

SustainaWeekly

High carbon sectors to suffer margin squeeze

- ▶ **Strategy Theme:** Rising oil and gas prices will be more difficult for corporates to pass through, as consumers are feeling the pinch as well. We use the reported carbon intensities of corporates to calculate fossil fuel energy usage and the impact of higher energy prices on corporate profit margins and leverage.
- ▶ **Economics Theme:** The Science Based Targets Initiative (SBTi) has decided to no longer validate the Paris-alignment of targets from companies in the oil and gas sector. This means that 5 companies who had their targets previously validated will be removed from SBTi.
- ▶ **ESG Bonds:** Four new deals from 3 different companies came to the Corporates market this week, all with an ESG label. Despite strong orderbooks, companies were still required to pay double-digit new issuance premiums to get the deals done.
- ▶ **Policy and Regulation:** An ECB report found that many banks still do not adequately disclose the impact of climate risks on their risk profile. Some improvement has been made with banks describing the incorporation of climate risk in governance, risk management and business model. However, the level of detail and disclosure of methods is still minimal.
- ▶ **Company and Sector news:** Emissions in the Netherlands fell sharply in 2020 but due to the cold early months of 2021 and the partial return to normal in the second half of 2021, emissions increased again annually last year. The buildings and agricultural sectors led the move higher.
- ▶ **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 cover a rich range of topics. We looked at the impact of the fossil fuel price shock on the margins of various sectors, using the carbon intensities reported by corporates. We then take a closer look at the Science Based Targets Initiative (SBTi), which will no longer validate the Paris-alignment of targets from companies in the oil and gas sector. We then go on to assess last week's ESG bond issuance in the corporate space, an ECB report on inadequate bank ESG disclosures and the recent deterioration in emission trends in the Netherlands. Enjoy the read and, as always, let us know if you have any feedback!

Nick Kounis, Head Financial Markets and Sustainability Research | nick.kounis@nl.abnamro.com

SBTi no longer validates targets from the oil and gas sector

Larissa de Barros Fritz – ESG & Corporates Strategist | larissa.de.barros.fritz@nl.abnamro.com

- ▶ **The Science Based Targets Initiative (SBTi) has decided to no longer validate the Paris-alignment of targets from companies in the oil and gas sector**
- ▶ **This means that 5 companies who had their targets previously validated will be removed from SBTi**
- ▶ **SBTi has seen rapid growth over the years, although most companies have still not set any targets**
- ▶ **The validated targets also still mostly refer to scope 1 and 2 only, with only 0.6% having combined scope 1,2 and 3 targets validated**

On March 8th, the well-known Science Based Targets Initiative (SBTi) has announced it would “no longer accept commitments or validate targets from fossil fuel companies”. In this piece, we quickly discuss what the SBTi is, what might be driving its rapid growth over the years, as well as what this decision means to the oil and gas sector.

What is the SBTi?

The SBTi is a partnership initiative between Carbon Disclosure Project (CDP), the United Nations Global Compact (UNGC), the World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). It was launched in 2015 (the same year of the Paris Agreement) and has as its main goal to validate whether a company's targets are in line with what the latest climate science deems necessary to meet the goals of the Paris Agreement – limiting global warming to well-below 2°C above pre-industrial levels and pursuing efforts to limit warming to 1.5°C. The SBTi aims to mobilize the private sector to take urgent climate action by guiding companies in such target setting.

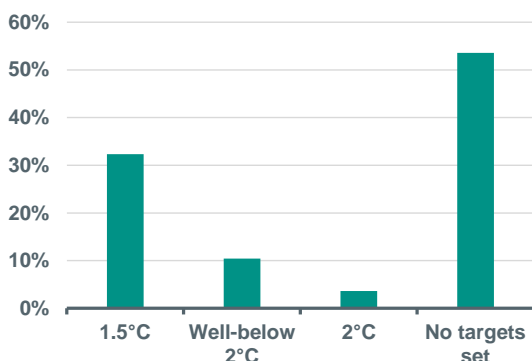
It is important to note that the SBTi, while validating and assisting companies to set decarbonization targets, does not require them to disclose *how* exactly those targets will be achieved. For example, its current methodology does not include an assessment of the amount of investments required to achieve those targets and/or what measures are going to be taken in order to reduce carbon emissions. Those should be included in the wider ESG strategy of the company. Investors should therefore look cautiously at SBTi targets, also always combining those with the wider action plan of the company when making assessments.

What sort of targets have the committed companies set?

Since the launch of the initiative, 2,643 companies have committed to the SBTi. Of these, only 46% have however already set a target. This means that the remaining 54% have made a public commitment to set a science-based target within the next 24 months, but have no targets set at the moment. Also within the 46% (1,227 companies) who have set a target, only 30% has aligned it with a “2 degrees” or “well-below 2 degrees” scenario, as defined in the Paris Agreement. Therefore the relatively high number of companies that align with a 1.5 degrees scenario is also attributed to the new SBTi criteria (October 2021), which stipulates that companies can no longer set scope 1 and 2 targets that are consistent with the 2 or “well-below” 2 degrees trajectory. That is not the case for scope 3, for which they can still set targets aligned with the 2 degrees scenario (except for companies involved in the sale/distribution of natural gas and/or other fossil fuels).

Most of companies do not have set targets yet

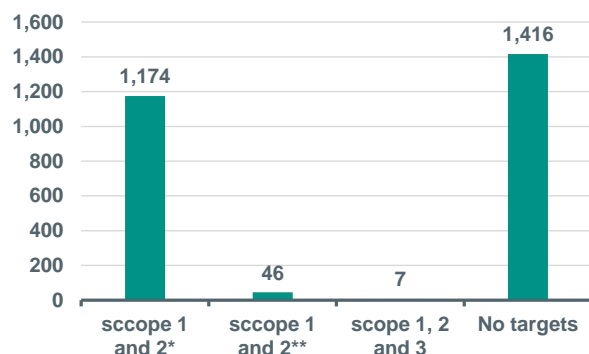
% of total



Source: SBTi, ABN AMRO Group Economics

And most targets set do not include scope 3

Number of companies



Note: Scope 2* refer to emissions that do not include the procurement of renewable energy, while scope 2** does. Source: SBTi, ABN AMRO

The target validation refers however still almost exclusively to scope 1 and 2 targets. From the 1,227 companies with validated targets, only 7 have set targets which include scope 3. Also, 46 companies have set scope 2 targets that include the renewable energy procurement (i.e. offset certificates). Under the existing (new) SBTi criteria, companies are allowed to refrain from a scope 3 target if these emissions do not represent more than 40% of total scope 1, 2 and 3. All companies however involved in the sale/distribution of natural gas and/or other fossil fuels must set a scope 3 target.

The targets mostly relate to 2030 (78% of the companies that have set a target). There are also 204 companies (17% of the companies) that have included targets for 2025. Meanwhile, a large majority - 75% - of those have also set a net-zero target. The current SBTi criteria requires companies to cover a minimum of 5 years and a maximum of 10 years (previously 15) from the date the target is submitted to the SBTi for validation. The choice of base year must be no earlier than 2015. There is however at the moment no limitations in order to evaluate whether the baseline year is in fact exceptionally higher than surrounding years. In particular, whether in that year specifically the company had exceptionally high emissions, which means that there is in reality hardly any emission reduction required.

The SBTi has grown sharply over the last years, especially since 2020

There are several potential reasons for that. The pandemic has shed light into more ESG-related matters, but even before that the awareness of climate change has been growing over the years. The growth of also ESG investing, and/or incorporation of ESG into investment decisions, might have spurred investors into applying pressure to companies to also set themselves clear actions and/or decarbonization trajectories. This includes, for example, Europe's largest asset manager Amundi, as well as a group of investors managing around USD 20tri in assets, who now require companies to set science-based targets. Also in the regulatory space, more ESG reporting requirements also require these companies to have ESG strategies and/or net zero targets. All these factors might have incentivised companies to look at credible initiatives that could assist them with these target-setting exercises.

