# European Banks – Quarterly ESG Update

- ESG-themed bonds continue to increase their share of total bond issuance
- The EU is set to become the largest green bond issuer in the world with its NGEU programme
- European Green Bond Standard and enhanced disclosure regulation set gold standards
- ESG bonds in the primary market become increasingly commonplace among sub-debt issuers
- 'Greeniums' at issue persist while only gradually levelling off in secondary due to increasing supply

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## Overview: ESG bonds increasingly becoming the norm

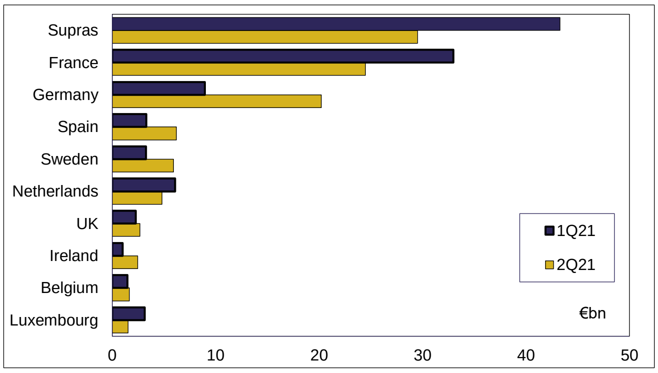
Issuance of ESG bonds – comprising green, social and sustainable bonds – continues to experience tremendous growth. Global ESG bonds in 2Q21 amounted to EUR225bn (2Q20: EUR91bn), taking the total for the first half of the year to EUR457bn (1H20: EUR149bn) and thus remaining on track to achieve our full-year projection of EUR850bn.

European ESG-linked bond sales from SSAs and FIGs reached EUR107bn in 2Q21 according to Bloomberg data. This represented an increase of 106% yoy. Of that total, green bond sales amounted to EUR47bn (+137% yoy), social bond volumes stood at EUR34bn (+62% yoy) and sustainable bonds accounted for EUR26bn (+135% yoy). Issuance of sustainability-linked bonds (SLB) by SSAs and FIGs, however, remained minimal in 2Q21 as regulatory concerns persist over their MREL eligibility. That market remains almost entirely driven by non-financial entities. Alongside Supras, France, Germany and Spain continue to lead the way in European ESG debt issuance.

ESG-themed bonds issued by European financial institutions reached EUR31bn last quarter compared to just EUR10bn in 2Q20, already matching 73% of total 2020 issuance and accounting for 33% of the global total in the sector. We also observed a steady increase in the overall proportion of euro-denominated ESG-themed debt in relation to total FIG and SSA issuance by European entities. One fifth of all debt was ESG-labelled in June, with occasional spikes of roughly 50% seen for SSAs in the preceding months.

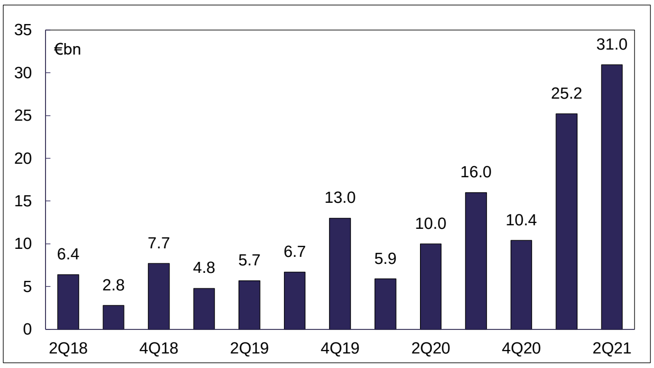
The pandemic and associated government stimulus plans have acted as catalysts for sustainable finance growth, particularly noticeable in the surge of social bond programmes. We expect these to remain integral within the ESG mix as FIGs and SSAs focus on a broader set of social issues such as affordable housing or SME business support. The rapidly developing regulatory and policy landscape in Europe is aiming to set a global 'gold standard', helping the region meet its climate goals and enabling green and sustainable bonds to carry forward momentum from previous quarters.

### European ESG Bond Issuance by Country



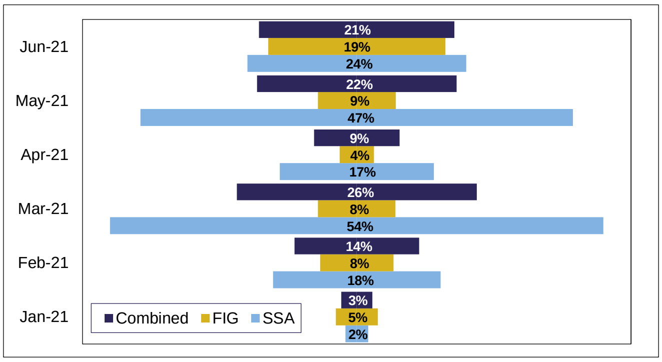

*Source: Bloomberg; includes FIGs & SSAs; Daiwa Capital Markets Europe Ltd.*

### Quarterly ESG Bond Issuance: European FIGs*



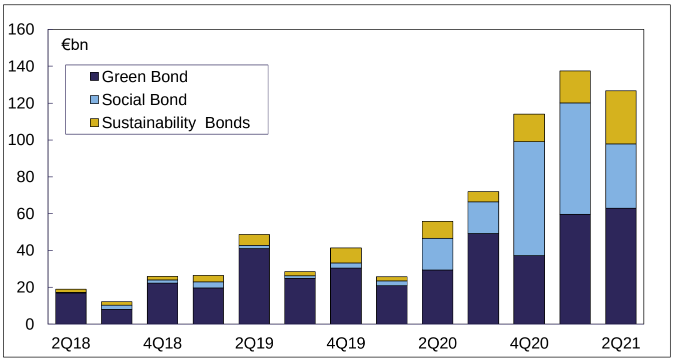

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.; *Green, social and sustainability labelled bonds >€250m.*

