Sustainable Finance Market Comment

A newsletter from DNB Markets summarising recent trends and developments within sustainable and transition finance

Sustainable Finance, Investment Banking Division, DNB Markets

November 2024

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Elections: What the Trump win and new EU Commission could mean for climate efforts

Although the clean energy transition is likely to continue, Trump could have a long-term negative impact on global climate diplomacy

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US DEVELOPMENTS

US Inflation Reduction Act may be dissolved, although benefits likely to stay (somewhat) intact

- **Nordic renewables shares plummeted in November…** In anticipation for, and in reaction to, the Trump win, Nordic renewables names such as Vestas and Ørsted took a double-digit hit on stock-prices. This was primarily driven by Trump's reluctance to approve more renewables (existing projects are likely less impacted), in addition to new offensive tariff plans.
- **…however, the *contents* of the US IRA, might still proceed for two reasons:**
  1. **The US IRA laws need a full Congress to be dissolved in its entirety.** Trump has already vowed to stop any 'new/unspent' funds under the US IRA, impacting *new* investments. With a 'red sweep' (Republican control of Senate, House of Rep's and Presidency), this puts the whole law at play. Trump is likely to tighten limits on tax credits, loans and grants to emissions-reducing technologies that benefited from the US IRA. Key to watch is whether the new administration will weaken key climate departments, such as the EPA and NOAA.
  2. **The US IRA gives disproportionate benefits** to Republican-led states, and the >100k new clean energy manufacturing jobs created since Aug 2022[1] will weigh in. However, some US IRA beneficiaries, e.g. grid infrastructure, are safer bets than others, e.g. (offshore) renewable power built to cancel out fossil.

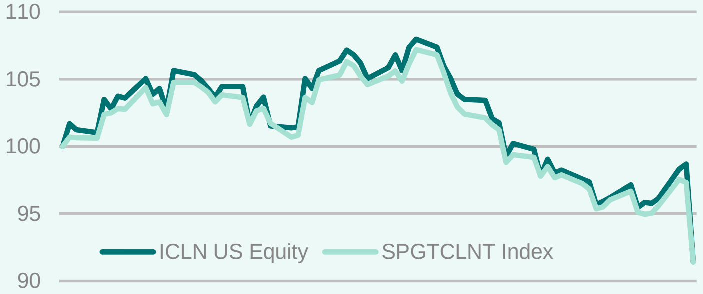
Negative impact on global climate diplomacy

- Trump has vowed to (yet again) pull out of the Paris Agreement in 2025. This will likely negatively impact, and further **slow down, the climate effort incentives of other countries**, such as India. Note, when the US pulled out in 2016, no other countries followed suit or pulled out.
- COP29 (11-22 Nov) will nevertheless proceed under the Biden administration and is likely to land a long-fought issue: **financial assistance for developing countries**.

ESG – and climate reporting likely to slow

- Trump might overturn the ESG –and climate risk disclosure requirements for listed companies which the Securities and Exchange Commission finally agreed upon in March after yearslong efforts. If this is overturned, it would delay investors' ability to compare companies' climate risks and plans.

Clean energy indexes' reaction to Trump's win



Index data between 6 Aug and 6 November 2024. Trump has vowed to 'unleash American energy' by freeing up the 'liquid goal' on public land, with more lease sales, pipelines, fracking.

EU DEVELOPMENTS

New five-year strategy in December

Ursula von der Leyen will launch the new five-year EU Commission strategy in Q4. She has flagged that after a successful five-year climate-policy wave (the EU Green Deal was launched as part of the 2019 five-year strategy), Competitiveness and Defense now overtake as EU's top strategic priority. We expect EU climate targets to remain an integrated priority in the new strategy, with a number of regulations coming into force from 2024 and onwards, see slide 7 for further details.

Nordic stamp on Environment and Energy in new European Commission could benefit Nordic priorities

- Former **Danish climate minister Dan Jørgensen will become Commissioner for Energy**. He is a strong supporter of hydrogen and renewables and has vowed to cut permitting timelines plus boost electricity/grid. Notably, as a nuclear sceptic he has refused to offer nuclear energy the same benefits that renewables.
- **Sweden's Jessika Roswall will become commissioner for environment, water and circular economy.** Roswall has been vague on priorities, although we expect biodiversity and forestry to be on her agenda.
- As before, **Dutch Wopke Hoekstra** is (re)confirmed as EU climate commissioner. New this time, is that the portfolio is expanded to 'climate, clean growth and taxation', indicating that climate taxes might get priority.