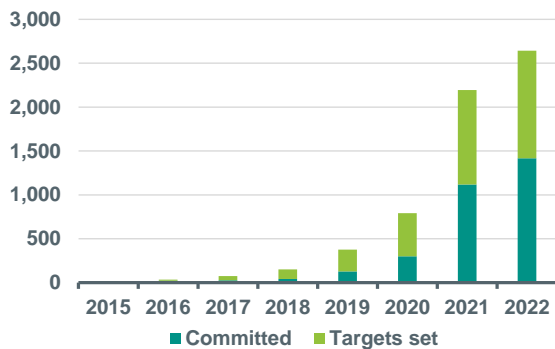
A closer look at the SBTi growth also shows that it is mostly driven by European-based companies. Europe is a leader when it comes to ESG. It was the first party to set a net zero target in line with the Paris Agreement. It has also set the ambition to reduce emissions by 55% by 2030 (vs 1990 levels). This has resulted in the EU green deal, the ESG strategy of EU, as well as several other initiatives (the "Fit for 55" package, the development of the EU Taxonomy, and the creation of financing tools dedicated for climate action, such as the NGEU and Just Transition mechanism). Europe is also the leader when it comes to ESG bond issuance, which includes as well Sustainability-Linked Bonds (SLBs). SLBs are instruments in which the company sets a target (usually linked to GHG emissions) and commits to reaching it within a pre-specified timeframe, otherwise it will have to pay a financial penalty to investors (e.g. a coupon step-up). Under the ICMA's SLB Principles (June 2020), these targets need to be "ambitious", which can therefore involve proving that they align with science-based scenarios. Hence, SBTi has served as a credible party to allow companies to demonstrate to their investor base (and Second Party Opinion providers) that their targets are, in fact, ambitious.

Indeed, since they first emerged in 2019, SLBs have grown also enormously. Only in 2020 and 2021, there were around EUR 126bn SLBs being issued, with nearly half in euro currency. This could have also served as another factor that pushed the growth of the initiative.

Despite the large growth of the SBTi, it is estimated that only 6% of all companies included in the MSCI World Index have set targets and/or decarbonization plans aligned with the 1.5 degrees scenario of the Paris Agreement, according to the Swiss-based investor Lombard Odier (data as of 2021). Around 25% aligned with a "well-below" 2 degrees scenario. This resulted in around 19% of the entire index universe to have set targets that were SBTi-validated. There is therefore still a significant amount of companies that need to set a decarbonization trajectory, which also opens the door for the SBTi to grow much further in the coming years.

SBTi validated targets have grown over the years...

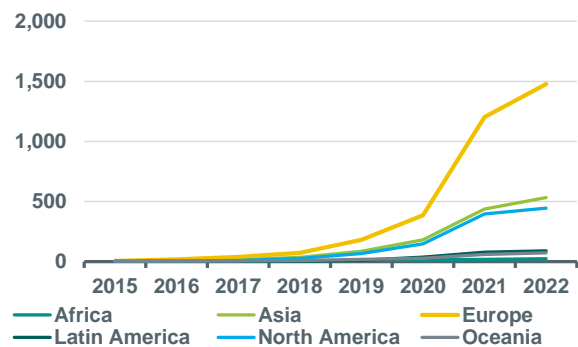
Cumulative number of companies



Source: Bloomberg, ABN AMRO Group Economics

... With the growth mostly driven by European entities

Cumulative number of companies



Source: Bloomberg, ABN AMRO Group Economics

The “exit” of SBTi from the Oil and Gas sector

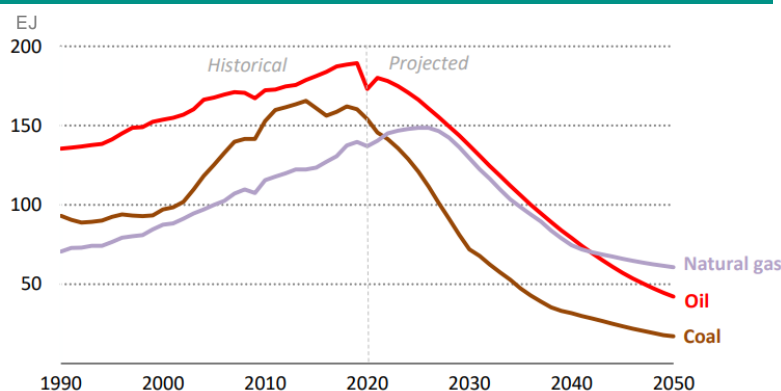
At the start of March, SBTi surprisingly announced it would no longer accept commitments and/or validate targets from fossil fuel companies. This means that, companies that have any level of direct involvement in exploration, extraction, mining and/or production of oil, natural gas, coal or other fossil fuels, irrespective of the revenues percentage generated by these activities, can no longer set SBTi-validated targets. This does not include however, companies are involved in the sale, transmission and distribution of fossil fuel, or that provide equipment / services to fossil fuel companies. In this case however, fossil fuel-related activities cannot represent more than 50% of the company’s revenues. Also electric utilities that mine coal and companies that derive less than 5% of their revenues from fossil fuel assets for extraction activities are excluded from this new rule.

SBTi had previously set a methodology for oil and gas companies. Hence, the new announcement required the initiative to remove some companies (5 in total) from the SBTi. The exact reason for the announcement is unknown, although it explained that the decision took place due to a “continuous work” on the existing oil and gas methodology.

We note that there has been increasing criticism from investors who say that it is not possible for oil and gas companies to set net zero targets, while still aiming to increase fossil fuel production. Indeed, the IEA also notes that under a 2050 Net Zero scenario, there should be no new oil and natural gas fields approved for development, and that supply should be concentrated towards low-cost producers.

The IEA does note however that oil and gas production does not drop to zero under a net zero scenario. It is however required to decline by around 75% compared to 2020 levels.

Oil and gas production needs to reduce in a net zero scenario



Source: IEA

The announcement of SBTi came also the same week that a group of the world's top oil companies, including Saudi Aramco, Shell and ExxonMobil, committed under the Oil and Gas Climate Initiative (OGCI) to cut fugitive emissions of methane, a potent GHG, to near zero by 2030. OGCI includes 12 of the world's largest oil and gas companies. The decision follows calls by governments at the COP26 climate summit last year to reduce methane emissions by 30% by 2030.

Methane emissions are currently one of the largest contributors for GHG emissions from the sector. The IEA also noted last month that methane emissions from the energy sector were 70% higher than officially reported. The IEA uses estimates based on scientific studies and measurement campaigns, and has compared that to the amount reported by companies to the UNFCCC. The discrepancy in reporting underscores the need for greater transparency and stronger policies in the oil and gas sector, where the target setting (which also usually requires a robust tracking) could play a role.

Using sustainability data to see how much profit margins suffer from higher energy prices

Shanawaz Bhimji, CFA – Senior Fixed Income Strategist | shanawaz.bhimji@nl.abnamro.com

- ▶ **A rising price of energy will be more difficult for corporates to pass through as consumers are feeling the pinch as well**
- ▶ **The advent of ESG disclosures makes it possible to quickly derive energy use at corporates**
- ▶ **This allows us to calculate the impact on corporate profit margins and leverage on the back of a surge in energy prices, assuming that pass through of costs does not take place**

Corporates have so far not faced difficulty in passing through higher input costs to consumers. However, the situation might be slightly different now. Economic growth this year is expected to not only be much slower than earlier estimated, but also uncertain due to the Russia/Ukraine conflict. Real wage growth in Europe is also currently negative. As consumers are starting to feel the pinch from higher utility and fuel bills themselves, passing through costs by corporates without compromising on volumes sold will become challenging this year. Below we have included a preview to an upcoming piece on the financial impact that high energy prices might have on corporates, when passthrough of costs becomes difficult.

