



Sustainability-Linked Bonds – Investors views
FEBRUARY 2021





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KEY TAKEWAYS OF OUR INVESTOR SURVEY



A new market segment on the rise

Introduction to Sustainability-Linked Bonds (SLBs)

With this investor survey, initiated during Q3 2020, we sought to understand **investors' appeal, concerns, themes of interests and preferred structure characteristics for SLBs in order to offer dedicated and suitable solutions for our clients.**

We warmly thank all respondents for their time and valuable insights.

A new sustainable debt instrument

- SLBs are defined as **a type of bond** in which the financial and/or structural characteristics can vary depending on whether the issuers **achieve predefined Sustainability/ ESG objectives**.
- This **new type of debt instrument is the latest addition to the green & sustainable financing toolbox** which will broaden the scope of eligible issuers, especially for less capital-intensive corporates and/or issuers struggling to have sufficient green/sustainable “capex” in hard-to-abate sectors (e.g., cement, steel & aluminum industry, oil & gas).
- **SLB product is a good complement to the green/social/sustainability bond products** (with dedicated Use-of-Proceeds) and proposes a more forward-looking and holistic view of an issuer's profile.
- **In 2019, the first KPI-linked bond from Enel paved the way** for a brand-new SLB segment.
- On Jun. 9, 2020, the International Capital Market Association (ICMA)'s Green & Social Bond Principles published a new set of voluntary process guidelines for debt capital market issuances related to sustainability-themed borrowing activity: [the Sustainability-Linked Bond Principles \(SLBPs\)](#).
- The **European Central Bank (ECB)** then decided that, from Jan. 1, 2021, bonds with coupon structures linked to certain Sustainability Performance Targets (SPTs), as defined in **SLBPs, will be eligible as collateral for Eurosystem credit operations and for Eurosystem outright purchases for monetary policy purposes**, provided they comply with all other eligibility criteria (see appendix for further details).

A new market segment

- Since Oct. 2020, **more than 25 SLBs have been issued in alignment with ICMA's principles**. As of mid-Feb. 2021, **the outstanding issuances of SLB totaled over than USD 12bn** and **we expect the SLB market to reach ca. USD 25bn in 2021**, mainly supported by corporates' appeal for this new sustainable debt instrument. This segment is expected to grow quickly in the future, as suggested first by Enel and more recently Total in their intentions to sell only bonds whose prices are linked to SDGs/ environmental objectives.

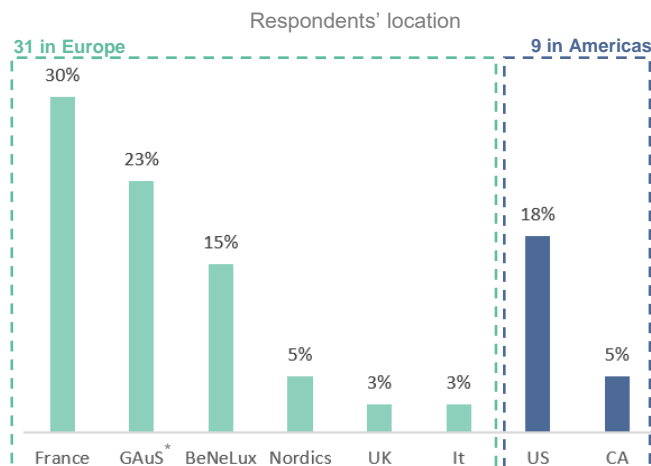
Natixis a pioneer of this new market segment

- Natixis positions itself as a **frontrunner in the green and sustainable finance space, including SLBs**. Our CIB has been a pioneer advocate of the format. In 2020, its Green & Sustainable Hub's Head, Orith Azoulay, acted as co-chair of the ICMA working group who designed the SLBPs.
- On Nov. 17, 2020, **Natixis acted as Sole Sustainability Structurer and Coordinator on NRG Energy's inaugural SLB** supporting the acquisition of Direct Energy. This transaction established **a great milestone for the market, representing 1st SLB from a North American issuer, 1st SLB from a power company outside Europe and 1st SLB with a “most ambitious target” clause** (i.e., SPT level applies as a minimum threshold for future emissions).
- On Dec. 7, 2020, **Natixis acted as Sustainability Structuring Advisor and Arranger on Albioma's 1st Sustainability-Linked Euro PP** to reinforce the **French independent energy producer strategic commitment to the energy transition**, targeting a growing share of renewables in its energy-mix thanks to the conversion of all its historic power plants to 100% biomass with a complete coal phase-out strategy.