Footnotes: 1) Clean Energy Investing in America 2024 (Aug 2024)

Sustainable Finance debt market developments

Sustainable bonds on track to reach the highs of 2021, slight return of momentum in SLLs while SLBs still under pressure

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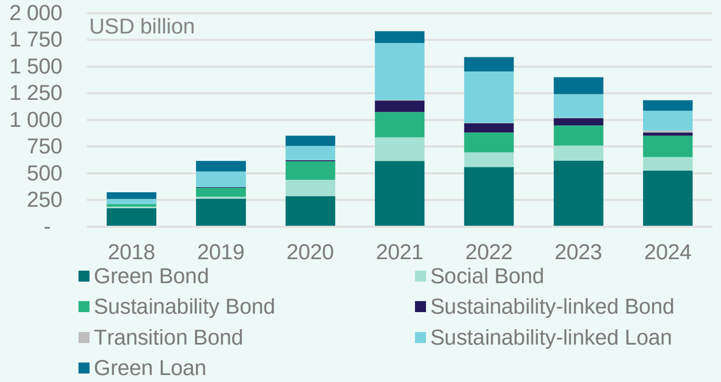
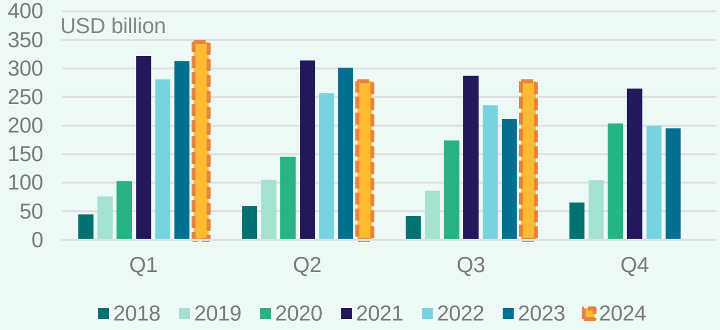
In the first three quarters of the year, we have seen approximately USD 1,200 billion being raised across global **sustainable bond and loan markets**. Overall, this is on par with 2023, however the clear volume driver is **sustainable bond** issuance, which is on track to reaching the highs of 2021, currently at USD 902 billion YTD.

Global issuance of sustainable bonds and loans



Quarterly issuance of sustainable bonds

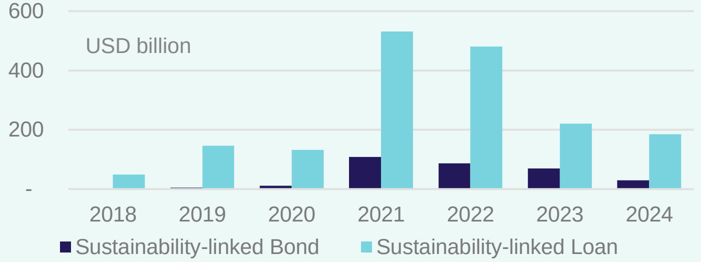


Since 2021, we have seen a steady decline in **sustainability-linked bond (SLB) and loan (SLL) issuance**, which we mainly attribute to concerns around the credibility of the ESG targets integrated in the structures. For **SLLs**, we see great potential for the format, as a way for banks to engage and incentivise clients to align with their own long-term portfolio targets.

Driven by regulation, strategies and targets are becoming more concrete, and quality of data collection and reporting is improving. We expect this to create a stronger foundation for companies and banks to set robust structures, and we sense a returning momentum in the market for SLLs.

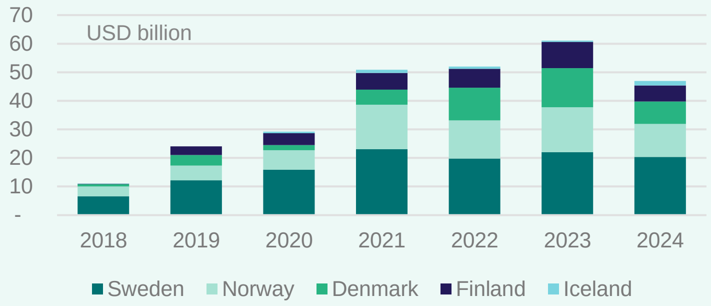
For **SLBs** however, we see several hurdles when it comes to implementing sustainability-linked structures, and volumes remain muted. The one-sided penalty structure makes it less attractive at the outset, and as structural changes may occur, such as new reporting methodologies, unexpected external events or M&A activities, tracking KPI performance can be more cumbersome than initially anticipated. For loans, a symmetrical structure with annual penalties and discounts makes a more agile structure, and potential renegotiation is more attainable with banks than investors.