### Proportion of ESG themed debt to total issuance*




*Source: Bloomberg; Daiwa Capital Markets Europe Ltd.;*EUR denominated by European issuers*

### Quarterly European ESG Bond Issuance by Type



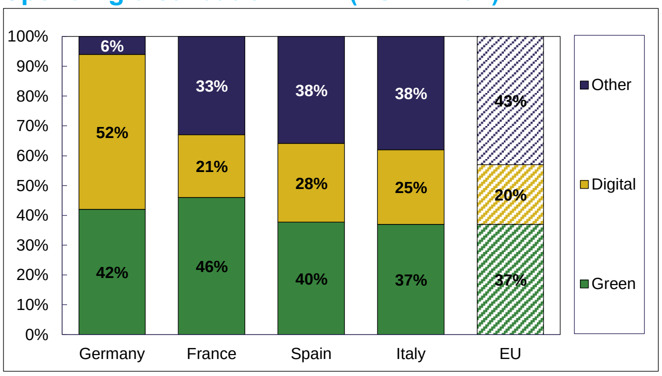

*Source: Bloomberg; Daiwa Capital Markets Europe Ltd.*

## NGEU makes the EU largest green bond issuer

The ratification of the EU's Own Resources Decision (ORD) by all 27 member states was completed at end-May 2021, establishing how the EU budget will be financed until 2027. It took more than two years to complete the procedure, which was given a sense of urgency as it was a pre-condition for the Commission to start borrowing for the Next Generation EU (NGEU) recovery instrument. Indeed, following ratification, the first set of bonds under NGEU were issued in June and July. So far, EUR45bn in funding has been realised of the planned EUR80bn for 2021, which will also be topped up with short-term EU-bills. An update of the funding plan will follow in September, when auctions will be launched, with an aim to issue via one syndication and one auction per month. Annual issuance volumes are expected to rise up to EUR150bn thereafter with an overall limit of EUR800bn by end-2026, with all funds to be repaid only by 2058. The Recovery and Resilience Facility (RRF) is the centrepiece of the NGEU, accounting for 90% of spending under the instrument, broadly evenly split between loans and grants to member states. The Commission made it a minimum requirement that 37% of spending needs will go towards climate investments and associated reforms, with 30% of NGEU bonds to be designated green bonds based on the ICMA green bond standard, making it the world's largest green bond scheme. 20% of the funds are aimed to facilitate increased digitalisation. The national plans of Europe's four largest economies show that their green spending alone will amount to roughly EUR128bn of the EUR326bn applied for. In nominal terms lending is skewed towards Italy (EUR192bn) that has applied for loans as well as grants while the three other countries have only applied for grants thus far. Indeed, with the highest-rated governments unlikely to apply for loans, total NGEU issuance will ultimately fall short of the EUR800bn total.

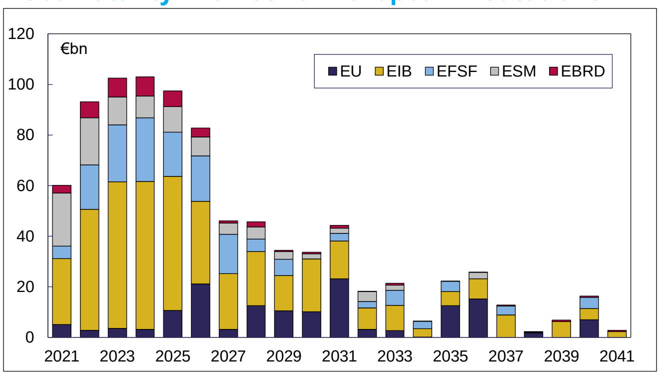
The NGEU comfortably makes the EU the largest SSA issuer in Europe for the foreseeable future. However, it is debatable whether this will position EU bonds as euro area public "safe assets", i.e. top-rated liquid assets with benchmark status that can also promote financial integration and stability, and enhance the effectiveness of monetary policy. With the SURE programme mostly funded, and certain leaders, not least in Germany, underscoring the temporary nature of the NGEU, the market might doubt that EU borrowing will become a permanent fixture. Recently however, some other senior EU figureheads have suggested that policymakers will draw lessons from being a regular capital markets issuer and that the success of the current programmes could determine whether they might become permanent features of the European policy arsenal. After all, a precedent has been set and debt-financed fiscal stabilisation at the European level could be a valuable policy tool to address future crises beyond 2026. Nevertheless, reluctance towards burden-sharing by some countries may in part explain why the EU currently trades above permanent European institutions and some high quality sovereign issuers such as Germany.

