NATIXIS BEYOND BANKING

GREEN & SUSTAINABLE HUB

2019 GLOBAL INVESTOR SURVEY

TRANSITIONING BROWN INDUSTRIES: A CONDITIONAL APPETITE

IN A NUTSHELL

- This survey originates from the debate around the role and eligibility of high-emitting industries to climate finance and more specifically to the green bond market. It aimed at identifying investors' appetite and red-lines when it comes to investing in brown companies' transition. That involved questioning what transition could mean, how to measure it and accordingly structure investments / financing products.

- Investors' willingness to invest in brown companies' transition is vivid among surveyed investors* (75% of our respondents) but without leniency. 43% of respondents declared not to be in favor of bonds or loans dedicated to finance transition, whatever their formats, if the transition claim is not properly defined with criteria, thresholds, or reference to a climate scenario.

- Main expectations revolve around disclosure and credibility of the transition pathways. Ability to assess ambition level against standards (e.g. SBTi) is unarguably a plus, especially since a lot of investors confess not being equipped yet with specific tools beyond generic ESG rating or engagement process.

- When asked what would be the most impactful Use-of-Proceeds for climate action, investors plebiscite energy supply decarbonization, circularity and breakthrough technologies, by contrast categories such as carbon capture technologies or refurbishing existing facilities attract less consensus.

- Investors are remarkably open to new products, including KPI-linked instruments although it is a very nascent market, provided that trust is established regarding KPIs selection and calibration (56% believe such instruments could be a driver of change and are willing to invest in it). In the absence of recognized standard or sectorial KPIs, case by case analysis remains the rule to choose whether to invest in alleged transitioners.

- However, the necessary scale to cope with climate emergency can only be achieved by lowering transaction costs (incl. analysis). *De facto*, market guidance is necessary when it comes to assessing transition & structuring its financing. This is the intent of our Transition Tightrope Publication Series.

**75 individual responses (from investors companies totaling ~$9trn AuM)*

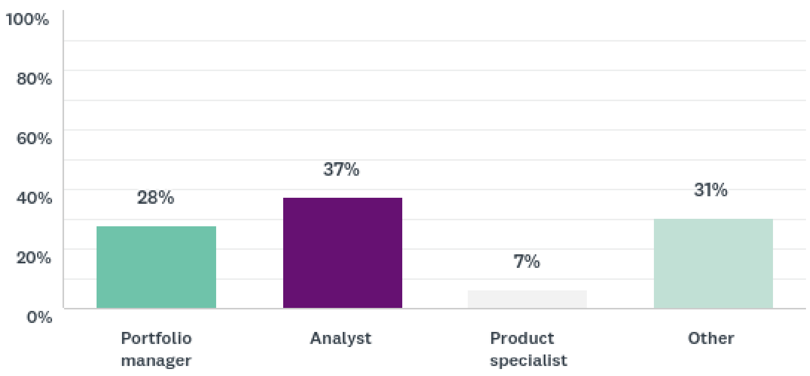
Follow our "Transition Tightrope" Series Publication

#Transitiontightrope

2019 global investor survey: our respondents

This investor survey was held online between March 2019 and November 2019. We collected 75 answers from individuals working for investment firms totaling $9 trillion of assets under management (AuM).
Among respondents' job positions, 28% were Portfolio Managers, 37% Analysts, 7% Product Specialists. Among other positions (31%), we found interesting, and somehow reflecting the evolution of the industry, to have Chief Risk Officer, Global Sustainable Credit Manager and Impact investing and thematic Specialists. We had mostly fixed income (credit & SSA) and equity respondents, both from specialized Green/RI funds and mainstream ones.

Respondents' positions



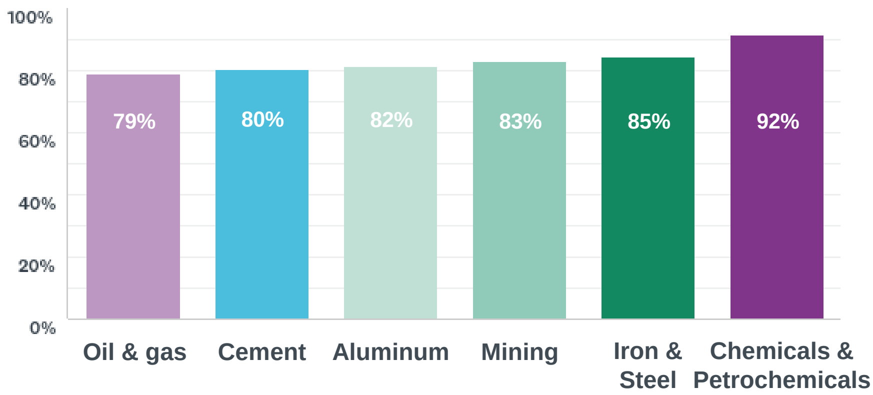
Responding institutions*

* The list is limited to those who agreed to publicly disclose their participation