Global issuance of SLBs and SLLs

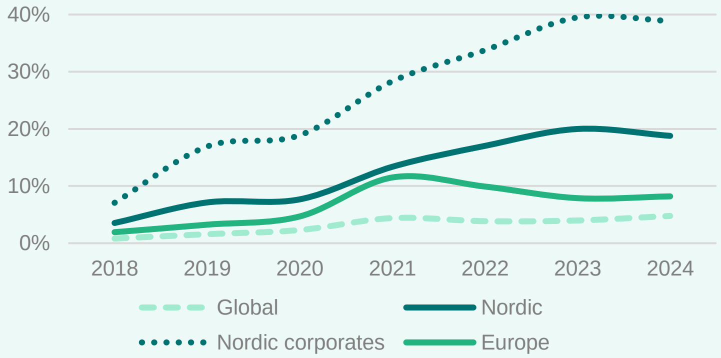


The **Nordic sustainable bond market** continues to show strong momentum, and roughly 20% of all capital raised by Nordic issuers in the bond market so far this year has had a sustainable label, compared to roughly 5% globally. For **Nordic *corporate* issuers**, the share is even higher at 40%. . The 'green' format remains a priority, with roughly 94% of Nordic sustainable bond volumes,

Nordic issuance of sustainable bonds



Share of bond market with sustainable label



Source: BNEF, Bloomberg, DNB Markets

Sustainability-Linked Bonds – how have Nordic issuers performed?

A desktop analysis of Nordic SLB performance to investigate level of ambition

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In 2019, Enel issued the world's first **Sustainability-Linked Bond** (SLB). The concept quickly became popular, as in comparison to green bonds, SLBs do not require proceeds to be earmarked for specific purposes. Instead, a financial penalty may kick in if the issuer fails to meet certain pre-defined **Sustainability Performance Targets** (SPTs), such as emission reduction.

In 2021, the ICMA launched their Sustainability-Linked Bond Principles and that same year we saw more than USD 100bn issued as SLBs, taking a 10% share of the global sustainable bond market.

Sustainability-linked finance relies on two key pillars: 1) KPIs need to be **material**, and 2) targets need to be **ambitious**. For example, reducing emissions tends to be a relevant KPI for many businesses, and a science-based approach where targets are aligned with 1.5 degrees trajectory can evidence its level of ambition.

The overall idea behind SLBs is to create a **direct link to the entity level sustainability performance** by integrating a financial incentive for issuers to deliver on their sustainability targets. Hopefully, this should support investor demand and generate favorable pricing for the issuer, in return for the potential penalty upon failing to deliver on targets.

However, with a heightened focus on greenwashing, in turn leading to growing scrutiny around corporate sustainability targets and strategies, many started to question the **integrity and credibility of the SLB market**.

As a result, and as was further detailed on the previous page, we have seen a steady decline in SLB issuance since its hype in 2021.

Nordic companies were early adopters of SLBs, and even if many of them, in our view, had a robust starting point for entering the SLB market, the general issues around credibility has also had a negative impact on Nordic issuance.

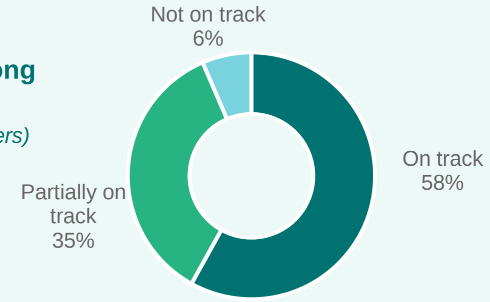
The critique against SLBs have mainly focused on targets not being ambitious enough, and that most companies could reach them simply by running their business as usual. According to a report issued earlier this year by the Climate Bond Initiative[1], only around 17% of sustainability-linked bonds issued to date were aligned with global climate goals. Even if this doesn't necessarily mean that the remaining 83% are all of poor quality (and all SLBs will not be linked to climate KPIs), we can assume that there has been room for improvement.

