# SustainaWeekly

## Bund greeniums at all-time lows

- **Strategy Theme: German green government bonds allow for good estimates on the level of the greenium, given their "Twin Bunds" structure. We find that Greeniums still exist and they are larger for the 5y area. However, the greeniums for the 10y and 30y areas are at all time lows. This might be explained by the flatness of the curve.**

- **ESG Bonds: SLBs accounted for almost half of the total volume of last week's issuance in the EUR IG corporate bond market. Pernod Ricard, Sanofi, CEZ – and in the private-equity space – EQT – all issued SLBs. We take a closer look at the structures of the new SLBs.**

- **Policy and Regulation: The European authorities published last week an updated statement on the application of the Sustainable Finance Disclosure Regulation (SFDR). The SFDR aims to impose mandatory ESG disclosure obligations for financial market participants and financial advisers. We look at some of the challenges facing investors.**

- **Company and Sector news: Heat pumps are gaining popularity and importance in the built environment transition. The installation of heat pumps can be a good step towards carbon neutrality. But at the same time, this requires higher energy efficiency of buildings through insulation.**

- **ESG in figures: In a regular section of our weekly, we present a chart book on some of the key indicators for ESG financing and the energy transition.**

In our latest edition of the Sustainaweekly, we start by assessing whether there is a financial premiums evident in German government bonds. These greeniums do exist but are modest. Indeed, at the longer-end of the curve they have fallen to all-time lows. We then go on to look at last week's ESG bond issuance, where SLBs were prominent. Our strategists take a close look at the structures and targets and compare them to peers. On the regulation side, we assess the challenges to investors of the SFDR. Finally, we present an analysis of heat pump trends in the Netherlands, where a strong upward trajectory has been taking shape and is set to continue.

Enjoy the read and, as always, let us know if you have any feedback!

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# Bund greeniums at all-time lows

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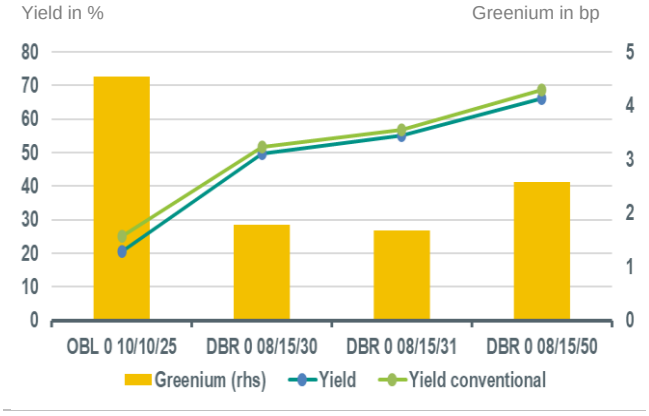
- **German green Bunds allow for good estimates on the level of greenium, given their "Twin Bunds" structure**
- **Our analysis shows that all of Germany's green bonds outstanding trade slightly tighter than the equivalent regular bonds. That is, all of them show a certain level of greenium**
- **We see that the shorter-dated green bond has a higher greenium compared to other maturities**
- **Meanwhile, the greeniums for the 10y and 30y areas are at all-time lows.**
- **The lack of steepness in the curve might explain why the 10y and 30y greeniums are at all-time lows**

Germany is building a green bond curve next to its conventional one. The modalities of the green bonds are exactly the same as the regular bond, also known as "Twin Bunds". This structure allays any concerns about liquidity, which was a key issue for the government prior to issuance. As a result of that, we can easily determine the greenium for Bunds (that is, the difference in yields between the conventional and the green bond). Currently, Germany has 4 green bonds outstanding and has financed EUR 25.5bn under a green format.

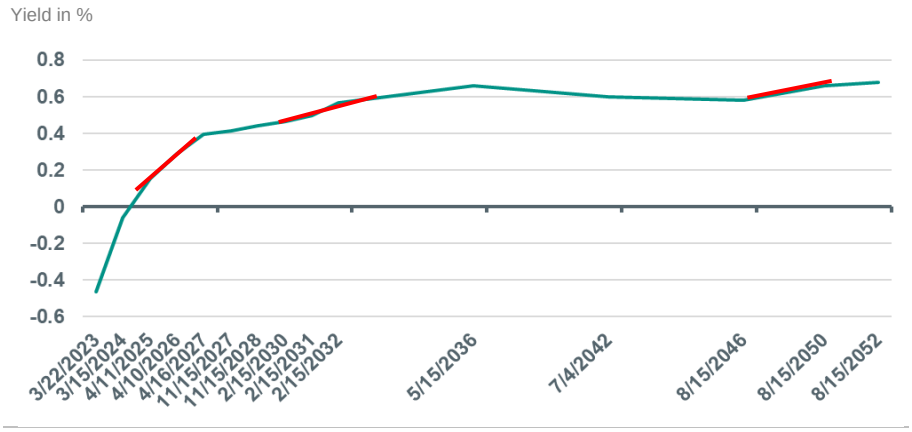
**The 5y Bund provides the highest greenium**




Source: Bloomberg, ABN AMRO Group Economics

The maturities of the green Bunds are 5, 10 and 30 years, and Germany issued two green bonds in the 10y area as shown in the graph above. The greenium for the OBL 0 10/10/25 is higher compared to the greenium of the 10y bonds, which is also the case when we are looking at the 30y horizon. This is in line with lower sovereign spreads and a flatter curve at the longer-end. Indeed, the 5y area of the German curve is the steepest area as shown in the graph below. Hence, we could assume that the flatter the curve, the lower the greenium. This would also explain why not only the 10 and 30yr have lower greeniums at the moment (compared to the 5yr), but why they currently trade at all-time lows (see more below).

**Bund greeniums seem to depend on the steepness of the conventional curve**

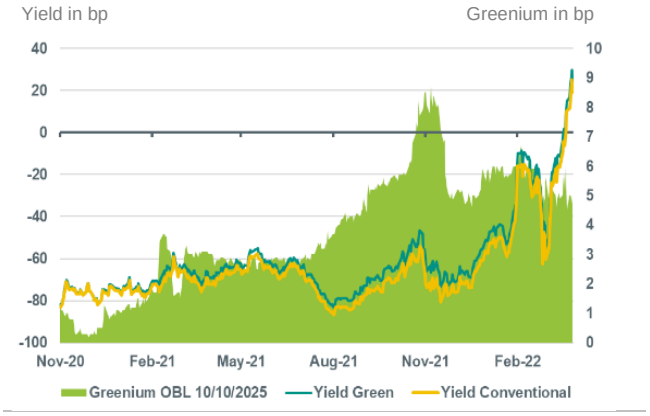



Source: ABN AMRO Group Economics, Bloomberg

**5y Bund greenium seems to be the most volatile greenium**

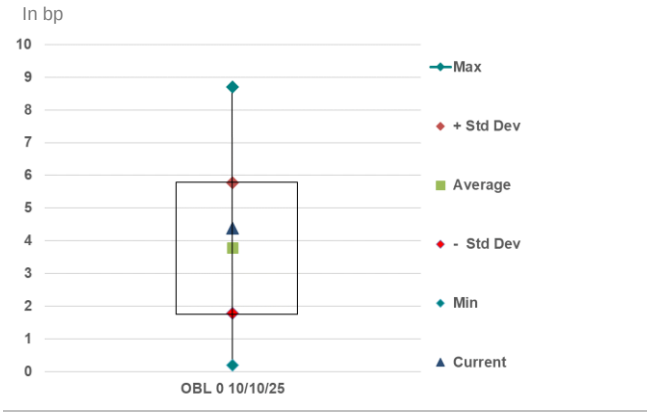
Since the launch of the 5y green Bund, the greenium has performed by about 3bp and traded between 0bp to 9bp. Currently, the 5y Bund greenium is trading at around 4bp, as shown in the graph on the next page on the left. This is slightly above the average. Finally, this greenium seems to be the most volatile as it has the highest standard deviation, of around 2bp. Below we will look at the 10y Bund greeniums, which are trading at attractive levels.