ABN Amro Investment solutions
Addenda Capital
Aegon Asset Management
AG2R La Mondiale Gestion d'Actifs
AllianceBernstein
Allianz Global Investors
AlphaFixe Capital
Amundi
ASR Nederland
Aviva France
Aviva Investors
AXA IM
BNP Paribas Asset Management
Brown Advisory
Candriam
CM-CIC Asset Management
Covea Finance
DNCA Finance
DPAM
Edmond de Rothschild AM
Erste Asset Management GmbH
Generali Insurance Asset Management
Groupama
Groupama Asset Management
Gutmann KAG
HSBC Global Asset Management
Ircantec
Kommunalkredit Public Consulting
La Banque Postale AM
La Francaise Asset Management
La Française Group
MainStreet Partners
Mandarine Gestion
M&G Investments
Mirova
Neuberger Berman
Newton Investment Management
Nomura Asset Management
ODDO BHF Asset Management
OFI AM
Öhman Fonder
Raiffeisen Capital Management
Robeco
Schroders
SCOR Investment Partners
Swisscanto Invest by Zürcher Kantonalbank
Sycomore AM
Tikehau Capital
Trusteam Finance
Wasmer Schroeder
Zurich Insurance

Brown industries footprint in investment portfolios remains high

Q1 | Do you invest in the following high-emitting industries?



Overall, explicit or implicit exclusion is limited, only ~ 20% of the respondents declared not to invest in the oil & gas industry, almost, and somehow surprisingly, at the same level than for cement, or aluminum. Note that 17% do not invest in mining nor in iron & steel industries. Chemicals & petrochemicals are the most present in our respondents portfolios, with 92% declaring investing in it.

Because a number of our respondents reportedly manage SRI or ESG funds or strategies, we can presume that the presence of brown industries in “mainstream” investment portfolios is even higher.

Anonymized respondents' quotes

“*We have different types of funds and only our sustainable funds exclude the oil & gas industry. Other funds are allowed to invest in this industry but have to integrate ESG risks in their financial analysis.”*

“We are "carbon-conscious" but don't view sector exclusion as the best way to curb GHG emissions. However, as we have opted for ESG integration we include carbon/GHG footprint assessment as one of the key metrics to consider when it comes to investing in most of the aforementioned high-emitting industries”.

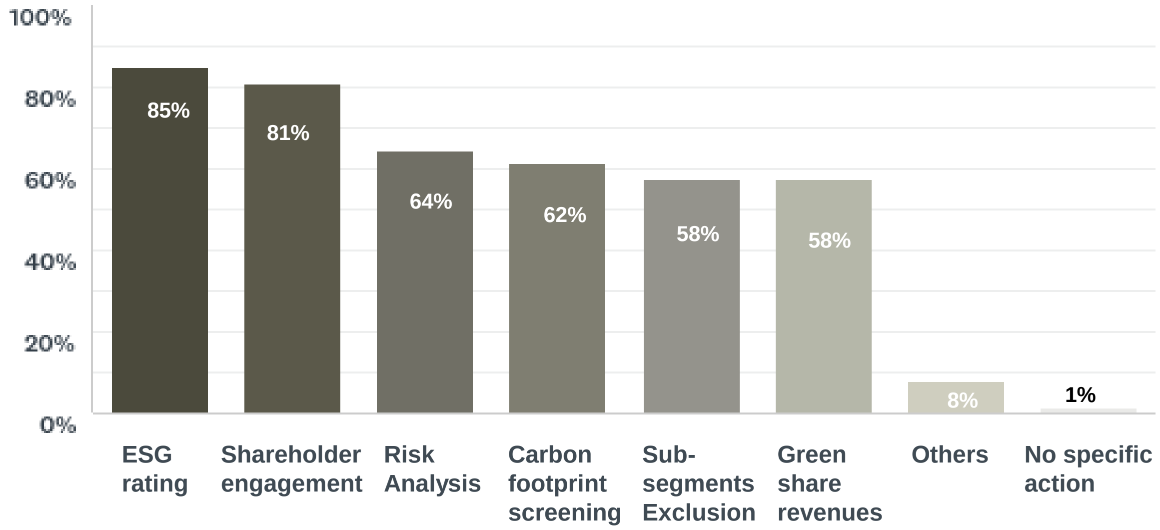
“Investment are focused on environmental solutions, and include high-emitting industries as part of a value chain approach based on LCA (for instance aluminium for light-weighting vehicle or lithium mining for batteries dedicated to large scale energy storage may qualify as an environmental solutions)”*

“These investments are possible in the context of traditional credit portfolios. They are possible but limited to Best-In-Class issuers for SRI portfolios. They would potentially be possible for Green Bond portfolios but so far no emission has been aligned with our requirements.”

