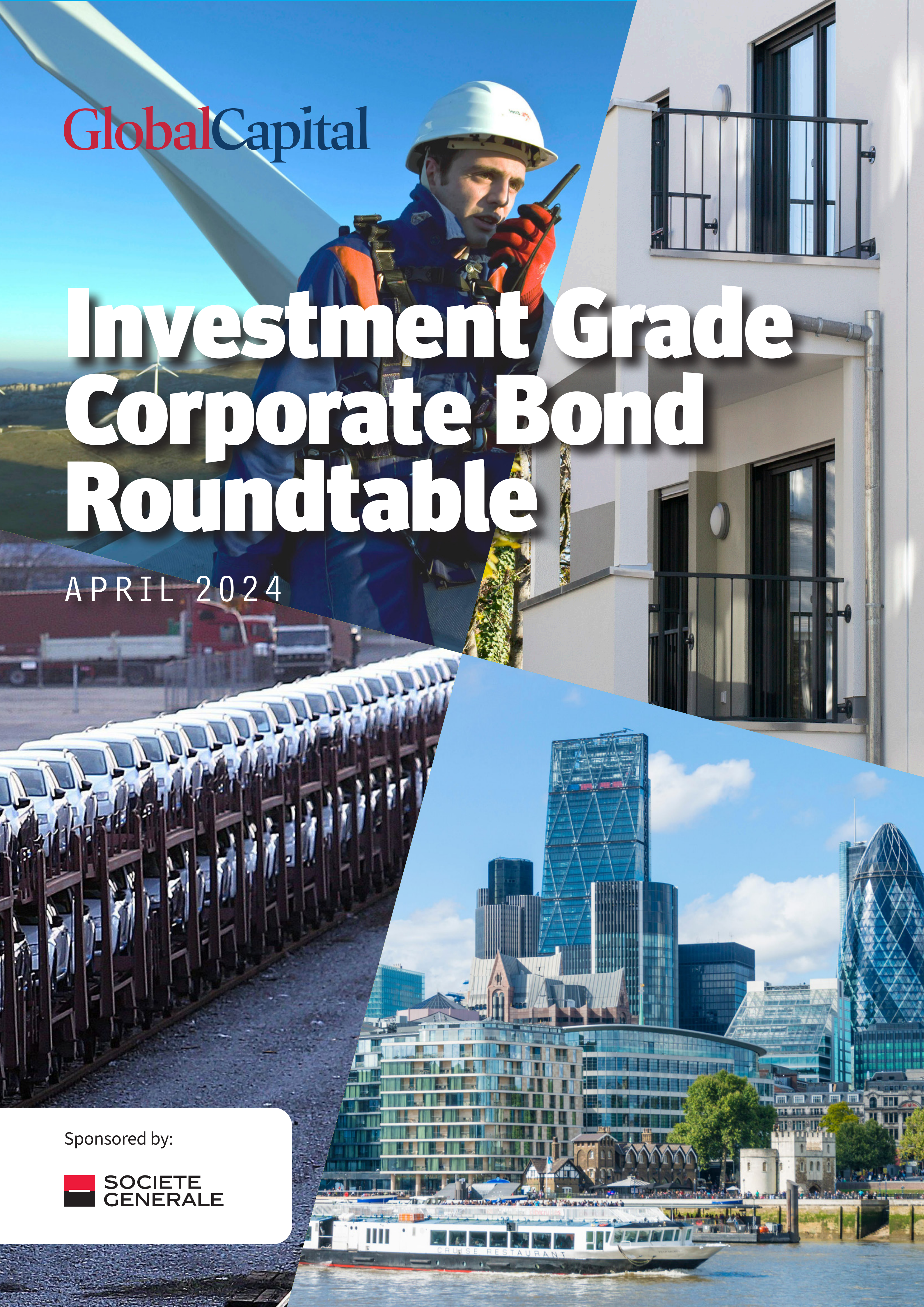

GlobalCapital

Investment Grade Corporate Bond Roundtable

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‘The market wants to be positive’ — but companies are wary of volatility

Europe’s investment grade corporate bond market has been remarkably resilient in the face of interest rate hikes, tougher economic conditions and rising default rates. In 2024, the strength and length of its bull run has astonished forecasters.

But corporate bond issuers know that rough markets can always be lurking round the corner and they have to be prepared. In March *GlobalCapital* brought together five leading participants in the market, representing issuers, investors and investment banks, to share their thoughts on how long the rally can last, and what will happen to spreads when the turn in the interest rate cycle finally arrives.

