

[1] By Steve Hays, Bellier (AXA) - version including APG remarks.

work schemes put in place as a response to the pandemic, in particular for the self-employed. The SURE issuance will triple the size of the European social bonds market.

"There is a lot of interest in the markets for a risk free European bond curve to materialise. Many investors from the U.S. and Asia say the Recovery Fund is a game changer for their investment strategies and will make them reassess allocations to Europe, not only in bonds, but also in equities. This will have a significant effect on the integration of European capital markets and the international role of the euro," Koopman concluded.

Recovery Fund could kick-in too late

Carsten Brzeski, Chief Economist Eurozone and Global Head Macro at ING, said there was a danger the dispersal of the Recovery Fund's proceeds, anticipated in the second-half of 2021, could come too late. Particularly if this was delayed by further objections from northern European governments, the main financers of the loans and grants, with the beneficiaries overwhelmingly in southern Europe, notably Italy and Spain.

Most western economies including those in the EU are experiencing a 'K-shaped' recovery from the crisis, with those countries in a more robust fiscal position going into the pandemic and less impacted by the virus in northern Europe faring better than others in southern Europe, he said. The same is true for companies, with those firms in sectors most exposed to social distancing measures like airlines and hospitality hit worst.

"I'm a bit afraid the Recovery Fund will come too late. We had a symmetric shock with an asymmetric impact on the southern European economies, while the northern economies had more fiscal power due to healthier public finances and better management in the past. All the ingredients for divergence. The Fund was set-up to calm financial markets, to be symbolic and tackle divergence between the northern and the southern countries. But before any money is given out and reaches the southern European economies, we are going to be in the second-half of 2021. Until then we will have more divergence. My biggest fear is that this divergence leads to new tensions in financial [2]markets," Brzeski said.

The role of institutional capital in financing Europe's ambitions

Geraldine Leegwater, Member of the Board of Trustees of ABP opened the institutional investors' panel by outlining the Dutch civil servants pension fund's new commitment to increase the target for Sustainable Development Investments to 20% of all assets in 2025. ABP's new responsible investment policy focuses on three key transitions in society: climate change and the transition to sustainable energy sources, conservation of natural resources and the digitalisation of society.

"At ABP we want to provide good returns for our participants, but also invest responsibly. We believe financial and societal returns can go hand-in-hand. That's why we invest so heavily in these instruments," she said.

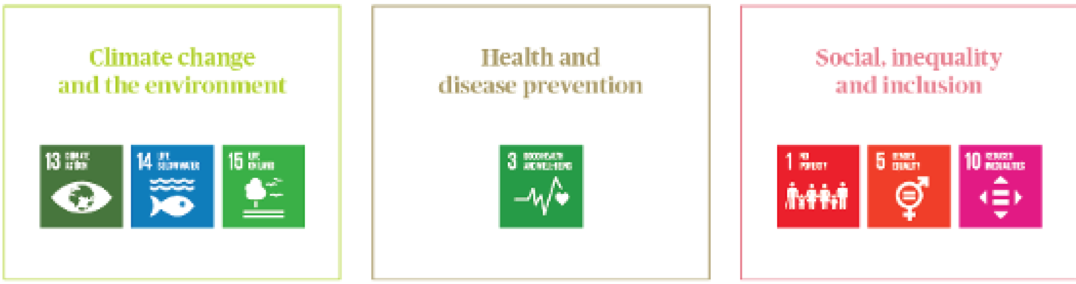
Pascal Christory, Chief Investment Officer at the AXA Group, said the insurer wanted to finance the energy transition, the societal transition and the Covid-19 recovery, by identifying and strongly backing the 'enablers.' These are the managements of companies leading the transition to a green and socially fair economy, but AXA is also prepared to accept "various shades of green," provided they show the commitment and have the capacity to implement their plans, he added.

"Through these investments we can steer our carbon footprint and AXA has committed to be 'net-neutral' in 2050. Therefore we have to take robust action now. We also want to avoid the risk of 'stranded assets' and believe green bonds from issuers that have been able to project themselves over the long term, will offer the strongest sustainable cash-flows," Christory said.