** Life Cycle Analysis*

Investment practices: ESG rating & engagement are mainstream, followed by risks analysis and carbon screening

Q2 | If you are an active investor in any of these sectors, how do you integrate climate considerations into your investment decisions?



Integration of climate topic within ESG rating is without surprise extremely widespread (85% of the respondents), followed by shareholder engagement (81%). These are the two main "practices". More sophisticated approaches are less common: integration of climate topics within risk analysis (64%), or carbon footprint-based screening (62%). Surprisingly, identification of products or share of revenues derived from low-carbon transition enablers is high despite the limited availability and reliability of data provided on it (58%). Sub-segments are excluded by 58% of the respondents, a quite high figure that contrasts with the responses provided in Q1. Overall, the most spread approaches (ESG rating, shareholder engagement and risk analysis) rely on forward looking and strategic positioning of various industries. The transition capital assessment methodology we are developing (see our Chapter 4 – Transition Finance Toolkit) is designed to serve such needs.

Anonymized respondents' quotes

"We conduct a specific transition linked analysis and also try to position companies on a 2°C pathway."

"For carbon footprint-based screening, we use a provider's database to calculate the carbon intensity of these issuers and use this information in asset allocation at sectoral level"

"Regarding the integration of climate topics within ESG rating: our rating Framework consists in 4 pillars, one of them being fully dedicated to the energy transition as the focus is placed on the practices, products/services of the issuers to promote the low carbon economy"

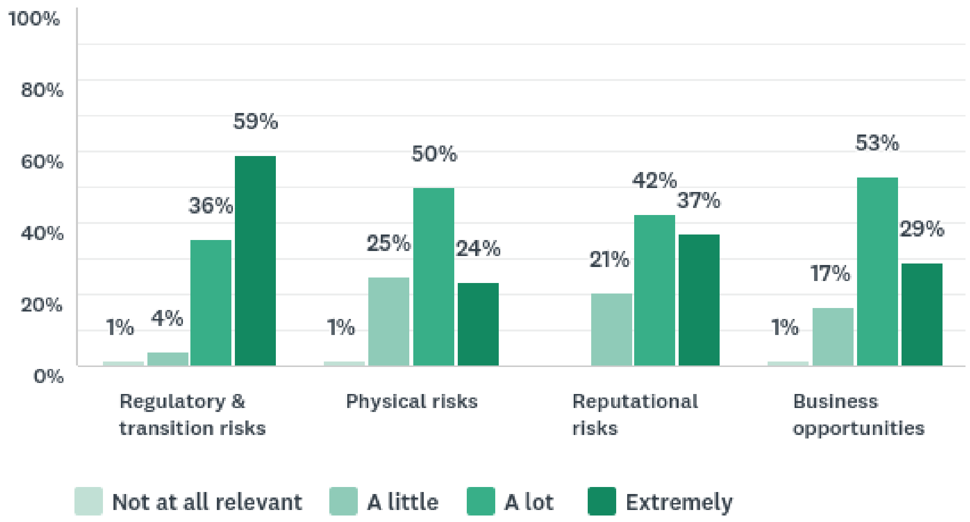
"We apply an exclusion policy which focuses on fossil fuel exposure (i.e. power generation, conventional O&G extraction, unconventional O&G extraction, coal mining). We defined clear eligibility thresholds for our actively managed Sustainable Strategies".

"We assess the environmental quality of the issuers in which we invest through our inhouse methodology. The "E" pillar (Energy and economic transition) assesses the position of the issuer towards a low carbon economy. We also have a tool that measures the issuer carbon footprint. We are finalizing our coal exclusion policy (3 step-approach). When it comes to green bonds, we put a strong focus on the overall climate and environmental strategy of the issuer. By doing so, we ensure that the green bond really fits into such strategy".

"In our impact investments, we have dedicated budget to invest in transition leaders"

Regulatory & transition risks are seen as critical for brown industries, business opportunities also seen as relevant

Q3 | Are the following climate-related considerations relevant when investing in high-emitting industries?



Regulatory & transition risks are unambiguously identified as the most relevant when investing in brown industries (almost 95% consider them as “extremely” or “a lot” relevant). Although it often remains hard to quantify reputational risks, they are considered very significant by around 80% of the respondents. Business opportunity is also considered important by a large part of the panel – more than 80% of the respondents. However, a lower share of investors consider it crucial (i.e. extremely relevant) compared with reputational or regulatory risks. For instance, some respondents point out the need to consider risks and business opportunities differently depending on the industries.