Investors need to be selective, since when conditions worsen, the recent across-the-board spread performance will be broken. Issuers are advised to roadshow thoroughly, away from deal execution, and broaden their funding to new markets — even if they cannot achieve arbitrage.

The group also discussed the likely impact of the US election, the value or otherwise of artificial intelligence, the influence of environmental, social and governance issues, and how the market values green and sustainability-linked bonds.

RATES AND SPREADS

***GlobalCapital*: Not long ago, it seemed like interest rates would be low forever. Some people longed for a normalised rate market, with proper interest rates and credit pricing. Now, in a very short space of time it has happened. What can be learned from this experience?**

Fabian Lander, Vonovia: Change can occur quite rapidly. The most important thing is that as a corporate finance professional, you have to be prepared for a volatile environment.

Real estate is a long term business and we need long term debt, and we like fixed rate, which is quite popular in Germany but not in the UK. Fixed rate takes out any interest rate risk in the funding, and the lesson learned is that this is the right approach. Don’t mess around with the funding strategy you have in place.

In the real estate industry, across Europe and other countries as well, there’s a correlation between rates and property yields, and sometimes a business model is not working anymore if rates go up that fast. That’s why the real estate industry is struggling quite a lot. I’m quite happy that we’ve seen the peak of rates and we know it’s not going any further.

Andrew Menzies, Société Générale: You’re at one end of the real estate spectrum, right at the most defensive end of the market, and you’ve been an issuer for a number of years.

What we did see through the period of easy money was how the sector massively grew, to the point where it was nearly 20% of euro corporate bond issuance. In a post-ECB quantitative easing world, one could imagine that the real estate market might go back to a more historical 10% number. Last year and in 2021 when rates were rising, we were down at the 5% mark because of the difficulty to access the market.

It does show that some of the traditional funding models and probably the really esoteric names will go back more to the secured loan markets. Maybe that’ll be a good thing for Vonovia because you’ll have more interest on yourselves.

Roundtable participants

Alessandro Canta
Head of group finance and insurance, Enel

Nachu Chockalingam
Senior credit portfolio manager, Federated Hermes

Fabian Lander
Head of corporate finance, Vonovia

Andrew Menzies
Global head of debt capital markets, Société Générale

Felix Orsini
Head of treasury and ALM, Ayvens

Mike Turner
Corporate bonds editor, *GlobalCapital* (moderator)

Lander, Vonovia: For real estate companies, having access to the bond market depends on your rating. Most of the real estate companies use the traditional funding source of secured lending. There was a massive pricing gap — it was much more attractive to do secured loans than an unsecured bond in 2023. But that gap has narrowed significantly in the last few months.

Alessandro Canta, Enel: The most difficult decision is the magic numbers you have to commit to over the next two to three years, that you put in your strategic plan. This market is a fantastic one — money is growing in investor pockets, it's quite evident from the volume and the oversubscriptions.

When it comes to issuers, everybody is waiting for interest rates to go down. But that is for short term interest rates, what's going to happen to the long term interest rate? Short term interest rates will decrease, but nobody knows what's going to be the shape of the curve in the long term.

If you have the possibility to repay some commercial paper, you don't suffer any carry after issuing a bond because, essentially, you're going to refinance yourself at a lower rate. So, is that possibly an incentive to go to the market?

After a very strange and unusual market in which we lived for a long time, with zero or negative interest rates, today the market is much more consistent and solid, because positive interest rates are the normality.

Nachu Chockalingam, Federated Hermes: Flows into credit as a whole have been very strong this year. We've seen cash coming in from different areas, but mainly from cash and money market funds into credit as people worry about reinvestment risk, especially when they're invested in very short duration assets and we are at peak rates.

At the beginning of the year, it was very easy to pretty much buy any new deal and for it to trade up in spread terms. Now, however, the new issue premiums have shrunk, and in some instances new issues are pricing through the curve. People have to be a lot more selective in what deals they're getting involved in.

At this point in time, there is such a bid for risk that pretty much every deal is doing fine in secondary. There's no material differentiation. But as the market becomes potentially less constructive in the next three to six months, that can't be guaranteed and more credit selection will be required.

We don't want to be in a position in three, six months' time, where we're owning a lot of names, but we don't really have a huge amount of conviction and the market agrees with us, and we're trading at much wider spreads than where we entered.