Against this backdrop, DNB Markets recently performed a desk top analysis of 31 SLBs issued by Nordic issuers between 2021 and Q1 2023, to get a better overview of how these entities have performed against their SPTs.

Our key findings show that about 60% of companies are well on track to achieve all of their SPTs with the remaining 40% lagging behind on one or more.

SPT progress among Nordic issuers

(company level, 31 issuers)



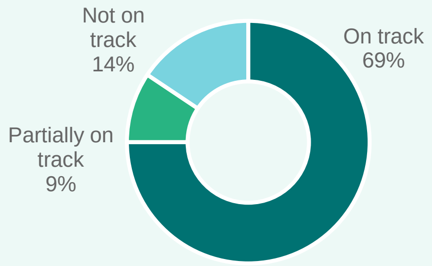
The financial penalties typically range between 50 and 100 bps, added to the redemption price at maturity, where the number of KPIs in the structure typically carry equal weights.

Combined, the 31 SLBs have 69 active SPTs, where we find that approximately 70% are most likely to be achieved with 30% either partly on track or lagging.

Due to the relatively short maturity of Nordic bonds (5-7 years), we will soon know whether they are able to catch up on SPT performance or will be forced to pay up for not achieving them.

SPT progress among Nordic issuers

(KPI level, 69 SPTs)



These findings suggest that 'business as usual' would likely not be enough for many of these companies to reach their SPTs. There can of course be several reasons for why an issuer fails to reach their targets, but on average, a healthy level of ambition in the structures should mean that some fail.

Many companies are now in the process of updating their materiality assessments, strategies and targets, and as data quality also improves, in theory, companies should be in a better position to issue SLBs today than a couple of years ago.

If this will be enough to mitigate both the credibility issue and the various other structural challenges for SLBs mentioned on the previous page remain to be seen.

Source: BNEF, DNB Markets

Footnotes: 1) Climate Bonds Initiative, "Sustainability-Linked Bonds: Building a High Quality Market"

Blue Finance

Just another label? Or an efficient tool for attracting capital to the sustainable blue economy?

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The sustainable finance market is not only home to green, social and sustainability-linked structures, but these also act as umbrellas for a plethora of other themes. A couple of examples include Response or Pandemic Bonds issued during covid, and Orange Bonds, dedicated to support gender equality – both qualifying under the Social Finance umbrella. Blue Finance, generally considered a sub-category of Green Finance dedicated to supporting a sustainable ocean economy, is another example where we have seen some noteworthy volumes.

The ICMA Green Bond Principles (GBPs) in fact include several 'blue' categories, such as sustainable fisheries and aquaculture, marine conservation, and water/wastewater management, but over the years, we have seen a number of issuers choosing to come to market under a dedicated 'blue' label, based on the GBPs.

Some may reasonably argue that additional labels run the risk of confusing the market. The growth in Blue Bonds however suggest that this label may be a useful tool to 'cut through the noise' and attract investors.

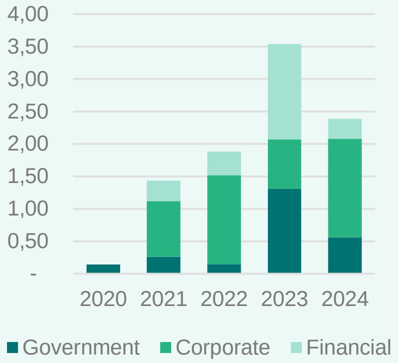
The first blue issuer was the Seychelles back in 2018, issuing a government blue bond to finance marine conservation projects and sustainable fisheries. Since then, a range of government, corporate and financial entities have issued blue bonds to finance projects ranging from nature conservation to water infrastructure and low-carbon shipping. These also include 'debt for nature swaps', issued by governments to free up debt in return for commitments to invest in conservation efforts.

With an aim to encourage additional funding towards a sustainable blue economy, a number of organisations have provided market guidance for blue finance, as described on the right, in the end converging into an ICMA-led practitioner's guide issued last year.

With biodiversity and water issues rising on many investors' list of priorities, we can assume continued growth within blue finance.