Watch out for the high carbon intensity names

Corporates have become more open about energy consumption through ESG data. We use the reported carbon intensities of corporates as provided by Sustainalytics and 'energy-to-carbon emission' conversion factors to reverse engineer the fossil fuel energy usage. We leave out the energy and utility sector from our exercise, since they either are the beneficiary of higher energy prices or, given the existing supply shortage of electricity installations, have no difficulty in passing through higher fuel costs in power rates.

Before we start with the analysis, we would like to note that we apply a highly standardized method across all sectors and do not take into consideration a company's actual fuel or electricity mix, mainly because this would require specialized knowledge about each individual company. With fuel and other energy source prices rising consistently across the board, and specialized fuels also derived from oil or gas, we are comfortable to use only oil and gas as proxy for all types of fuel. Also, we take the average of gas and electricity prices between Western Europe and the United States as input for the change in energy prices, given that most issuers tend to have big presence in these regions. As we previously mentioned, we exclude oil & gas and utility issuers from the analysis.

By using the standard emission conversion factors as provided by publicly available websites (we used the Dutch one which can be found [here](#)), we convert the usage of carbon mainly into a unit of energy, such as a cubic metre of natural gas (from the scope 1 emissions) or into a MWh of electricity (from scope 2 emissions).

How do we get from carbon data to financial impact from higher energy prices?

Inputs

- 1kg CO₂ per \$1 Revenue
- 50% EBITDA margin

1 cubic metre (m³)
gas = 1.788 kg CO₂

Energy usage

0.55 cubic metre (cm)
natural gas per \$1 revenue

Price goes up from \$0.3 to \$0.7
per cubic metre of natural gas

Impact per \$1 revenue

equals usage * price rise =
 $0.55 * (\$0.7 - \$0.29) = \$0.23$ per \$1
revenue

Recalculate other
metrics

Impact on profit margin

EBITDA drops from \$0.5 to \$0.27 (ie \$0.5 -/- \$0.23)
EBITDA margin drops from 50% to 27%

We have conducted the above assessment on industry level. To get to industry aggregates, we took the average of latest available EBITDA margins and leverage on investment grade Western European and North American issuers for each of the below industries, as per Moody's financial metrics database. For the scope 1 & 2 emission intensity, we took the trim-mean or median (which-ever was the highest) from the companies in the same industries as included in the Sustainalytics database. The table below highlights our results, **again assuming that corporates do not manage to pass through the higher cost of energy** since H2 2021 (given that 2021 YE numbers have not been entirely processed at Moody's end) and therefore absorb this impact entirely themselves. This is a big assumption, but as we previously said, the ease of passing through costs to consumers is becoming increasingly difficult. This allows our assumption to hold up in the longer term, with energy prices set to rise even further from current levels. We highlighted the pro-forma EBITDA margins as red when the drop exceeds 5 points.

EBITDA margin pulled down by higher energy prices, in some cases extremely

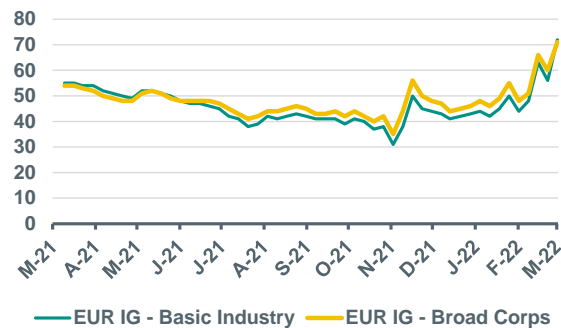
Sector	Scope 1 (tonne kg per 1mn USD revs)	Scope 2 (tonne kg per 1mn USD revs)	total scope 1&2 margin hit per USD 1 revs	EBITDA margin now (%)	EBITDA margin after higher energy price impact (%)
Airlines	1122	6	0.1175	15.7	4.0
Building Materials	349	74	0.1028	22.0	12.0
Steel Producers	1212	188	0.1124	26.3	15.5
Chemicals	187	108	0.0761	20.4	12.9
Packaging	155	96	0.0650	16.4	9.8
Forestry/Paper	233	82	0.0786	22.4	14.5
Metals mining	200	101	0.0769	42.0	34.5
Rail & Truck transport	125	16	0.0218	10.7	8.6
Packaged Food	51	31	0.0212	17.4	16.2
Beverage	33	15	0.0122	26.8	25.6
Household & Personal	12	15	0.0074	20.7	20.0
Food & Drug Retailers	14	21	0.0097	7.7	6.7
Pharma	14	14	0.0075	38.3	37.5
Transport Infrastructure	18	10	0.0055	52.2	51.7
Aerospace/Defense	10	14	0.0066	12.9	12.2
Autos	9	14	0.0064	13.1	12.5
Auto Parts & Equipment	8	34	0.0123	12.2	11.1
Cable & Satellite TV	9	10	0.0051	22.1	21.5
Capital goods	9	18	0.0076	18.3	17.6
Electronics	7	17	0.0068	38.5	38.0
Tobacco	8	9	0.0046	43.8	43.2
Medical Products	7	13	0.0056	28.0	27.4

Source: Sustainalytics, Moody's, ABN AMRO Group Economics

We would like to point out that the exercise is highly theoretical, but it does show how fast profit margins can drop when the ability to pass through costs becomes challenging. Especially the considerable drop of margins for the basic industry space (including chemicals, metals/steel and building materials) when energy prices are high, explains why we are already hearing about factory shut-downs more frequently. Elsewhere the margin contraction seems less severe, but can still be anywhere between 50bp to 200bp. Furthermore, our analysis is limited to energy usage only and does not consider higher costs coming from e.g. the unavailability of other raw materials such as agricultural goods for the consumer staple space or microchips for the machinery, electronics, aerospace and automotive space. Hence, there is a case for reality to quickly catch-up to the above theory or even become uglier. The strange thing is that these potential outcomes have not yet been priced into debt markets yet. For example, credit spreads on the basic industry index continue to trade very close to the broad market, as they also had over the course of many years. But with basic industry being clearly the most affected in our analysis, we fail to see why credit spreads have not widened more than the broad market.

Bad outcomes not yet properly priced in debt markets

Credit spread (over swap rate) bp



Source: Bloomberg, ABN AMRO Group Economics

ESG is the name of the game for this week's new issuance

Larissa de Barros Fritz – ESG & Corporates Strategist | larissa.de.barros.fritz@nl.abnamro.com

- ▶ **Four new deals from 3 different companies came to the Corporates market this week, all with an ESG label**
- ▶ **Despite strong orderbooks, companies still required to pay double-digit new issuance premiums (NIPs) to get the deals done**
- ▶ **Both EDP and Segro have opted for a green bond transaction, while Lanxess has issued its second Sustainability-Linked Bond**
- ▶ **We do note that Lanxess has chosen for a target below the one assessed by the Second Party Opinion provider, which no longer seems to be consistent with a 1.5 degrees trajectory as per the Paris Agreement**

The primary market for corporate bond remains relatively calm, with only 4 bonds being issued last week. Investors seem to still remain cautious and selective, showing that not every deal can fly in these volatile markets. The ESG label – as well as the ESG profile of issuers - also seem to play favourably for issuers at the moment.

On Monday, Portuguese electricity and gas generation and network company **EDP** came to the market with a 7.5yr green bond. The deal was eventually priced at ms+100bps, a 30bps squeezing vs IPTs, on the back of a robust EUR 6.1bn book, which allowed the company to print a EUR 1.25bn bond. Nevertheless, the company is estimated to have paid a juicy 15-20bps NIP. As we noted last week, investors seem to be quite eager to invest in utility companies at the moment that have a large renewable energy potential, as well good ESG scores. EDP is one of the leading European utility companies when it comes to planned renewable capacity additions: it plans an annual average addition of 4 GW, the same as Engie, but slightly below Iberdrola (4.7GW), who also priced a green bond the week before. EDP renewable business contributes to 63% of its EBITDA, the largest amongst peers. The company aims to have 100% of its generation coming from renewable energy by 2030.

