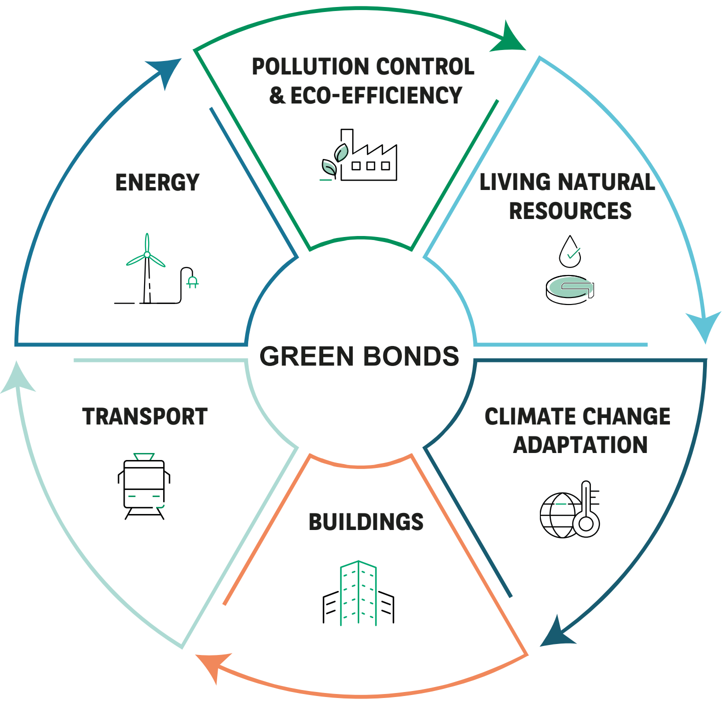
Marketing communication - For professional investors - December 2023

UNDERSTANDING GREEN BONDS

WHAT MAKES A GREEN BOND CREDIBLE?

Before we answer this question, let's recap what green bonds are, and what the funds raised are used for. Green bonds finance and refinance projects, assets, and activities that contribute to the ecological transition such as renewable energy, energy efficiency or reducing the use of natural resources. They are an essential vehicle for the bond markets to help fund the inevitable change to a more sustainable economy.



BNP PARIBAS ASSET MANAGEMENT

The sustainable investor for a changing world

We believe these elements make a green bond credible:

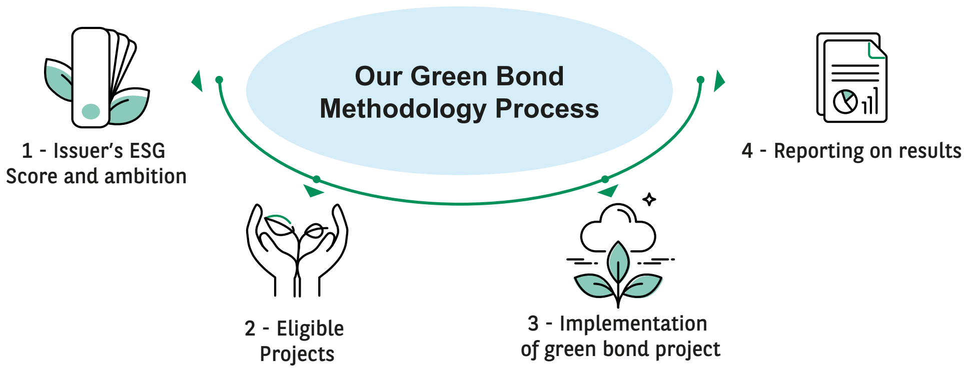
- 'Green-ness' – This concerns the extent of the environmental benefits which the proceeds generate such as the amount of renewable energy produced or amount of energy savings. We use the EU Taxonomy to define the green-ness of an activity unless our ESG analysts decide to apply stricter criteria or use alternative criteria in the event verifiable data does not exist.
- 'Integrity' – This concerns the processes and management systems governing the allocation of the proceeds by the issuer including how the issuer mitigates potential risks and measuring and reporting the benefits of the proceeds.
- 'Ambition' – This concerns the extent of the bond's contribution to the issuer's sustainability ambitions such as their renewable power capacity target.

'Green-ness' concerns the extent of the environmental benefits that the proceeds generate such as the amount of renewable energy generated, or emissions saved. We use the EU taxonomy to define the 'green-ness' of an activity unless our ESG analysts decide to apply the stricter criteria that we already use or use alternative criteria in the event no verifiable data exists.

Integrity concerns the processes and management systems governing the allocation of the proceeds, mitigating potential risks, and measuring and reporting.

Ambition concerns the extent of the bond's contribution to the issuer's sustainability ambitions such as their renewable power target.

Our methodology in a nutshell:



Key considerations for each component are:

1. How does the issuer rate in environmental, social and governance (ESG) terms and what is their ambition?
2. Which activities will the issuer use the bond's proceeds for, and how green are these activities against the EU Taxonomy?
3. How is the issuer using the proceeds? How is the Issuer managing negative risks or avoiding doing significant harm?
4. Is the issuer reporting clearly and transparently on the allocation of the proceeds and the benefits achieved?