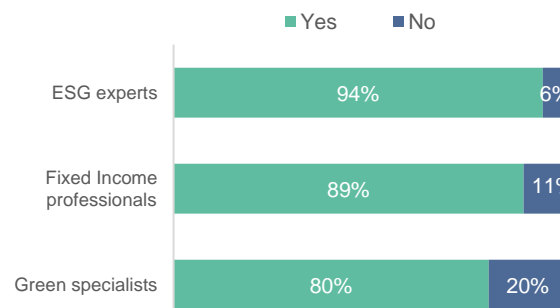
Investors are eager to invest in SLBs

Our investors Survey

Our panel: **40** global investment managers totaling **>USD19,9** trn in AuM

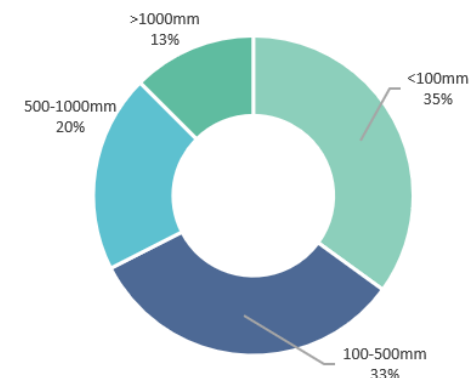


A very large majority of our respondents (88%) are considering or already investing in SLBs



NB: each sub-category includes both analysts and portfolio managers

Respondents' AuM (USD)



Genuine ambition, robust structuring and meaningful impact reporting will support market interest for this new sustainable debt instrument

Four out of five investor see SLBs as not competing with Green Bonds

- Two third of investors see it as a **great value-add to ESG integration** because SLBs imply issuers have **“skin in the game”**
- SLBs are considered as a **product that fits most investment strategies**, including as a **side allocation within dedicated green bond funds**

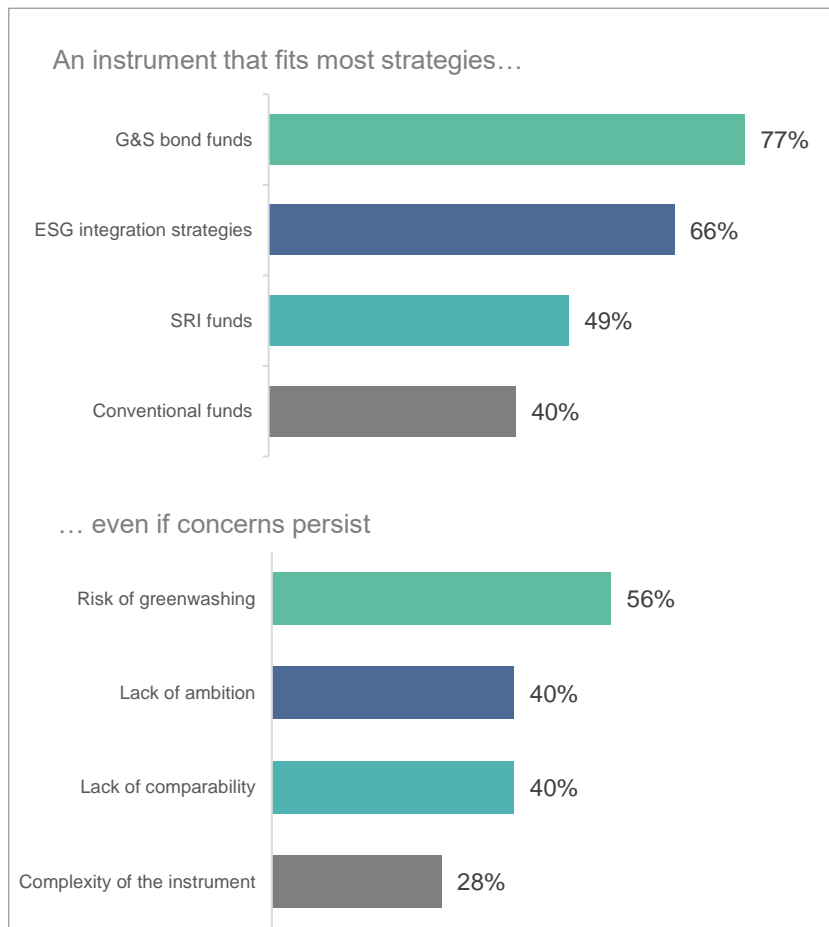
Less than 30% of the respondents are concerned by the instrument's complexity