This is why we have framed the concept of “irreplaceability” in our Report (applied mostly to basic materials industries), that differentiates between brown industries that must shrink or transform (See our Chapter 2 “Unpacking the Transition Box”).

Anonymized respondents' quotes

“*Efforts to mitigate emissions and technological disruption are most likely to have an impact on emissions - the physical risks and their consideration are less easily integrated due to geographical differences in physical impacts and asset location as well as the relevance of physical issues to different high emitting sectors. The main issue is likely to be water scarcity over the next ten years.”*

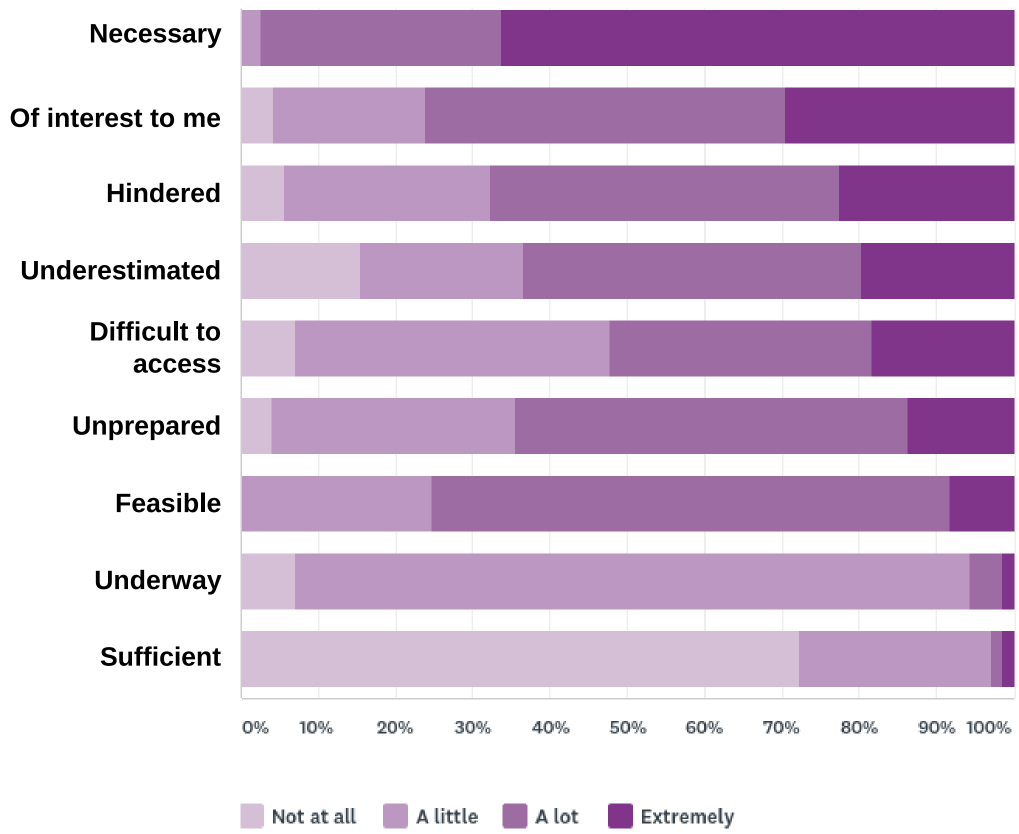
“We seek companies that could solve customer environmental problems and transforming them into opportunities”.

“We use a proprietary ESG risk and opportunity assessment to identify risks and how they are being managed as well as target specific sustainable opportunities. We do not screen out anything on the front end because that could prohibit us from finding impactful investments in controversial sectors that need financing the most to move to a lower carbon economy.”

Transition: necessary, feasible, of interest but little underway

Q4 | Do you agree with the following statements?

The transition of the Brown Industries is...



Investors recognize the huge know-do gap: whilst they unanimously consider this transition highly necessary (96%), they also widely recognize that it is little or not at all underway (94%). 3 out of 4 also consider it is a matter of interest as investors. They are more split when it comes to the difficulty to assess the ongoing transition, the preparedness of the brown industries and the potential underestimation of the problem. But they remain globally optimistic about its feasibility.

Anonymized respondents' quotes

“We are not ready to embrace the transition […] we lack tools to evaluate when it is genuinely occurring.

“Evaluation becomes more difficult when you lump brown industries all together - they have different dynamics in terms of transitioning, and also play different roles - steel and concrete are necessary to building green infrastructure whereas oil and gas largely compete with renewables.”

Investors' attitude vis-à-vis transition products: ambition level of the issuer's strategy under strong scrutiny

Q5 | How do you feel about the concept of "Transition Bonds"* or "Transition Loans"? What following statements express your view the most?