### Spending distribution RRF (EUR724bn)



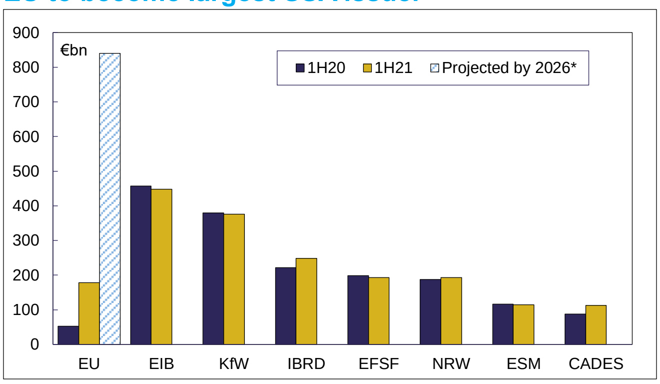

*Source: European Commission; Daiwa Capital Markets Europe Ltd.*

### Debt Maturity Profiles for European Institutions



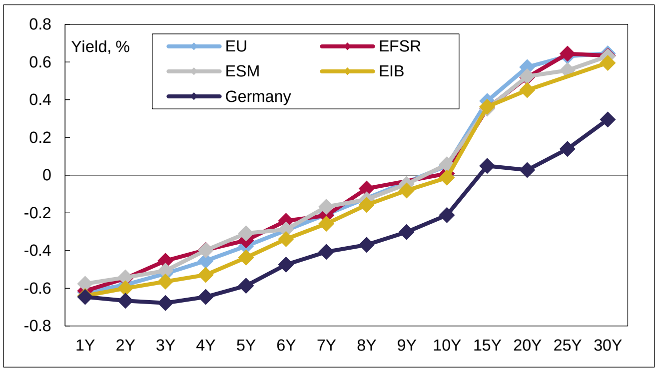

*Source: Bloomberg; Daiwa Capital Markets Europe Ltd.*

### EU to become largest SSA issuer




*Source: Bloomberg; Daiwa Capital Markets Europe Ltd.*

### Yield Curves of major European Institutions




*Source: Bloomberg; Daiwa Capital Markets Europe Ltd.*

## Regulatory Developments: Enhanced disclosures and GBS at heart of Sustainable Finance Strategy

A whole host of measures have now been implemented to enact the European Union's 'Action Plan on Sustainable Finance' formulated in 2018. Measures include the EU Taxonomy, the Sustainable Finance Disclosure Regulation (SFDR) as well as the European Green Bond Standard (GBS). Most recently, the EU adopted its 'Sustainable Finance Strategy' in July 2021 aiming to support the flow of finance for the transition to a sustainable economy. The scale of investments required to reach the EU's sustainability goals is beyond that of the public sector alone, thus requiring private financial flows into relevant activities. Among other things, the package includes: i) a delegated act supplementing article 8 of the EU-Taxonomy regulation; ii) a strategy for financing the transition to a sustainable economy; and iii) a proposal for an EU Green Bond Standard. A stocktake by June 2023 will assess the contributions of EU member states and financial institutions (incl. asset managers, pension funds, banks and insurers) to eliminating net carbon emissions by 2050. The ECB will then calibrate the appropriate pace for the transition by setting intermediate targets for the sector.

The aforementioned delegated act specifies the information to be disclosed by financial and non-financial entities within the scope of the Non-Financial Reporting Directive (NFDR). Disclosure requirements include the impact of a company's activities on the environment and society, and the business and financial risks faced by a company due to its sustainability exposures (the 'double materiality' concept). At present, NFRD applies to 'large public interest entities' with more than 500 employees and transferable securities traded on an EU regulated market, among other things. However, the Commission proposes to extend the scope of NFRD under its proposal for a Corporate Sustainability Reporting Directive (CSRD) to encompass all 'large companies' that meet two of the following three criteria: Balance sheet total of EUR20m; net turnover of EUR40m; or an average number of employees of 250 during the financial year. The delegated act will be subject to a scrutiny period of four months by the EU Parliament and Council.

**EU sustainability disclosure regime for financial and non-financial companies**

| Instrument | Corporate Sustainability Reporting Directive (CSRD) | Sustainable Finance Disclosure Regulation (SFDR) | Taxonomy Regulation |
|---|---|---|---|
| **Scope** | All EU large companies and all listed companies (except listed micro enterprises) | Financial market participants offering investment products, and financial advisers | Financial market participants;<br>all companies subject to CSRD |
| **Disclosure** | Report on the basis of formal reporting standards and subject to external audit | Entity and product level disclosure on sustainability risks and principal adverse impacts | Turnover, capital and operating expenditures in the reporting year from products or activities associated with Taxonomy |
| **Status** | Under negotiation; expected to apply from 2023 | Applies from 10 March 2021 | Applies from January 2022 |

*Source: European Commission*

The European Green Bond Standard is a voluntary standard to help scale up and raise the environmental ambitions of the green bond market. Based on the recommendations of the Technical Expert Group on Sustainable Finance it aims to set a gold standard for how companies and public entities can use green bonds to raise funds while meeting stringent sustainability requirements. It also sets a benchmark against which other market standards can be compared and aligned. In an attempt to stamp out greenwashing, the GBS defines what 'green' is, and bonds issued under the standard must have proceeds dedicated to green activities as classified by the EU Taxonomy of Sustainable Economic Activities. These can include projects that are not yet Taxonomy compliant but will be within five years, provided the issuer plans to achieve that compliance. This gradual progression towards greenness is a nod towards transition finance, recognising the support needed for activities that are not yet green but plan to be. This gives flexibility to transitioning issuers and expands the pool of securities that align with the Taxonomy, addressing a key concern in sustainable finance which is the limited pool of eligible assets. However, practical considerations suggest that investors would only accept gradual alignment with Taxonomy criteria for longer-dated bonds as non-compliance could result in GBS labelling being revoked.