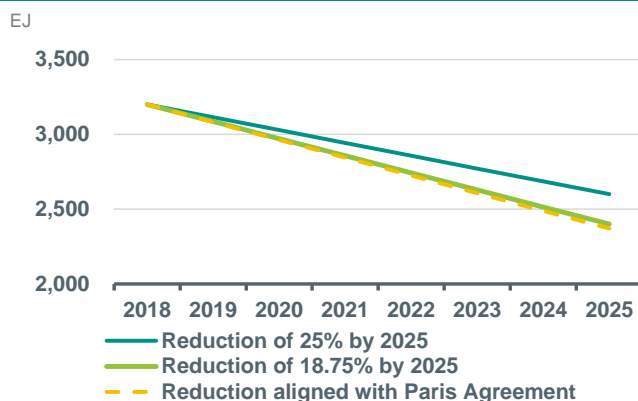
EDP's green bond will be used to finance and/or refinance wind and/or solar power plants. The company currently estimates a EUR 24bn capex to be deployed by 2025 towards the energy transition, being around 80% of this towards renewable energy. This would imply a ca. EUR 6bn of investments per year, suggesting more green bond issuance potential.

German chemical company **Lanxess** opened books at the same day as EDP for a Sustainability-Linked Bond (SLB). This is the second issued by the company after a debut in November last year. Compared to EDP, it opted for a smaller tenor, namely a 6yr EUR 600m bond. Lanxess also had to pay up a quite significant NIP to get the deal done, estimated to be around 18-20bps. The ESG structure of the transaction, as well as its decent sustainability profile (it ranks at the top of the Dow Jones Sustainability Index World for the Chemicals category, has a "prime" status by ISS ESG, and an A rating by MSCI) might have also played favourably to investors. We do note however that the company only holds a 27.4 (medium risk) ESG risk rating by Sustainalytics.

Looking at the structure of the SLB, Lanxess has selected only one KPI, being a reduction in scope 1 and 2 GHG emissions. The company aims to reduce emissions by 18.75% by 2025, vs a baseline of 2018. In its Sustainability-Linked Bond Framework, Lanxess aimed a "25% reduction by 2025, or [anything] below the KPI-SPT baseline". Hence, while the selected KPI for this transaction is still in line with the Framework – it still refers to a target below the reference year of 2018 – it is significantly below the targeted 25%. We do note as well that the assessment of whether Lanxess' KPI was ambitious (given this is a requirement under the ICMA Sustainability-Linked Bond Principles), as evaluated by the Second Party Opinion provider, was based on the 25% reduction target. For example, the assessment concludes that the target is ambitious against the Paris Agreement as its 2030 KPI (Lanxess has also set a target for 2030 in the Framework) represents an annual linear reduction that is consistent with a 1.5 degrees scenario (-4.2% p.a.). The 2025 target was slightly above the 1.5 degrees scenario (-4.0% p.a.), but we would assume it to still be consistent with a "well-below" 2 degrees scenario. However, the KPI used for this SLB transaction would represent a 2.9% annual linear reduction rate, which is well below the 4.2% required to be aligned with the Paris Agreement's 1.5 degree scenario. We would therefore assume that the KPI used

by Lanxess in this (and its previous transaction in November last year) to not be evaluated as ambitious against international targets.

Lanxess' targets used in the SLB no longer aligned with the Paris Agreement



Source: Lanxess' SLB Framework and Second Party Opinion, ABN AMRO Group Economics. Note: the Paris Agreement trajectory considers a reduction aligned with the 1.5 degrees scenario.

The Second Party Opinion also notes that the KPI of Lanxess is only moderately material, as it does not include scope 3 emissions, while scope 3 is around 85% of the company's total GHG emissions.

In case it fails to meet the softer targets, a 25bps coupon step up will be applied for the remaining 3 coupons, representing therefore a combined 75bps increase. The 25bps coupon step up represents ca. 15% of the annual 1.75% coupon paid by Lanxess in this transaction.

Later in the week, also the British logistics real estate company **Segro** came out with a dual-tranche green transaction. The company opened books on Wednesday for a 4yr and 8yr transaction – the same day that the FED was holding its FOMC, where it later announced an interest rate increase. Hence, Segro also benefitted from having the market for itself that day. Segro is a high-quality name in the real estate space, also benefitting from a logistics property business, which currently has the upper hand within REITs. The company is rated A- by Fitch, and has a very conservative balance sheet, despite having an ongoing focus on property development and 3rd party acquisitions. Segro has low vacancy levels and assets are largely the sought after urban warehouses and big box logistic properties in UK and Continental Europe. Also on the ESG side, the company has a strong sustainability profile, being rated AAA by MSCI and having a 10.2 (low risk) risk rating by Sustainalytics.

The strong name combined with a solid sustainability profile, as well as the green label of the bonds, might have assisted the company to reach a combined book of EUR 7.3bn, representing a 4.6x and 8.6x book-to-coverage ratio for the 4 and 8yr transaction, respectively. Nevertheless, the company still had to pay up ca. 20bps NIP to get both deals done.

This transaction represented the second time Segro was in the market with a green bond, following a debut in September last year. The company aims to use the proceeds of these bonds to finance/refinance projects as defined in their Green Finance Framework. This includes: (i) buildings that have achieved a minimum green building certification as following: BREEAM "Very Good", DGNB "Silver", HQE "Very Good" and EPC label B; (ii) low-carbon transport projects, such as EV charging points; (iii) on-site renewable energy projects, such as solar panels; (iv) refurbishment of buildings that achieve a reduction of at least 30% in primary energy demand; (v) projects that have a positive influence on biodiversity, such as installation of green walls; and (vi) projects that aim for an improvement in air quality, such as sensor technology to identify high levels of carbon dioxide. We do note however that the current criteria of Segro is not fully aligned with the EU Taxonomy.

ECB urges banks to improve disclosures on climate-related risks

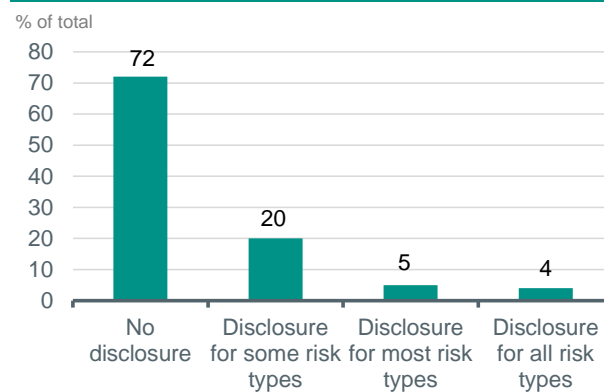
Joost Beaumont – Senior Fixed Income Strategist | joost.beaumont@nl.abnamro.com

- ▶ **The ECB has published a report on the supervisory assessment for climate risk disclosures**
- ▶ **Many banks still do not adequately disclose the impact of climate risks on their risk profile**
- ▶ **Some improvement has been made with banks describing the incorporation of climate risk in governance, risk management and business model**
- ▶ **But the level of detail and disclosure of methods used is still minimal**

The ECB published a report this week (see [here](#)) highlighting that banks were not yet meeting its expectations on disclosures of climate and environmental risks. Back in November 2020, the ECB had published a guide about climate-related and environmental risks (from now on called climate risks), including its expectations about how banks would manage and disclosure information about these risks. At the same time, the ECB published a first assessment report about banks' climate risk disclosures, concluding that significant efforts were needed for the sector to improve its transparency. This week's report was the second assessment on climate risk disclosures. It was based on publicly available disclosures of 109 banks with a reference date of 2020 (or later if available). The banks involved were classified as significant institutions at the start of August 2021. Finally, the assessment was conducted against the backdrop of the increased importance of climate risks on bank risk profiles. Indeed, banks need to start reporting climate-related risks under the EBA's Pillar 3 disclosures, the Capital Requirements Regulation (CRR) is likely to be amended as well in this respect, while the ECB supervisory department has made climate risk also one of its key focus areas during 2022-24.