- **Choice of the KPIs** should be driven by sustainability rather than financial considerations
- There is no clear-cut opinion on the **number of KPIs** to select. According to respondents, it should depend on the **issuer's strategy**, but **simplicity** is expected by several investors and **high ambition with regards Sustainability Performance Targets (SPTs)** makes consensus
- When feasible, **SPTs should rely on absolute benchmarks** (e.g., energy transition pathways, planetary boundaries, etc.), but also on **historical performance and peers benchmarking** when relevant

SLBs fit most investment strategies, but proof of concept still to be demonstrated

Our investors Survey

Product appeal and main concerns



Shared views

- Corporates happen to be the most relevant SLBs issuers, but SSAs are also good candidates
- Alignment with the Sustainability-Linked Bond Principles is seen as a prerequisite, albeit not necessarily sufficient as an evaluation criteria
- When assessing forward looking performance, investors see SLBs as a tool that can strengthen their opinion on the reliability of ESG performance targets
- Complexity and innovation of the instrument call for dedicated roadshows and investors Q&A

Energy among most relevant sectors

- *“SLBs should be open to all sectors”*
- *“Power Utilities, high carbon emitters”*
- *“Sectors for which we need to monitor closely transition pathways”*

SPTs of utmost importance

- *“We think SLBs could be used for any type of business, but sustainability targets should be robust and ambitious”*