(NB: Respondents were proposed to tick several answers)

ANSWER CHOICES	RESPONSES	
I will only consider such investment if it demonstrates to be part of a genuine and ambitious transition strategy of the issuer	69%	52
I will be careful of the 2°C alignment potential of the UoP (e.g. attention to controversial fuel switching such as coal-to-gas projects or similar)	47%	35
As long as it is not properly defined – thresholds, criteria, reference to decarbonization scenario – I am not in favour of them	43%	32
As long as they abide by Green Bond / Loan Principles, I would consider them	35%	26
I am more flexible about technological and transition options in the context of developing countries, provided that the UoP lead to drastic GHG savings (e.g. switch from coal to gas in China or Pakistan)	32%	24
If I estimate the UoP is best available technology (BAT) and cannot be substituted to by cleaner solutions, I might consider such investment	25%	19
I will wait for the EU Taxonomy screening criteria for high-emitting industries to establish my view	16%	12
Other (please specify)	8%	6
Total Respondents: 75		

* NB: we asked this question being fully aware that a clear definition of "Transition bond / loan" is yet established, keeping – on purpose - the interpretation of its structure open.

Investors are not lenient vis-à-vis transition claims, almost 70% of them will consider Transition Bonds or Loans only if they are part of a genuine and ambitious strategy of the issuer. **Unsurprisingly, as it is a new "concept" or product, the practical meaning of "Transition Bonds" remains unclear to investors**. For instance, they are not confident on the best way to identify an ambitious strategy, be it through specific UoP allocation or framework, standard definition or depending on specific decarbonization targets. In that respect, 45% of the respondents stipulate they will be careful of the 2°C alignment potential of the Use-of-Proceeds, even if such alignment is hardly assessable at asset level in our view (because transition is more of a holistic notion). 43% are more cautious and would decline Transition Bond that are not properly defined with thresholds, criteria or reference to decarbonization scenario. They also do not seem to see the Green Bond / Loan principles nor EU Taxonomy as totally fit for transition purpose: only 16% of them wait for the taxonomy criteria to establish their view, or 35% would require GBP / GLP compliance.

Anonymized respondents' quotes

"The issue is - if the transition is ambitious, genuine and part of a broader strategy that makes it a green bond. So why the differentiation?"

"Transition bonds make sense to fund a transition in brown industries, which can't be funded with green bonds".

"Should be in line with science based Targets; application of EU taxonomy in emerging markets probably not applicable (too ambitious, not in line with nationally determined contribution, etc.)"

"We would evaluate those bonds/loans in the context of the relevance to the issuers' investment cases"

"I will consider such investment if it is part of a "positive" value chain"

Opinion on past green issuances from high-emitting companies: a clear absence of consensus

Q6 | The green bonds from the following issuers have fostered debate about the notion of transition. Have you invested in any of the following green bonds (tick if applicable)?

Answer Choices	Sectors	Responses	
Republic of Poland	Sovereign	31%	13
Schipol	Airport	26%	11
SNAM	Gas utility	21%	9
Repsol	Oil & Gas	12%	5
Fibria	Pulp & paper	12%	5
Mexico City Airport Trust	Airport	7%	3
Volvofinans	Vehicle manufacturer	5%	2
Suzano Papel e Celulose	Pulp & paper	5%	2
BRF	Food	2%	1
Westar	Electricity utility	2%	1
NTPC	Power utility	0%	0
Total Respondents: 42			

It is noteworthy, that only 42 investors answered this question out of 75 participants. This is obviously due to the fact that some of them are analysts, not portfolio managers. Overall, Republic of Poland is the most invested one (~30%), followed by Schipol (26%), SNAM (21%) and Repsol (12%). There is no clear preference nor "no go" in terms of sectors. Some invest into it out of their green bucket, other see the strategic commitment of the issuer (or lack of controversy) as sufficient.

Anonymized respondents' quotes

"Pulp production from best in class players is sustainably run with planted forests and use of biomass as energy input (both Suzano and Fibria sell energy to the grid). Also end use of paper packaging helps with lowering plastic usage"

