Creditflux
November 2021 | Online
Global credit funds & CLOs

Zais and BNP Paribas strike ESG breakthrough with climate change CSO

by Dan Alderson

The growing theme of environmental, social and governance standards helping to revitalise the market for collateralised synthetic obligations appears to have taken a big step forward, with Zais Group and BNP Paribas partnering on a first-of-its-kind deal that could lay a template for future transactions.

The two firms have worked for around six months on the bespoke portfolio, in which Zais managed vehicles are taking an equity stake. Named Glasgow, the deal's signing on Friday was timed to coincide with the UN Climate Change Conference (COP 26) taking place this week in the Scottish city.

"Some of our previous bespoke transactions included high level negative screening against well-established ESG databases," says Guillaume Mear, head of structured credit trading at BNP Paribas. "Zais's criteria drove the portfolio construction and it has helped strengthen the definitions for ESG in the credit market — and especially for the CDS market. It is also a first for rating agencies, with whom we have worked closely."

A standout feature of the deal is that it employs not one but two forms of ESG filter.

"We wanted to construct a climate change-focused portfolio that would be as impactful as possible and so have used two different screens," says Andreas Ross, head of product research and development at Zais. "The first, with which the market is more familiar, is a negative screen that rules out typical high-risk activities based largely on environmental and social considerations."

But the transaction also utilises a second, positive screening that selects what Zais believes are the companies best positioned within their class to transition to a low carbon economy.

"Clearly there is a difference between industry sectors in terms of their carbon intensity," says Ross. "Some, such as intellectual services, have low intensity. But those in higher carbon intensity fields had to demonstrate a commitment to transition to a low carbon future."

The transaction is of regular market size and follows a familiar three-year tenor, popular in the industry. The portfolio selection is tilted towards investment grade and slightly stronger focus on Europe than the US. This reflects the relative progress of companies in these bands and geographies towards disclosure goals for ESG.

"There has been much more focus on ESG standards in the equity market where ESG labels defined by European agencies already exist," says Mear. "In this way, part of the exercise with Zais was to define an approach for credit, using comparable standards in the equity market."

With the equity tranche placed, BNP Paribas will hold more senior pieces on its books to open 'meaningful talks with investors' about taking positions in this advanced criteria portfolio.

"We wanted to set a template," says Ross. "We certainly would like to follow it with other transactions that apply the same process. What form that takes will depend on client adoption and what they would like to address. This one was focused on climate change, but perhaps a future deal could focus on diversity. We look forward to exploring this further."

Zais's criteria have helped strengthen the definitions for ESG in the credit market

Guillaume Mear
Head of structured credit trading
BNP Paribas

The positive screen selects companies positioned to transition to a low carbon economy

Andreas Ross
Head of product research and development
Zais