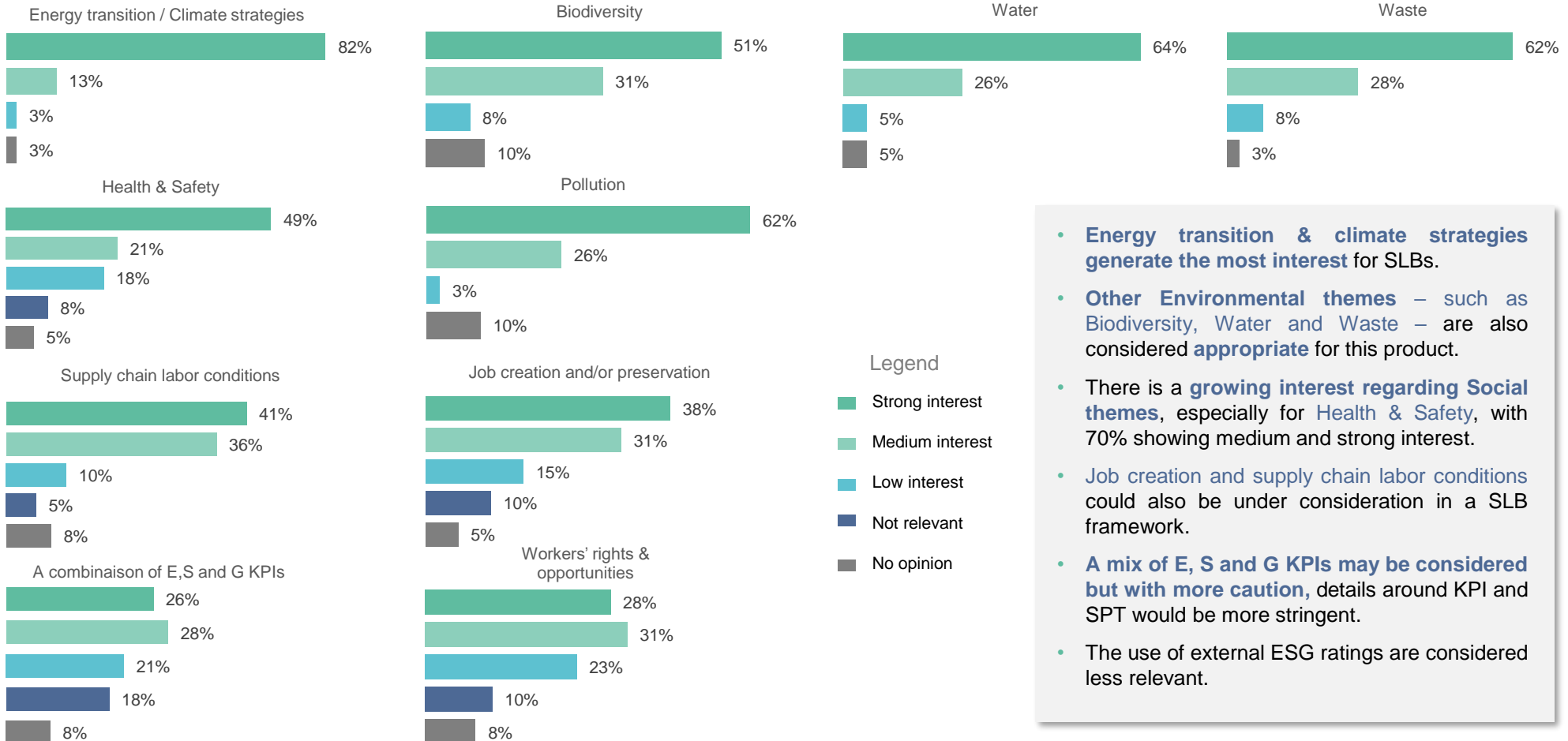
Preferred ESG themes

- Environmental KPIs seen as natural, also including non-climate related ones
- Social parameters also a possibility
- Governance aspects of limited interest
- ESG rating not considered relevant

Investors prove to be open to a wide variety of themes and KPIs

Our investors Survey

Main themes of interest



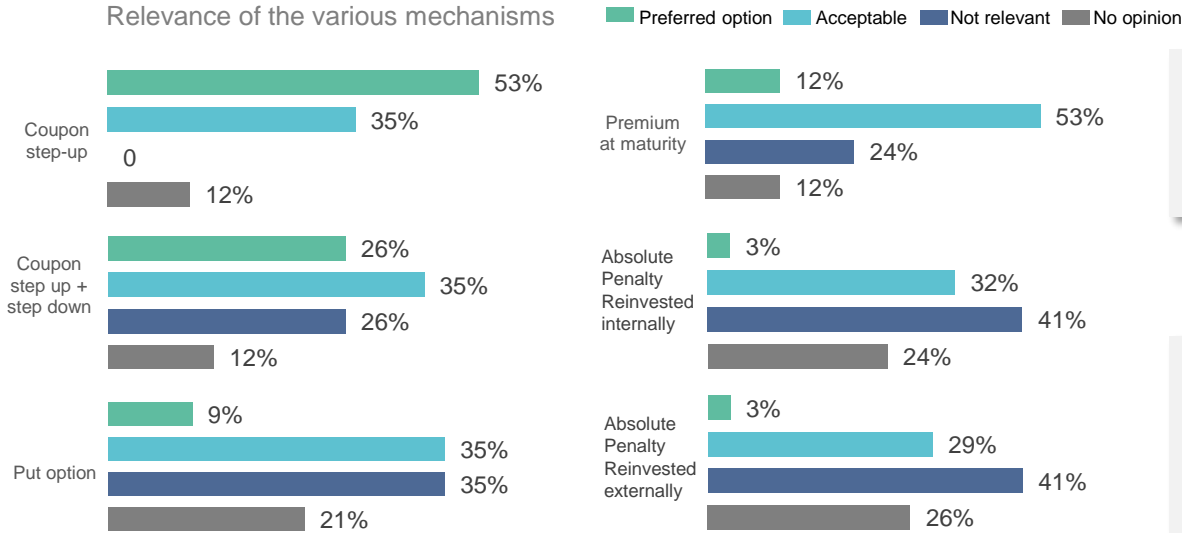
- **Energy transition & climate strategies** generate the most interest for SLBs.
- **Other Environmental themes** – such as Biodiversity, Water and Waste – are also considered **appropriate** for this product.
- There is a **growing interest regarding Social themes**, especially for **Health & Safety**, with 70% showing medium and strong interest.
- **Job creation and supply chain labor conditions** could also be under consideration in a SLB framework.
- **A mix of E, S and G KPIs may be considered but with more caution**, details around KPI and SPT would be more stringent.
- The use of external ESG ratings are considered less relevant.