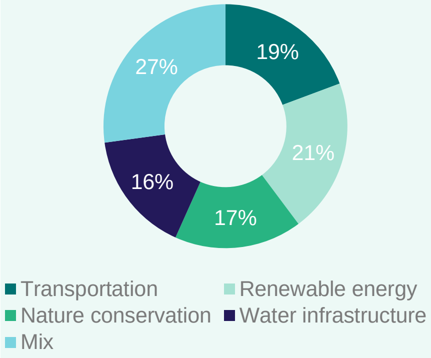
Annual issuance

EUR billion



Use of proceeds

Top 20 issuers, ~86% of issued volume



Top 10 issuers

Issuer	EUR bn	Main UoP
Export-Import Bank of Korea	0.93	Transportation
CGN Wind Energy Ltd	0.71	Renewable energy
Seaspan Corp	0.63	Transportation
Equador (debt for nature swap)	0.60	Nature conservation
Saur	0.55	Water infrastructure
Fujian Zhanglong Group	0.47	Mix
Gabon (debt for nature swap)	0.46	Nature conservation
Yankuang Group Cayman Ltd	0.45	Renewable energy
BRK	0.38	Water infrastructure
Asian Development Bank	0.37	Mix

The history of Blue Finance

2018 — *First issuer* **The Seychelles**
The world's first Blue Bond, financing marine conservation and sustainable fisheries

2020 — *First Nordic issuer:* **Nordic Investment Bank**
Blue bond financing water resource management

2020 — **UN Global Compact**
Blue Bond guidance to secure funding for ocean-related projects that contribute to the SDGs – including both 'use of proceeds' and 'sustainability-linked' concepts[1]

2021 — *First corporate issuer:* **Seaspan**
Blue transition bond financing low-carbon containerships

2021 — **Government of Belize**
Debt conversion for marine conservation, reducing the country's external debt by 10% of GDP while committing to spend ~USD 4m/year on marine conservation until 2041[2]

2022 — **IFC guidelines**
Guidelines for Blue Finance, identifying eligible blue project categories to guide IFC's investments to support the blue economy, in line with the ICMA GBPs and LMA GLPs[3]

2023 — **ICMA guidelines**
'Bonds to finance the sustainable blue economy – a practitioner's guide' – a comprehensive resource developed in cooperation with the UN and IFC, highlighting how existing standards for green, social and sustainability-linked finance can be a foundation for Blue Bonds and investments dedicated to the sustainable blue economy[4]

Source: Bloomberg, DNB Markets

Footnotes: 1) UN 'Practical Guidance to Issue a Blue Bond', 2) International Monetary Fund, 3) IFC 'Guidelines for Blue Finance', 4) ICMA 'Bonds to finance the sustainable blue economy – a practitioner's guide'

'Rational sustainability' – growing the pie for both shareholders and stakeholders alike

Reflections from Professor Alex Edmans during DNB's recent Sustainable Finance seminar in Oslo

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On October 8th, DNB organised a Sustainable Finance seminar in Oslo with Professor Alex Edmans as key-note speaker.

During his presentation, Mr Edmans showcased some of his recent research, where he asks for a material shift in the general practice of ESG. This involves avoiding sustainability becoming a box-ticking, compliance and marketing exercise, and instead implement what he refers to as 'rational sustainability', with a focus on long-term value creation.

We had the opportunity to ask him a few additional questions for this Q3 sustainable finance market comment.

Alex Edmans
Professor of Finance
London Business School

1. What has in your view been the key challenges in ESG practices in the recent past?

There are challenges from both sides. Some ESG sceptics believe that ESG is at the expense of profit: in particular, a reason why Republicans in the US tend to be more sceptical about ESG is due to concern that it is anti-business. But this assumes a fixed pie mentality: a greater slice of the pie for stakeholders means a smaller slice for shareholders. Instead, the pie is not fixed: ESG, properly implemented, grows the pie for both shareholders and stakeholders alike.

However, some ESG advocates believe that ESG is the most important aspect of a company – even more important than other value drivers such as productivity, innovation, and culture. They may refuse to invest in a firm that crosses an ESG red line even if it outperforms on those other dimensions.

Both problems arise from viewing ESG in a black-and-white way. Sceptics view it as always bad; advocate view it as always good and indeed more important than other factors.

2. In short, what do you mean by 'rational sustainability'?

Rational sustainability is an evolution of ESG which aims to address the above challenges and recognises the shades of grey.