SCORING

We assess component one, two and three ex-ante (i.e., before issuance of the bond). We assess component four ex-post (i.e., 12 to 24 months after the bond has been issued).

We score each green bond out of 100 points. The score corresponds to a rating of Positive, Neutral or Negative.

Green bonds from **developed market issuers** must score at least 50 to be rated Neutral and at least 70 to be rated Positive. They are rated Negative if they score below 50.

Green bonds from **emerging market issuers** must score at least 30 to be rated Neutral and at least 50 to be rated Positive. They are rated Negative if they score below 30.

Across the lifecycle of the bond, we monitor for controversies or high reputational risks related to the green bond. Our sources include our portfolio managers and rating agencies. When we believe the controversy or reputational risk is substantial, we will adjust our score and change the rating to Negative.

To enhance our methodology periodically, we may use research and ideas from investment banks, non-governmental organisations, academics, industry associations, consultancies, and rating agencies.

DETAILS OF EX-ANTE ASSESSMENT

- **Issuer's ESG score and ambition** – We review the issuer's ESG characteristics. Specifically, where the issuer's ESG score is in the bottom 10% of its peer group, we automatically rate the green bond Negative since we believe the issuer is unlikely to carry out the projects and activities financed successfully and credibly. We also assess how the bond fits with the issuer's transition ambition.
- **Eligible projects** – Where projects target climate mitigation, we use the EU Taxonomy whenever applicable to determine the extent to which the project align with the technical screening criteria for a substantial contribution to climate mitigation. We use various levels of alignment (e.g., fully aligned, partially aligned, worse than significant harm) in our scoring of a project's 'green-ness'.
- **Implementation of projects** – We assess whether the issuer respects the 'Do No Significant Harm' principles such as how they implement certified environmental management and health and safety management systems. We also use the issuer's historical controversies in related activities as an indication of how likely the green bond projects will avoid doing significant harm. In addition to the 'Do No Significant Harm' principles, we look at whether the issuer will prioritise new financing over refinancing, and in the event of refinancing, the look-back period allowed.

DETAILS OF EX-POST ASSESSMENT

- **Reporting on results** – We determine whether the issuer has reported on their green bond 12 to 24 months after issuance. If there is no report at the time of our assessment, we will engage with the issuer to understand the situation. Where the issuer confirms there is no reporting and there is no intention to report on their allocation and benefits of the proceeds, we will rate the bond Negative. Where there is a valid report, we assess how the proceeds were allocated and what the benefits were. We also review the issuer's methodology for measuring the benefits. We believe issuers should obtain third-party verification or assurance on the numbers disclosed in the report as best practice. Finally, we are looking for further details from the issuer on how the bond contributes to their sustainability ambition.

ENGAGEMENT

We believe engagement with green bond issuers is key to achieving and improving the benefits of green bonds, but also protecting clients' investments from the potential risk of 'reputation washing'.

- **At-issuance engagement** – We focus on 1) an issuer's sustainability credentials and integrity, 2) 'green-ness' of the project, and 3) the bond's proposed ambition, expected allocation and implementation. A project's limited 'green-ness', a weak issuer ESG rating or unsatisfactory engagement feedback may result in a Negative rating.
- **Engagement after investment** – We focus on output and impact indicators and the actual project allocation. If the issuer fails to provide a satisfactory explanation for not providing impact indicators, we may give the bond a Negative rating.

ENVIRONMENTAL BENEFITS

Several metrics help quantify the physical impact of projects green bonds finance. These include renewable energy produced, the floor space of green buildings, passenger kilometres travelled on low carbon transport, and energy saved through energy-efficient products. Most green bonds also contribute towards climate mitigation and their contribution is measured using avoided emissions. We believe transparency by the issuer on how the environmental benefits of the green bond are measured is critical for us to continue to regard the green bond as credible.

Also read:

An outlook for the sustainable bond market (bnpparibas-am.com)

EU aims to make green bonds greener (bnpparibas-am.com)

INVESTMENTS RISKS

Investments are subject to market fluctuations and other risks inherent to investing in securities. The value of investments and the income they generate may rise or fall and it is possible that investors may not recover their initial investment.

The sub-fund may be exposed to specific risks listed below:

- **Credit Risk**
- **Emerging Markets Risk**
- **Extra-Financial Criteria Investment Risk / Environmental, Social and Governance (ESG) Investment Risk**
- **Small Cap, Specialised or Restricted Sectors Risk**

The sub-fund may be exposed to specific risks related to investments in Mainland China:

- **Risks related to Bond Connect**

For a complete description and definition of generic and specific risks, please refer to the Appendix 3 of Book I of the Prospectus.

VIEWPOINT

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