Choice remains rather open regarding choice of structure and Sustainability Performance Target's (SPTs)

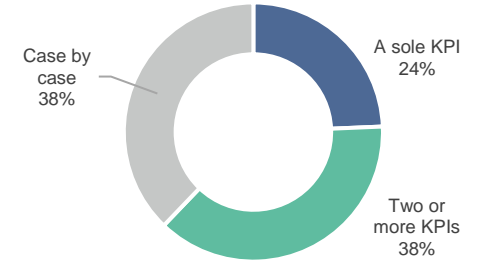
Our investors Survey

KPIs, Sustainability Performance Targets and payoff mechanisms

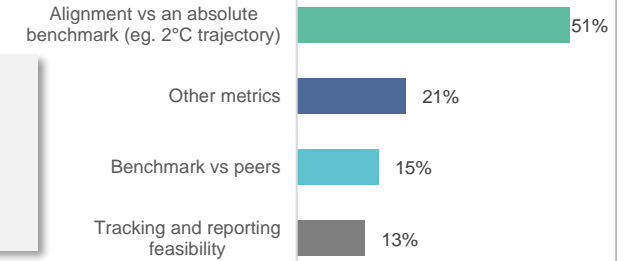
Relevance of the various mechanisms



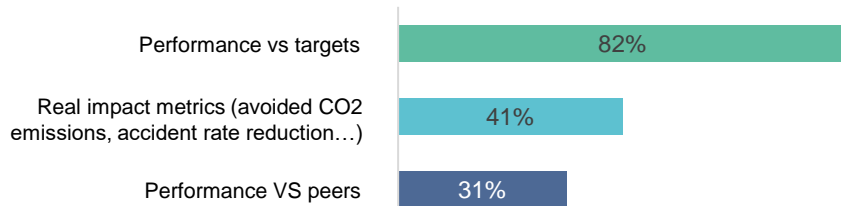
Preference between one and several KPIs



Most relevant criteria to legitimate the SPTs ambition level



Impact reporting expectations are strong, following the footsteps of Green Bonds best market practices



- All investors expect **impact reporting**, including views on the levers actioned to achieve the target(s)
- Investors expect the measurement of such KPIs are checked by an **independent third party**



2

SUSTAINABILITY-LINKED BONDS PRINCIPLES



Sustainability-Linked Bond Principles at a glance



Definition of a Sustainability-Linked Bond (1/2)

Introduction

- Sustainability-Linked Bonds **incentivize the issuers' achievement** of material, quantitative, pre-determined, ambitious, regularly monitored and externally verified **sustainability (ESG) objectives**
- The Sustainability-Linked Bond Principles ("SLBP") provide guidelines that recommend structuring features, disclosure and reporting and position integrity protection at the heart of the guidance.
- **Natixis was co-chairing the SLBP working group** under ICMA secretary

Definition – Sustainability-Linked Bonds

- Sustainability-Linked Bonds ("SLBs") are any type of bond instrument for which the **financial and/or structural characteristics** can vary depending on whether the **issuers achieve predefined Sustainability/ ESG objectives**
- In that sense issuers are committing to **future improvements in sustainability outcome(s)** within a **predefined timeline**
- It is a **forward-looking performance-based** instrument
- Those objectives are
 - measured through **predefined Key Performance Indicators (KPIs)** and
 - assessed against **predefined Sustainability Performance Targets (SPTs)**