## Regulatory Developments: EBA provides clarification on SLBs and ESG regulatory capital

Innovation in ESG debt can spur growth for the segment and access a broader investor base. Berlin Hyp broke ground when it launched the world's first sustainability-linked bond (SLB) in the FIG space showing that what was already commonplace among corporates could also have a place among financial institutions. However, regulatory concerns over MREL eligibility have forced potential issuers to rethink their approach. Typically embedded in these SLB's are coupon step-ups or fees tied to specific KPI's that run contrary to current MREL regulation. This has prompted Berlin Hyp to specifically remove any MREL language from the documentation to avoid discussions on eligibility. In a recent note, the EBA stated that, at this stage of its monitoring, these step ups should not be allowed or encouraged, as they could be regarded as incentives to redeem, hence contradicting the eligibility criteria for own funds and eligible liabilities and potentially compromising the loss absorbing capacity of the issuance. The EBA will continue to monitor and assess these features going forward. The EBA also highlighted that, for investor awareness, documentation should also highlight that resolution tools, write-down mechanisms and bail-in powers apply equally to all notes, including those that are issued as ESG bonds (i.e. no impediment to resolution). In this context, for ESG AT1's, documentation should specify coupon cancellation risk and state that cancellation does not constitute an event of default. These statements should make the format more appealing.

## Primary markets in 2Q21

| SSA - Top 10 European ESG Issuers 1H21 | | |
|---|---|---|
| Issuers | Total Issued (€m)* | Average Tenor (years) |
| European Union | 46,137 | 14.4 |
| CADES | 26,248 | 6.7 |
| IBRD | 10,687 | 7.1 |
| France | 9,280 | 23.3 |
| Italy | 8,500 | 24.1 |
| UNEDIC | 8,000 | 12.8 |
| Germany | 6,000 | 29.2 |
| EIB | 5,744 | 8.3 |
| KfW | 5,685 | 4.3 |
| NRW | 3,500 | 15.0 |

*Source: Bloomberg, *Cumulative issuances 1H21*

Second quarter **SSA** volumes reached EUR72bn of which 43% had a social bond indicator, 29% were sustainability bonds and 28% were green. Among SSAs, the disproportionally large increase in social bond volumes in recent quarters was driven primarily by pandemic-related financing needs, while issuance remained concentrated among a few participants such as the EU (46% of SSA social bond total), CADES (24%) and UNEDIC (16%). With broad-based vaccine rollouts in Europe expected to enable a gradual return to normal economic activity, we have seen the use of proceeds of social bonds pivot away from programmes aimed at mitigating unemployment risk, such as the EU's SURE scheme. Instead, we have observed a shift towards affordable housing, small business support, pandemic recovery and gender and racial equality. The EUR45bn issued under the NGEU to date (June: EUR35bn; July: EUR10bn) do not carry an ESG label, yet despite this the EU sits on top of the SSA ESG issuer list in 1H21 due its social bond issuance carried out earlier in the year. Nevertheless, 30% of the NGEU will go towards green bonds, amounting to up to EUR250bn, which may start as early as 3Q or 4Q 2021. This will establish the European Union as the biggest issuer of sustainable bonds globally.

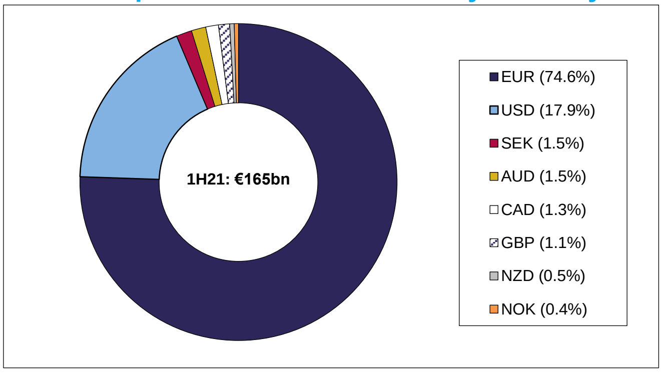
Outside of the Eurozone, the UK government was the first to commit to a net zero economy by 2050 back in June 2019. Enshrined in law, this was the most ambitious commitment by a major economy. The UK government's Green Financing Framework was published on 30th June 2021, in line with the ICMA Green Bond Principles. The principles will be adjusted once the government has established its own green Taxonomy with the help of the Green Technical Advisory Group (GTAG). GTAG met for the first time in June 2021 and is expected to provide initial recommendations to the UK government by September 2021. However, a UK green Taxonomy is not anticipated to be established before next year. The green framework also contains some innovative features such as the world's first green retail product, the Green Savings Bond, which is to be issued through National Savings and Investments (NS&I). These will allow individuals to support green projects the same way institutional investors do through sovereign green bond purchases.