**Historical evolvement of the 5y greenium on Bunds…**




Source: ABN AMRO Group Economics, Bloomberg

**… which is currently trading around its average level**



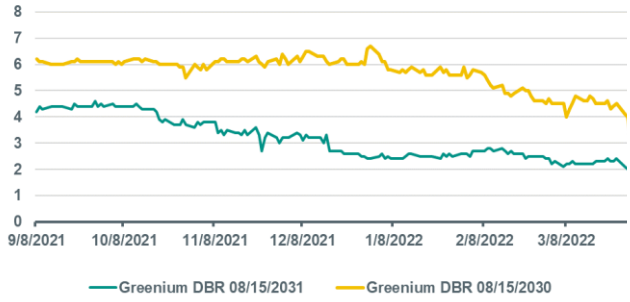

Source: ABN AMRO Group Economics, Bloomberg

**10y Bund greeniums at lows**

Germany launched two green Bunds in the 10y area of the curve, the DBR 08/15/2030 and the DBR 08/15/2031. The outstanding amount in the DBR 2030 is EUR 8bn, while this is EUR 6.5bn for the DBR 2031. In addition, the greenium on the DBR 2030 has always been higher compared to the greenium of the DBR 2031, by at least 1 standard deviation.

**Historical evolvement of the 10y Bund greeniums**

Greenium in bp

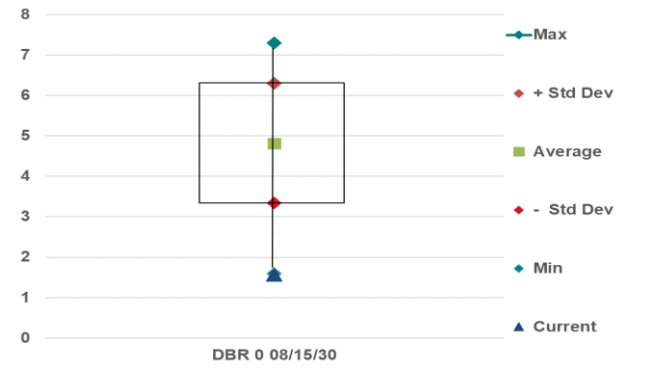



Source: Bloomberg, ABN AMRO Group Economics

Indeed, the average greenium of the DBR 2030 is 4.8bp versus 3.1bp for the DBR 2031. Meanwhile, both greeniums are trading around their lowest levels at the moment. As a result, the 10y Bund greeniums seems to trade at attractive levels. Both greeniums are trading about two standard deviations below the average greenium, but the standard deviation of the DBR 2030 is higher and therefore we judge that this one is particularly attractive. Last but not least, we will look into the evolvement of the 30y Bund greenium.

**Historical evolvement of the 10y greenium on Bunds…**

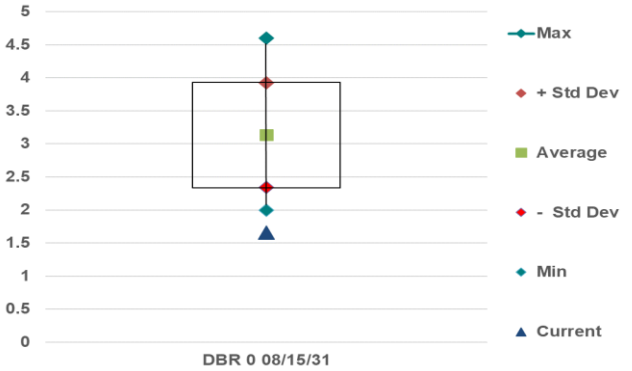
Greenium statistics DBR 0 08/15/30 in bp




Source: ABN AMRO Group Economics, Bloomberg

**… which is currently trading around its lowest value**

Greenium statistics of DBR 0 08/15/31



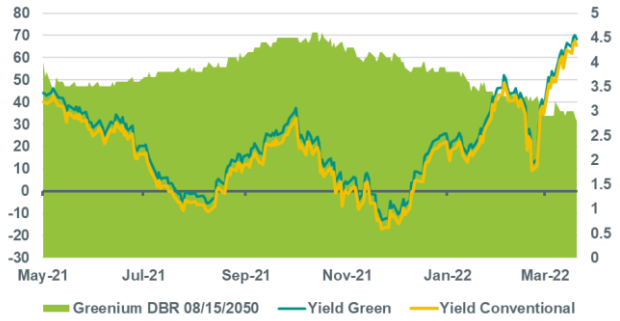

Source: ABN AMRO Group Economics, Bloomberg

**Greenium on the 30y Bund has been relatively stable**

Germany launched a 30y green Bund in May last year and raised EUR 6bn. The greenium of the 30y Bund hasn't performed since the launch and is trading in a relatively tight range as shown in the graph below on the left. Indeed, it has a trading range between 2.6bp and 4.6bp, while the standard deviation is only 0.4bp, which is the lowest amongst all green Bunds. In line with the 10y Bund greeniums, the 30y Bund greenium is also trading around its lowest value as shown in the figure below on the right.

## 30y Bund greenium is relatively stable…

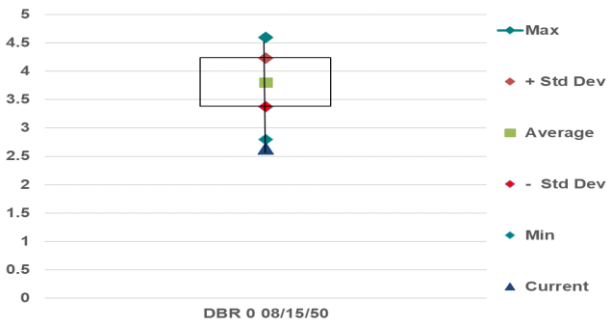
Yield in bp 30y greenium in bp




Source: ABN AMRO Group Economics, Bloomberg

## …and is trading around its lowest level

Greenium statistics of DBR 0 08/15/50 in bp




Source: ABN AMRO Group Economics, Bloomberg

# It is SLB week in the corporate bond space

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- **The Sustainability-Linked Bond (SLB) market remains relatively busy in the corporate space**
- **Last week, we saw 3 issuers coming to the market with inaugural SLBs, while the private-equity firm EQT issued its second, following a debut last year**
- **This represents almost half of the total volume of last week's issuance in the EUR IG corporate bond market**
- **Below, we have reviewed the structures of these new SLBs**

It was a busy last week with several issuers coming to the market with Sustainability-Linked Bonds (SLBs). On Wednesday, we saw private-equity firm EQT issuing its second SLB, following a debut late last year. EQT is the only private-equity firm (and one of the only in the holding company / financial space) to issue a SLB. The company opted for EUR dual-tranche 6- and 10-yr SLBs, which attracted modest books given 2.0x and 1.8x oversubscription, respectively. Despite the ESG angle, EQT still had to pay double-digit NIPs to get the deal done. For the new SLBs, EQT has as a KPI that for 40% of its eligible fund's private and listed equity portfolio companies should have science-based targets (approved by the Science-Based Targets Initiative, or SBTi) by 2025. As we stated in previous publications (see **here**), the SBTi validates whether a company's targets are in line with what the latest climate science experts deem necessary to meet the goals of the Paris Agreement. EQT itself had its targets validated by SBTi in October 2021 and now it aims that all of its funds' private and listed equity portfolios will have science-based targets by 2030.

