THE FINANCIAL INSTITUTIONS SENIOR BOND ROUNDTABLE

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Bank on Germany

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Bank senior bonds: the calm before the storm?

Banks are enjoying familiar dynamics in the senior bond market in 2021. Spreads have returned to record lows, pushing many transactions into negative yields, while central banks are doing their best to reduce any funding pressures by dishing out ultra-cheap loans.

The question on everyone's lips is whether this will be as good as it gets. While it may seem like the worst of the coronavirus pandemic is over in western Europe at least, the longer-term effects of national lockdowns are only just starting to reveal themselves. Inflationary pressures threaten a new monetary policy environment, while investors are beginning to wonder whether they are owed more of a premium to compensate for the risks lurking on the horizon.

Market experts gathered virtually in September for a roundtable convened by DZ Bank and *GlobalCapital* to discuss these topics and more.

Participants in the roundtable were:

Alexander Boor, head of funding and investor relations, Hypo Vorarlberg

Bodo Winkler-Viti, head of funding and investor relations, Berlin Hyp

Dag Hjelle, head of treasury, SpareBank 1 SR-Bank

Ger Buls, head of Asia Pacific long-term funding, Rabobank

Christian Klocke, financial institutions credit syndicate, DZ Bank

Tyler Davies, moderator, *GlobalCapital*

GlobalCapital: If you look at where the senior market is today, it almost seems as though the pandemic never happened. What do you make of the incredible recovery in yields and spreads over the last 18 months?

Dag Hjelle, SpareBank 1 SR-Bank: As an issuer it feels like we are back to normal. We have been quite active in different formats, including with senior non-preferred and covered bonds in the euro market. Spreads have come back down to pre-pandemic levels, and it looks as though investors are still happy to invest. We have managed to print at very favourable levels.

Bodo Winkler-Viti, Berlin Hyp: We all remember spring last year. In all asset classes, spreads widened in record time to reach highs we haven't seen for quite a while. But they also came back in record time. In terms of our own senior spreads, we were already back at pre-crisis levels by September or October. You found yourself asking what was happening. Most European countries were at the start of the second wave, but in the capital markets the whole pandemic seemed as though as it was already over.

Back then we thought spreads couldn't get any tighter. We learned at the beginning of this year that they could, even if we have lower yields in the market.

But now I fail to see how there could be any further tightening in spreads from here for either senior preferred or senior non-preferred. We are at such low levels it suggests the risks are not adequately paid for. I can't imagine how the conditions for refinancing could get any more favourable than they are now.

Bodo Winkler-Viti
Berlin Hyp

Ger Buls, Rabobank: It is worth noting that we've had quite a bit of help from the authorities. We have seen TLTROs coming into the market on very favourable conditions, which have had strong participation from the banks. There has also been a big influx of savings. That takes pressure away from issuance, which has also been felt in the covered bond market, where supply is down meaningfully.

On the other side, investors have seen good inflows into their funds next to coupon payments and redemptions of bonds. There is therefore an enormous amount of liquidity available that needs to find a home. I completely agree that on a yield basis and on a spread basis we are very tight, but what is the alternative? Everything in the market is extremely tight.

I don't think we will see an extension of the trend we've had in the senior market during the pandemic, whereby spread levels continue to come down considerably. But I doubt we will see a meaningful widening either. If you look at recent order books, they are still well oversubscribed. And it's not just in euros either, we have seen enormous supply also in dollars and sterling and yet all these trades have been performing well.

Alexander Boor, Hypo Vorarlberg: We were also surprised by the amount of volatility in the senior market. But now we feel very comfortable about market conditions, given the very low spread levels we are seeing.

We don't expect spreads will widen significantly. Most balance sheets in the banking system look rock-solid from an equity and liquidity perspective. The challenge with liquidity in the eurozone is more about an over-surplus — with banks having to put all their excess cash at the ECB at negative rates.

Another point is that, especially in Austria, we had a huge government support programme, which totalled something like 10% of national GDP. There were short term work guarantees, emergency aid, tax deferrals and reductions, sale replacements etc. It was a huge package that helped society, the economy, and the markets. I cannot see the EU or national sovereigns withdrawing their measures very quickly, so we expect spreads should remain very stable.

