Green Bonds and Sustainable Securitisation

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"GREEN BONDS AND SUSTAINABLE SECURITISATION – THE MARKET PARTICIPANTS' VIEW"

The recent agreement by the EU bodies on the principles of the European Green Bond Standard has put the spotlight on the current status of the market for green bonds. Secured funding instruments such as securitisations have their own complexities when it comes to sustainability. What does sustainable finance actually have in store for those who take care of secured and unsecured funding so that their companies turn green? How do market participants deal with the multitude of financial instruments? What experiences have they made so far with sustainable finance? What are the challenges in the operational funding business? We have discussed these and other questions in a roundtable with treasurers and financial market experts from Porsche Holding Salzburg Group (Austria) and Landesbank Baden-Württemberg (Germany).

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Michael Osswald: It's a pleasure to have you all here in this roundtable. At the same time, we ask our audience to fasten their seatbelts as we aim to take you on a journey around the current state of play of the European green bond and sustainable securitisation markets, key considerations for issuers and investors and future developments. Let's kick off with the green bond market. Would you describe the current green bond market as an efficient market? What are current pitfalls?

Andreas Wein: Judging by LBBW's experience as bank issuer, we would certainly see the green bond market as an efficient market: it brings together investors with an ESG focus and issuers who can promote their ESG lending activities. At the same time investors can to a degree give the issuers an orientation as to where they see the relevant trends in the ESG area.

Michael Osswald: What about pricing? How do the margins and profitability of green bonds compare to non-green assets?

Andreas Wein: Speaking as an issuer we do see a slight pricing advantage – the well-known "greenium" – when issuing green bonds compared to "normal" bonds. The main reason for this is the growing urge for asset managers and other investors to invest in green assets which is faced by a still limited supply of green financing instruments. What is probably even more important to us is that through the issuance of green bonds we have been able to gain access to a whole range of new investors across Europe, thereby contributing to a widening and diversification of our investor base.

Christian Fahrholz: What's your general outlook on the future of green bonds? Will in your view green bonds become even more relevant?

Peter Kammerer: Yes, absolutely so. We would expect a continuous growth in green bond issuance, even though the rate at which this segment has been growing over the last couple of years will somewhat decline. In the long term, of course, the benefits of climate change mitigation and adaptation far outweigh the costs of climate change on business. Hence, both investors and issuers have a vested interest in continuing in this direction.

Michael Osswald: If green bonds in general are scarce at present, sustainable securitisations are almost non-existent, with the exception of a few green RMBS and some social bonds. But despite the lack of supply, the concept of sustainability has been around for some time on the buy-side. What is your experience of investors' ESG requirements in the public securitisation markets?

Thomas Mairer: Porsche Bank has been a regular issuer in both the public and the private securitisation markets for over 20 years. In 2021, Porsche Bank returned to the public securitisation markets with the FACT 2021-1 transaction that securitised Austrian auto loans and leases from its car financing business. The difference regarding ESG data requirements between this transaction and our previous public securitisation that we issued in 2018 was quite significant. While sustainable securitisation did not even exist back in 2018, we have received directly or indirectly through the lead managers very detailed ESG questionnaires from several investors that looked at the transaction in 2021. The questionnaires covered all three ESG components – environmental, social and governance – with a focus on environmental assessment. A timely response was a prerequisite for some investors for a potential investment. For future transactions, a significantly increasing number of ESG questionnaires can be expected. Thus, our strong recommendation for issuers is to be prepared for all known or expected ESG questions before approaching investors in order to meet investors' expectations.

Michael Osswald: Is there any difference to private securitisations in that respect?

Robert Katzelberger: Porsche Bank is equally active in the private securitisation market, running both a larger revolving securitisation funded by several European bank investors and a bilateral securitisation involving one funding party. The requirements of the sponsor banks have so far been limited to the request for stratification tables in the monthly report regarding engine types – e.g. diesel, petrol, electric – or emission standards, e.g. EURO 5, EURO 6. In addition, questions on ESG topics were addressed during the due diligence presentations.

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Christian Fahrholz: Let's have a look at current regulatory developments. In your view, will the new European Green Bond Standard regulation have a positive effect on the green bond market in Europe?

Andreas Wein: We absolutely welcome this development: While it will be challenging for the majority of the current Green Bond issuers to comply with the European Green Bond Standard in the nearer future – our institution included - we appreciate that the European Green Bond Standard gives orientation in which direction the markets will be developing.