We do note that the existing EQT Sustainability-Linked Financing Framework targets that its own science-based targets are validated by the SBTi. Hence also the analysis of the Second Party Opinion (SPO) provider refers to only this EQT holdco target. We find it therefore hard to assess this specific new target aimed for the investment companies, and it would be constructive if the company were to issue an updated SPO.

Furthermore, as we stated in our previous publication, having SBTi approved goals does not necessarily mean that the company will be able to achieve those targets. It is not part of the initiative's assessment to evaluate whether there is, for example, an investment plan in order to achieve those targets. Additionally, EQT, by requiring companies to have science-based targets, also assumes that the carbon reduction of its own investment portfolio will be according to the Paris Agreement. However, if companies are not able to reach their own SBTi-validated targets, it could likely be that EQT's emissions are not reduced as expected, bringing therefore the degree of ambition of this KPI into question. Furthermore, EQT reported that only 5 companies in its portfolio had submitted commitment letters to SBTi in 2021 (expected to increase to around 45 by the end of this year). This compares to 184 companies it currently has in its portfolio. Hence, it still seems that EQT has a challenge in front of it to reach its own 40% (74 companies) target.

**SLBs as attractive instruments for utility companies still invested in coal**

Later the same day, Czech-based electricity generation and distribution company CEZ came to the market with an inaugural SLB. CEZ follows in the footsteps of SLB pioneer Enel, as well as the Dominican Republic-based EGE Haina. The company issued a 5-year EUR 600m bond, which attracted solid demand of over EUR 3.2bn. Nevertheless, by looking at its existing curve, we estimate that it had to pay around 13bps of NIP, which indicates that investors still require some spread premium to be paid in the primary market. CEZ is relatively active in energy sources usually "disliked" by ESG investors, such as nuclear, natural gas and in the coal space, although we do note that coal power-fuel generation represents only less than 1% of the company's revenues but 33% of the electricity generation (if including coal mining, coal would represent around 6% of the company's total revenues). Nevertheless, the company has strong commitments on fully phasing out coal by 2038, while reducing its contribution to electricity generation to 12.5% by 2030. However, this will be achieved by also increasing the electricity generation coming from other contentious sources such as natural gas and nuclear. CEZ also has committed to investors that, although used for general corporate purposes, the proceeds of the SLB will not be used for coal power projects.

Under this new SLB, CEZ has committed to reduce scope 1 GHG emissions by ca. 31% by 2025 (from a 0.38 tCO2/MWh baseline in 2019). This KPI was assessed by the SPO provider as core and relevant to the company, as well as being ambitious compared to its past performance. However, it does not include scope 2 and 3, so it only represents 42% of CEZ's total GHG emissions, since CEZ also delivers natural gas to clients for heating purposes. The company is also still awaiting SBTi validation on its targets. Looking at CEZ's peer Enel, the Italian-based electricity generation and distribution company and SLB pioneer, it aims to reduce scope 1 emissions to 126g CO2/kWh by 2030. Although not linked to this SLB, CEZ has also included a 2030 target in its Sustainability-Linked Financing Framework, mainly to reduce scope 1 emissions to 0.16 tCO2/MWh by 2030. Transforming Enel's target so it is comparable, we can see that CEZ's target is only marginally higher than Enel's (0.13 tCO2/MWh). However, we do note as well that Enel reports two times more GHG emissions than CEZ due to its much bigger size but also a ratio of GHG emissions/ revenues which is almost 7 times higher than CEZ. If it fails to meet its target, CEZ will pay up a final payment at maturity of 75bps. This represents 32% of the company's final coupon.

**Sanofi expanding the SLB market for pharmaceutical companies**

Sanofi, the Paris-based pharmaceutical company, was also in the market last week with an inaugural SLB. The company issued (along with a regular EUR 850m 3yr bond) a EUR 650m 7yr SLB. The company attracted an orderbook of EUR 2.4bn (3.7x oversubscription) on the SLB, which allowed it to price the bond only 2bps above its curve. This compares to a 5bps NIP paid in the conventional bond, despite its shorter maturity.

The Sanofi SLB KPI targets treatment provision to at least 1.5 million patients between 1 January 2022 and 31 December 2026 (cumulative) in low- and lower-middle income countries by Sanofi Global Health (its non-profit arm). In 2019, it provided treatment to 140k patients. Hence, this represents a yearly increase of around 300% compared to 2019 levels. In the pharmaceutical EUR bond space, we only have seen Novartis and Teva issuing SLBs so far. Novartis has also included in their Framework to treat - by 2025 - 1.64 million patients across low- and middle-income countries with strategic innovative therapies (that is, non-generic therapies that, for example, address a significant global disease burden, are commercially viable and represent innovative standings). Although this target is slightly higher than Sanofi's, we do note that Novartis had reached 548k patients in 2019, which is a significantly higher base than Sanofi. In its SLB, Teva targets an increase in the cumulative number of new regulatory submissions in low- and middle-income countries on certain pre-specified WHO's essential medicine list (EML) across six key therapeutical areas (TAs) by 150% by 2025. Hence, Teva did not have a commitment in terms of increasing patient outreach, and has however focused on submissions rather than approvals on the WHO's EML list. While we do acknowledge that Teva does not have control over the approvals, we do note that there is no commitment towards the level (and significance) of these submissions.

If Sanofi fails to reach its 2025 target, it will increase its coupon from April 2028 onwards (that is, only 2 coupons) by 25bps. The 2028 is relatively far away from the observation date of 31 December 2025. This brings the total step up to 50bps, compared to an annual 125bps coupon on the bond.

**Pernod Ricard attracted solid demand for its inaugural SLB**

Lastly, on Thursday, Pernod Ricard, the French wine and spirits producers issued an inaugural SLB. The deal attracted a solid EUR 3.4bn demand, which allowed the company to print a EUR 750m 7yr. The SLB structure, as well as the company's profile, looks to have assisted Pernod in having to pay only 2-3bps of NIP in this deal. Despite fears of inflationary pressure in the consumer staples space, the company provides a high degree of comfort to investors. Pernod holds a strong market position, securing the top 2 position globally and therefore accounting for about 6% of the total volume (close to 10% by value) in the global spirit industry. Hence, this allows the company to have sound revenue diversity in terms of brands, channel, and regions, which represents a key mitigant to limit market volatility. Furthermore, Pernod's focus on premium brands, as highlighted by its recent acquisitions in the high-end spirit segment, allows the company to secure higher pricing flexibility and drive sales growth. Nevertheless, it also stills hold a good position within the so-called "mass market" (lower-end beverages). We believe that all-in-all, Pernod presents itself with a good profile to mitigate risks given the deterioration in consumer confidence, as well as the general macroeconomic environment.

In the Consumer staples universe, beverage companies provide a "safer haven" as they continue to benefit from a gradual recovery in demand as the effects from the pandemic begin to ease. This might help offset higher inflationary costs.

Furthermore, as other peers suffer from their decisions to withdraw business from Russia (such as Carlsberg), Pernod only has a limited exposure to the country (in the single digit space, ca. 8% of total earnings).