Felix Orsini, Ayvens: I'm not even trying to guess what will be the rates in the coming months. We have a large funding programme, so we need to come on a regular basis.

It's another reason to anticipate our financing needs and prefund as much as possible. We have executed 60% of our annual funding programme already and that's something we'll try to do every year to be on the safe side.

Canta, Enel: Felix, you are totally right. We are here to stay, and we are a recurring issuer. I should not say I don't care what is happening in rates, I care very much. But I'm going to be there in the next month, in the next years. And when it comes to the market change, I've been working in this sector for the last 31 years — we have to be there, being consistent.

I'm not saying this because there is an investor here, but strengthening the partnership with investors as much as possible, diversifying access to different markets and preparing yourself for being active has been proved to be very important, much more than the possible evolution of interest rates.

Not for, say, the relative value of a market versus another one — because otherwise dollars today for European issuers would not be a choice — but for continuing to enforce your capacity to access the market even in bad times.

Chockalingam, Hermes: We're encouraged that issuers are proactively dealing with their capital structures by refinancing bonds. They're generally very nicely balanced in investment grade. It's not like in the high yield space, where you tend to find large and chunky maturity walls hitting in the next few years.

And so even if you know issuers need to refinance a small piece of their capital structure at higher rates, we think with earnings growth over the next few years, that should be relatively easily absorbed. But I do think more selectivity is necessary, especially right now, when issuers are definitely looking for every basis point they can get. We just need to be careful on that.

"Strengthening the partnership with investors as much as possible… has been proved to be very important, much more than the possible evolution of interest rates"

Alessandro Canta, head of group finance and insurance, Enel

FUNDING DIVERSIFICATION

***GC*: How important is funding diversification, and what sort of dynamics do you need to consider when diversifying?**

Lander, Vonovia: One of the lessons learned for us was in 2021, we hit the euro bond market four times, in 2022, two times, and raised approximately €15bn of long term debt.

There was good long duration, very cheap money. We still benefit from it, but one of the elements we realised is when you hit the market too often, when you raise too much capital, it does impact your secondary.

If peers that do not have a rating as good as ours trade tighter than us, then something is not right in my opinion.

This has an impact on the funding cost in future, and that's why a key element is to further diversify our funding sources and investor base. That's why we did, for example, the Schuldschein deal two years ago, and then we went to the sterling market earlier this year and the Swiss franc market.

It does take off pressure from the euro bond market. The question is: how do you look at it if you access a different market? Is there arbitrage for the time you hit the market? That is one thing, but we look at it more holistically because you will benefit in the long run from tighter euro spreads. That's why diversification is key and it's not about arbitrage.

Orsini, Ayvens: We came to the bond market already twice since the beginning of the year, and I know that if we come very often, I will have what you are saying.

So we did our first Swiss franc issue this week. I'm not looking for arbitrage, but it has to be consistent obviously, not to get too far away from what we do in euros. The priority is to build a new investor base, develop new areas of funding. This first transaction was successful. My intention is really to tap this market on a regular basis and develop it.

When I get pitches from banks, it's all about what kind of new market or new investor base can I develop.

Menzies, SG: I totally agree, because you don't want to be beholden to any particular investor base.

Orsini, Ayvens: You're told: don't come too often in the market, you need to give it some breathing space. We did a transaction on January 15, €1.5bn, so quite large. And in mid-February, another for €1bn — so contrary to all the rules you would follow normally. But the trigger was that the market was empty at that time.

A lot of issuers were still in blackout. The message from the banks was that supply was lacking. We were almost the only ones on the market on that day, and it was the largest order book we've had in the young history of the combined group.

So I'm trying to be flexible, listening to the market and looking for the right time. It's not easy. The market is very crowded, so to find the days or weeks where you have a bit less competition or you can get most attention from investors is important.

"More selectivity is necessary, especially right now, when issuers are definitely looking for every basis point they can get"

Nachu Chockalingam, senior credit portfolio manager, Federated Hermes

Menzies, SG: Alessandro probably has the largest funding book around this table here. Obviously, Alessandro, when you go to the market, you make quite big splashes. You're present in the dollar, euro and sterling markets. Are you looking at other areas as well?

Canta, Enel: Yes, we have been present in Swiss francs, even if the size is, I wouldn't say limited, but lower. If you come to the euro market two, three, four times a year, the market can become a little bit tired. Tired doesn't mean it doesn't have the capacity, but investors become much more selective.