To date UK ESG issuance across all sectors lags behind that of continental peers. So far in 2021, YTD UK issuance has been less than 40% of that of France and Germany with GBP6.95bn issued across 21 green bonds. It appears as though the GBP market is less developed than other bond markets as Sterling contributed just 1.1% of total 1H21 ESG issuance among SSAs. In part, this owed to the fact that the UK government, compared to many of its continental peers, has not issued a green sovereign bond yet. However, under its recently published green bond framework the government has committed to issue at least GBP15bn of green gilts during the current financial year, as well as build out a green curve in coming years. The first ever UK green government bond is expected to land in September with a second transaction to follow later in 2021, subject to investor demand and market conditions.

Total **FIG** ESG supply continued to grow strongly to EUR35bn in 2Q21 (+17% qoq) outpacing any previous quarter in terms of volumes, bringing the 1H21 total to EUR66bn. Primary market activity was somewhat back-loaded during the quarter with 46% of all deals taking place in June, 36% in May and 18% in April. Issuers took advantage of tighter spreads and lower premiums on bail-inable debt towards the latter stage of the second quarter, which saw a continued emphasis on senior-non preferred issuance. Notable issuers and transactions include:

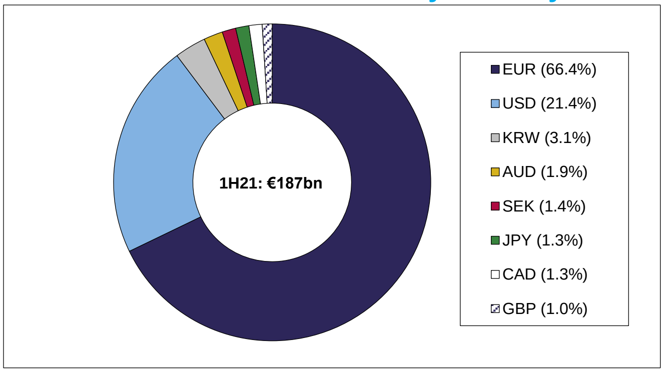
- **Caixa Bank** – Following a series of large-ticket ESG issues, Spain's largest bank heads our ESG leader board for 1H21. Caixa issued EUR2bn in ESG debt during the first quarter split across one SNP and a subordinated deal and also issued EUR1.58bn in 2Q21 across two SNP bonds. In May, Caixa issued its first deal after its merger with Bankia, building out its social bond curve with a 7NC6, EUR1bn SNP. The deal will primarily help finance loans

**1H21 European ESG SSA issuance by currency**




*Source: Bloomberg; 8 largest currencies Daiwa Capital Markets Europe Ltd.*

**1H21 Global ESG SSA issuance by currency**




*Source: Bloomberg; 8 largest currencies Daiwa Capital Markets Europe Ltd.*

to SME's in some of Spain's poorest regions while also funding micro-loans to low-income households, healthcare facilities and education. This is Caixa's third social bond alongside its EUR1bn SNP and SP bonds earmarked for Covid-19 related loans. In May, Caixa also completed its first public issuance in a non-Euro market in SNP format. The bank tapped the Sterling market for GBP500m with a green SNP fixed to floating rate note (5.5NC4.5; G+132bps).

| FIG - Top 10 European ESG Issuers 1H21 | | |
|---|---|---|
| **Issuers** | **Total Issued (€m)*** | **Average Tenor (years)** |
| Caixa Bank | 3,582 | 7.7 |
| LBBW | 2,166 | 7.9 |
| BPCE | 1,500 | 9.5 |
| CTP NV | 1,500 | 6.0 |
| DNB Boligkreditt | 1,500 | 10.0 |
| ING Groep | 1,429 | 9.4 |
| Swedbank | 1,407 | 6.2 |
| Bank of Ireland | 1,250 | 8.2 |
| Intesa Sanpaolo | 1,250 | 7.0 |
| Berlin Hyp | 1,113 | 8.9 |

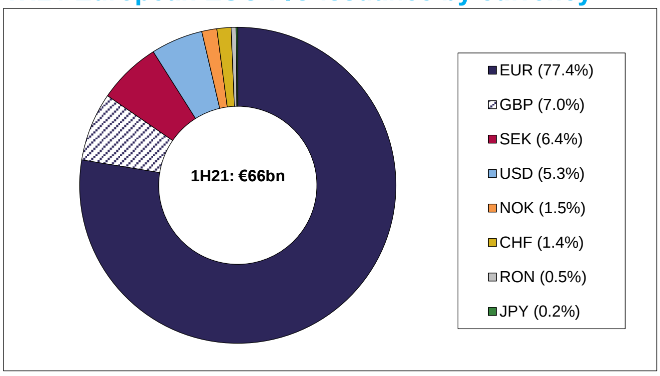
*Source: Bloomberg, *Cumulative issuances 1H21*