We have benefitted mainly through long dated senior issuances. We have done a lot of euro private placements in that part of the market, as well as Swiss franc denominated deals.

This has been one of the most favourable segments for us.

GlobalCapital: **Christian, what do you make of the market from a syndicate point of view? Are you nervous about senior spreads moving wider, given how tightly transactions are valued? Or are bonds still well-supported by favourable credit and liquidity conditions?**

Christian Klocke, DZ Bank: From a syndicate's perspective, this should feel like happy times. Spreads are at tight levels and liquidity is still pouring out of investors. But we have just experienced a severe crisis worldwide. Many of the results of that — broken supply chains and inflationary pressure on various goods and services — simply aren't being priced into spreads at all.

Christian Klocke
DZ Bank

When we are asked what we expect over the next three to six months, we might think the market is very much safeguarded by the central banks. They are taking care of everybody by giving them as much liquidity as they want, so that hopefully it flows through into the real economy. But we are already starting to see some inflationary pressures and other severe impacts from the overabundance of liquidity. My personal fear is that this will eventually lead to a repricing in credit. There is no immediate risk of a blowout, but we need to keep an eye out for triggers that could change the outlook.

If we look at senior, tier two and additional tier one, these asset classes are not being priced properly in the sense of their default risk. The pricing is more influenced by the liquidity pressure that's being placed on investors. They are between a rock and a hard place: should they keep their cash at the short end with negative rates, should they put their money to work in relatively safe asset classes such as senior preferred, or should it go into higher risk asset classes to get a better return on their investments? It is a difficult question and that's why I'm cautious. Many investors are not happy with the credit spread environment, but they are price takers in an environment of over-liquidity.

Boor, Hypo Vorarlberg: Would you expect this over-liquidity to go away in the near term?

Klocke, DZ Bank: No, I wouldn't. I can't see central banks pulling the plug in the short term. They have been discussing inflation targets instead, including the possibility of allowing overshooting. I expect they will end up being more flexible when we see inflation pressures, rather than pulling the plug on liquidity.

But at some stage I think they will need to have a closer look into the rates environment and into TLTROs, so that we can move back into a healthier financial environment. Central banks will need to rethink their strategies in the next few years. It will start in the US and then the ECB will need to adapt as well. At a certain point, market participants will realise that spreads are too tight and then the development will be a quick move wider rather than a slow grind wider.

Winkler-Viti, Berlin Hyp: I don't think the ECB will carry on giving out the same level of subsidies to banks as it is today. I don't expect them to stop their measures immediately, but I also don't expect these favourable conditions will stay in place. The ECB will give us some guidance on monetary policy at the end of the year, also with respect to the TLTRO programme.

The best rate on TLTRO is minus 1%. If you want that you just have to keep your eligible portfolio where it is — you do not need to grow it by a single cent. It is not a hard benchmark for many to reach. Economically speaking, we don't have any need to continue with these sorts of incentives, so I think the policies could be tightened sooner than what Christian described.

As for the idea that funds have lots of liquidity and it needs to go somewhere, I always ask myself why investors buy senior products. Either it should make some profit out of spread tightening in the secondary market or should generate a return out of interest. At this point investors don't get any of the latter, especially in the senior preferred market. And, at the same time, spreads are very low with limited potential for further tightening.

Klocke, DZ Bank: I think it's a view on relative value and where you should park your liquidity. Investors are concerned about where they can get high grade senior preferred issuance in mid length maturities, without exposing themselves to too much duration risk or taking on negative yields. Those with more open or risky investment mandates have been going into lower products or issuers with lower credit quality. In the last few weeks, we have senior preferred bonds being sold with reasonably high new issue concessions, for instance, while non-preferreds and tier twos have been priced with much smaller premiums. The pressure on the investor side to find some sort of return on investment is huge. If that desperation goes away, I think we will see a significant price reaction.