Christian Fahrholz: Is it possible that the European Green Bond Standard will be more attractive to issuers and/or investors than the ICMA Green Bond Principles? Or would you expect the cost and the liability attached to the European Green Bond Standard to negate its benefits?

Peter Kammerer: We would be reluctant to see the two standards as competing. For the time being we expect the large majority of the bond issuance to follow the ICMA principles. However, over time the issuance of European Green Bond Standard compliant bonds will increase. That will be less a function of cost but more of the volume of taxonomy assets on the issuers' balance sheets that allows for an increased issuance of European Green Bond Standard compliant bonds. On the other hand, the ICMA Green Bond Principles are somewhat less formalistic and may remain for certain issuers and investors an alternative to the European Green Bond Standard.

Christian Fahrholz: The EBA has made it clear in their report on Sustainable securitisation earlier this year that they do not recommend a dedicated sustainable securitisation label in the short term. Instead, securitisation issuers should also use the European Green Bond Standard to issue ESG compliant securitisations, while certain minimum green requirements for the securitised portfolio will be set. What is your view on this and when will we see the first securitisation that is compliant with the European Green Bond Standard?

Robert Katzelberger: First of all, the European Green Bond Standard is not yet in force – hopefully, the remaining political finetuning on this, in particular to the requirements for how green the securitised portfolio will have to be for securitisations, will be done in the next weeks and months. In principle, we see it as positive if the European Green Bond Standard is also applicable for sustainable securitisations. This reduces the complexity that already exists for issuers due to the constantly increasing regulatory requirements for all types of financing. But to manage your expectations: The first European Green Bond Standard compliant securitisation bond of Porsche Bank will certainly not take place in the short run, as the volume of pure BEV vehicles in the portfolio is currently still too low. However, with the sales figures expected to further rise in the future, this will certainly change within the next 2 to 3 years.

Michael Osswald: Would an unsecured bond be the more efficient and easier to implement alternative for Porsche Bank if it were to go the European Green Bond Standard route?

Robert Katzelberger: The issuance of an unsecured bond would indeed be easier to implement, but nevertheless we consider the refinancing of a car financing portfolio via securitisation to be more efficient, as this also ensures perfect matching maturities, for example. The issuer in the Porsche Holding Salzburg subgroup for an unsecured bond would be the parent company Porsche Holding GmbH anyway. For sustainable financing, the

Porsche Holding Salzburg Group – as a car dealer – primarily pursues the goal of KPI-based financings such as promissory note loans and bank loans.

Michael Osswald: Now this is an interesting aspect given that sustainability-linked bonds have recently evolved as a new asset class and are becoming more and more popular. What makes this type of fixed income product so attractive from the perspective of issuers and investors compared to green bonds based on a use of proceeds approach such as ICMA-Green Bond Principles or the forthcoming European Green Bond Standard?

Christian Fahrholz: Sustainability-linked bonds have gained considerable momentum since their first issuance 2-3 years ago. Because they do not focus on individual green projects, but rather on the entire company, sustainability-linked bonds enable a broader range of borrowers to obtain sustainable financing. In all likelihood, sustainability-linked bonds will be allowed to coexist with bonds issued under the European Green Bond Standard as well as the ICMA's Green Bond Principles. For issuers who do not have the capacity or willingness to comply with the disclosure requirements of "typical" green bonds, sustainability-linked bonds are an alternative. Investors may also find the focus on green projects too narrow. Sustainability-linked bonds offer investors the opportunity to take a holistic view of a company. In this respect, sustainability-linked bonds represent an enrichment in the universe of green financing.

Michael Osswald: Let's come back to securitisation and the situation after the securitisation framework became effective in early 2019, which introduced the „Simple, transparent, standardised" („STS") premium segment. Representing one component of the STS requirements, the transparency criteria for non-ABCP securitisations have included the requirement for originators to publish environmental performance data of underlying exposures in the asset classes residential mortgage loans and auto loans & leases provided that such information is available to the originator and captured in its IT systems. What is your experience with this requirement?

Thomas Mairer: In fact, the availability of environmental data at Porsche Bank is very good, at least when it comes to Volkswagen group brands, which make up the majority of our financing portfolio. Data on engine type, emission standard, CO_2 and NO_x emissions are available from the importer's systems in these cases. As environmental data are currently not collected manually in the origination process of leases or loans, such data are not available for third-party car brands. Nevertheless, Porsche Bank was able to provide environmental data for around 90% of the securitised portfolio for its most recent public securitsation in 2021. When it comes to the STS reporting requirements on environmental data, the situation is tricky. The relevant data fields in the ESMA loan-level reporting provide for a specific energy performance certificate which is not used in Austria. Thankfully, regulatory-wise, we have actually seen a rather practical approach here. As you have mentioned, data only have to be submitted to the extent that they are available or obtainable with reasonable effort. It would be very desirable if such regulatory requirements would be better harmonised at EU level.