- **UBS** – The Swiss lender launched its Green Funding Framework on 16th June, which was aligned with the recently updated ICMA 2021 Green Bond Principles, and shortly after priced two senior green bonds. The bank launched its inaugural green senior OpCo bond for EUR500m (WNG). Backed by strong investor demand the issuer only narrowly avoided negative yield territory (0.05%) as the spread on the 5-year deal settled at MS+30bps (-20/25bps from IPT). The tight valuation led to some attrition in the order book that nevertheless reached EUR1.15bn (2.3x). It was one of the tightest spreads for a senior transaction in the last two years, implying a 4-5bps greenium compared to UBS's conventional curve.
- **UniCredit** – Italy's second largest lender issued its first green bond under its recently launched sustainability bond framework, allowing the bank to also issue labelled debt out of its key German and Austrian subsidiaries. The EUR500m, 8NC7, green SP is ICMA aligned and attracted strong final book orders of EUR2.7bn (5.4x) leading to a final spread of MS+90bps. According to UniCredit, it is likely that the next ESG issues will come from its aforementioned subsidiaries in the Pfandbrief format. UniCredit identified EUR8bn eligible ESG assets across the group that could lend themselves towards future issuance, 61% of which were identified for social transactions and the remainder for green deals. Although the transaction priced in June, the settle date was set for 5th July and therefore doesn't count towards our quarterly ESG count.
- **Berlin Hyp** – The German real estate and mortgage bank was the first worldwide to issue a sustainability-linked bond (SLB) in the FIG space. The bond was launched in SP format for EUR500m and it took several months to collect environmental loan book data, determine relevant ESG criteria and develop performance indicators that would ultimately allow investors to assess whether or not Berlin Hyp was meeting its pledge to reduce the carbon footprint of its loan book by 40% over the next 10 years. Should the issuer not be able to meet this pledge it will pay an extra 25bps on the final coupon of its 10-year SLB. Despite the innovative format, demand for the issue was modest (1.58x), likely due to tight pricing at launch resulting in a final spread of MS+35bps (-15bps from IPT). Berlin Hyp specifically removed any MREL language as to avoid discussions on eligibility, as eligible issues are currently not permitted to contain redemption incentives, compromise their loss absorbing capacity or include features that may change interest based on credit standing or accelerated payment features. It remains to be seen how SLB's will evolve in the FIG space and whether regulators will eventually permit their use for loss-absorption. A clarification from the EBA in June suggests that the format will require adjustments in order to align itself with EU capital standards.

ESG-themed **subordinated FIG** deals saw a surge in activity over the second quarter. 2Q21 issuance rose to EUR4.9bn (+209% qoq) bringing the 1H21 total to EUR6.5bn. This is a significant development as volumes already surpassed 2020 totals of EUR5.2bn. The development was spurred by lower price sensitivity for these types of instruments, which helped issuers achieve significant greeniums compared to their conventional counterparts.

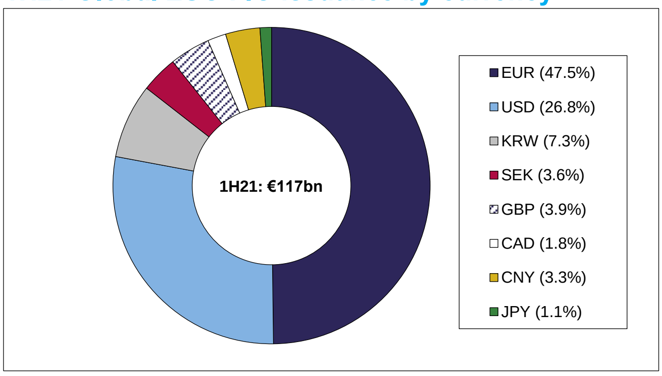
- **Bayern LB** – In June, the bank issued its first green Tier 2 bond in Euros that priced very tightly. The EUR500m bond with a maturity of 10.25NC5.25 priced at MS+135bps (-30bps from IPT) backed by book orders of EUR2.2bn. The green nature of the bond helped reduce the premium that has historically existed between German Tier 2 bonds compared to those of other core European markets. The issuance followed BayernLB's launch of its green commercial paper programme back in January 2021, one of the first in Europe, as well as its February debut green SNP.

**1H21 European ESG FIG issuance by currency**




*Source: Bloomberg; 8 largest currencies Daiwa Capital Markets Europe Ltd.*

**1H21 Global ESG FIG issuance by currency**




*Source: Bloomberg; 8 largest currencies Daiwa Capital Markets Europe Ltd.*

- **ING Group NV** – Dutch lender ING launched its first green subordinated transaction through a EUR500m Tier 2 bond in early June. ING has already issued six senior transactions from its green bond programme launched in November 2018. The green Tier 2 had a maturity of 11NC6 and settled at a spread of MS+115bps (-25bps from IPT). Based on comparable securities issued by ING a greenium of 5bps was inferred for this transaction.
- **Raiffeisen Bank International (RBI)** – The Austrian bank was an early adopter of ESG-labelled debt and launched its green bond programme back in 2018. It has become Austria's largest issuer of green bonds and as per its most recent June 2021 Green Bond Update, the bank had a green loan portfolio of EUR1.4bn. RBI recently launched its inaugural green Tier 2 for EUR500m with a 12NC7 maturity. The spread tightened 30bps to MS+160bps due to strong investor interest (4.4x) and the deal priced 10bps within fair value to its vanilla curve.