Boor, Hypo Vorarlberg: I would add that, as long as the ECB's collateral framework is as generous and favourable as it is, and senior preferred is typically ECB eligible, there is another driver for some investors to carry on buying preferred senior from good issuers. They can broaden their collateral pool for the ECB.

GlobalCapital: **Do the other participants worry about the impact on the senior market should central banks start withdrawing some of their supportive measures in the near term?**

Buls, Rabobank: The ECB has been flagging their actions well in advance. I can't see the ECB saying, in one go, that they are done with the TLTRO programme. That would create a lot of chaos in the market. The expectation is that the ECB will do it step by step, so we could potentially see the conditions of the programme being changed in the foreseeable future. I also can't see the Federal Reserve doing anything that would have a massive impact, whereby the market becomes extremely volatile. That's simply not their aim.

On the other hand, I do understand that, at some point, the central banks will need to turn around and reduce these extra facilities. I think they will wait and see what impact that has on the market and then react accordingly. If the impact is limited, they can take another step. If the step was too big they might hold back a bit. I can't see them making big moves that cause widespread volatility in the market.

Hjelle, SpareBank 1 SR-Bank: In Norway we don't have any ongoing facilities and the central bank is already beginning to raise rates. There is no help from the central bank here. But SR-Bank does still benefit from the programmes that exist in the eurozone. Our covered bonds are eligible for repo with the central bank, for instance, though our senior bonds are not.

I think to some extent that the lack of repo eligibility has dampened the spread moves on some of our recent senior transactions. But, on the other hand, we also hear that quite a few investors were interested in our senior deals because we aren't eligible and can offer a pick-up. I share the view that the central bank cannot do anything abruptly. They will withdraw their programmes gradually.

Boor, Hypo Vorarlberg: I also think the central bank will stick with more accommodative measures but the most beneficial period of the current TLTROs will end in June 2022. There could be some widening around that, and banks will probably have more to issue in the market. But I think the programme will end gradually rather than abruptly. Economies in the southern part of Europe are on the weaker side than they are in the northern parts and the pandemic is still not over. I expect the central banks will remain supportive.

Alexander Boor
Hypo Vorarlberg

GlobalCapital: It certainly seems as though the interest rate environment will take a much longer time to change in Europe. I'd be interested to know how this has been affecting senior bonds. Are issuers struggling with their funding choices, given that a lot of the market is trading below 0%?

Klocke, DZ Bank: This is going to be fascinating. We haven't seen significant amounts of fixed rate primary issuance in the negative coupon territory. It is interesting to think about a scenario where the TLTROs are gone, but the rates environment is still where it is, and financial institutions need to find a broader range of maturities for their funding. Have we not seen any issuance recently in the three to four year part of the senior preferred curve because no one wants to buy at negative coupons? Or have we not seen any issuance because central banks are providing funding at these maturities?

My belief is that it comes down to the first part. Senior preferred bonds partly benefit from bank treasuries buying for ECB repo purposes, but the rest of the market is driven by real money accounts. To some extent these investors have a relative value mindset, but for the most part their approach is governed by total returns. Logic would prevent them from putting their money to work in primary on products with negative yields. So, there is a limited amount of liquidity available for a negative return on investment. This will lead to a situation where banks find it difficult to issue in the short to the mid end and investors are still being pushed into the sorts of maturities we are seeing at the moment — five to seven years and over. I can only see spreads widening at some point as a result of these dynamics.

Winkler-Viti, Berlin Hyp: When it comes to negative rates at issuance, I pretty much share Christian's view. In contrast with covered bonds, investors cannot use senior preferred for any regulatory purposes. I can't see how this would be attractive for them.

That being said, we did see a green five year senior bond from Deutsche Kreditbank in February that priced with a slightly negative yield. It was not just oversubscribed, but very well oversubscribed, and it came at a very tight spread level too. Apparently negative yielding senior preferred deals can find buyers in a constructive market environment.

Klocke, DZ Bank: It was indeed an outstanding transaction, though I think that very much came down to the dynamics in the order book. For that product, in that maturity, at that point in time, DKB had an opportunity to drive into negative pricing. But if it were planned as a negative yielding deal right from the start, there might have been a different result. So, yes, there are examples where it does work. But it is another story when you are talking about shorter maturities where deals are not at the borderline between flat and negative yields.