Looking at its SLB and chosen KPI's, the company aims to reduce scope 1 and 2 GHG emissions by 26% by 2025 (that is, to below 220 kT) and reduce water consumption per thousand litters of pure alcohol distilled by 12.5% by 2025, to 17.34 (both against a 2018 baseline). Looking at other beverage companies, only Coca-Cola has a SLB outstanding (through its issuing company Coca-Cola Icecek, although we note the Framework refers to the Coca-Cola FEMSA Group) . The company has similar targets as Pernod, aiming to also reduce water consumption per litter of beverage. Although Coca-Cola does not have a 2025 target, it does include a 2024 and 2026 one. Hence, through a simple linear extrapolation, we could assume that Coca cola aims to achieve 1.31 litters of water per litters of beverage by 2025 (which is also expressed in m3/thousand litters). Hence, Pernod's target of 17.34 is significantly higher than Coca-Cola's. However, we note that the different business models (Pernod produces distilled alcohol, which requires more water than normal beverages) makes this perhaps not a fair comparison.

## ESA urges investors to use draft RTS for upcoming reporting requirements

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- **The three European Supervisory Authorities (EBA, EIOPA and ESMA) published last week an updated statement on the application of the Sustainable Finance Disclosure Regulation (SFDR)**
- **The SFDR aims to impose mandatory ESG disclosure obligations for financial market participants and financial advisers**
- **The ESA has been mandated to develop the content, presentation and methodology of certain reporting requirements, for which a draft was submitted last year**
- **While the final text awaits final approval from the European Commission, the ESA urges investors to use the draft for upcoming reporting requirements – including the Taxonomy regulation, which is applicable as of this year**
- **Regulatory uncertainty, as well as certain reporting requirements under the SFDR, remain a challenge for investors**

The three European Supervisory Authorities (EBA, EIOPA and ESMA – ESAs) last week disclosed an updated statement on how the Sustainable Finance Disclosure Regulation (SFDR, see **here**) should be applied. Below we have highlighted what the SFDR is, its relationship with the Taxonomy Regulation, as well as a brief recap of the relevant timelines and disclosure requirements for financial market participants.

**What is the SFDR?**

The SFDR is a regulation on EU-level that imposes mandatory ESG disclosure obligations for financial market participants and financial advisers (with the focus on investments, for example, of asset managers, credit institutions that provide portfolio management, investment funds, and insurers – hereby named as "investors"). Its goal is to increase transparency on how sustainability is integrated into investors' investment decisions. This includes, for instance, (i) the incorporation of sustainability risks, (ii) the consideration of adverse sustainability impacts, and (iii) the provision of sustainability-related information (including sustainable investment objectives), all with respect to financial products. The required ESG disclosures under the SFDR are set both on firm and product-level.

The SFDR came into force on 10 March 2021.

**What is the relationship between SFDR and the Taxonomy Regulation?**

As we noted in previous publications (see **here**), the Taxonomy Regulation, introduced in 2020, establishes a framework to "facilitate sustainable investment" by the means of establishing a definition of "environmentally sustainable" activities (the EU Taxonomy). Similar to the SFDR, this regulation also requires investors to disclose information related to their investments in financial products (Article 5 and 6). For example, investors shall disclose (i) the proportion of investments in environmental sustainable economic activities, as percentage of all investments; and (ii) a confirmation that these investments in environmental sustainable economic activities "do no significant harm", as specified in the regulation. As such, there is some overlap between the two regulations.

It is important to note is that the SFDR was created with the purpose of setting out much more detailed and extensive ESG disclosure requirements than the Taxonomy regulation. However, to ensure harmonization, the SFDR also aims to interrelate to the extent possible with the Taxonomy regulation.

The taxonomy regulation is effective from 01 January 2022.

**What are the disclosure requirements under the SFDR and when do financial market participants need to report on those?**

A set of the disclosure requirements set out under the SFDR are already applicable since 10 March 2021, when the regulation came into force. These include the so-called "SFDR level 1" disclosures, which are on investor level. Below we have highlighted a few of these disclosure requirements.

Level 1 disclosures (applicable as of 10 March 2021)

Investor's shall disclose:

- Information about the integration of sustainability risks on their policies
- Information about the identification of principal adverse sustainability impacts and indicators, including a description of this adverse impact
- A statement on due diligence policies with respect to the adverse impacts of investment decisions on sustainability factors (commonly known as "Principal adverse impacts"), which takes into account size, nature and scale of their activities and the types of financial products. Or, in case adverse impacts on sustainability factors are not considered, a clear reason for why this is the case, including whether they intend to consider those in the future (applicable as of 30 June 2021 for investors with over 500 employees).
- Information on whether and, if so, how, investments take into account principal adverse impacts on sustainability factors (applicable as of 30 December 2022 for investors that do consider adverse impacts of investment decisions on sustainability factors; applicable as of 10 March 2021 for those that do not)
- Information on how remuneration policies are consistent with the integration of sustainability risks
- Information on how sustainability risks are integrated into investment decisions and the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products

Additional (more detailed) disclosures are applicable further in the future, which are called SFDR level 2 disclosures. These are also on a product-level (and not only entity-level, as is the case with those of level 1). The key difference between level 1 and 2 disclosures is that the latter includes a quantification of sustainability risks and/or adverse impacts of their investments. This requires therefore quantitative (alongside qualitative) disclosures of the outcome of that assessment. In addition, level 1 disclosure requirements are usually on a "comply-or-explain" basis only.

Furthermore, level 2 disclosure requirements also vary according to the sustainability classification of the investor. For example, investors that offer financial products with clear sustainable investment as their objective (Article 9 or "dark green" investors), must disclose also the proportion of investments in environmental sustainable economic activities. This is not the case for investors that offer financial products/portfolios that only promote environmental and social characteristics (Article 8 or "light green" investors). Please see below examples of level 2 disclosures:

Level 2 disclosures

Investor's shall disclose:

- A statement that the financial product/investment complies with the 'do no significant harm' principle of the Taxonomy regulation
- Within the statement on due diligence policies with respect to the adverse impacts of investment decisions on sustainability factors (level 1 disclosure), the investor shall disclosure sustainability indicators in relation to adverse impacts (i) on the climate and other environment-related adverse impacts and (ii) in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters
- Information on how financial products promote environmental or social characteristics (only applicable to Article 8 investors)
- Information on how financial products are aligned with sustainable investment objectives (for example, if the objective is reduction in carbon emissions, the investor must disclose a view on how it assists to achieve the long-term global warming objectives of the Paris Agreement) (only applicable to Article 9 investors)
- Information on the proportion of investments in environmental sustainable economic activities, as percentage of total investments (only applicable to Article 9 investors)

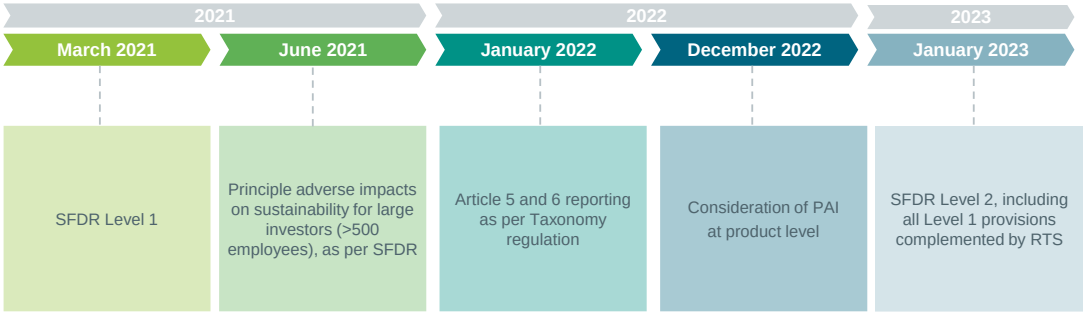
**What is ESA's role?**

Level 2 disclosures, as highlighted above, require the development of a methodology specifying how exactly these items need to be assessed, especially with regards to quantitative assessments. These are called "regulatory technical standards", or RTS, for which the ESA has been responsible for. The ESA needed to propose these RTS for all relevant articles in the SFDR (related to Level 2 disclosures), which it did in two parts, with draft reports published on 4 February 2021 and on 22

October 2021. The drafts need to still be reviewed and adopted by the European Commission, which had until January of this year to put forward any objections. As the EC did not do so, a Commission Delegated Regulation containing the Regulatory Technical Standards (RTS) is therefore expected for later this year (the "RTS regulation"). You can find the ESA's draft RTS **here** and **here**.