(Table 1) Key ESG Transactions – 2Q21

| Bank | Rank | Amount | Maturity | Final Spread (bps) | IPT (bps) | Book Orders |
|---|---|---|---|---|---|---|
| **SSA** | | | | | | |
| European Union (SURE) | Sr. Unsecured (Social) | EUR6bn | 25Y | MS + 17 | MS + 19 | >EUR37.5bn |
| European Union (SURE) | Sr. Unsecured (Social) | EUR8.14bn | 8Y | MS – 2 | MS +/- | >EUR51.2bn |
| CADES | Sr. Unsecured (Social) | EUR4bn | 5Y | OAT + 15 | OAT + 16 | >EUR9.4bn |
| AFD | Sr. Unsecured (Sustainable) | EUR1.5bn | 7Y | OAT + 18 | OAT + 20 | >EUR2.75bn |
| ICO | Sr. Unsecured (Green) | EUR500m | 6Y | SPGB + 6 | SPGB + 10 | >EUR2bn |
| Unedic | Sr. Unsecured (Social) | EUR2bn | 15Y | OAT + 10 | OAT + 12 | >EUR5bn |
| World Bank | Sustainable Development Bond | USD2.5bn | 5Y | MS + 2 | MS + 2 | >USD3.1bn |
| BNG Bank NV | Sr. Unsecured (Sustainability) | EUR2bn | 12Y | MS - 3 | MS +/- 0 | >EUR3.2bn |
| IFFIm | Sr. Unsecured (Vaccine Bond) | USD750m | 5Y | MS + 11 | MS + 11 | >USD1bn |
| EIB | Sr. Unsecured (Climate Awareness Bond) | NOK1.5bn | 6Y | MS – 9.5 | MS – 9.5 | n.a. |
| **FIG (Senior)** | | | | | | |
| Banco de Sabadell | SNP (Green) | EUR500m | 7NC6 | MS + 115 | 3mE + 70 | >EUR1.5bn |
| DeVolksbank | SNP (Green) | EUR500m | 5Y | MS + 65 | MS + 80/85 | >EUR1.1bn |
| La Banque Postale | SNP (Social) | EUR750m | 10Y | MS + 70 | MS + 90 | >EUR1.1bn |
| Banco Santander SA | SNP (Green) | EUR1bn | 8NC7 | MS + 78 | MS + 108 | >EUR2.5bn |
| Credit Mutuel | SNP (Green) | EUR750m | 7Y | MS + 40 | MS + 60/65 | >EUR1.55bn |
| Caixa | SNP (Social) | EUR1bn | 7NC6 | MS + 100 | MS + 120/125 | >EUR1.85bn |
| UniCredit | SP (Green) | EUR1bn | 8NC7 | MS + 90 | MS + 90/95 | >EUR2.7bn |
| Berlin Hyp | Sr. Unsecured (SLB) | EUR500m | 10Y | MS + 35 | MS + 50 | >EUR790m |
| Erste Group Bank | SP (Sustainability) | EUR500m | 7Y | MS + 35 | MS + 60 | >EUR1bn |
| Swedbank | SNP (Green) | EUR1bn | 6NC5 | MS + 57 | MS + 80 | >EUR1.8bn |
| **FIG (Subordinated)** | | | | | | |
| RBI | Tier 2 (Green) | EUR500m | 12NC7 | MS + 160 | MS + 190/195 | >EUR2.2bn |
| ING Groep NV | Tier 2 (Green) | EUR500m | 11NC6 | MS + 115 | MS + 140 | >EUR3bn |
| BayernLB | Tier 2 (Green) | EUR500m | 10.25NC5.25 | MS + 135 | MS + 165 | >EUR2.2bn |
| Bank of Ireland | Tier 2 (Green) | EUR500m | 10.25NC5.25 | MS + 165 | MS + 185 | >EUR1.8bn |

*Source BondRadar; Bloomberg; Daiwa Capital Markets Europe Ltd.*

## Secondary markets in 2Q21

For the most part, funding conditions remained robust throughout 2Q21 and issuers took advantage of this by increasingly accessing the sub debt space towards the latter part of the quarter. In June, the ECB's Governing Council extended its net asset purchases throughout 3Q21at a "significantly higher pace" than at the start of the year. There was little volatility in the rates market following the meeting and with sizeable supply from the EU via its NGEU offering this contributed to further spread tightening in Euros. The ECB's GDP and inflation outlooks were revised upwards but inflationary pressures are expected to remain transitory. In July, the ECB announced a new symmetric 2% inflation target and revised its forward guidance to underscore that no rate hikes are likely for a number of years to come.

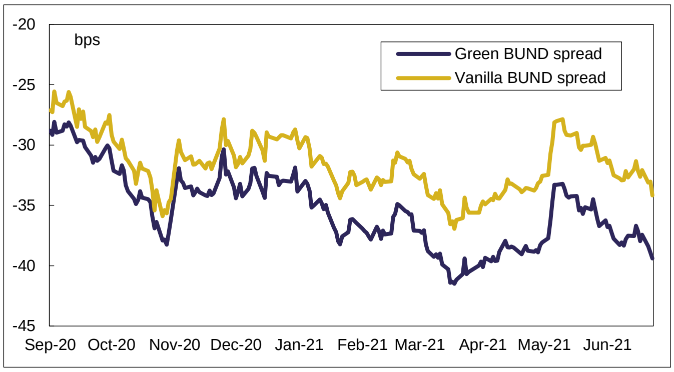
In June, Federal Open Market Committee (FOMC) members also raised their near-term forecasts for growth and inflation and brought forward their projection for the timing of the first hikes in the Fed Funds Rate. The median view of the FOMC foresees two rate hikes to take place in 2023, while seven members of the Committee now predict a hike in 2022. That news temporarily, yet significantly, impacted the US Treasury curve.