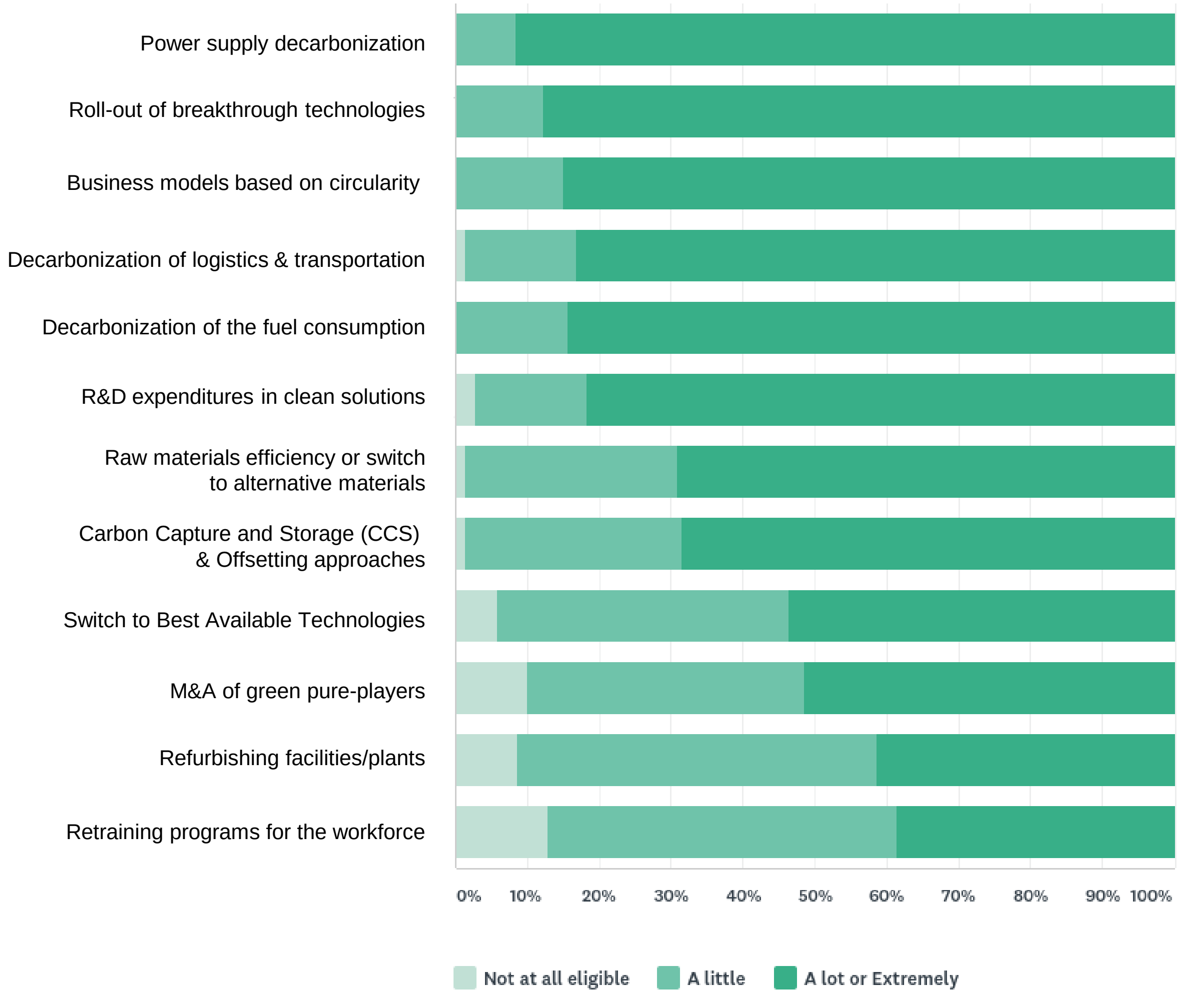
"We are well aware of the debate on the green bonds we invested in. However, we would like to inform that the bonds are not part of green bond-exclusive strategies or strategies with pre-defined green bond criteria".

"We have reviewed our green bond analysis methodology and Republic of Poland green bonds are no longer flagged as green assets within our portfolio".

"We invested in Schipol because air traffic emissions are airport's scope 3. Also, Schipol demonstrates means to boost sustainable development: the buildings are fully integrated in and around Airport Premises, where relevant measures to promote the accessibility and connectivity of buildings are allocated, such as access to public transportation and promotion of electric vehicles, promoting bio fuels, charging airlines with old fleet, and overall objectives: zero waste target in 2030 , carbon neutral (scope 1 and 2) in 2040. For Fibria, we invested because at least there is no controversial projects."

Brown industries' green financing requires clear cut benefits

Q7 | What technologies or expenditures from brown companies would you consider as eligible proceeds for green financing?



Investors strongly value decarbonization of the power supply (renewable energy PPAs, i.e. OPEX, or direct investment in clean power supply), disruptive technologies, business models based on circularity (waste or byproducts valorization, recycled scrap/"urban mining").

Roll-out of transformative/breakthrough technologies catches lot of interest, 45% consider it as "a lot" eligible and almost 43% as "extremely". It reveals a strong appetite for disruption technologies.