As with ABP, the AXA Group also has an ambitious strategic plan in which the insurer expects to have €24 billion of green assets invested in 2023, from €14 billion currently. Half the €10 billion to be invested in the next three years will be in green bonds, with a quarter in renewable infrastructure and a quarter in 'green real estate.'

Mikkel Svenstrup, Chief Investment Officer at ATP, said Denmark's largest pension and investment company is an active investor across its assets, from fixed income, to real estate and infrastructure, and wants to have influence over them pushing ownership in a green and social direction.

"ESG is an integrated part of the investment costs and green bonds fit perfectly. We want to have a good dialogue with the issuers and full transparency, which is a very important part of being an active owner. We're focused mainly on the government and SSA (Supranationals, Sub-sovereign & Agencies) side of green bonds, but not on corporate bonds, so we have a huge interest in this market," he said.



Institutional asset owners will resist paying 'greeniums'

All three institutional asset owners on the panel said they would hold the line on paying significant 'greeniums,' or premiums over standard debt in their green bond investments. Not least because In the future, as the supply of green and social bonds steadily increases, sovereigns, SSA and corporate issuers will find it increasingly difficult to attract capital from investors running greater portions of their portfolios based on internal, or external, ESG benchmark taxonomies – the science-based target (SBT) framework for classifying green investments, unless they adhere to these standards themselves.

AXA's Christory said: "There is a real trade-off between quality and quantity. We want to have certainty over the use of the proceeds of the bonds we invest in, but at the beginning the EU impact taxonomy was focusing on 'dark green' with really strict certification with very few projects qualified. Now it's very positive to see more and more transition 'enablers' can also qualify for this taxonomy to make the transition happen. At AXA we issued a 'transition bond' last year because we are convinced 'light green' companies wishing to transit should also be financed and it would be a shame if they did not receive the money to be able to do so."

AXA Group's CIO added he was heartened to see the global green bonds market had grown by 12% in the first nine months of 2020 alone and now stood at around $1.0 trillion, meaning it was well on the way to becoming a true investment asset class.

ATP's Svenstrup said the Danish investor was inspired by the green bond principles, but had gone further through developing its own green taxonomy and also following-up on how the proceeds of its investments have been used to make sure they have the impact intended.

"Our experience is that it (the green bond investment process) takes a lot of time and resources on our side and also the issuer's, so we welcome greater standardisation from the EU's taxonomy to get a clearer definition of what is green or not," he added.

ATP sees all of it investments as a risk/return trade-off and in general hasn't been willing to pay a green premium (greenium), although Svenstrup acknowledged that there was a clear risk in not being green encompassed in the threat of stranded assets. He noted that ATP hadn't invested in the German government's 30-year green bond issuance because there was a small greenium in these compared with the pricing of standard German bunds of the same duration.

Geraldine Leegwater elaborated on ABP 's view on transition bonds and the pension fund's preferences to have a conversation with issuers about their transition path, rather than bringing more labelled bonds to the market.

"We are reluctant to move into new type of bonds with new criteria, because we think standardisation is key and it is better to incorporate the current frameworks….We also don't want to pay a premium, because we look at all our investment in terms of risk, return and sustainability, as well as costs. We look at the full picture and then assess whether it's worth buying the bond….Although bonds that fit our SDI criteria do get higher attention and go through the first round of our investment assessment because of their social responsibility characteristics," she concluded.

Sustainable instruments for funding Europe's recovery

In the second parallel panel of the APG webinar, senior representatives from the debt issuing departments of the European Commission, European Investment Bank and Dutch government, discussed the sustainable instruments needed to fund Europe's recovery from the Covid-19 crisis.

Eila Krevi, Director and Head of the Capital Markets Department at the EIB, said the bank first became involved with green financing in 2002 with the issuance of climate awareness bonds, where the proceeds were allocated to renewable energy and energy efficiency projects. But it wasn't until about six years ago that high-tier political engagement kicked-in and large institutional investors became interested in the issue and engaged with their investor bases, taking the debate to a whole new level.