Lastly, the BoE left its policy stance unchanged, agreeing to continue its gilt purchase programme, and reiterated that it does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably. Despite some hawkish comments from a couple of MPC members, near-term inflationary pressure is expected to be "transitory" and considering additional headwinds from the delta Covid-variant pre-emptive tightening of monetary policy still looks unlikely.

Option adjusted spreads (OAS) for ESG and non-ESG themed indices appeared to be levelling off over 1H21 as funding conditions were largely accommodative, especially during 2Q21. The median negative OAS between Barclays MSCI

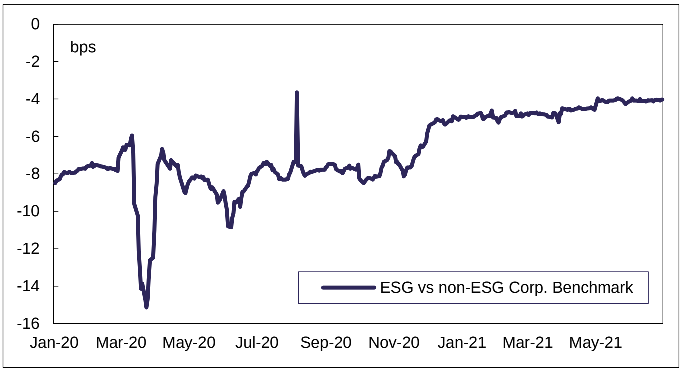
Euro-Corporate ESG Index and Barclays Pan-European Aggregate Corporate Index over the observation period was -7.46bps (at 1Q21: -7.64bps). Rising supply of ESG labelled debt in both senior and subordinated markets and the subsequent share increase of labelled bonds as a proportion of overall debt could be a driver of the benchmark OAS differential narrowing. However, we also note that the greenium for liquid sovereigns such as German BUNDS remains in place compared to their conventional curve. Over the course of 2Q21 the median spread differential even widened to -5.2bps (1Q21: -4.2bps). The greenium was reaffirmed in May when Germany priced another green bond. The EUR6bn, 30 year bond settled 2bps inside fair value of its conventional twin.

### Green vs Vanilla BUND Z-spreads




*Source: Bloomberg; Daiwa Capital Markets Europe Ltd.*

### Spreads (OAS) of ESG vs non-ESG benchmarks




*Source: Bloomberg; Barclays MSCI Euro-Corporate ESG Index vs Barclays Pan-European Aggregate Corporate Index*

## Appendix:

### Regulatory Timeline

**2Q-21**

- EC adopted first Taxonomy DA (climate change adaption/ mitigation)
- EC adopted SFDR RTS (Art. 8 & 9, PAI)
- EC launched EU Green Bond Standard proposal under renewed Sustainable Finance Strategy
- EC amends DA on sustainability preference, fiduciary duties and product governance (UCITS, AIFMD, MIFID II, IDD, Solvency II)
- EC launched CSRD (revising current NFRD)
- EC launched consultation on CBAM/EU-ETS proposals
- EBA published report on integration of ESG in risk management
- EC adoption of Sustainable Corporate Governance expected
- BoE published Climate Biennial Exploration Scenario and Green Finance Framework

**3Q-21**

- ESAs to develop draft RTS on content, methodologies, presentation of sustainability indicators for securitisation disclosure
- BCBS to consult on integration of climate risks in Basel Framework
- EBA to publish final draft ITS on Pillar III disclosures
- EC to launch proposal on ESAP
- IPSF to publish reports on Common Ground Taxonomy Report and Report on sustainability related disclosure

**4Q-21**

- EBA to publish sustainable securitisation framework
- EBA to publish 2020 pilot climate sensitivity analysis results
- IFRS details on creation of Sustainability Standards Board
- EC to adopt Taxonomy DAs for remaining four environmental objectives
- Review of Taxonomy Regulation and Report on min. social safeguards

**1Q-22**

- EC JRC to publish final criteria for Ecolabel
- ECB to conduct supervisory review of bank practices, based on 2021 self-assessment
- ECB to conduct supervisory stress-test on climate-related risk

**2Q-22**

- EC to publish draft review of the Shareholder Rights Directive II
- EU Platform to publish report on application of Taxonomy Regulation

**3Q-22**

- EU Platform to publish a report on updating criteria for all six environmental objectives

*Source: Association for Financial Markets in Europe (AFME)*
*Glossary Regulatory Abbreviations: (EC): European Commission; (BCBS): Basel Committee on Banking Supervision; (ESAP): European single access point; (EU Platform): European Platform on Sustainable Finance; (RTS): Regulatory Technical Standards; (SFDR): Sustainable Finance Disclosure Regulation; (CSRD): Corporate Sustainability Reporting Directive; (DA): Delegated Acts; (NFRD): Non-Financial Reporting Directive; (CBAM): Carbon Border Adjustment Mechanism; (EU-ETS): EU Emissions Trading System; (BoE): Bank of England; (JRC): European Commission Joint Research Centre; (PAI): Principle Adverse Impact; (ITS): Implementing Technical Standards*

# Credit Research

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As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.

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3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of Y10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
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- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
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