Boor, Hypo Vorarlberg: There are lots of investors in the market who are interested in relative value in spread terms and not so much in real yields. From my point of view, the spread is even more important than the yield. I think the pool of potential demand is certainly large enough to do successful deals through 0%.

Buls, Rabobank: We have also seen negative yielding issuance in the corporate space, though of course it is a different dynamic there because of the ECB's buying programme. But there is still the question of relative value. Even a deal with a negative yield can have a pick-up versus another alternative — and potential to perform.

Most banks have steered away from negative yields by going out longer in terms of maturity. If this carries on, and lower beta names continue to avoid the shorter/middle part of the curve, then investors might start getting oversupplied in the somewhat longer tenors. When investors expect volatility, and/or interest rates to rise considerably, they probably will be less keen on buying in the longer tenors and will want to buy somewhat shorter. With that in mind, we could well see some negative yielding paper at some point.

Rabobank hasn't been active in the senior preferred market for some time because our focus has been more on senior non-preferred for MREL. But all our outstanding senior preferred bonds are trading with a negative yield, so if we do decide to issue in the format then potentially it would be priced below 0%. That said, I cannot rule out the possibility that we might follow other banks and term out the tenor a little bit to avoid the question entirely. Even if investors could be pushing into negative yields, it is not as if they are particularly enthusiastic about them. We still need to be careful and need to see where the demand is.

Another element to mention is that, being a global issuer, there are other markets where we can get favourable funding levels at the short end. Dollars is the market to beat here. When conditions for execution in other markets are good, or even better, we would rather not take the risk by going inside 0% in euros, as these other markets are a good alternative and not having the same challenge.

Hjelle, SpareBank 1 SR-Bank: We would tend to go further out on the curve to avoid negative yields. At one point, we saw lots of issuers printing at 10 years in the covered bond market and even those investors who didn't want to go beyond the middle of the curve ended up being pushed into the transactions. My guess is that we would see the same happening in the senior market. There are investors who cannot go longer than, say, five years. But the majority can and would be forced into longer tenors to avoid negative yields.

Dag Hjelle
SpareBank 1 SR-Bank

As an issuer in euros we tend to like following the sweet spots. Of course, if we did see lots of issuance at negative rates we would follow that trend too. But for now we would prefer to avoid it.

GlobalCapital: Have you also had good alternative options in Norwegian kroner?

Hjelle, SpareBank 1 SR-Bank: We have been quite active in the euro market. We did a 10 year covered bond in March and a senior non-preferred in July. It is marginally cheaper for us to get funding in euros with covered bonds, while in senior it is seems a little more skewed to Nokkie. But the volume of the trades also matters. Here in Norway, you do smaller trades than you would in euros. While non-preferred senior pricing seems to be cheaper in Norwegian kroner, we have chosen the euro market because of the sizes and the maturities on offer. It is also a very important market for us, of course. We want a presence in euros and we want to open ourselves up to investors who don't have credit exposure to us already.

GlobalCapital: What do participants think about the relative value between different parts of the bank liability structure. We have talked about how tight spreads are across the board, but is there enough differentiation between asset classes?

Klocke, DZ Bank: I think this goes back to the discussion about how investors are being forced into other products, from senior preferred down into senior non-preferred or even into tier two and AT1. Currently it is one big compression trade.

I don't think it can continue. Relative value between senior preferred and senior non-preferred might stay stable for a few months, but at some point we will be looking at the decompression of these asset classes. There are plenty of risks that can put enormous pressure on spreads, especially when we think about tapering scenarios and how supply and demand patterns could evolve going forwards.

Winkler-Viti, Berlin Hyp: I agree with what Christian is saying. During the last few months, spread compression has become unhealthy. Some issuers have a spread of less than 10bp between their senior preferred and senior non-preferred bonds in the same maturity. But there are three rating notches between the asset classes. For me this is not an adequate pricing of risk. Of course, there is potential for widening. Everybody must know that these three notches express a totally different probability of defaults for the assets. Just as Christian said, it may not happen in the next few weeks, but in the near term the spread between senior preferred and senior non-preferred should definitely widen.