The key objectives of the assessment were to identify gaps in climate risk disclosures versus the ECB's guide on this topic, to get a view on the extent that banks report on the methodologies, definitions and criteria of the underlying disclosures and to identify best practices. Below, we will zoom in on the key take-aways of the ECB assessment.

Institutions disclosing whether climate-related risks are material for types of risk they are exposed to



Source: ECB

The graph above shows that a majority of banks does not disclose information about whether climate risks have a material impact on their risk profile, while roughly half of this group considers that climate risks are indeed material to their risk profile. Meanwhile, 25% of the banks do report climate risks for some risk types, such as credit risk or market risk. Overall, the outcome implies that there is still large gaps in climate risk disclosures for a large number of banks.

A similar picture arises when looking at the substantiation of the disclosed information. Only 20% of banks disclose the methodologies, definitions and criteria used to collect and compile the information, while 43% does so for only part of the disclosures. This also implies that one-third of the banks does not disclose information about how they compile the figures at all. The ECB further notes that this also applies for banks that have committed themselves to objectives of the Paris Agreement, with information lagging about how banks are going to meet these objectives. As such, the central bank deems these banks exposed to reputational and liability risks.

In terms of good practice, there was only one bank that has adopted a clear strategy to achieve net zero emissions by 2050. This bank reports in detail about interim targets, progress made, metrics used, its methodology as well as scenarios. This bank seems therefore the “best in class”.

The report continues to zoom in about the content of the climate risk disclosures, focussing on the business model and strategy, governance, risk management and good practice. Most banks (57%) do not disclose any specific information about how climate risk will affect their business model or strategy, they mostly only report some high-level information about how climate risks can affect the economy. However, 31% of banks do report about the impact of both transition risk and physical risk, of which around a third also give a breakdown for short term and long term risks. Meanwhile, 25% of banks are using KPIs in setting their strategy.

An increasing number of banks do report on governance-related matters related to climate risk. 71% of banks describe how the board keeps oversight of climate risks and opportunities, which is up from 53% in 2020. However, the level of detail remains limited. Also regarding risk management, a rising number of banks (71%) describes how they identify, assess and manage climate-related risks. This was still only 57% in 2020. A majority of banks uses scenario analysis as well as stress testing as main tools to identify climate risks. This share is expected to increase further, given that the ECB is currently conducting a climate stress test exercise. Finally, two-thirds of all banks describe how climate-risks are integrated in their lending as well as investment procedures, which is up from 54% in 2020.

Banks have also stepped up efforts to disclose their scope 1, 2 and 3 GHG emissions. Scope 3 emissions are linked to a banks' lending and investment portfolios and they likely account for most of a bank's GHG emissions. Although 74% of banks report information about scope 1, 2 and 3 emissions, only a few provide a breakdown of these, while in many cases it remains also unclear what activities/portfolios have been included in measuring scope 3 emissions. This makes it difficult to compare results. However, in cases where scope 3 emissions were clearly identified, they had on average a share of 93% in total scope 1, 2 and 3 emissions, underlining the importance of this category.

Broadly speaking, there still seems to be much room for improvement for banks regarding their transparency about the impact of their exposures to climate risks. The ECB will send individual feedback to banks, which should help to improve available information, while upcoming reporting requirements in this field will help as well. As such there is still time for banks to get their act together.

Greenhouse gas emissions in the Netherlands up again in 2021

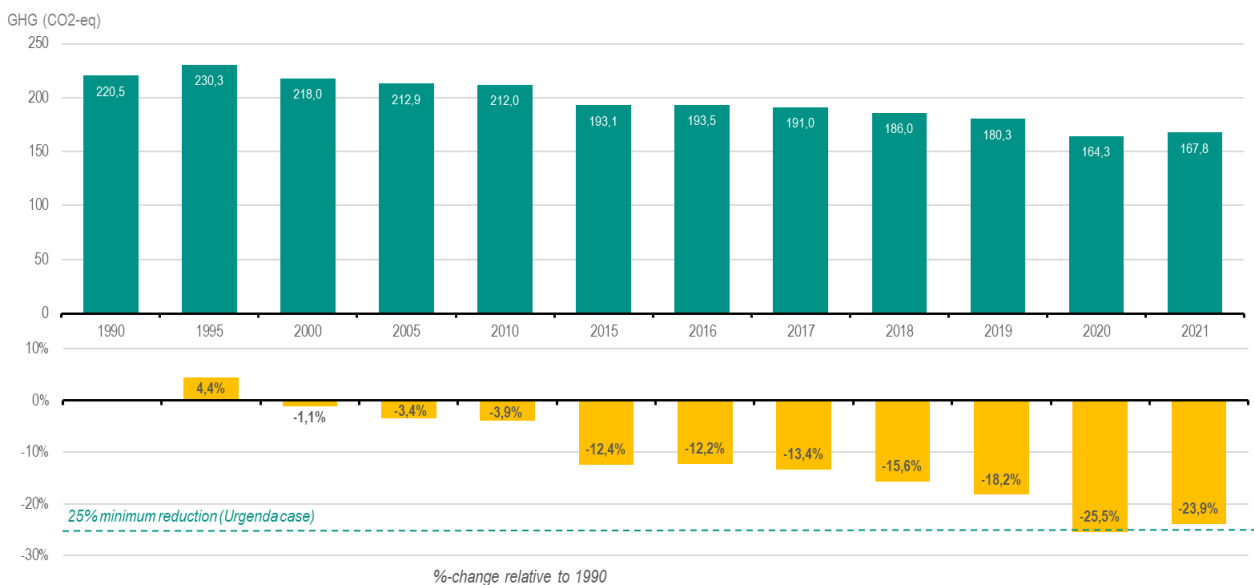
Casper Burgering – Economic Transition Economist | casper.burgering@nl.abnamro.com

- ▶ Emissions of greenhouse gases in the Netherlands reached their peak in 1979, while 1996 was the next highest in term of the total amount of greenhouse gases emissions
- ▶ Emissions in the Netherlands fell sharply in 2020 on an annual basis, mainly due to the corona shock
- ▶ Because of the cold early months of 2021 and more importantly the partial return to normal in the second half of 2021, emissions increased again annually last year
- ▶ The Dutch government is targeting a 60% reduction in emissions by 2030 compared to 1990 levels and has put in place a significant step up investment to this end

A historical perspective of Dutch emissions

Following the end of World War II, greenhouse gas emissions in the Netherlands rose almost continuously in the following decades. Due to the oil crises in the 1970s, there were some short and swift drops in emissions, but nevertheless the peak in emissions did not come until 1979. In the end, Dutch greenhouse gas emissions increased by a staggering 1,176.4% between 1945 and 1979, or an average of 35% per year. The recession of the 1980s subsequently led to a strong reduction in emissions, but peak emissions were no longer reached in the subsequent recovery years. In fact, in the period 1980 to 1990, greenhouse gas emissions fell by 8%. However, this was only temporary, because after 1990 emissions increased again. With a 12% rise in emissions after 1990, the second highest peak was reached in 1996. Emissions then follow a fairly stable pattern until the financial crisis of 2008-2009. After 2010 the downward trend in emissions picks up more speed. In the ten years following 2010, greenhouse gas emissions were reduced by 23%.