Christian Fahrholz: Recently, the regulators have come up with an alternative to the environmental performance data by allowing originators to publish "the available information related to the principal adverse impacts of the assets financed by the underlying exposures on sustainability factors". What are, in your view, the benefits of this option and do you envisage Porsche Bank using this in future transactions?

Robert Katzelberger: The draft Regulatory Technical Standard on this topic reads quite technical. At the same time, one of the main benefits of the RTS is the alignment with the sustainability-related disclosures in financial services under the previously mentioned Sustainable Finance Disclosure Regulation. In our view, the proposal represents a desirable further consolidation of the regulatory standards that is preferable to a completely new type of reporting. On the other hand, the adverse impact calculations and benchmarking processes are quite extensive and complex. The data to be reported are also very extensive and not yet available in its entirety at Porsche Bank. If this approach also catches on with investors and delivers added value for them, we could well imagine using this approach for future transactions.

Christian Fahrholz: Is it a problem that worldwide there are many different taxonomies? How important is the interoperability of these different taxonomies?

Andreas Wein: We feel very confident that the EU taxonomy will play an important role and should be well received by the European investor base. In fact, it already sets international standards and could well act as a pace-setter compared to taxonomies used in other parts of the world. Our activities as bank issuer and lead manager for clients of the bank, for example in the field of green Schuldschein loans, focus on the

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European Union which is why for us the EU taxonomy is most relevant.

Michael Osswald: In 2020 the green bond market only represented approximately 3 - 3.5% of the overall bond issuance and is thus rather small compared to the overall bond market. Nevertheless, green bonds are gaining in popularity. Do you think that this popularity gain will continue, or will it reach a plateau?

Christian Fahrholz: Frankly, the dynamics of the green bond market, including sustainable securitisation, are in the hands of the regulator. There is no question that issuers and investors are both striving to become greener. However, an issuer or originator has to weigh things up: Can I balance my funding structure in such a way that I can finance green activities without alienating "normal" investors at the same time, because I am implicitly signalling to them that their investment is not so green on average? For the time being, no business is already completely green, and green projects are rather rare. Going completely green from one day to the next is practically impossible. That's why a "normal" investor will always finance the parts of my assets that are not yet green – and less so if I tap green funds for green projects. If the internal governance effort required for this balancing act is less than the benefits from having access to more investors and cheaper funding, then the green bond market including sustainable securitisation will develop more dynamically than before. But these cost-benefit considerations are effectively shaped by the regulator. The practical approach that European legislators have taken in reaching a preliminary agreement on the European Green Bond Standard gives us reason to be confident in that respect.

Michael Osswald: Thank you very much to all of you for your valuable insights! With that, we will conclude this roundtable.

Note: At this point, the offical roundtable had to be closed due to space limitations for the printed version of the roundtable. Depending on interest from the audience, we will consider continuing this dialogue in the future to cover all remaining discussion points!

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Before joining LBBW, Peter Kammerer worked for 8 years at Landesbank Rheinland-Pfalz in various positions in the capital markets business.

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Prior to that, he worked as fund manager in the fixed income segment for several years. Robert holds a degree in business administration from the Leopold Franzens University of Innsbruck.

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Michael has extensive securitisation experience both as investor and the origination and structuring of term ABS, ABCP and synthetic transactions, which he gained from 1998 at Landesbank Baden-Württemberg in Stuttgart and London and subsequently at ABN AMRO Bank in Frankfurt as part of the European ABS team. In 2009, he moved to the transportation finance division of KfW IPEX-Bank and was, prior to joining SVI, Senior Credit Officer at Erste Abwicklungsanstalt in Düsseldorf, where he was responsible for the asset securitisation, infrastructure, aviation and shipping sub-portfolios. Michael holds a degree in business administration from the Julius Maximilian University of Würzburg.

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Prior to joining DIHK, he was a visiting scholar at the Central Bank of Estonia (Eesti Pank) and worked as a freelance consultant for public and private clients in Egypt, South Africa and the United States. Earlier appointments included a visiting professorship at the Chair of Macroeconomics, in particular monetary theory, at the University of Erfurt.

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