In the US, the market is always open and there is always a price for something, because the dollar market is the most consistent one.

Menzies, SG: Do you consider hybrid capital as bringing you a slightly different investor base? Does it bring some additional capacity?

Canta, Enel: It can absolutely bring additional capacity, but it needs consistency. In fact, we issued the first hybrid some years ago, at the time of the crisis of the peripheral eurozone countries. We promised the market that hybrid would remain a permanent layer in our capital structure.

THE MARKET THIS YEAR

***GC*: Where do you think spreads are heading over the next 12 months? Are they destined to move wider? And how are you positioning yourselves?**

Chockalingam, Federated Hermes: That's the $1m question. We're very surprised at how strong the market has been in the first quarter. I don't think we would have anticipated this — the strength in the fourth quarter continuing for this prolonged period of time into the first quarter.

In investment grade, there is still more of a spread cushion than there is in high yield and I think you are starting to see some capital transition further up the rating spectrum. There is more momentum potentially to be had in the investment grade space.

Lander, Vonovia: If you stick to financial discipline in your capital structure, then everything is fine. If you don't stick to it, spreads will go up.

Menzies, SG: At the end of last year, Société Générale was forecasting credit spread indices to widen by over 100bp across euros and dollars. Sometimes you've got to put your hand up when you're wrong, and we were wrong.

Yes, default rates have risen. If you look at Moody's, they've gone from 1% to 5%. But that's where they forecast a peak. But it doesn't really matter to issuers if your interest rate cost rises a little bit, it's really can you afford to pay?

Interest and corporate earnings have exceeded expectations, to the point where, alongside

stimulus spend, capex deployed for the transition, etc, we're now expecting US GDP growth to be 2.2% in 2024 versus what we were forecasting at 0.8%.

Chockalingam, Federated Hermes: Spreads are tight, but the yield is still pretty decent. You're still looking at a yield close to 5% and these are levels we haven't seen for decades.

The composition of investors' total return changes, but their outcomes could still be quite good for the next few years. And generally speaking, in investment grade the entry yield is your expected return, at least for the next three years or so.

Technicals will probably stay quite strong for investment grade, but if we see macro weakness, geopolitical events take off, spreads will widen. But in investment grade you still have some protection.

Menzies, SG: The 10 year Bund yield had gone below 2% in December. We now see them back up quite a lot around 2.4% and that provides protection in the form of carry for investors to get involved. Therefore spreads are performing. So long as the Bund yield doesn't suddenly go back down to 2%, our strategists now are probably the most bullish in the Street, and expecting a material tightening.

March typically sees wider credit spreads — it's one of the two months, March and September, because of the technicals. But actually as things stand, we're forecasting that things will continue to go tighter in the investment grade space.

***GC*: This year has more people voting in elections globally than ever before, but so far, the corporate bond market has shrugged at the outcomes.**

Lander, Vonovia: It does have an impact on the operational side of your business, but not necessarily on the liquidity in the market. If you take the US for example, if Trump becomes the new president, we know what's going to happen economically. It does make it harder for some companies to operate, because for German companies, it's hard to export things to the US. But from a funding perspective, it does make the US stronger again.

Canta, Enel: If you had put such a question to us in 2014: 'what do you think the market's going to be like if Trump is elected?' Or just like it, 'what is going to happen if there is Brexit?' It would have been terrible. 'Oh dear. Oh, a nightmare. The market would be shut down.' But this did not happen, so everything is surprising us.

When interest rates were zero, most likely you were allowed by investors to have a certain capital structure. Now it has changed, and we are doing our deleveraging.

The market, in any case, wants to be positive. I wouldn't say the market wants to ignore geopolitical risks, because it is always there. But we have got used to living with geopolitical risk.

Orsini, Ayvens: Covid was a good example. Things got very shaky in the market for a time, and then it settled back because the supply-demand balance was there.

There's room for compression on spreads. There is a lot of liquidity, and they should continue to tighten, but by definition, something unexpected will happen.

So I come back to my initial statement. I'm not in a position to guess how spreads will move, but at the same time, spread is super-important for me. If I have a tighter spread than my competitors, I have a funding advantage.

What can I do? I cannot guess or drive the absolute spreads. But I can try to play on relative value, and then you come back to your issuing strategy.