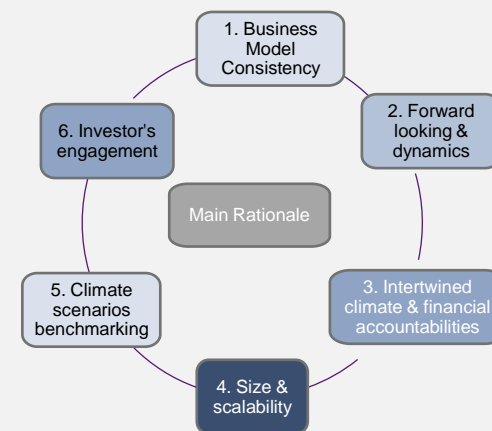
- SLBs are intended to be used for **general corporate purposes**, hence the use of proceeds is not a determinant in its categorisation

- **The SLBP have five core components :**

- Selection of Key Performance Indicators (KPIs)**
- Calibration of Sustainability Performance Targets (SPTs)**
- Bond characteristics**
- Reporting**
- Verification**

- SLBP recommend that the issuers **publicly communicate**, about the selection KPI(s) (i.e., relevance, materiality), the SPT(s) (i.e., ambition level and consistency with overall strategic planning), trigger events for change of bond characteristics, intended post issuance reporting and external review format, as well as overall issuers' representation of the alignment with the SLBP
- Such disclosure may take place in the bond documentation and/ or on the issuers' webpage, a dedicated framework, external reviews, or investor presentation, etc

- **SLBs can be used by issuers playing an important role in the energy transition** (e.g., developing new energy efficiency products, or coming from highly energy intensive sectors) but with no capacity to issue green bonds (e.g., by lack of identifiable eligible investments or coming from asset light / "opex" intensive sectors) or reluctant to do so (e.g., by lack of an undisputable definition of what constitute eligible green assets).
- **SLBs allow the design of ambitious transactions, potentially embedding the full corporate strategy**, and aligning it with global targets (e.g., Paris Agreement, Sustainable Development Goals, etc.), with a potentially simple approach (potentially no need for a framework or for separate reporting, no necessarily separate management of funds) and introducing the notion of **"skin in the game"**
- SLBs **seem fit for purpose given the dynamic nature of transition / sustainability strategy between investors and issuers, complementing & adding value to commonly used ESG ratings**
- Intrinsically **forward-looking instruments** which may significantly contribute to amplify the **ESG impact of bond markets**



Sustainability-Linked Bond Principles into details



Definition of a Sustainability-Linked Bond (2/2)

CORE COMPONENTS

1 Selection of KPI(s)

- **Relevant, core and material** to the issuer's **overall business**, and of **high strategic significance** to the issuer's **current and/or future operations**
- **Measurable or quantifiable** on a **consistent methodological basis**
- **Externally verifiable**
- Able to be **benchmarked** (i.e., as much as possible using an external reference or definitions making the ambition assessment of SPTs possible)

2 Calibration of SPTs

The SPTs should be **ambitious**:

- Represent a **material improvement** in the respective KPIs and be beyond "Business as Usual" trajectory
- Where possible be compared to a **benchmark** or an **external reference**
- Be consistent with the issuers' overall **strategic Sustainability / ESG planning**
- Be determined on a **predefined timeline** set before (or concurrently with) the issuance of the bond

The target setting exercise should be based on a combination of benchmarking approaches:

- **the issuer's own performance over time** : track-record of 3 years is recommended and forward-looking guidance on the KPI when possible; and
- **the issuers' peers** i.e., the SPT's relative positioning versus its peers' where available (average performance, best-in-class performance) and comparable, or versus current industry or sector standards; and/or
- **reference to the science**, i.e., science-based scenarios, or absolute levels or to official country/regional/international targets (Paris Agreement on Climate Change and net zero goals, Sustainable Development Goals (SDGs), etc.) or to recognized Best-Available-Technologies or other proxies to determine relevant targets across environmental and social themes.