Furthermore, the EC announced in November last year that the application date of the RTS will be 1 January 2023, while this was 1 January 2022 originally. It was not the first time a delay in implementation took place. Nevertheless, in the statement released last week, the ESA urged market participants to apply the draft RTS as preparation for the level 2 disclosures within the interim period from 10 March 2021 until January 2023. Moreover, as the disclosures under the Taxonomy Regulation (Article 5 and 6, as we mentioned above) are already applicable as of 01 January 2022, the ESA has also advised investors to make use of the draft RTS for the purpose of reporting as per the Taxonomy regulation.

**Updated timeline for SFDR application**




Source: EBA, ABN AMRO Group Economics.

**What are the current challenges of the SFDR?**

The key message of ESA's statement was that the application of the SFDR (as well as the Article 5 and 6 of the Taxonomy regulation, which is already applicable as of this year) should not depend on the formal adoption and entry into force of the RTS regulation. This brings the risk that the final RTS will be different. On top of that, this means that investors will need to rely on a report not yet approved by the European Parliament as well as the EU Council, whereas the regulation has already come into force. Importantly, even after the adoption of the RTS regulation, EU legislators have up to three months to intervene. This, coupled with the regular delays in the application of the RTS (as well as unclarity on whether the regulation will be in place before end of this year) has resulted in regulatory uncertainty amongst investors.

The ESA's statement also allows for some flexibility on how the draft RTS will be applied, given that investors already need to disclose information under the Taxonomy Regulation Article 5 and 6, for which they need to use the same RTS. For example, ESA allows for qualitative clarifications explaining the determination of the Taxonomy-alignment of products, which will probably be rather fragmented. This flexibility results in perhaps granularity (and differences) in terms of reporting. This raises questions for clarification on what exactly is expected from investors in terms of SFDR reporting.

Another point of attention is that ESA did not clarify a publication date for the detailed RTS nor provides clarity on the frequency of periodic requirements. Hence, while the statement did make clear that level 2 reporting should take place as of 1 January 2023, it does not specify whether this needs to be done on a quarterly or annual basis, for example (that is, by end of March or by end of December 2023).

Furthermore, as we previously noted, disclosure requirements vary according to the investors classification ("dark green", or investors that comply with Article 9 of the SFDR, "light green", or those that comply with Article 8, or "neutral", which are investors that neither comply with Article 8 nor 9, and are therefore only required to fulfil reporting obligations under Article 6). However, what we did not mention is that the classification is done on a "self-reporting" basis, as there is no yet guidance from the European Commission on how the classification should be established.

Hence, an analysis performed by Morningstar earlier this year showed that more than 1,000 funds that have actually classified themselves as either “light” or “dark green” under the SFDR do not really seem to fit the “green” box (see **here**). Morningstar, who performed an extensive due diligence across all funds, discovered problems including “ambiguous language in their legal filings”. These combined funds have around USD 1.4bn of assets under management. Hence, it seems that finding a common ground on what constitutes a sustainable investment remains a challenge.

Furthermore, the SFDR application can be particularly challenging for index-tracking and exchange traded funds (ETFs). As these are passive funds, and therefore cannot actively decide on investments, they are not allowed to adjust their strategies in order to meet disclosure requirements as stated under Article 8 and 9 of the SFDR. Consequently, only 20% of the assets in index funds and ETFs have been able to classify themselves as dark or light green. This compares to around 40% for actively managed funds, according to Ignites Europe. This might have an impact in future growth, as investor demand is set to increase in sustainable funds in the future.

# Scale up investments in heat pumps set to continue

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- **Heat pumps are gaining popularity and importance in the built environment transition**
- **The growth in the number of installed heat pumps is higher for non-residential than for residential**
- **The installation of heat pumps can be a good step towards carbon neutrality**
- **But at the same time, this requires higher energy efficiency of buildings through insulation**

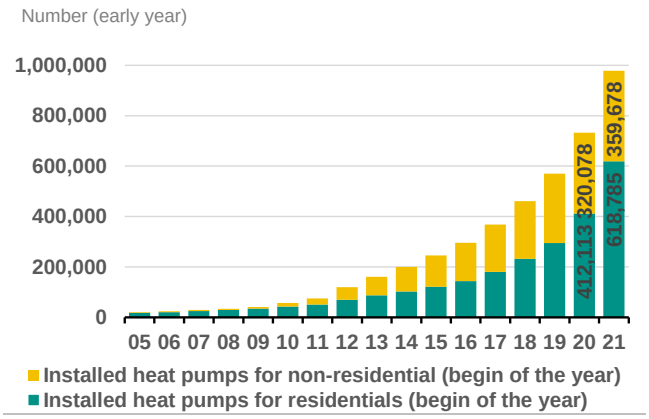
**Heat pumps gain more popularity**

The built environment is a major consumer of gas in Europe. About 40% of the total gas consumption in the EU is used in the built environment. The vast majority of this is intended for heating purposes. But much of that gas currently comes from Russia and the European Commission (EC) wants to reduce dependence on that flow more quickly in the coming years, as part of its *REPowerEU* plan (see our note on the plan here). To realise this transition, heat pumps have received increasing attention. In addition, heat pumps also play a role in achieving the EU's low-carbon future. Reason enough for the EC to accelerate the roll-out of heat pumps.

An advantage of many heat pumps is that a large part of the energy required for the heat pumps to heat buildings can come from renewable energy sources. This share varies of course and is strongly related to the time of year and also the type of pump. In any case, it is certain that the amount of fossil fuels burned compared to when using a traditional gas boiler will fall significantly.

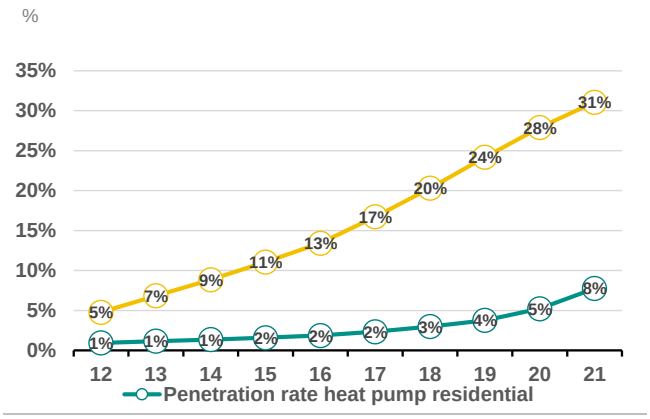
Another reason why investing in heat pumps has gained more attention is because they can be used relatively easily on a broader scale. This means they can be used in large commercial or multi-family buildings. A network of heat pumps is therefore an efficient way to reduce CO2 emissions at a faster pace while lowering costs.