Do you squeeze the last basis point and price as tight as possible, hoping that that becomes a reference for the market? Or do you play it differently, saying maybe I'm going to leave a few basis points on the table, and that will help the transaction to perform strongly and then maybe that will set a secondary spread I can rely on for my next transactions?

We are a frequent issuer, so I'm in the latter camp. I'm trying to drive my secondary curve this way. The other way to drive the secondary curve is to try to find the right windows to issue.

EXECUTION TACTICS

***GC*: It's become much more of a window market. Do you think it's the best approach to do an intraday issue, to cut market execution risk as much as you can? Or is it better to take a slower approach, speak to investors and give yourself a few days to try and come?**

Menzies, SG: You've got to go back to the original conversation, which is diversity in the investor base. More investors equals more a resilient funding programme, and therefore more marketing is better.

But how do you realistically manage that, especially as we get volatility in the rates market? It is good to be in and out in a day if you can. Therefore non-deal marketing with a credit update, below the radar, is probably the easiest way to set yourself up to do drive-by transactions.

If you're an inaugural borrower it's different, but as a macro concept, I think that's the way to manage the long term plan efficiently.

Chockalingam, Federated Hermes: I agree with Andrew there. We're seeing a lot more issuers take that approach. New issues done within a day, but then you have a lot more access to them during the year. That's a good thing, especially as everyone is very busy. Most of our access generally comes around earnings season, when you are extremely busy, and it is often nice to talk to issuers about things other than new deals and earnings, such as strategy and sustainability.

Orsini, Ayvens: Non-deal roadshows take time, but they're critical.

Chockalingam, Federated Hermes: Having that non-deal touch point, intra-earnings period, is really important, and just means we're up to date on the credit. So when you do need to come on a drive-by deal in one day, we can price it up very quickly and be involved.

Lander, Vonovia: We do the same thing — lots of roadshows, and every time I hit a new market it's a connection being made with the marketing.

In our regular, frequent issue bond markets, we do not have to do much marketing, just some non-deal information. But if you go to Canada or Switzerland or the UK — places we had not been before — it's worth it to do one or two days of marketing.

Canta, Enel: It's much more a partnership with investors now, because at the end of the day they have the same interest as you in your deal performing. We look for windows to be opportunistic and get the best possible market conditions, but as Felix was saying, we want to be sure we have a good deal and have a certain performance.

We have to come back to the same investors in light of the performance of the previous deal.

This means we are likely not going to do a deal on a volatile day, but will take advantage of certain good days, in which we have a common interest with the investor.

To do that, you have to prepare yourself well in advance. You don't ask the investors to update their file on you the same day of your issuance, that would be impossible. It takes too much time. We've learned for sure that we have to decouple the marketing exercise from the execution.

Investors are one of the most important stakeholders of several companies, especially of companies issuing debt instruments. We have been misled some years ago that we should consider shareholders our only stakeholders. If you look at the balance sheet of a major company, the bondholders are one of the major stakeholders.

Menzies, SG: Is there any concern about if you do marketing on a non-deal basis, whether you get the same traction and interest? Sometimes that's a concern people have, that not as many investors turn up because there's no imminent deal.

Orsini, Ayvens: Yes, but it works both ways. We are doing a non-deal roadshow this week. Initially I was planning to do the full week, and then something came up and we had to cancel one day. Sometimes also, key investors are not available and it is better to reschedule.

What I mean by this is you do have flexibility. If you know you're not available, or the investor is not available, you can do it five days later and it is not a problem. A lot of things are virtual, you don't need to group everything anymore. A non-deal roadshow gives you the flexibility to make sure you have the right person in front of you at the right time.

ISSUER-INVESTOR COMMUNICATION

_GC_: Are physical roadshows a thing of the past?

Orsini, Ayvens: They're still here, but definitely less than before Covid. We did a combination of physical and virtual. It's more complex to have attendance on the physical one. You know that you shouldn't be in London on Fridays, for instance, but when you manage to be in front of people it's important — it makes a difference.

Canta, Enel: It's important for us to ask investors, because we are the seller and they are the buyer, so they decide. We give the optionality every time to investors if they want to see us physically or not, and they decide what is the best option.

Chockalingam, Federated Hermes: Virtual roadshows save us a huge amount of time. We get quite a lot out of them because if there are several deals in a day, we can quickly assess them. But obviously we like to meet our issuers in person, so we're attending a lot more conferences where there are many more issuers grouped together. That gives us that touch point.