Boor, Hypo Vorarlberg: I would totally agree. The spread differential between senior preferred and senior non-preferred should widen. But we have absolutely no need for senior non-preferred at Hypo Vorarlberg, because we have a huge MREL surplus and we don't have a subordination requirement. Even if the market is extremely favourable for non-preferred, we wouldn't consider issuing the product.

I would also suggest that the spread differential is even tighter between senior preferred and senior non-preferred in Swiss francs, so this could be a market for other issuers to consider. It has been a good option for us in preferred senior, covered bonds and tier two. You can also print in smaller sizes, which is attractive for us as a smaller issuer. We are very well established in Switzerland.

Buls, Rabobank: The relative value discussion is also a little theoretical for us, because we haven't been issuing senior preferred for a while. But we have been issuing senior non-preferred and we know our spreads are very tight.

The low yield environment means senior preferred spreads have also been pushed up a little to avoid negative yields. So if we do see rates go up, we will potentially see a correction on that side as well, with senior preferred spreads finding room to tighten. At that point we could see the differential between senior preferred and senior non-preferred widening a bit.

When it comes to tier two versus senior non-preferred, we are seeing tourists moving down the credit spectrum and bringing spreads lower. We have seen tier two transactions landing at extremely tight levels, while still being well subscribed and performing well in secondary. Overall, you have to recognise that everything is trading at extremely low spreads and extremely low yields, so the differential between asset classes will necessarily be tighter than when spreads are meaningfully wider.

Hjelle, SpareBank 1 SR-Bank: Another factor here is that, if an investor is happy with an issuer, and it fits their mandate, they will probably go for the juicier products they offer. Given the low yield environment, they will move down into senior non-preferred from senior preferred, for example. In my view, those two asset classes are too close together. But I agree it will depend on developments in the overarching yield environment as to whether senior non-preferred spreads should go up, or senior preferred spreads should go down.

GlobalCapital: Do credit fundamentals have any influence on the outlook for senior spreads? How are bank balance sheets holding up?

Klocke, DZ Bank: There has hardly been any decline in asset quality compared with what the majority of market participants projected for the end of 2021. Instead, it has been the other way around, with banks taking back some of their loan loss provisions over the last 18 months. The big question here is whether the losses are still to come or whether we were too pessimistic in the first place.

Boor, Hypo Vorarlberg: Or has the taxpayer already paid the bill? As I mentioned earlier, we have seen huge state support measures underpin the economy in Austria. Our balance sheet is stable, our asset quality is very strong, and our non-performing loan ratio is even lower than it was before the pandemic. We also maintain a very confident outlook for the next six to 12 months.

Winkler-Viti, Berlin Hyp: I'm a little surprised there has been so little impact on bank balance sheets. We were more pessimistic a year ago. Berlin Hyp had an NPL ratio of 0.5% before Covid appeared, for instance, but now it stands at 0.2%.

As in Austria, we have seen many countries introduce lots of different measures, from furlough to direct government support, to delays in insolvency declarations. But these measures did not save everybody. When you go down the high street, you can see that some businesses have given up or reduced their retail spaces. Yet you don't see the impact on banks. I think this is a sign that we are not quite out of the effects coming from support programmes yet.

Buls, Rabobank: The government in the Netherlands has also stepped in with temporary liquidity support for SMEs, compensation on labour costs for companies that saw a decline in their-turnover-of more than 20%, compensation on fixed charges, some tax measures etc. It was helpful. As a result, a very low number of companies have gone insolvent. The unemployment rate is also extremely low in the Netherlands, so the recovery looks very healthy and far more promising than everyone was expecting last year.

Ger Buls
Rabobank

On the other hand, there are some more vulnerable sectors, such as hospitality or sub-sectors of commercial real estate, like retail non-food. We will need to see how they cope once the support measures have ended. Rabobank has kept a management buffer on loan impairments because we do still expect some impact, even though the situation looks more promising.