**Number of heat pumps residential and non-residential**




Source: CBS, ABN AMRO Group Economics

**Heat pump penetration rate**




Source: CBS, ABN AMRO Group Economics

The number of heat pumps has increased significantly in the built environment in recent years. In the past 15 years, 30 times more heat pumps have been installed in Dutch residential buildings. The number of heat pumps has grown even faster in non-residential buildings. Since 2006, close to 117 times more heat pumps have been installed in this segment. In this case, non-residential buildings refer to utility buildings, greenhouses and stables. Utility buildings include buildings that have a function other than living, such as offices, hospitals, sports halls and schools. The growth in the number of heat pumps is expected to continue in the coming years, partly fuelled by climate policy and is currently being enhanced by geopolitical stress and high gas prices. This means that the total number of installed heat pumps will exceed the 1 million mark in 2022.

The penetration rate of the heat pump – this is the extent to which heat pumps have been implemented in the built environment – has also increased with the growth of installed heat pumps in recent years. Here we see also a large differences between residential and non-residential buildings. In the past ten years, the share of heat pumps in relation to the number of residential buildings has increased by 7%-points and for non-residential buildings this is 26%-points. The difference in growth rate between the two types of buildings is not only due to the level of investments for a heat pump and

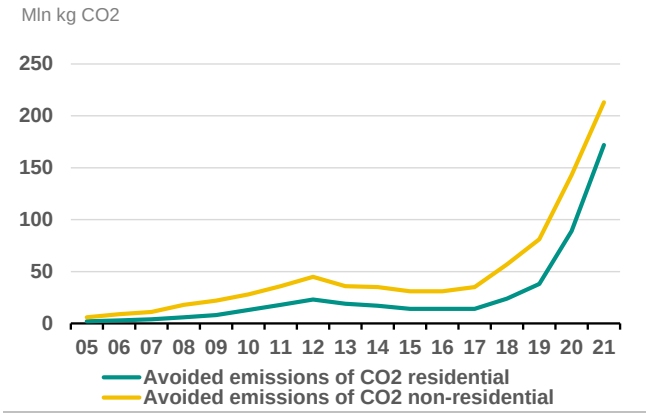
the financial capability of the owners or user. The obligation to bring offices up to at least an energy label C in or before 2023 also plays a major role here. Because of the current relatively high gas prices the payback period is considerably shortened, which provides an investment incentive. On the other hand, the costs of making heat pumps rose over the past years significantly, which partly dampens the incentive to invest.

**Social gains**

The installation of heat pumps can be a good step towards carbon neutrality, provided the heat pumps are powered by renewable energy sources. It is important in this case that the wind and solar capacity must be scaled up in the coming years. But on balance, the heat pumps are only part of the low-carbon puzzle for the built environment and reducing gas demand to almost zero. More is needed. For example, it must also take place in tandem with more efficiency measures in the built environment. This means that higher energy efficiency of buildings through insulation should be more encouraged and financially incentivized.

*Carbon Trust* – an independent British consultancy with a mission to accelerate the transition to a low-carbon economy – has calculated that heat pumps have great potential for saving CO2. The use of heat pumps can lead to a 65% reduction in CO2 compared to an A-classified gas boiler and even up to 70% compared to electric heating.

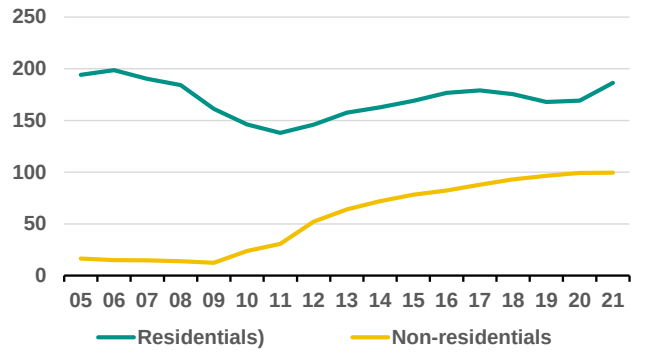
**Avoided CO2 emissions by heat pump**




Source: CBS, ABN AMRO Group Economics

**Ratio energy flow usage versus number of heat pumps**

Consumption of electricity/gas heat pump (in TJ) vs number of heat pumps




Source: CBS, ABN AMRO Group Economics

This effect can partly be seen in the avoided CO2 emissions with the installation of heat pumps, in both residential and non-residential areas. The consumption of fossil fuels – via the conventional gas boiler – has decreased over time. The efficiency of many heat pumps has improved and this contributes to the reduction in CO2 emissions. However, an acceleration of the avoided CO2 emissions from non-residential buildings can only be seen after 2017. For residential buildings, this is the case from 2019 onward. Many heat pumps depend on the use of electricity and natural gas. These are mainly hybrid heat pumps that are installed in residential buildings, for which a gas connection remains necessary. The air-to-water and air-to-air heat pump systems use electricity, because the heat pump's compressor needs power. This also applies to the geothermal and water/water heat pumps, but both use less power than the air/water and air/air variants. The geothermal pumps are ideal for new construction or large-scale renovations.

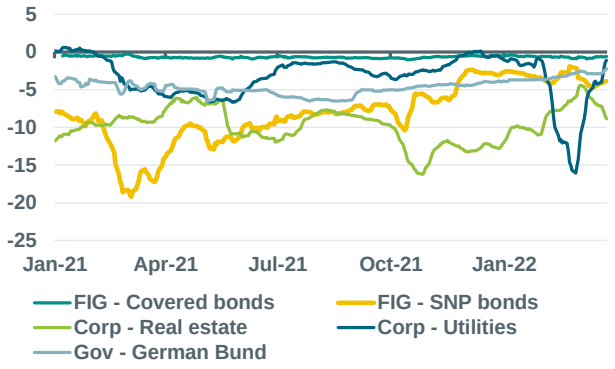
Netbeheer Nederland, Techniek Nederland en Natuur & Milieu launched a plan in 2021 to install up to 2 million heat pumps by 2030. It should be possible to install at least 100,000 heat pumps per year from 2024 on the basis of the government subsidy scheme.

Despite the fact that investments in heat pumps will continue to increase, it will take some time before the large scale is reached. Demand is currently so high that there is a major shortage of installers. Moreover, the network capacity is still insufficient to serve a larger scale of heat pumps. To achieve a good balance in this respect, highly energy-efficient buildings are crucial. And this starts with insulation measures and the installation of solar panels.