Lander, Vonovia: The interesting thing is for an issuer, you can't do any selection of the investors who attend a conference. That's why I really like roadshows personally, because then you do the selection. With the high quality investors, you have some kind of relationship and you have to make sure you keep engaged, and that's why roadshows are important.

For the broader perspective, and to speak to as many investors as possible, conferences are fine. In fact we do both, to be fair.

_GC_: Linked to marketing deals, how receptive are you to communication drafted by

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Andrew Menzies, global head of debt capital markets, Société Générale

artificial intelligence? If you were to receive some sort of communication like that from your banking group, would it be a good thing?

Orsini, Ayvens: It's very interesting, and very strange. Artificial intelligence is here to provide the usual answer given to a question. And if it's around playing with data, fine. But I don't think you need artificial intelligence for that. You just need macros to calculate secondary curves and send that to the issuer.

But what matters for me is the opinion, and how can you give an opinion based on history? You know, like how a syndicate manager feels about the market that morning? How that transaction was received two hours ago? The colour and opinion change every day, you cannot make it automatic.

You could compare the bond market to a road, so that there's congestion and sometimes there are accidents. If there's a big accident, everyone sees it — the road is blocked and there's a lot of noise around it. But sometimes there are small accidents, or accidents just avoided, that you don't see.

One of the difficulties I see with the information from banks is that they don't necessarily make a lot of noise around transactions that don't go exactly as planned, or when something happens that the issuer was not expecting, and I understand that.

But for us on the funding side, it's important. If there is a quasi-accident ahead, it doesn't mean most of the time it's to do with the quality of the driver. It's just because the road is dangerous, and it's a very valuable signal.

And that's what I'm telling the banks. You know, I'm interested in all the nice transactions you are making every day, but I'm even more interested in those things that didn't go exactly as planned.

Weak signals are important for me to assess exactly what is our execution risk, how cautious we should be in setting initial price thoughts, and so on. I try to understand what is behind the curtains, more for picking weak signals than criticising anyone. And I don't think artificial intelligence can achieve this.

Canta, Enel: We are not conservative when it comes to new technology. We have created our fintech company for digital payments, we have digitalised payments internally. We are utilising blockchain to do our intercompany transactions. It's not a question of innovation. We welcome innovation, but, and I hope that I'm right, this is still a business made by people.

We need syndicate and salespeople to market our transaction, and I see Andrew smiling. But we need people for marketing, to give us advice, we need the origination.

Unfortunately, I don't see a lot of bankers saying 'you have to wait'. Very few don't say that 'sooner is better'.

Unfortunately, or maybe fortunately, we have to read ourselves the numbers in the book composition, in the performance of the deal, to see if the deal was good or not.

This is still a market driven by people, by trust, by faces. And by the experience of people in the banks that intermediate our needs with the needs of investors.

We have to bear in mind that the real clients for the banks are the investors, because with them they may execute 10 deals a day — with us, it's just two or three a year. For this reason, we have to leverage on the relationship, and it cannot be replicated by artificial intelligence.

I would like to hear from Nachu, does she as an investor want contact first with the bank that is blessing the deal?

Chockalingam, Federated Hermes: I really agree Alessandro, this is definitely still going to remain a people business, at least hopefully. We like to have that interaction, not only with you but also DCM colleagues on the sell side. So that we can get more information, more insight. We can also give you our feedback, and hopefully that resonates well with you as well, when it comes to thinking about structure of deal, currency, potentially tenor etc. Definitely more conversation is the preferred option for most investors.

THE INFLUENCE OF ESG

***GC*: Are environmental, social and governance issues a normal part of the conversation between issuers and investors? Are they significant and driving what you do?**

Lander, Vonovia: In the European bond market, ESG is massive, for a very simple reason: the whole market is highly regulated. If you look at the investors in the euro bond market, two thirds are asset managers, and asset managers are subject to the Sustainable Finance Disclosure Regulation. They are regulated and they have to classify their processes, their strategy and their products. The outcome is funds defined under Articles 6, 8 and 9.

Ten years back, there was no regulation in place, so everyone was buying conventional bonds. Nowadays with Article 9, they cannot buy conventional bonds. They have to buy ESG products that fit into their own fund regulation. With green bonds, the likelihood is that you get a bigger order size, that's probably the most successful outcome, but it doesn't change the transaction.

If you look at the US market or the Canadian market, they are far

"I try to understand what is behind the curtains, more for picking weak signals than criticising anyone. And I don't think artificial intelligence can achieve this"

Felix Orsini, head of treasury and ALM, Ayvens

behind the EU, they don't really care about ESG.