Greenhouse gas (GHG) emissions in the Netherlands (according to IPCC guidelines)

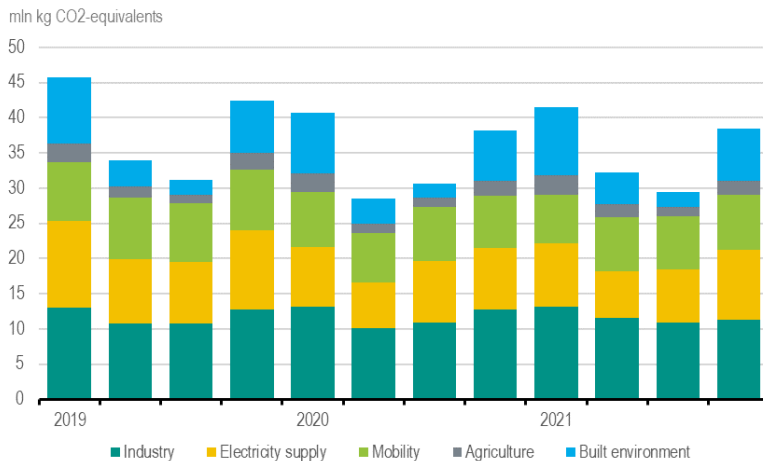


Source: Emissieregistratie, ABN AMRO Group Economics

Emissions 2010 to 2021

The cumulative greenhouse gas emissions reductions between 2010 and 2020, proved to be insufficient. The overall pace is still too slow and insufficient to reach the 2030 and 2050 emission reduction targets. Initially, the court decision in the Urgenda climate case from 2015 seemed to bring more progress in the emission reductions. The ruling dictated that Dutch greenhouse gas emissions in 2020 must be at least 25% lower than the emissions level in 1990. With a reduction of 25.5% in 2020 compared to 1990, these legal conditions have been met. The reduction was due to less coal use and the relatively warm winter weather. But for a large part corona and the lockdowns caused less economic activity and road traffic, and therefore fewer emissions.

Greenhouse gas (GHG) emissions by sector



Source: CBS, ABN AMRO Group Economics

In 2021, emissions increased again by 2.3% year-on-year, after almost six-years of emissions reductions. The increase was mostly because of the relatively cold weather at the beginning of that year. As a result, more natural gas was consumed in the built environment, resulting in a 10% increase in greenhouse gas emissions. In agriculture, greenhouse gas emissions were 7% higher on an annual basis in the same year. In manufacturing and in the mobility sector, emissions remained virtually stable, while in the electricity sector, emissions increased slightly by 2% during 2021. In the fourth quarter of 2021, the industrial sector in particular showed a sharp annual emission reduction of 12%. This coincided with the increased oil and gas prices at the time, after which more energy efficiency measures were introduced in order to cut costs.

Future emissions

In 2020, greenhouse gas emissions were not allowed to exceed 165 billion CO₂ equivalents. This maximum permissible limit also applies to subsequent years. However, the Dutch government has set ambitious targets to stay well below this limit. By 2030, the government up until recently aimed to achieve a CO₂ reduction of 55% of the 1990 level. But in the recent Coalition Agreement it was agreed that the government will target for 60% compared to the 1990 level. In this case, the maximum permissible limit will be approximately 90 billion CO₂ equivalents in 2030.

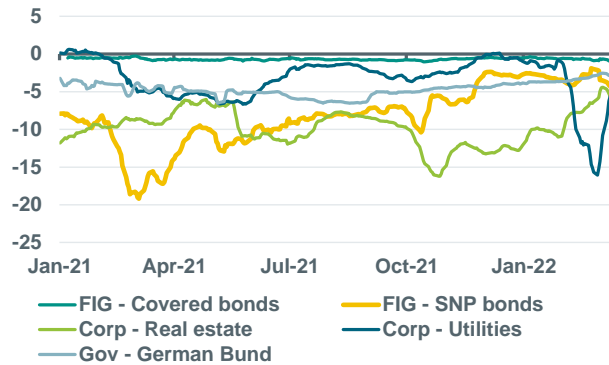
The government has also set targets for the years after 2030. In 2035 greenhouse gas emissions must be 70% lower than the 1990 level and in 2040 this will be 80%. Ultimately, the emission reduction should be completed by 2050, ideally with greenhouse gas emissions at 95% of 1990 levels.

The recovery in emissions during 2021 must remain an one-off, the IEA warns. The IEA therefore recommends that sustainable investments should be continued and scaled up. As only more public and private sustainable investments in combination with the accelerated deployment of clean energy technologies will reduce greenhouse gas emissions at a faster rate. The Dutch government has put in place significant funds to this end, with just under EUR 7bn in the budget and a further EUR 35bn in the Coalition Agreement. In addition, Dutch utility companies have also put in place a significant step up of their investment plans in the coming years. This should help to accelerate emission reductions in the coming years, though there still remain important obstacles, such as a shortages of the necessary skilled labour and the scarcity and cost of the materials needed to roll-out transition technologies at scale.

ESG in figures

ABN AMRO Secondary Greenium Indicator

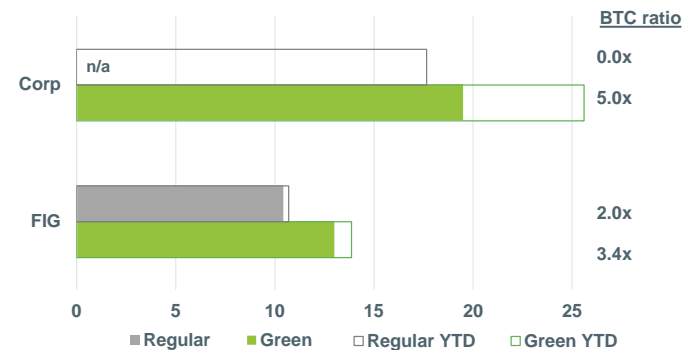
Delta (green I-spread – regular I-spread)



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

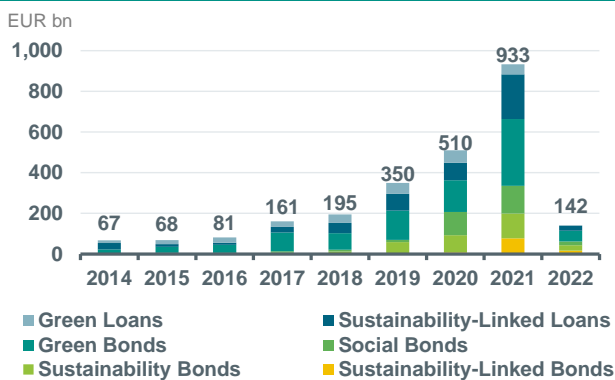
ABN AMRO Weekly Primary Greenium Indicator

NIP in bps



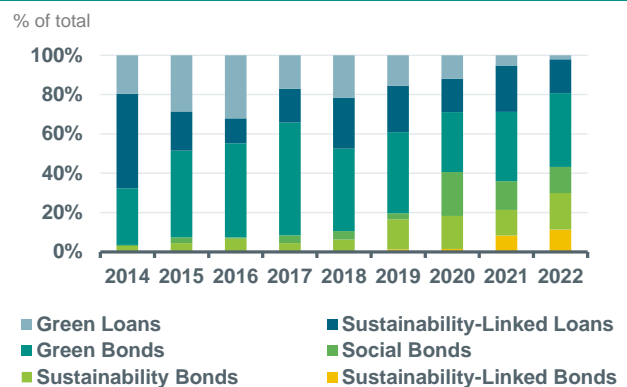
Note: Data until 18-3-22. BTC = Bid-to-cover orderbook ratio. Source: Bloomberg, ABN AMRO Group Economics.