# ESG in figures

## ABN AMRO Secondary Greenium Indicator

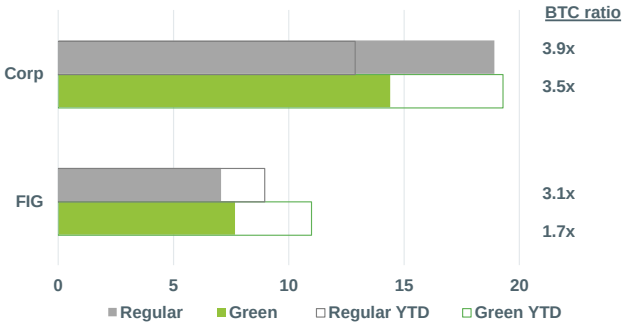
Delta (green I-spread – regular I-spread)




Note: Secondary Greenium indicator for Corp and FIG considers at least five pairs of bonds from the same issuer and same maturity year (except for Corp real estate, where only 3 pairs were identified). German Bund takes into account the 2030s and 2031s green and regular bonds. Delta refers to the 5-day moving average between green and regular I-spread. Source: Bloomberg, ABN AMRO Group Economics

## ABN AMRO Weekly Primary Greenium Indicator

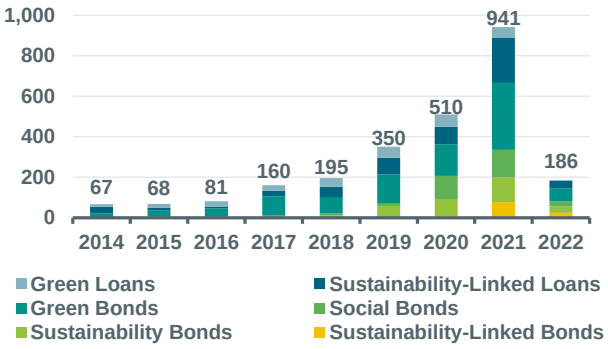
NIP in bps




Note: Data until 31-3-22. BTC = Bid-to-cover orderbook ratio. Source: Bloomberg, ABN AMRO Group Economics.

## Sustainable debt market overview

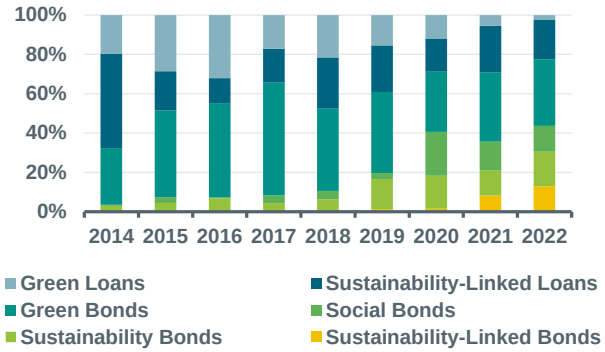
EUR bn




Source: Bloomberg, ABN AMRO Group Economics

## Breakdown of sustainable debt by type

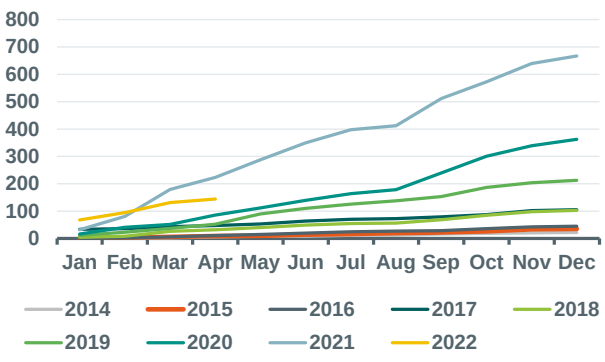
% of total




Source: Bloomberg, ABN AMRO Group Economics

## YTD ESG bond issuance

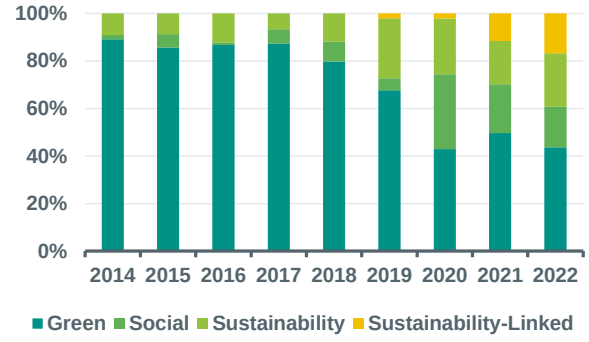
EUR bn




Source: Bloomberg, ABN AMRO Group Economics

## Breakdown of ESG bond issuance by type

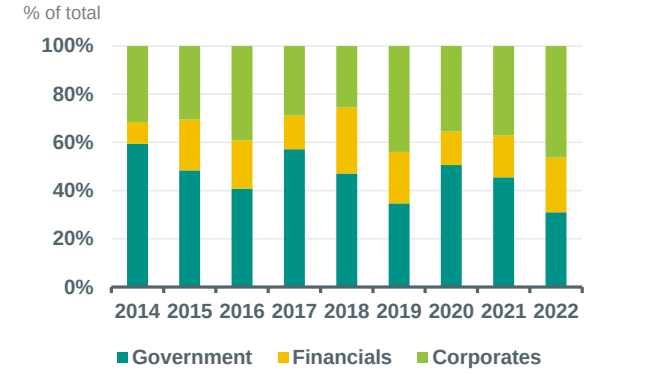
% of total




Source: Bloomberg, ABN AMRO Group Economics

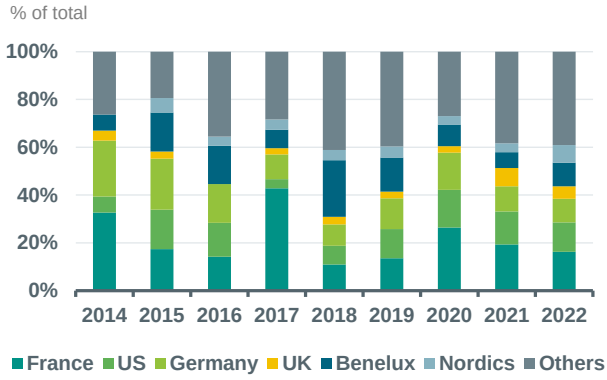
Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

