The Reformed SSA Trader:

Kreditanstalt Fossil Wiederaufbau?

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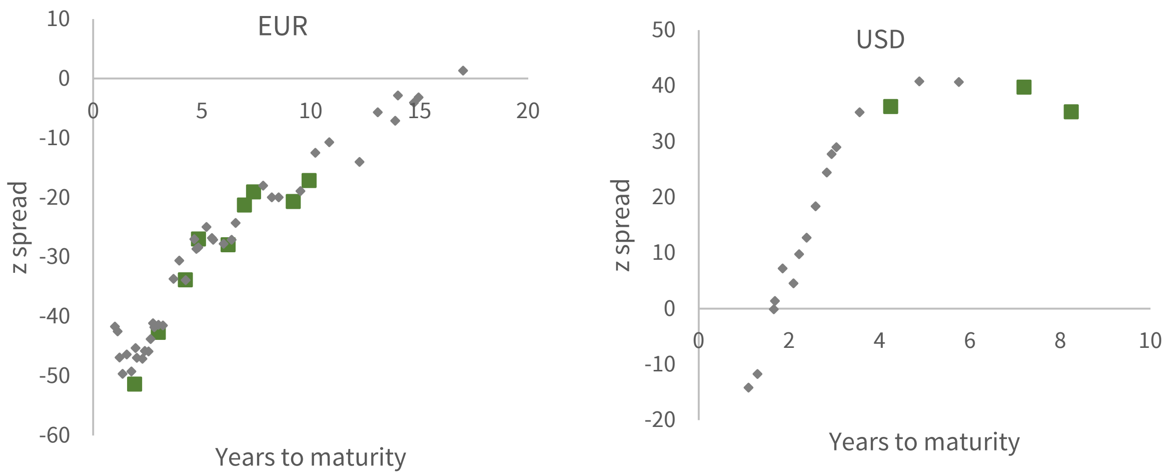
On the back of a looming bailout of a major gas and coal company ("Russian Gas Squeeze Spurs Bailout Talk for Germany's Uniper") , gigatonne-significant liquefied fossil gas commitments ("Kreditanstalt für Wiederaufbau (KfW), Gasunie and RWE sign MoU to build LNG terminal in Brunsbüttel") and negative sentiment around the German government's climate commitment at the recent G-7 meeting ("Germany Pushes for G-7 Reversal on Fossil Fuels in Climate Blow"),[1] we suggest that green bond investors in Kreditanstalt für Wiederaufbau (ticker: KFW) engage with the issuer, asking questions how KfW's strategy is aligning with investors' own climate and energy security views. Such discussions should be particularly interesting for investors in the recent KFW €2 11/2029 green bond (XS2498154207, EUR4bn), issued on 28 June.

As a technical detail, KfW green bond proceeds are not specifically earmarked but have general corporate purpose use-of-proceeds (UOP) language with an offset mechanism:[2] a physical dollar invested in a KfW green bond may be used to, for example, bail out a heavy carbon company, and then later has to be offset by an investment into something green bond framework-eligible.

Figure 1. KfW bond curve in EUR and USD, as of 30 June 2022. Square markers for green bonds. Source: Bloomberg.



[1] Full references in the text below.
[2] For an overview of types of use-of-proceed structures in green bonds, refer to "Explaining green bonds: Types of green bonds", Climate Bonds Initiative web-page, accessed 30 Jun 2022.

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KfW: GCP green bonds in the context of fossil financing

Finnish-German utility company Uniper (BBB- neg) has long lodged a heavy bet on fossils in general and in Russia in particular, as illustrated in Figure 2. Following Russia's invasion of Ukraine, and with recent triggers through Russia ceasing to deliver fossil gas to Uniper, the company has come into considerable financial distress.[3,4] It is being reported that a rescue package is being orchestrated through the German government's books.

Figure 2. Power generation mix of Uniper's portfolio, in GW. Fossil generation highlighted. Source: Company website, accessed 30 Jun 2022.

Country	Gas	Coal	Hydro	Nuclear	Oil	Total
Russia	8.5	2.3	0	0	0	10.8
Germany	3.3	3.2	2	0	1.4	9.9
UK	4.2	2	0	0	0.2	6.4
Sweden	0	0	1.6	1.4	1.2	4.2
Netherland	0.5	1.1	0	0	0	1.6
Hungary	0.4	0	0	0	0	0.4
Total	17	8.5	3.6	1.4	2.8	33.3

One report names KfW as the potential vehicle for such a rescue, which would be notable albeit not a complete surprise. KfW is a cornerstone issuer in the global SSA[5] market: with more than USD450bn of debt outstanding it is big in its own right, but also an important green bond issuer with around USD60bn issued since inception of that market segment.