Sustainable debt market overview



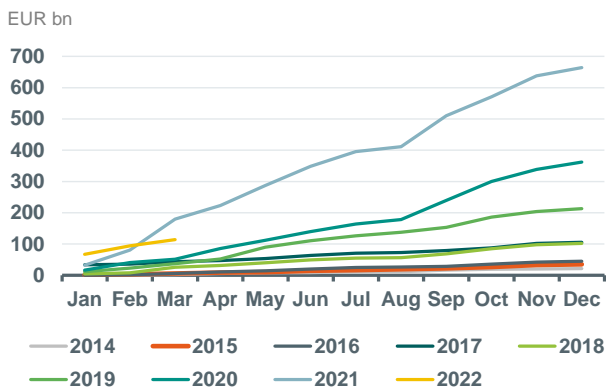
Source: Bloomberg, ABN AMRO Group Economics

Breakdown of sustainable debt by type



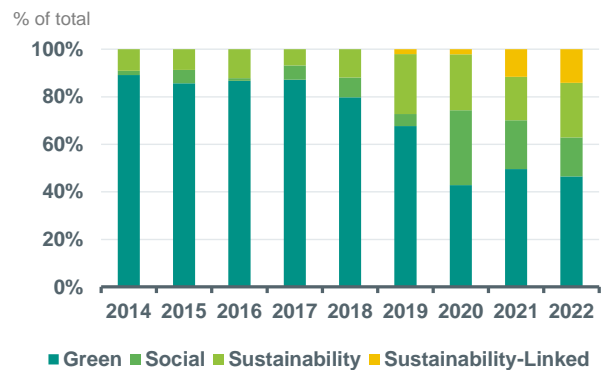
Source: Bloomberg, ABN AMRO Group Economics

YTD ESG bond issuance



Source: Bloomberg, ABN AMRO Group Economics

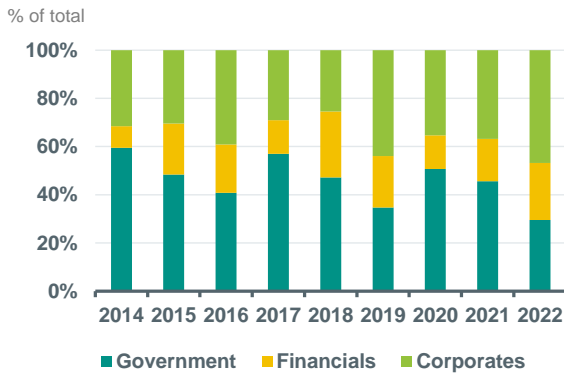
Breakdown of ESG bond issuance by type



Source: Bloomberg, ABN AMRO Group Economics

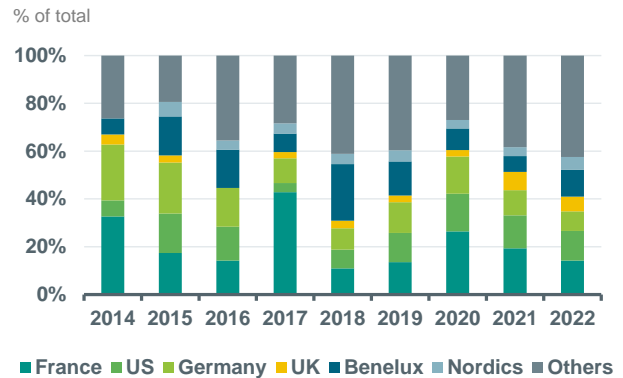
Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

Breakdown of ESG bond issuance by sector



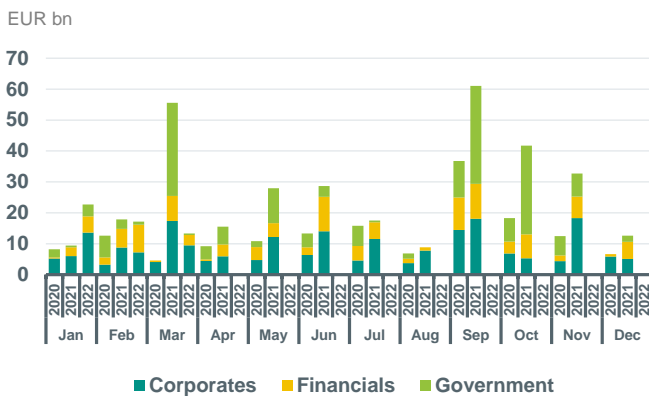
Source: Bloomberg, ABN AMRO Group Economics

Breakdown of ESG bond issuance by country



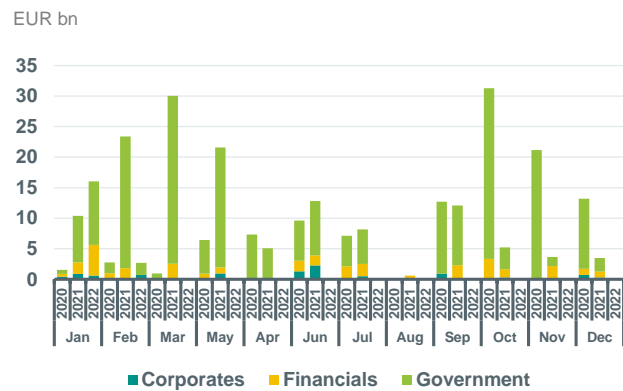
Source: Bloomberg, ABN AMRO Group Economics

Monthly Green Bonds issuance by sector



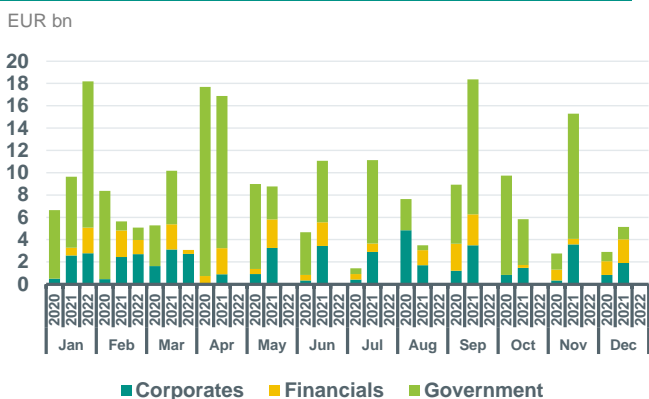
Source: Bloomberg, ABN AMRO Group Economics

Monthly Social Bonds issuance by sector



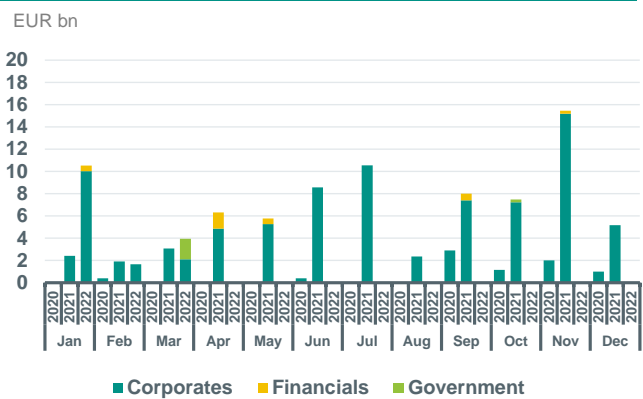
Source: Bloomberg, ABN AMRO Group Economics

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

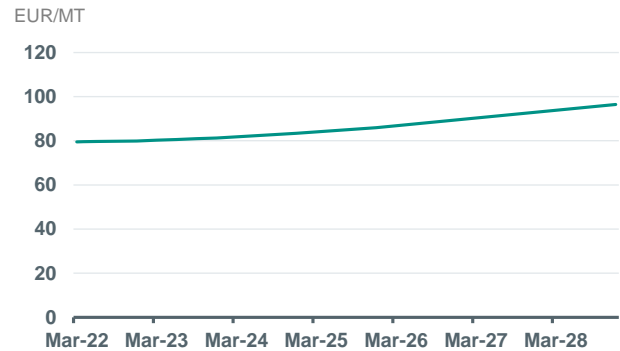
Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

