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Sustainability on the SSD market: On track to becoming standard practice

- Outlook for 2022: Sustainability megatrend set to drive market share of ESG transactions above 50 %
- Placement volume expected to pass EUR 10-billion milestone
- New reporting requirements to act as catalyst for further sustainable growth
- Importance of social impact to grow in medium term

The transformation of the financial sector is poised to gain further impetus, with political decisions playing a significant role, such as the recent UN Climate Conference in Glasgow in 2021 (COP26). In addition, investors are facing more stringent regulatory require-ments. For instance, the European Banking Authority (EBA) has been pushing ahead with measures to limit climate risks among financial institutions and establishing sweeping reporting requirements. Companies seeking to raise capital will also find themselves con-fronted with greater regulatory hurdles. In the future, they will not only have to report on the extent to which their sales and investments comply with the EU taxonomy, but will also have to provide much more extensive information on their ESG performance as part of the planned Corporate Sustainability Reporting Directive (CSRD).

Against this backdrop, Helaba Landesbank Hessen-Thüringen expects that the overall number and volume of SSD transactions with sustainability components will continue to rise sharply. Specifically, Helaba's analysts anticipate that the share of Schuldscheine with coupons linked to ESG metrics or ratings, in addition to sustainable use of proceeds is-sues, will amount to more than 50 % of total market volume in 2022. As a consequence, it is likely that the total placement volume will exceed EUR 10 billion in the current financial year. "Increasing regulation is leading to a holistic view of material sustainability risks, both on the part of issuers and investors alike", explains Yannick Ferber, Senior Advisor for Sustainable Finance, Corporate Research & Advisory.

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2021: Breakthrough for sustainability on the Schuldschein market

The first Schuldschein notes with sustainability components were issued at the beginning of 2016, shortly after the 2015 UN Climate Conference in Paris (COP21). However, the final breakthrough for ESG on the Schuldschein market came in 2021 as the entry into force of the EU's Taxonomy Regulation, in particular, as well as the Covid-19 crisis, galvanised interest in sustainability from both investors and issuers. The volume of Schuldscheine structured with sustainability components rose to EUR 5.8 billion. As a result, their market share increased threefold to 29 %, dominated by sustainability-linked transactions at more than 80 % of total ESG issuance.

The placement highlights of 2021 included the first-ever issuance of a social corporate SSD by the Swedish healthcare provider Medicover, which paved the way for use of proceeds issues with a social focus. Meanwhile, Nassauische Heimstätte, one of the leading housing companies in Germany, pioneered another innovation: its sustainability Schuldschein was the first transaction whose proceeds were used to fund both green investments in energy-efficient housing schemes as well as social investments in affordable housing. Faurecia broke new ground with respect to sustainability-linked transactions. Rather than adopting the step-up/down system of linking the interest rate to the achievement of ESG targets, which has so far been standard practice in the SSD market, the largest French automotive supplier opted instead for a novel step-up only concept - an approach that is customary in the bond market.

New reporting requirements as a catalyst for further growth in sustainable issuance

Helaba expect that the CSRD will act as a catalyst by imposing significantly more enhanced reporting requirements. Many companies are likely to spend this year preparing for the new regulations by ensuring their sustainability reporting is future-proof and by defining precise ESG targets that are consistent with their respective corporate strategies. "Sustainability goals defined in a company's corporate strategy are increasingly being underpinned by capital market funding," says Klaus Distler, Head of Corporate DCM. This will result in a dramatic fall in the additional cost and effort of issuing sustainability-linked SSD notes. While there are usually good reasons for choosing certain metrics that can be supported by a materiality analysis in a company's sustainability reporting, it is often more challenging to determine whether targets are sufficiently ambitious. For this reason, there will be a greater tendency for companies to have their sustainability targets externally validated or align them towards reference values that are scientifically proven and recognised. At the same time, though, ESG ratings will remain a factor as it is not possible to find adequate ESG metrics in every sector or it is difficult to quantify the most critical aspects of sustainability.

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Head of Corporate DCM

Coinciding with a sharp increase in sustainability-linked placements, Helaba's experts also anticipate that issuance of use of proceeds notes will pick up this year from a comparatively low recent level. As the precise nature of the EU taxonomy, which essentially defines a catalogue of green investments, becomes clearer and market participants become more familiar with its application, the absolute volume of green SSD transactions should rise again. Moreover, demand from investors for use of proceeds issues is likely to remain high, as the latter provide the best possible transparency in terms of how proceeds are deployed, and taxonomy-compliant investments also offer advantages when it comes to calculating the green asset ratio.

Importance of social impact to grow in medium term

Currently, the majority of companies are already considering their carbon footprint and are thus addressing environmental concerns as part of their business strategy. However, the issue of social impact has so far taken more of a back seat. One reason could be the infinitely more com-plex definition and quantification of this factor. The European Commission has committed itself to strengthening this pillar. A group of experts commissioned by the EU is currently developing a corresponding social taxonomy that will build on the EU taxonomy. With a wide-ranging scope, which will include the provision of essential infrastructure, healthcare and education as well as affordable housing, social SSDs may not only appeal to traditional corporates but also to local governments and, at the very latest, will likely grow in significance with the publication of the social taxonomy.

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