## Breakdown of ESG bond issuance by sector



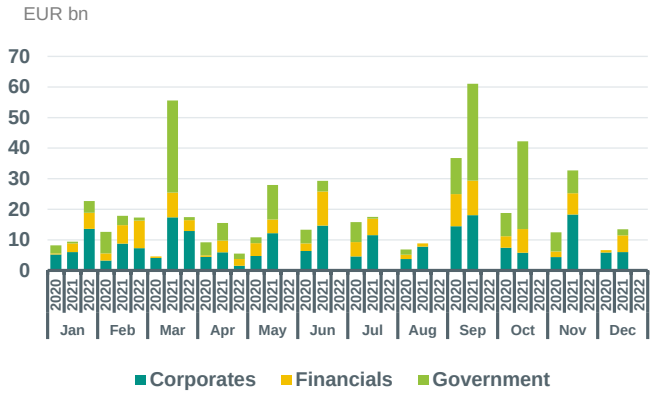

Source: Bloomberg, ABN AMRO Group Economics

## Breakdown of ESG bond issuance by country



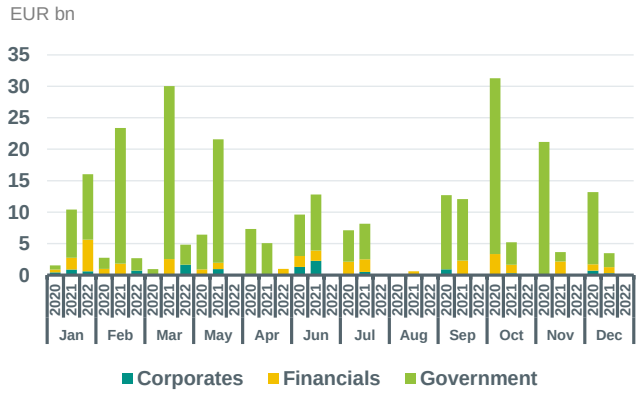

Source: Bloomberg, ABN AMRO Group Economics

## Monthly Green Bonds issuance by sector



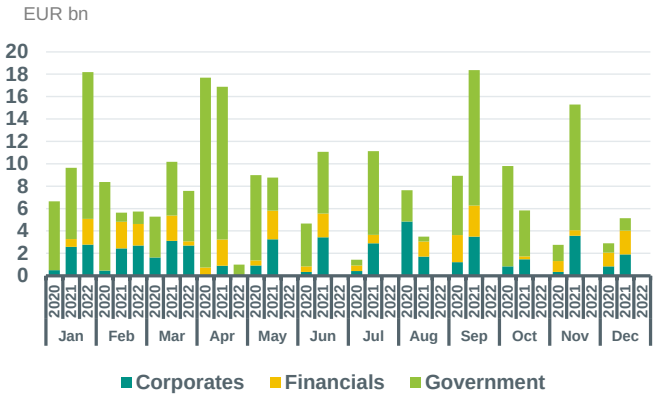

Source: Bloomberg, ABN AMRO Group Economics

## Monthly Social Bonds issuance by sector



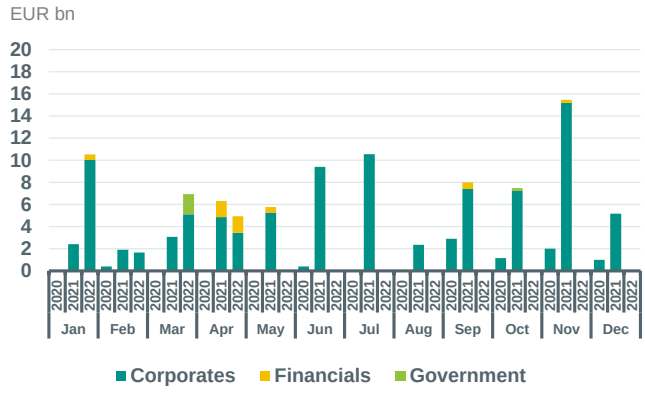

Source: Bloomberg, ABN AMRO Group Economics

## Monthly Sustainability Bonds issuance by sector




Source: Bloomberg, ABN AMRO Group Economics

## Monthly Sust.-Linked Bonds issuance by sector



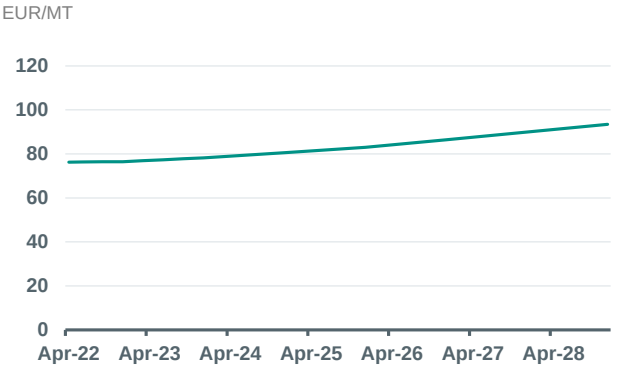

Source: Bloomberg, ABN AMRO Group Economics

Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

## Carbon contract current prices (EU Allowance)

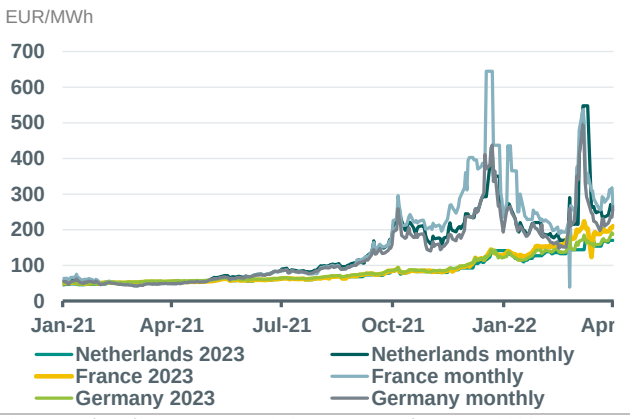

Source: Bloomberg, ABN AMRO Group Economics

## Carbon contract future prices (EU Allowance)



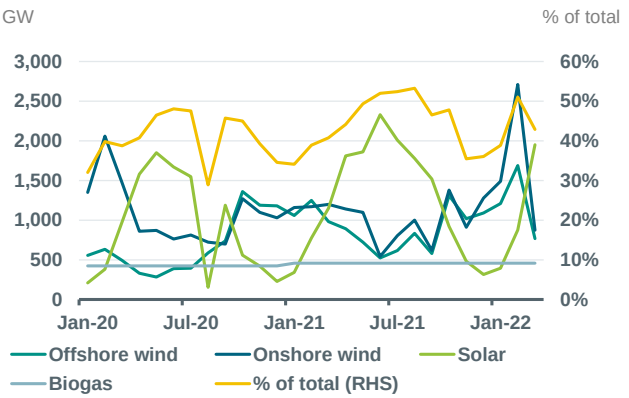

Source: Bloomberg, ABN AMRO Group Economics

## Electricity power prices (monthly & cal+1 contracts)



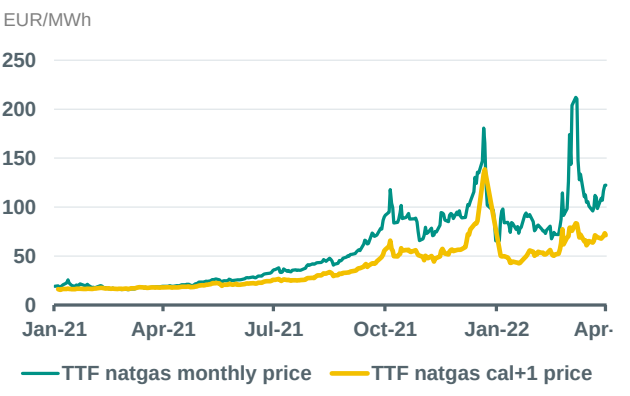

Source: Bloomberg, ABN AMRO Group Economics. Note: 2023 contracts refer to cal+1

## Electricity generation from renewable sources (NL)



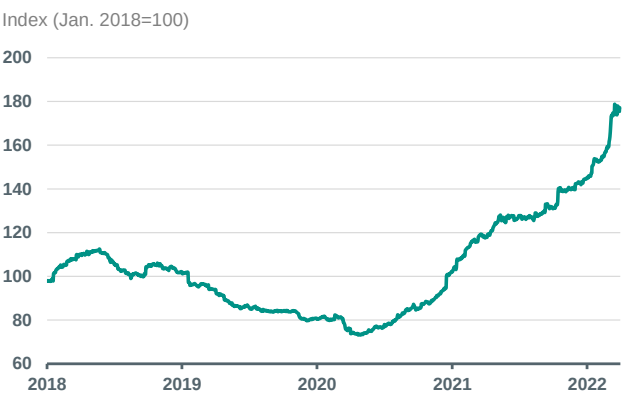

Source: Energieopwek (Klimaat-akkoord), ABN AMRO Group Economics

## TTF Natgas prices




Source: Bloomberg, ABN AMRO Group Economics

## Transition Commodities Price Index




Note: Average price trend of 'transition' commodities, such as: corn, sugar, aluminium, copper, nickel, zinc, cobalt, lead, lithium, manganese, gallium, indium, tellurium, steel, steel scrap, chromium, vanadium, molybdenum, silver and titanium. Source: Refinitiv, ABN AMRO Group Economics

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