Carbon contract current prices (EU Allowance)



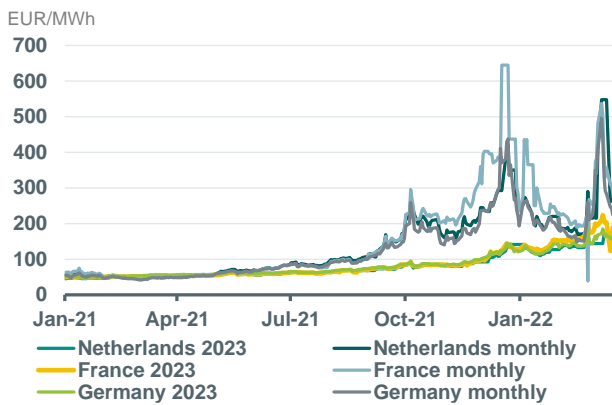
Source: Bloomberg, ABN AMRO Group Economics

Carbon contract future prices (EU Allowance)



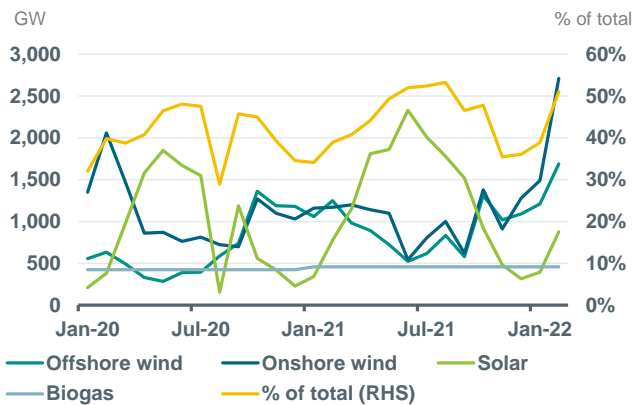
Source: Bloomberg, ABN AMRO Group Economics

Electricity power prices (monthly & cal+1 contracts)



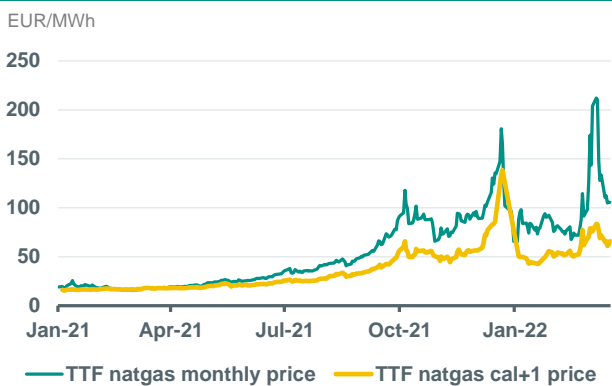
Source: Bloomberg, ABN AMRO Group Economics. Note: 2023 contracts refer to cal+1

Electricity generation from renewable sources (NL)



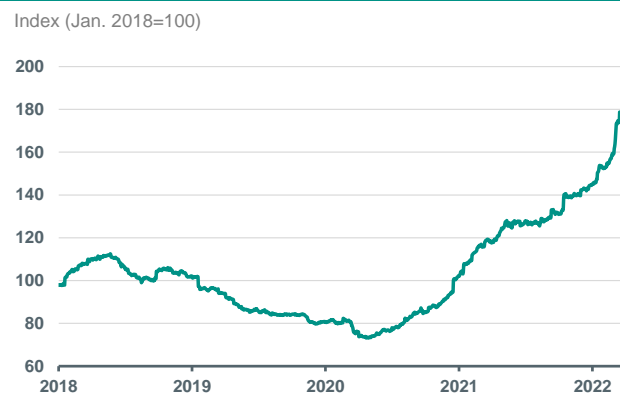
Source: Energieopwek (Klimaat-akkoord), ABN AMRO Group Economics

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

DISCLAIMER

ABN AMRO Bank
Gustav Mahlerlaan 10 (visiting address)
P.O. Box 283
1000 EA Amsterdam
The Netherlands

This material has been generated and produced by a Fixed Income Strategist ("Strategists"). Strategists prepare and produce trade commentary, trade ideas, and other analysis to support the Fixed Income sales and trading desks. The information in these reports has been obtained or derived from public available sources; ABN AMRO Bank NV makes no representations as to its accuracy or completeness. The analysis of the Strategists is subject to change and subsequent analysis may be inconsistent with information previously provided to you. Strategists are not part of any department conducting 'Investment Research' and do not have a direct reporting line to the Head of Fixed Income Trading or the Head of Fixed Income Sales. The view of the Strategists may differ (materially) from the views of the Fixed Income Trading and sales desks or from the view of the Departments conducting 'Investment Research' or other divisions

This marketing communication has been prepared by ABN AMRO Bank N.V. or an affiliated company ('ABN AMRO') and for the purposes of Directive 2004/39/EC has not been prepared in accordance with the legal and regulatory requirements designed to promote the independence of research. As such regulatory restrictions on ABN AMRO dealing in any financial instruments mentioned in this marketing communication at any time before it is distributed to you do not apply.

This marketing communication is for your private information only and does not constitute an analysis of all potentially material issues nor does it constitute an offer to buy or sell any investment. Prior to entering into any transaction with ABN AMRO, you should consider the relevance of the information contained herein to your decision given your own investment objectives, experience, financial and operational resources and any other relevant circumstances. Views expressed herein are not intended to be and should not be viewed as advice or as a recommendation. You should take independent advice on issues that are of concern to you.

Neither ABN AMRO nor other persons shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information contained in this communication.

Any views or opinions expressed herein might conflict with investment research produced by ABN AMRO.

ABN AMRO and its affiliated companies may from time to time have long or short positions in, buy or sell (on a principal basis or otherwise), make markets in the securities or derivatives of, and provide or have provided, investment banking, commercial banking or other services to any company or issuer named herein.

Any price(s) or value(s) are provided as of the date or time indicated and no representation is made that any trade can be executed at these prices or values. In addition, ABN AMRO has no obligation to update any information contained herein.

This marketing communication is not intended for distribution to retail clients under any circumstances.

This presentation is not intended for distribution to, or use by any person or entity in any jurisdiction where such distribution or use would be contrary to local law or regulation. In particular, this presentation must not be distributed to any person in the United States or to or for the account of any "US persons" as defined in Regulation S of the United States Securities Act of 1933, as amended.

CONFLICTS OF INTEREST/ DISCLOSURES

This report contains the views, opinions and recommendations of ABN AMRO (AA) strategists. Strategists routinely consult with AA sales and trading desk personnel regarding market information including, but not limited to, pricing, spread levels and trading activity of a specific fixed income security or financial instrument, sector or other asset class. AA is a primary dealer for the Dutch state and is a recognized dealer for the German state. To the extent that this report contains trade ideas based on macro views of economic market conditions or relative value, it may differ from the fundamental credit opinions and recommendations contained in credit sector or company research reports and from the views and opinions of other departments of AA and its affiliates. Trading desks may trade, or have traded, as principal on the basis of the research analyst(s) views and reports. In addition, strategists receive compensation based, in part, on the quality and accuracy of their analysis, client feedback, trading desk and firm revenues and competitive factors. As a general matter, AA and/or its affiliates normally make a market and trade as principal in securities discussed in marketing communications.

ABN AMRO is authorised by De Nederlandsche Bank and regulated by the Financial Services Authority; regulated by the AFM for the conduct of business in the Netherlands and the Financial Services Authority for the conduct of UK business.

Copyright 2022 ABN AMRO. All rights reserved. This communication is for the use of intended recipients only and the contents may not be reproduced, redistributed, or copied in whole or in part for any purpose without ABN AMRO's prior express consent.