Hjelle, SpareBank 1 SR-Bank: We had similar measures in Norway to what Ger just mentioned for the Netherlands, though the programmes have now ended. What also helped was that we had tax benefits for investments in different sectors. The unemployment rate is plummeting here as well. Listening to the positive stories in Austria, Germany and the Netherlands — though we have to bear in mind that the situation is different in Spain, Italy and France which have slightly different experiences — you have to ask whether we need all the support from the central banks. Do we still need to subsidise the financial sector?

GlobalCapital: Since the pandemic started, we have seen a surge of senior issuance from banks in environmental, social and governance (ESG) labels. What is driving this trend?

Klocke, DZ Bank: I think we were lucky the market had already established this new asset class in the years before Covid-19, so there was already a mechanism in place for dealing with ESG products. But I think the fallout from the pandemic really highlighted a number of the social aspects on bank balance sheets — support for healthcare and other services, for instance — which could lead to a real broadening of the ESG space. We've seen a few social bond issuances from banks recently. They were not necessarily linked to Covid-19 support measures directly, but I think these sorts of deals do fill in another piece of the puzzle in terms of what financial institutions can do to help the world to overcome certain aspects of the pandemic.

Investors clearly differentiate between different ESG products. Green is still the gold standard. But social bonds can also play a bigger role going forward. I would expect all ESG-related activity to be much more broadly based going forwards, even if it is still dominated by a pure green use of proceeds. I think that's fuelled by the pandemic.

Winkler-Viti, Berlin Hyp: I also think there's a link between the pandemic and social bond supply. If you look at the numbers, social bond issuance was not even $20bn worldwide in 2019. In 2020 it was almost $150bn. Clearly that was driven by one big issuer in particular — the EU. But in the financial institutions space, many new issuers have been looking at social bonds. Last year, more or less everybody felt it was time to think a little deeper about how they can develop this part of the market further. We are getting more and more interested in social lending and would be thinking about a social bond at some point in the future.

The increase in green bond issuance last year had nothing to do with the pandemic. The world has lots of goals linked to climate neutrality and banks can use their lending standards to help reach these targets. They should then use green bonds as a refinancing tool. We have said this since 2015; in 2021 it is mainstream. I can hardly think of a name that doesn't have a green bond framework now. With newer developments such as the development of a green asset ratio and the publication of the EU Taxonomy, this is a topic that simply will not go away. In the future I think the new normal will be for financial institutions to issue with lots of different ESG labels, rather than issuing conventional bonds.

GlobalCapital: What about the other issuers. Have you also thought about printing senior bonds in social formats?

Hjelle, SpareBank 1 SR-Bank: I don't think we will be issuing many social bonds, because Norway funds a lot of social issues at the state level and through municipalities. But we will carry on with our focus on issuing green bonds, both as SR-Boligkreditt and as SR-Bank.

The world has had greater focus in recent years on rising water levels and global warming. We should also think about these issues as banks, and that started long before the pandemic, when ESG was already high up on the agenda. I'm not sure if banks should lead the way, but we should certainly play a role.

As big producers of oil here in Norway, we would also argue that it is better to use oil instead of using coal, which is much more polluting. So we have been taking a look at the idea of doing a transition bond. The question we are asking is, how can we use the knowledge in the oil industry to generate better energy sources, such as through wind and wave power?

Boor, Hypo Vorarlberg: Green issuance is also very important for us — more important than social bonds. Hypo Vorarlberg has had a green bond framework for a long time, having become the first Austrian bank to issue a green deal in 2017. We are focusing on energy efficient buildings and have been collecting the EPCs for these properties. We want to stick with our well-established green methodology, though we also want to adapt it to the new EU Taxonomy. We are also working on harmonising impact reporting for CO_2 savings in Austria. We want to find a way of standardising the reporting with many other Austrian banks, because we have seen a lot of issuers doing it in very different ways.

I think the market accepts the idea of a greenium, which is probably at a level of around 5bp compared with ordinary senior issuance. In my view, this is a much larger benefit than you would be able to get with a social bond.