On our debut sterling and Swiss franc transactions in January, we had like 16 meetings, not a single question about ESG or green or social. Nothing. In the Swiss market, you can do it, but there's actually not a real demand for green.

Orsini, Ayvens: We have a limited volume of assets that are eligible because we're only doing green bonds, so we have to choose how to use them. For me, a green bond is like the best table in a restaurant, you know, near the terrace. People come in and they will always ask you for that table. Every time we meet investors they're like 'are you going to do a green bond?' And you have to assess to what extent this table really makes a difference for them.

And in some instances, when it's very hot outside or whatever, it does. My inclination would be to keep the green bond for the later part of the year, when there is a bit of fatigue in the market. Investors are more tempted to close their books as they get closer to year end. There's a risk that you have volatility in September, October as well. I would keep that green bullet for that time.

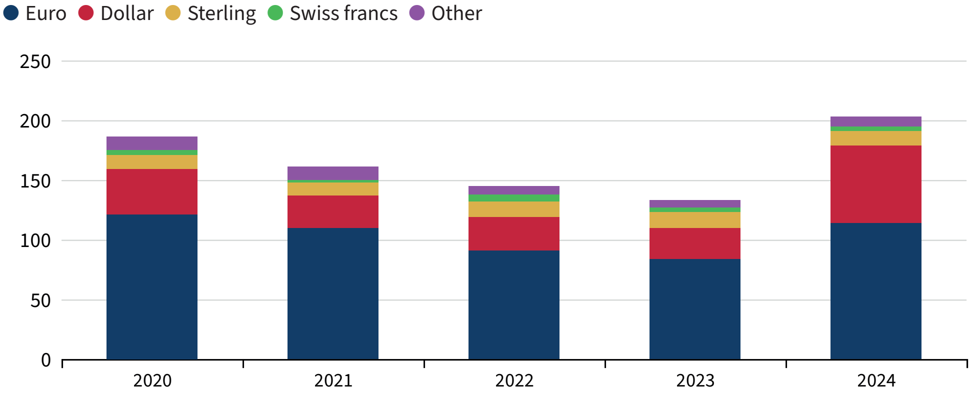
Lander, Vonovia: We've done green, social and conventional bonds, and I always compare our secondaries of these bonds, and you see a huge gap. The gap goes up, it widens, it comes down. But for the majority of the time, the ESG bonds trade much, much tighter than the conventional. The question is: how much can you benefit on the primary market? I would say slightly, by a few basis points definitely, but only in euros. If you do transactions in other markets there's nothing, there's no greenium, just order size.

Menzies, SG: It also depends very much on the issuer and the type of transaction you're bringing. Greenium is one element, but there are other objectives behind an ESG strategy, right?

We did a very interesting transaction last week for Ahold Delhaize, with a conventional tranche, a sustainability-linked tranche and a green tranche. You're sort of thinking 'what on Earth are we doing here?' But actually it did make sense.

They had only so many proceeds they could deploy towards a green

European corporate bond issuance in the first quarter of the year (€bn)



Source: *GlobalCapital* analysis of Dealogic data

tranche, so that ended up being the middle one. And why the middle one? Because with the SLB, the KPIs wouldn't really fit into a seven year, which was the intermediate tranche. It didn't make a ton of sense to make that the SLB.

In general, we do see a greenium on use of proceeds deals. On SLBs it's less obvious, but SLBs are obviously fantastic in terms of communicating the overall corporate strategy. They're two very different ways of coming at it, and two very different objectives you're trying to achieve.

We do see some clients who have embarked upon SLB strategies, which have now rolled back and might just go conventional because they can't get the premium.

If you're doing an SLB just for the extra 2bp you can save, it's the wrong approach. It's more about what's the message you're giving, and you've got to think about it holistically, not just pricing one bond against your curve.

It's more about what's the overall impact on your portfolio, the depth of your investor base, and that's something that's very hard to prove on a quantitative basis, but I'm sure it has benefits in terms of passing the message.

Canta, Enel: You know, unfortunately I disagree, because this is a market that is led by money. If there is no economic incentive, it will be unsustainable. I've been the one to invent the sustainability-linked bond, in order to secure a certain value in sustainability.