CCS and offsetting approaches are less consensual, 40% consider them as "a little" eligible. Refurbishing facilities/plans is even less attractive to investors (c. 60% answered "a little" or "not at all"). It is not consistent with IEA's (see dedicated interview) estimates according to which efficiency measures can make out 37% of the decarbonization potential of the Sustainable Development Scenario compared to the baseline Stated Policies Scenario.

The question of the "fair transition" and the management of its social cost, while important in our view, raised little appetite from investors (more than 60% see them not at all or little eligible).

Opinions are dissenting on M&A of green pure players, almost 20% consider it as "extremely" eligible, 34% as "a lot", but also 36% as "a little. Probably, we assume, out of additionality concerns.

Anonymized respondents' quotes

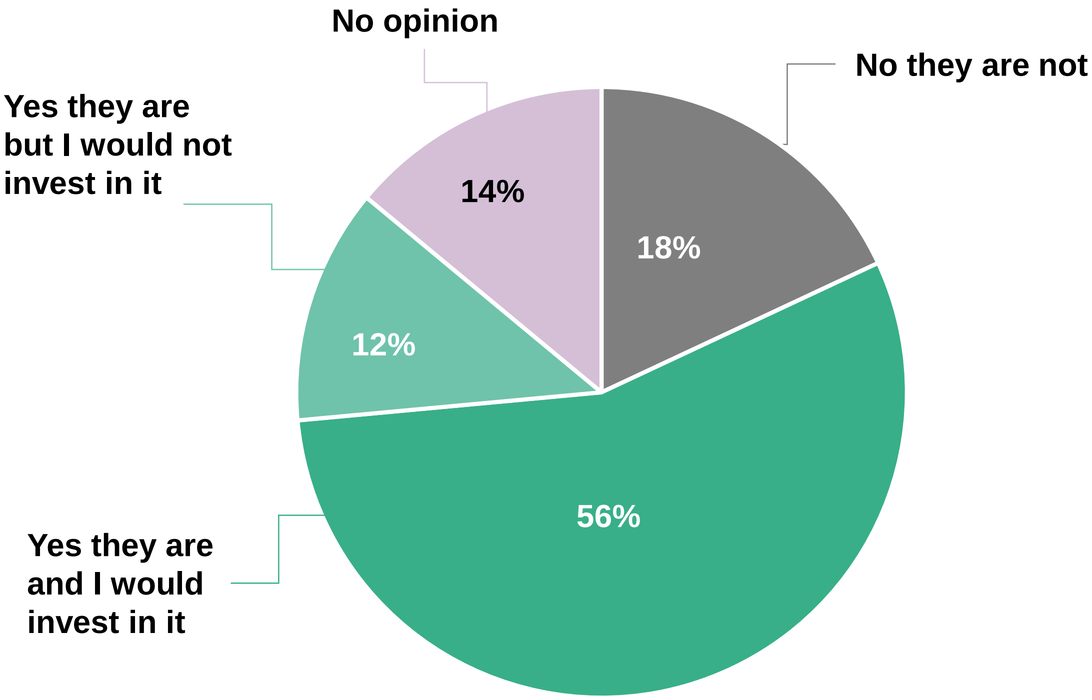
"We would like to specify that we are not comfortable with green bonds financing OPEX due to assets and liability management (ALM) mismatch.."

"Shall be in line with EU Taxonomy and the technical criteria therein"

"Green qualification depends on: - project impact (value chain, LCA and incremental impact, significance that should not be thought independently) - issuer positioning (is the issuer green or has a clear pathway for transitioning?)"

Transition KPI-linked instruments generate significant appetite provided trust is established

Q8 | Do you believe sustainability-linked financial instruments (e.g. loan margins redetermination or indexed bond coupon) tied to KPIs (≠ ESG score) can be a driver of change for brown companies? If yes, would you invest in such financial instruments?



Whilst two third of respondents acknowledge the positive impact KPI-linked products could have and 56% would be ready to invest in such products, they remain very cautious and keen to conduct a case by case analysis before investing, as many comments show.

Anonymized respondents' quotes

"*Unlike a green factor, these indicators can be tailored to the specifics of each company to make sure the effort is real and backed by a long term strategy"*

"We would invest in such instruments after a case by case analysis"

"I think any initiative is welcome, but it is a case by case approach to decide if we invest or not."

"They are questionable as the decision criteria is missing in my opinion for deciding whether the "sustainability improvement " is in line with Paris agreement (or the like). Inclusion of Science based Targets in the sustainability assessment and/or reference to EU Taxonomy would be requirement".

"Only if linked to a meaningful decarbonization strategy with a visible time horizon for switch to completely green assets, and with a discount compared to "pure" green loans."

