

The corporate premium in green finance

There is a cost saving to issuing Green. It varies according to circumstances, but the baseline assumption now is for green yields to be below vanilla ones; not by much, but it's persistent enough. It's between 1 basis point to 10bp, with EURs drifting lower while the USD version is a tad more elevated. It reflects ESG scarcity, but also longevity



Frankfurt's skyline behind a field housing an art installation

The market for sustainable financing features a premium on ESG bonds; a reflection of long term aspirational change

Environment, Social & Governance (ESG) as a concept has been elevated in importance on both sides of the financing fence – the issuer and the investor. It's reflected in the deployment of product by issuers that prefer to pursue an ESG objective, alongside investors that want to be seen embracing the same. Green issuance trades at a premium; that's a clear measure of tilt towards greenness.

As a consequence of an excess of demand over supply of ESG bonds, a so-called "greenium" is in play, where ESG bonds trade at a higher price than vanilla ones (thus commanding a lower yield). In consequence, issuance in ESG bonds is cheaper for the issuer, and the buyer accepts a lower running yield.

Sustainability reduces existential risk, the ultimate default ...

Why? It's not just because embracing ESG is seen to be the right thing to do, it is also seen as a sensible long-term investment practice; to be in things that are seen to be sustainable. The ultra buy-and-hold strategy must embrace this, as holding on for the long term requires sustainability, by definition. At the extreme, sustainability reduces existential risk (the ultimate default).

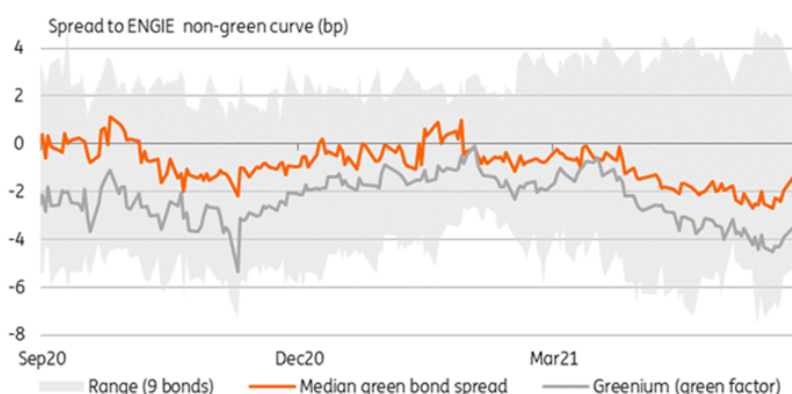
Changing times

The lower yield on Green issuance has not always been the norm. A number of years back it was the reverse, where Green issuance meant higher funding costs for issuers. Back then, issuing in the Green space meant making a statement that issuers were willing to pay a bit more to be more Green. Now it's investors making the statement that they are willing to sacrifice (a bit of) yield to help build their Green credentials (both for the investor, and the intermediary).

And this has occurred alongside a [dramatic build in ESG issuance](#). It is clear though that there is demand for more.

Example of recent evolution of the greenium and its deviations for different bonds from the same issuer

EUR Enegie, bp



Source: Refinitiv, ING estimates

Our calculations show a Greenium of some 1bp to 3bp in EUR versus a higher greenium of 5bp to 8bp in USD

We've done an updated holistic analysis of where the greenium is. We base it off EUR and USD issuance completed in 2020 and 2021 to date, from mostly European - and US-based corporates. For EUR issues we find a median greenium of 2bp, but can be much higher depending on circumstances. Our credit strategy team has looked at the greenium specifically in EUR investment-grade corporates and has concluded that it is [now in the 1bp area](#), and has fallen in the past number of quarters, mostly on account of more Green issuance. This illustrates

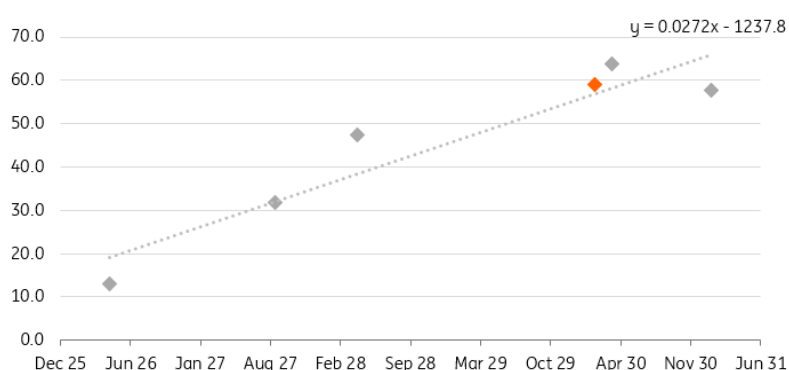
considerable variability in the size of the greenium, but also some evidence that is not as large as it was (some 6bp a year ago).

Our calculations confirm a definite greenium, and currently larger in USD vs EUR

When we look at the USD numbers we find evidence that the greenium is currently larger (versus EUR). Our USD debt capital markets team spends its days looking at new issues and identifies a spread of anywhere between 1bp to 10bp as the greenium currently for the bulk of bonds that have been issued so far in 2021. We've done a separate exercise looking at secondary market levels and have found that the average greenium is in the area of 5bp to 8bp, and in some extreme cases, the greenium can be in excess of 20bp (albeit callable/coupon size impacted). There has been a [clear build in issuance from US corporates](#), and the greenium on USD issuance commands a demand for more.

Example where vanilla bonds sit alongside a relatively new green bond

USD, Toyota, bp



Source: Refinitiv, ING estimates

There are various ways to do this exercise, depending on whether we fit a curve or simply look at comparison versus immediate adjacents, and we provide a summary of the detailed outcomes in the illustrations below.

Table of greenium calculations for EUR and USD

Negative means green yield below vanilla equivalent

	USD Greenium	EUR Greenium
Mean	-8	-3
Median	-6	-1
High	-33	-18
Low	11	6

Source: Refinitiv, ING estimates

Lets take a middle ground, say a 5bp greenium. For a \$1bn bond, that comes to a cost saving of \$500,000. Or for a \$10bn bond portfolio that is then a \$5m cost saving. Maybe not determinative, but also not nothing.

Driving towards a sustainable future

Does this make a difference to the overall drive for a more sustainable future? As a stand-alone, probably not. Even the brownest of operators can identify green aspects to what they do and look then to embrace them by highlighting and ring-fencing them from a financing perspective. The financing decision is part of a bespoke set of processes that as a collective characterises where any corporate is on the spectrum of greenness.

The bigger lifting in terms of making a real difference comes from how businesses are run, what they produce, how they produce, where it's done and what efforts are made to actually make a difference. That still likely requires some carrot and stick. But the pleasing aspect is that Green finance is increasingly positioned to partake in this, and indeed as an aid to lubricating the bigger effort, and that's important in itself.

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