We crystallise certain premium, otherwise I would have been in trouble because I would have given out to investors optionality for free. If I was not able to really crystallise a certain premium, I would have given up 25bp of a step-up without getting anything back.

What was evident in the last communication we had with US investors is they are coming back to say that SLBs are 'a nice-to-have because we have a fund that is specialised in sustainability bonds', but this is not the driver, because the US market is now giving less value to sustainability.

Lander, Vonovia: Interesting. I really like the sustainability-linked bond, because it gives you lots of flexibility. But from a funding perspective, we like stable funding, taking out all the risk. That's where I struggle, because the SLB gives you risk over a testing period in the future. You have no clue if you will fail or not, and if you fail, you pay. That's a risk from a funding perspective that I don't like.

Canta, Enel: You're right Fabian, you're totally right.

Lander, Vonovia: That's why I don't consider sustainability-linked bonds as of now. But I think there's the option in the future. Investors get the chance of a higher coupon, and this optionality has a value and that should be discounted at the beginning in the primary market, but I don't see it happening.

Canta, Enel: You are right, there is of course a risk associated, but the concept is today I promise to be a sustainable company and I deserve a lower cost of debt. In case I'm going to be a little bit less sustainable than I plan to be, then my cost of debt will rise. I have to equate my cost of debt to this higher risk I present to investors. This is the proposition we give to people like Nachu.

Chockalingam, Federated Hermes: The greenium does come and go, that is for sure. But one thing that is interesting from our perspective, and we have noticed this in several sell-offs, is labelled bonds tend to be less volatile. That gives us an advantage to want to own these instruments as well.

We're generally security-agnostic when we think about the capital structure of an issuer. But clearly we do factor in the volatility associated with owning conventional versus labelled bonds.

The one thing I would add, though, is we are a little bit concerned about the degree of scrutiny going into some of these sustainability-linked bonds. We would like to see more investors scrutinise deals a bit more closely. There are certain instances when things are getting done that we don't agree with. Generally speaking we will stay out of those deals if we're not entirely confident that the issuer is likely to do what they say they're going to do.

Menzies, SG: Some of the KPIs are quite liberal and I think probably one of the challenges you have on your side, Alessandro, is you have very robust and challenging KPIs that are there to challenge your business, to transition. And that is what we are here to do, but there are some actors in the market where the KPIs are too easy.

Chockalingam, Federated Hermes: Andrew, you hit the nail on the head, there are less ambitious targets we see coming from certain issuers and that's something we do question. Sometimes the test dates can be quite interesting, the way they are structured. This is less of an issue in the investment grade space, but in high yield, we've noticed there's often call optionality put into high yield deals and sometimes the test dates are after the call period. There are some nuances the market still needs to get used to.

Menzies, SG: Sustainability is for everybody. Sustainable finance might not be for everybody.

Chockalingam, Federated Hermes: ESG is very important to us as a house — we run only Article 8 and Article 9 funds, and Fabian, you're right — the barrier to entry on an Article 9 fund is very high.

We have to scrutinise investments very closely if they are to enter those funds. We welcome more data, more disclosure from issuers.

It's getting better, more data is clearly very helpful. We also very much believe in the power of engagement. We engage with pretty much everybody on this roundtable. So thank you very much for your support, but we do think engagement is a useful tool to enhance sustainability.

I also agree with Fabian's point about European issuers being more focused on sustainability. When we speak to US companies, emerging market companies, they are much less advanced in their sustainability strategies going forwards and hopefully we will see some change there.

Canta, Enel: Andrew, you are working at one of the banks that has taken sustainability more seriously. French banks have been the pioneers. But there has been a huge complaint by some shareholders because they may have missed some opportunity in light of their sustainable strategy, and have missed exceptional profit. What is the feeling internally in your bank?

Menzies, SG: It's a very interesting question, Alessandro. The reality is we have to balance the desires of all our stakeholders. Shareholders are fundamentally important, but they're also not the only stakeholders.

We need to have a profitable future, but also a sustainable future as an organisation and that comes through engagement with all our partners.

We have some stricter policies in terms of what we can and can't do, and potentially you could argue that does restrict opportunities.

We are increasingly focused on reputation risk, which is a massive issue for us. Our stakeholders do demand we look at this with very close scrutiny, and therefore we must be careful with which transactions we get involved with.

In the shorter term, it may mean that there is a little bit of opportunity that you could argue is left on the table; but in the long run, for the sustainability, and so ultimately for the profitability of the bank, it is a necessary approach. GC

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