"Sustainability" refers to the goal: creating sustainable, long-term value, which is relevant to all job functions and political beliefs. It considers all factors that create value, regardless of whether they fall under an ESG label, and deprioritizes immaterial factors even if they can be called ESG.

"Rational" refers to the approach: it recognises diminishing returns and trade-offs; it is based on evidence and analysis; and it challenges and questions rather than following the herd.

3. In the context of rational sustainability, how do you see the financial sector's role in the sustainable transition?

The financial sector has a key role to play in the sustainable transition. Many sustainability factors improve both financial and social value. By investing in companies that perform well on these dimensions, or engaging with firms to improve their performance, investors can both enhance their financial returns and also benefit society.

However, for other factors there are trade-offs: for example, in the absence of government intervention, climate change is an externality whose effects are not fully borne by emitting companies. Investors can finance the mitigation of climate change but be clear that this won't always maximise financial returns, or alternatively engage with governments and regulators to address these externalities.

4. What would be your key recommendation(s) to organisations to avoid sustainability becoming a mere compliance and box-ticking exercise and instead implement rational sustainability?

Ask yourselves the question: if you could not tell anyone you were doing it, would you still do it? This ensures that you are investing in sustainability because it genuinely creates long-term value, not to tick a box and get external credit.

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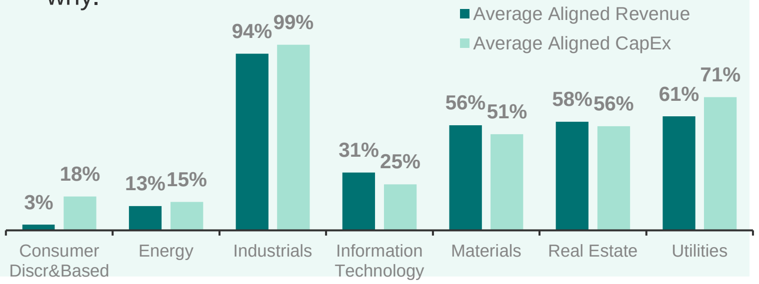
Views from our ESG research analyst – Sustainability market drivers

Key developments in 2Q and 3Q 2024

EU ESG regulations are deepening > widening

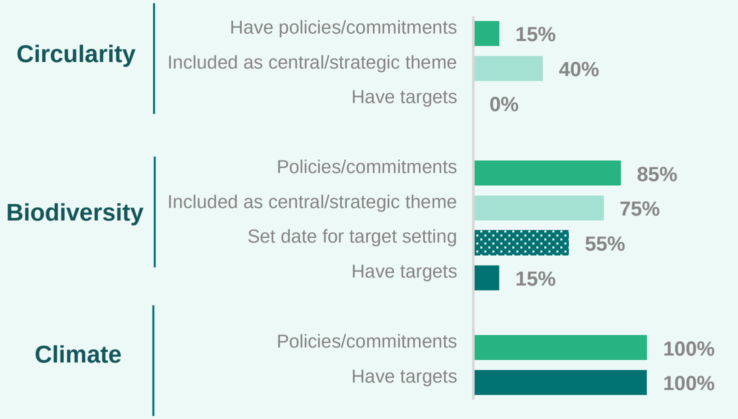
The EU fast-tracked climate policies before the June 2024 elections. The next five years will focus on strengthening current ESG rules rather than launching new ones. Key regulations and election outcomes to watch:

- **Green Deal stumbles on**. Despite the as anticipated meagre electoral outcome for EU Greens, the EU Green Deal still has majority support and signals steady political speed towards 55% emissions cut by 2030.
- **Deforestation will cost**. New rules starting 30 Dec 2024 require all EU importers of palm oil, soya, wood, cocoa, coffee, cattle and rubber to document the products are deforestation-free. We see Nordic sectors potentially impacted, e.g. retail, consumption, forestry, industrials.
- Final law of the **Energy Performance of Buildings Directive** was published 28 May 2024, expected to double renovation rate and have broad market impact: tailwinds to construction & energy efficiency and headwinds (increased capex) to real estate asset owners.
- Industrials, Materials, Real-estate and Utilities stand out in our **2024 EU Taxonomy Navigator.** Feel free to ask us why.



