

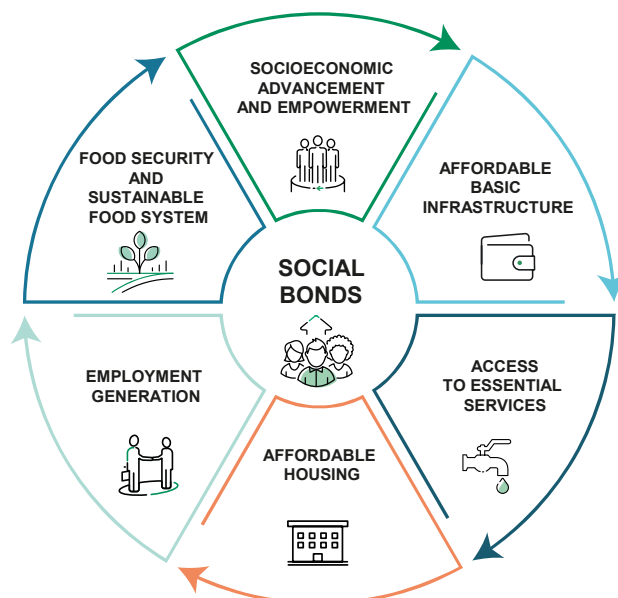
UNDERSTANDING SOCIAL BONDS



WHAT MAKES A SOCIAL BOND CREDIBLE?

Social bonds finance and refinance projects, assets and activities that have social benefits such as affordable housing, improving access to credit or increasing employment opportunities. They are a way for bond markets to contribute to actions and measures that benefit a population or a community.

In contrast to the way that proceeds raised by a green bond are used, it can be challenging to have tangible metrics to assess the 'social-ness' of the projects financed. There is no EU taxonomy for social bonds unlike the taxonomy that can be used to assess green bonds. The EU Platform for Sustainable Finance has published a draft social taxonomy, but it does not use quantitative metrics to determine the extent of the contribution of activities to social objectives. It is unclear when the draft will be signed into law.



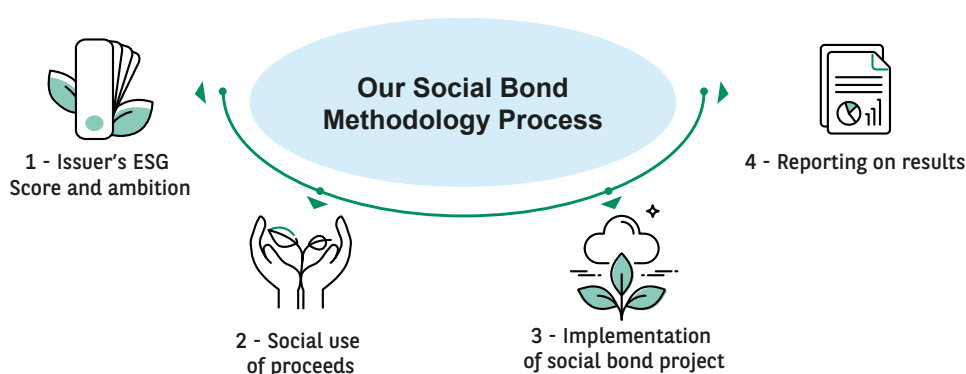
BNP PARIBAS
ASSET MANAGEMENT

The sustainable
investor for a
changing world

Based on our experience with green bonds, we believe these elements make a social bond credible:

- **Ambition** – This concerns the issuer’s goal to contribute to social objectives and grow their activities to meet those objectives.
- **Integrity** – This is about processes and management systems governing the proceeds, mitigating potential risks, and measuring and reporting.
- **Specificity** – This concerns the identification of specific target populations and the social gaps these populations face that the issuer intends to mitigate with the proceeds of the social bond.

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 contribution to social objectives?
2. Which activities will the issuer use the bond’s proceeds for, and do these activities match the ICMA Social Bond Principles?
3. How is the issuer using the proceeds? How is the issuer managing the risks or avoiding doing significant harm? How specific are the target populations and the social issues faced by the populations?
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 social bond out of 100 points. The score corresponds to a rating of Positive, Neutral or Negative.

Social 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.

Social 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 social 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 social bond Negative since we believe that the issuer is unlikely to carry out the projects and activities financed successfully and credibly. We also assess how the social bond fits with the issuer's ambition.
- **Eligible projects** - We determine whether the use of proceeds can be mapped to the categories in the ICMA Social Bond Principles, e.g., providing affordable basic infrastructure or improving access to essential services.
- **Implementation of projects** - We assess whether the issuer respects the 'Do No Significant Harm' principles such as due diligence of users of credit to ensure the proceeds are used responsibly. We also use the issuer's historical controversies in related activities as an indication of how likely the social bond projects will avoid 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. Importantly, on the notion of specificity, does the issuer identify the target populations and the social gaps these populations face (e.g., a lack of accessible dwellings for low-income groups) that the issuer intends to mitigate with the proceeds? We look for specificity and clarity in these definitions.

DETAILS OF EX-POST ASSESSMENT

- **Reporting on results** - We determine whether the issuer has reported on their social 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 that there is no reporting and there is no intention to report on their allocation and the 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

Engagement with social bond issuers is key to achieving and improving the benefits of social bonds, but also protecting clients' investments from the potential risk of 'reputational washing'.

- **At-issuance engagement:** We focus on 1) an issuer's sustainability credentials and integrity, 2) the type of project, and 3) the bond's proposed ambition, expected allocation and implementation. A project's limited 'social-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.

SOCIAL BENEFITS

In contrast to green bonds where the benefits may be measured primarily in terms of avoided emissions, the benefits of social bonds can vary depending on how the proceeds are used. For example, a social bond financing affordable housing may measure its benefits using number of units built and number of households benefiting from the affordable housing. A social bond financing loans specific to small and medium-sized entrepreneurs from a selected area may measure its benefits using number of borrowers and number of new jobs created by the borrowers. Regardless of the projects, we believe that transparency by the issuer on how the benefits are measured is critical for us to continue to regard the social bond as credible.

Also read:

[Social bonds – A tool to effect positive social change \(bnpparibas-am.com\)](https://bnpparibas-am.com)

[Social bonds – A better outlook \(bnpparibas-am.com\)](https://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**
- **Extra-Financial Criteria Investment Risk / Environmental, Social and Governance (ESG) investment Risk**
- **High Yield Bond Risk**

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

DISCLAIMER

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Investors are invited to consult the most recent financial reports, which are also available on the website. Investors should consult their own legal and tax advisors prior to investing. Given the economic and market risks, there can be no assurance that the financial instrument(s) will achieve its investment objectives. Their value can decrease as well as increase. In particular, changes in currency exchange rates may affect the value of an investment. Performance is shown net of management fees and is calculated using global returns with time factored in, with net dividends and reinvested interest, and does not include subscription-redemption fees, exchange rate fees or tax. Past performance is not a guarantee of future results.

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"The sustainable investor for a changing world" reflects the objective of BNP PARIBAS ASSET MANAGEMENT France to integrate sustainable development into its activities, although not all funds managed by BNP PARIBAS ASSET MANAGEMENT France fulfil the requirement of either Article 8, for a minimum proportion of sustainable investments, or those of Article 9 under the European Regulation 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR). For more information, please see www.bnpparibas-am.com/en/sustainability

VIEWPOINT



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