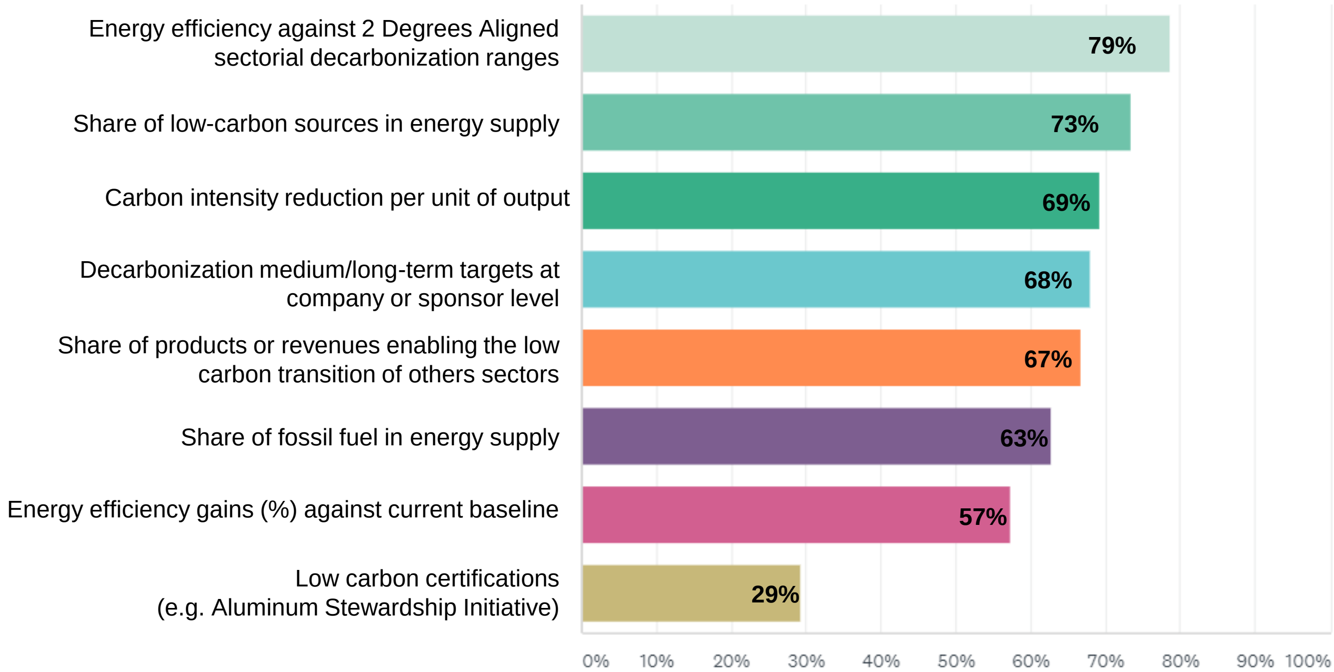
"We are currently evaluating such instruments." […] "Trust would be essential here..."

"Yes, we would invest, provided the measurement of such KPIs are checked by independent third party."

"Only if KPIs clearly defined without any possible distortion in their assessment.

Transition KPIs are considered relevant when holistic, forward-looking and related to decarbonization pathways

Q9 | Which of the following indicators are relevant for assessing the transition ambition (tick if applicable)?



Energy efficiency against 2 Degrees Aligned Sectorial decarbonization ranges is clearly the preferred KPI (79%); followed by the share of low-carbon sources in energy supply (73%) and the carbon intensity per unit of output (68%, which is used, notably by TPI or SDA). It is indeed the only way to have a holistic KPI that can be seen with the perspective of a recognized third party analysis and put into the broader perspective of the Paris Agreement 2°C target.

About 7 out of 10 investors consider as relevant indicators that are comprehensive in the sense of holistic and benchmarkable.

The share of products or revenues enabling the low-carbon transition of other sectors is quite high with 67%.

Improvement against own performances is considered as relevant by only 57% of the respondents, showing the importance of broader benchmarks and comparability against something which is climate-science based.

Lastly, low-carbon certification does not convince, with only 29% of the respondents finding it relevant.

Anonymized respondents' quotes

"*Perhaps a 1.5 degrees alignment would be the right target even if the official one is 2 degrees. Of course a long term plan is an evidence (including steps 5 years - 10 years). It is probably difficult to achieve as disruptive product can emerge.*"

"Most are relevant, depending on activities or industries."

"A holistic view should apply here. Energy efficiency gain are not green if applied to coal power generation for instance. Share of green revenues has to be compared to share of brown revenues..."

"It is not a one-size-fits-all, but it depends on sectors/industry and company level analysis."

"Transition ambitions should be addressed by forward looking indicators."

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