"It's coming to a type of fruition with the EU sustainability plan and the creation of the EU taxonomy. Now the whole market is involved you think you can change things. At some point it just takes you over," she said.

Elvira Eurlings, Agent at the Dutch State Treasury, said a study by the Dutch government in 2018 to see if green sovereign bonds were feasible concluded that it would really give the market a boost and lead to the creation of a solid new asset class.

"We weren't the first country issuing green bonds, but we were the first issuer to create a high quality green bond framework that other countries could take a look at for guidance," she said.

Serge Patou, Senior Expert-Portfolio Manager at the European Commission's General Budget Directorate, echoed Gert Jan Koopman in saying the EC's issuance of €350 billion in SURE social bonds and green Covid bonds would be a game changer for these markets.

"The EU is the new kid on the block, but with strong ambitions to further foster the creation of a social bond market, to give leadership and work with member states. We want to create a full dynamic dialogue and we're exploring very actively how to reach the target of 30% green bond issuance in the European recovery plan," he said.

Green bonds lead to 'joined-up' planning and deployment by government and SSA issuers

The Dutch Treasury's Eurlings said it was necessary to have a whole network of supportive "ambassadors" throughout the governmental structure to make green bond issuance a success because of the need to engage with a range of other ministries to ensure the most optimal allocation of the proceeds to the right projects and also proper controls.

"Stick to your plan, because demand is so high it's tempting to issue more and more, but we need to be accountable for where the money is spent. Don't change your green bond framework in the middle and add other strategies, so you strengthen your credibility with the investor community. When we issued green bonds we had only modest funding needs, but those have tripled now with the corona crisis," she said.

All the panellists said an underappreciated, but very important side effect of the strong growth in green bond issuance by governments and SSAs, was the way it built bridges between debt issuing and policy departments and other stakeholders, where people are eager to understand the mechanics and parameters of financing solutions to the greatest challenges of our time in Global Climate Change and social inequality.

The EIB's Elia Kreivi said: "The green bond issuance of 2007 created a lot of cohesion internally in the EIB. Previously we did not have a lot of contact with our technical experts on the lending side. Now we are in daily contact because we discuss how to develop a project and how to do this and that. It's a very positive thing bringing everyone onboard. Our expert colleagues learn about the capital markets function and we learn about so many things in environmental matters. It's like peeling an onion. You take one layer and then there's another, a third and a fourth. Everybody's knowledge base expands and that is a fantastic thing."

The EC's Serge Patou added that the same phenomenon of accelerating communication and collaboration could be seen in Brussels' and European member states' reaction and adaption to the Covid-19 crisis. The political resolution for the Pandemic Recovery Fund was made in March and the legislation adopted in June -- a speed record for the EU, he said.

Elvira Eurlings from the Dutch Treasury concluded: "We welcome the issuance by the European Commission of social and green bonds. The ultimate goal is to make more money for climate-related purposes. I'm not sure (green financing) through equities would be more effective than bonds. What we see from our roadshows is that issuing green bonds is also a podium for governments to have a dialogue with investors on the ESG agenda. It really enriches the dialogue on climate change."

Europe to be the world's first climate-neutral continent

The European Union has collectively decided that Europe will be the world's first "climate-neutral continent," which means by 2050 greenhouse gas emissions will have to go down to net zero and any residual emissions will have to compensated for through the 'carbon sink,' Antoine Colombani, BioMember of the Cabinet of the EC's First Vice President, Frans Timmermans, told the APG webinar in its concluding presentation.

"The EU's Green Deal is of momentous proportions and a massive structural change of the European economy, happening at the same time as other shifts such as the digital transformation, in what has been termed a new Industrial Revolution. But the Green Deal is also occurring as we are facing the deepest recession in Europe since the Second World War. Some are asking is this a too big a challenge, but it's certainly not a challenge we should try to escape from. In 2019, average global temperatures reached 1.1 degrees Celsius above pre-industrial levels and the devastation it can bring is not an abstract threat, in many ways it is already with us," Colombani said.