Current KfW green bonds are particular to many other green bonds in that the bond proceeds are not the typical earmarked "use of proceed" bonds. As stated in a recent filing to the US Securities regulator SEC[6] the KfW green bonds use of proceeds (UOP) is "General business, however, amount equal to net proceeds for climate friendly projects accord. to KfW Framework".[7] We find KfW's commitment to actually deploy a similar amount to green projects as raised through green bond issuances as highly credible, however, the UOP language illustrates that it is not certain that it is the actual money that green investors have contributed that gets deployed. Hypothetically, one could see the green EUR4bn raised this week being deployed into different parts of KfW's activities (such as a Uniper bail-out) than green projects, but with other (non-green) money being deployed to green projects later on as an 'offset'.

The potential exposure for green bond investors to fossil financing through KfW would not only be related to a hypothetical Uniper bailout. It would actually be a follow-on of a rather controversial EUR10bn deal to bail out Gazprom's German subsidiary.[8] Furthermore, given the renewed efforts of the German government to rebuild dependency on fossil gas[9], we would expect more

[3] "Russian Gas Squeeze Spurs Bailout Talk for Germany's Uniper", Bloomberg, 30 Jun 2022.
[4] As we noted in an earlier piece, "UnFortumate: iTraxx Main S35 vs ESG version", AFII, 16 Mar 2022, the link between Uniper and Fortum has even driven some macro-credit relative value propositions.
[5] SSA stands for Supras, Sovereigns (in foreign currency) and Agency bonds. Refer to "The Reformed SSA Trader: New Year's Exclusions", AFII, 6 Jan 2021, for a brief overview.
[6] "Green bonds- Made by KfW (SEC filed)", Issuer web-page, accessed 30 Jun 2022.
[7] In KfW's own green bond framework this is expressed as "Net proceeds from the issuance of green bonds will be used by KfW in its general business. However, upon issuance an amount equal to the resulting net proceeds is allocated to an internal register in the order of issuance. KfW has set up an internal process to track requests for disbursements for Eligible Green Projects and net proceeds of green bonds".
[8] "Seized Gazprom division to keep paying bonuses after €10bn German bailout", Financial Times, 30 Jun -22.
[9] Recent information coming out of the G7 summit indicates that the German government believes a renewal of fossil gas supply routes is necessary to ensure energy, if not climate, security. See "Germany Pushes for G-7 Reversal on Fossil Fuels in Climate Blow", Bloomberg, 25 Jun 2022. We note that Germany raised EUR4bn in long-dated green capital through tapping their 30yr sovereign green bond (DBR 0 08/2050, DE0001030724) in early June.

propositions for KfW to finance LNG projects in the not too distant future, similar to the already agreed Brunsbüttel liquefied fossil gas facility.[10]

We do believe that this puts investors in KfW green bonds in a potentially awkward position, as the agency in a short period of time has become (or looks likely to become) a key financier and partner in/with high-carbon exposed companies such as Uniper, RWE and seized Gazprom businesses.[11] Our advice would be to engage with the issuer to ensure alignment of strategies or consider other options if that is not possible. With KfW playing such a central role for low-risk green bond paper, especially in USD, it should be important for the whole market to illustrate how green bond investors can drive ambition and consistency within green bond issuers' full balance sheet activities.

For avoidance of doubt, we do not suggest that Europe should be thrown into an even worse energy crisis than Russian fossil dependency has already landed her in. However, policy actions from this point onwards need to be monitored and challenged to ensure that they are aligned with long-term climate and energy security goals.[12]

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[10] The planned capacity of the Brunbüttel facility will be 8bn cubic metres p.a. We estimate this to be equivalent to ~16Mt CO_2e, Scope 3 emissions, not counting potential leakages. Over a hypothetical 30yr usage period, cumulative emissions thus would be in the region of 0.5 gigatonnes of CO_2e for the facility. KfW will acquire 50% of the shares in it with other stakeholders being RWE and Gasunie. See "Kreditanstalt für Wiederaufbau (KfW), Gasunie and RWE sign MoU to build LNG terminal in Brunsbüttel", RWE press-release, 5 Mar 2022.

[11] As an example, we note that the Norwegian sovereign wealth fund has RWE on exclusion and Uniper on observation on the basis of their coal based activities, see "Norges Bank Investment Management: Observation and exclusion of companies", Fund web-page, list as of 15 June 2022.

[12] In this context, we would refer to the discussion in "The rights and wrongs of investing in natural gas: Should multilateral development banks finance gas projects?", The Economist, 23 Jun 2022.

The Anthropocene Fixed Income Institute is a non-profit organization "to monitor, advocate for and influence the impact of the fixed income and bond markets in the age of human induced climate change." For more information about the Institute, please visit wwww.anthropocenefii.org or follow us using the hashtag #anthropocenefii.