Incoming ESG themes

- **'Transition alpha' > 'deep green'**. We see growing market interest in names with relatively better ESG performance than peers, i.e. the 'transition alpha', compared to interest in established sustainable assets where green alpha is priced in. Much anticipation is put on companies' **transition plans in the upcoming CSRD** (for FY2024). Notably, this 1st round of reporting will contain many assumptions and approximations.
- COP29 in Baku (11-22 Nov 2024), will prioritize **climate finance**. This mainly involves national funds to developing countries, but will also encourage more private financial funding mechanisms.
- Our updated 2024 analysis shows that **of 25 key Nordic asset managers, *all* have policies and targets on climate change.** Biodiversity and circularity policies are on the rise.



Nordic ESG-related research highlights 2Q & 3Q 2024

- '**From ESG hype to Transition Winners**': covering the tailwind stocks from current ESG and Transition trends
- 'EU **Taxonomy Navigator 2024**: Green activity up, confusion down' assessing companies and sectors with high EU Taxonomy reporting
- 'EU **Green Deal tracker'**: a review of notable EU ESG regulations 1H 2024 and impacted Nordic stocks
- Notable ESG-related research **from our Sector teams**
  - '**Norwegian bank survey 2024**': our Financials team's annual survey includes a chapter on banks' climate work
  - '**Seafood – the Quality report**': our Seafood team's thorough assessment of ESG & site quality in fish farming
  - '**Renewables: Private market seen cooling down**': our Renewables' team's view on Scatec (**SCATC, Sell**), Cloudberry (**CLOUD, Hold**), Ørsted (**ORSTED, Sell**) etc.

Please contact us to receive published, or subscribe to our forthcoming, ESG research

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DNB Markets

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DNB Markets: A dedicated Sustainable Finance team working across sectors and regions

DNB Markets

DNB's ambition

We aim to be a driving force for sustainable transition

We have set an overarching goal of reaching net-zero emissions across lending, investments and operations by 2050

Sustainable Finance team

Our DNB Markets Sustainable Finance team, established in 2017, offers sustainable finance advisory services across sectors and global offices

The team assists clients in meeting investor expectations across debt and equity capital markets by highlighting and integrating sustainability features in a transactional setting

Product and advisory services

We offer advice on:

Sustainable financing solutions, such as green, social and sustainability linked-bonds and loans

ESG narrative from an ownership perspective in M&A/IPO situations, identifying ESG risks and opportunities and enhancing equity stories

ESG Equity Research

Using a bottom-up approach results in a unique product with high value add for readers, with ESG drivers integrated in the estimates

Our combined company and sector expertise is utilised in identifying opportunities, risks and valuation implications

Track record

- Market leader in the Norwegian Sustainable Bond Market
- Market leader in the Nordic HY Sustainable Bond Market[1]
- Prospera ESG Equity Research Norway 2021, 2022, & 2023

A dedicated team working in close cooperation with other product and client teams across DNB

Nina Ahlstrand
Managing Director
Global Head of Sustainable Finance
DNB Markets

Selected experience:
- 15 years of experience from Nordea, Nomura and DNB
- Joined DNB in 2012
- Extensive experience from debt capital markets and established the DNB Sustainable Finance team in 2017

Thomas Hemmestad
Director
Sustainable Finance
DNB Markets

Selected experience:
- 18 years of experience from DNB in London, Oslo and Stockholm
- Joined DNB in 2006
- Extensive experience within loan transactions and private equity

Magnus Piene
Director
Sustainable Finance
DNB Markets

Selected experience:
- 20+ years of experience from DNB
- Joined DNB in 1998
- Extensive experience across syndicated loan transactions, DCM, ECM and M&A within offshore energy service industries

Camilla Løvic Salbuvik
Associate Director
Sustainable Finance
DNB Markets

Selected experience:
- 12 years of experience from DNB in Oslo, London and Houston
- Joined DNB in 2012
- Extensive experience within loan transactions and corporate banking with ocean industries

Ulrik Hallén Øen
Associate Director
Sustainable Finance
DNB Markets

Selected experience:
- 7 years of experience from PwC and DNB
- Joined DNB in 2020
- Extensive experience from public affairs, politics and sustainability consulting

Anne Margrethe Platou
ESG Analyst Equities Research
DNB Markets

Selected experience:
- 18 years experience of ESG/CSR related profession
- Joined DNB in 2017 as Advisor Sustainability & Public Affairs

[1] Nordic issuances, excluding Real estate.

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