Buls, Rabobank: We have also been active in green bonds, mostly based on solar and wind energy. We have seen some greenium in these transactions as well. Given the shortage of supply in green bonds, the investor base has accepted this.

Recently we have also had our ESG framework characterised in sub-frameworks, which also has social elements. But we haven't issued a social bond yet, so it is difficult to compare the pricing and demand with green bonds. We are having discussions with investors on their appetite for social bonds and what a social bond could bring us in terms of pricing and diversification.

GlobalCapital**: You've also sold ESG-labelled senior paper in the dollar market. Are the benefits the same as in the euro market, which has traditionally been the home for new green paper?**

Buls, Rabobank: We saw a lot of the same buyers in the book as we would have seen in a conventional trade. It is always difficult to understand who the 'dark green' investors are, and this was also true in dollars. But the accounts involved in our green dollar senior bonds were quite sticky. Most of them kept their orders in the book after the price was tightened, where potentially on a conventional trade they would have (partially) dropped. That gives an indication that the green label is helpful in dollars, like it is in euros. In the future, we will definitely look at different currencies when we use our green assets to see what makes most sense and to provide different investors with green assets.

GlobalCapital**: Berlin Hyp brought a new format into the senior market this year when it became the first bank to issue a sustainability-linked bond. But we haven't seen many other issuers following suit. Bodo, what kind of a role do you think SLBs will play in the FIG space going forwards?**

Winkler-Viti, Berlin Hyp: This will very much depend on whether the EBA reconsiders their stance towards sustainability-linked bonds. They are arguing that these structures create incentives for issuers to redeem their bonds and that sustainability-linked debt should therefore not be included in the MREL ratio. Because banks use both senior preferred and senior non-preferred bonds for MREL purposes, I think the future for sustainability-linked issuance in these formats is limited.

It is a real pity because sustainability-linked bonds can be really effective in helping the world to meet climate goals. They don't just have a bearing on a single portfolio of bank loans, they can steer the direction of the entire company. There is no bigger statement that a bank can make in the capital markets than using the strategic performance targets in a sustainability-linked deal to commit to the carbon neutrality of their lending in the future.

I think it is important the EBA reconsiders its position. Even if a sustainability-linked structure does create an incentive to redeem a bond, banks will still need the possibility of redeeming the instrument. When it comes to MREL, institutions need to ask the authorities in advance for permission to call anyway — the authorities could simply say no. In our case, we did not include a call option so there is not even any automatic way for us to redeem our sustainability linked bond.

GlobalCapital**: Would you issue again following the EBA opinion?**

Winkler-Viti, Berlin Hyp: We deliberately excluded our sustainability-linked bond from MREL. We were issuing at a time when we didn't use any preferred senior instruments at all in our MREL ratio. From June onwards we will include preferred senior, except for this sustainability-linked deal of course. But MREL is not a big issue for us because our ratio stands at 76%.

I really love the sustainability-linked structure and I think it's important that banks are able to use to it as well as other issuers. But I probably wouldn't issue in a senior format until they are treated in the same way as other senior instruments for regulatory purposes.

GlobalCapital**: Have any other issuers thought about issuing sustainability-linked bonds in senior formats?**

Boor, Hypo Vorarlberg: We have discussed the potential for issuing a sustainability-linked bond, but we came to the conclusion that it is a bit too early for us. We would have chosen the green asset ratio as the key performance indicator, but it's not yet clear how this will be defined.

We aren't really concerned about the lack of MREL eligibility because we also have a huge surplus, with a ratio of approximately 44%. We could take that disadvantage from a regulatory perspective. It is a very attractive product. Going forwards we will be looking out for the possibility of issuing sustainability-linked bonds, even if the regulators stay with their position. The challenge for us at the moment has more to do with the KPIs.

Buls, Rabobank: The regulatory uncertainty is the main hurdle for us. We are closely monitoring the discussions within the EBA, but we are in wait-and-see mode. We have no need for senior preferred in euros at the moment, so it would have to be in the senior non-preferred format. GC