3 Bond characteristics

- Bond **financial and/or structural characteristics** should **vary depending on whether the selected KPI(s) would reach (or not) the predefined SPT(s)** i.e., the SLB will need to include a financial and/or structural impact involving trigger event(s).
- Potential variation of the coupon is most common example, but it is also possible to consider other variations
- Variation of the bond financial and/or structural characteristics should be **commensurate and meaningful** relative to the issuers' original bond financial characteristics.
- **Necessary element of the bond documentation**: The KPI(s) definition and SPT(s) (including calculation methodologies) and the potential variation of the SLB's financial and/or structural characteristics.
- **Any fallback mechanisms in case the SPTs cannot be calculated or observed in a satisfactory manner, should be explained.**
- Issuers may consider including, where needed, language in **the bond documentation** to take into consideration potential exceptional events or extreme events, including drastic changes in the regulatory environment that could substantially impact the calculation of the KPI, the restatement of the SPT, and/or proforma adjustments of baselines or KPI scope.

4 Reporting

To be kept readily available & **regularly published**, at least annually and in case for any date/period relevant for assessing the SPT performance:

- Up-to-date information on the performance of the selected KPI(s), including baselines where relevant
- A verification assurance report relative to the SPTs outlining the performance against the SPTs and the related impact, and timing of such impact, on the bond characteristics
- Any information enabling investors to monitor the level of ambition of SPTs

5 Verification

- **Independent and external verification** of performance level against each SPT for each KPI by a **qualified external reviewer** with relevant expertise (an auditor or an environmental consultant)
- **At least once a year** and in any case for any date/period relevant for assessing SPT performance leading to a potential adjustment of SLB financial and/or structural characteristic
- Verification of the performance against the SPTs should be made **publicly available**

External review : SPO: recommended

Recommendation to appoint (an) **external review provider(s)** to confirm the **alignment of their bond with the five core components** of the SLBP (such as a SPO)

Suggested mandate includes the assessment of :

- the relevance, robustness and reliability of selected KPIs,
- the rationale and level of ambition of the proposed SPTs, the relevance and reliability of selected benchmarks and baselines,
- the credibility of the strategy outlined to achieve them, based on scenario analyses, where relevant.

Post issuance, in case of any material change to perimeter / KPI methodology / SPT(s) calibration, issuers are encouraged to ask external reviewers to assess any of these changes.

In cases where no SPO sought, it is recommended that issuers demonstrate (and document) or develop the internal expertise & processes to verify their methodologies..

Topics left to market innovation and/or Q&A

- Nature of financial and/or structural characteristics
- Examples of KPIs, benchmarks, references
- Documentation & structuring of changes in KPI & SPTs
- Exclusions / Do No harm approaches / Minimum ESG performance for issuers
- Programmatic or bond specific approach
- Detail on what "meaningful" and "commensurate" can mean?
- ECB eligibility discussion
- Articulation with GBP/SBP or transition bond.

Milestones of the Sustainability-Linked Bond Market

Publication of the Sustainability-Linked Bond Principles (“SLBPs”) - June 2020

The Sustainability-Linked Bonds Principles incentivize the issuers’ achievement of material, quantitative, pre-determined, ambitious, regularly monitored and externally verified sustainability (ESG) objectives.

Natixis has been an active co-author of the SLBP and co-chaired the SLBPs working group under ICMA secretary.



ECB to accept SLBs as collateral - September 2020



Bonds with coupons linked to sustainability performance targets have become eligible as central bank collateral.

Potential eligibility also for asset purchases under the APP and the PEPP subject to compliance with program-specific eligibility criteria.

This decision came into effect on January 1st, 2021

- The European Central Bank (ECB) has decided that bonds with coupon structures linked to certain sustainability performance targets will become eligible as collateral for Eurosystem credit operations and also for Eurosystem outright purchases for monetary policy purposes, provided they comply with all other eligibility criteria.
- The **coupons must be linked to a performance target referring to one or more of the environmental objectives set out in the EU Taxonomy Regulation** and/or to one or more of the United Nations Sustainable Development Goals **relating to climate change or environmental degradation.**

This further broadens the universe of Eurosystem-eligible marketable assets and signals the Eurosystem’s support for innovation in the area of sustainable finance. Non-marketable assets with comparable coupon structures are already eligible. The decision aligns the treatment of marketable and non-marketable collateral assets with such coupon structures.



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