
ESG integration in green & social bonds

Assessment process

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1. WHY ACTIAM INVESTS IN GREEN AND SOCIAL BONDS?

The green bond market has grown in recent years, a process that started with the European Investment Bank and World Bank in 2007. Whereas ACTIAM initially concentrated mainly on 'green' activities such as renewable energy and energy efficiency, it has widened its focus to include social bonds and sustainability bonds that are designed to provide a combination of environmental objectives and social objectives (e.g. access to housing, health services and an adequate income).

ACTIAM wants its investments to contribute to the UN Sustainable Development goals (SDGs) for 2030. Through ACTIAM's focus themes- climate, water and land, and impact investing- we actively pursue our future vision of a world that is fit to live in and in which people can meet their basic needs. That is why, ACTIAM decided to focus its strategy on three SDGs in particular: climate (#7), water (#6) and land (#15). Moreover, ACTIAM believes that focusing on the societal impact of investments results in higher long-term financial returns. Given the market for green and social bonds is still in its infancy it is not yet clear whether in the long-term they provide higher financial returns. However, the market expectation is that in a more pressured market, green bonds in specific will be less volatile and will outperform the other plain bonds, because green bonds are in more fixed hands. Especially when external costs like carbon emissions are captured in carbon prices, this becomes even more relevant.

This document describes the choices ACTIAM makes when buying green, social or sustainable bonds. Such choices are not arbitrary, but follow from certain well-recognized principles, as well as ACTIAM's own carefully researched view on the perceived positive (or less negative) impact and credibility of the issuer.

The principles refer to the Green Bond Principles (GBP), Social Bond Principles (SBP), Sustainability Bond Guidelines (SBG). These three voluntary initiatives draw up guidelines on transparency requirements for the issuance of green, sustainable and social bonds, however, they do not yet provide an objective definition of what makes a bond green, sustainable or social.

Unlike the above-mentioned initiatives, the Climate Bond Initiative (CBI) has developed standards for many activities and technologies so that investors can assess the positive environmental impact of the bond concerned. However, CBI is also a voluntary initiative and only focuses on green activities. Therefore, only a few bonds researched by ACTIAM have been certified in accordance with the CBI standards. In this context, we highly support the recommendation of the High-Level Expert Group on Sustainable Finance to introduce an official EU Green Bond Standard (EU GBS) and consider an EU Green Bond label or certificate.

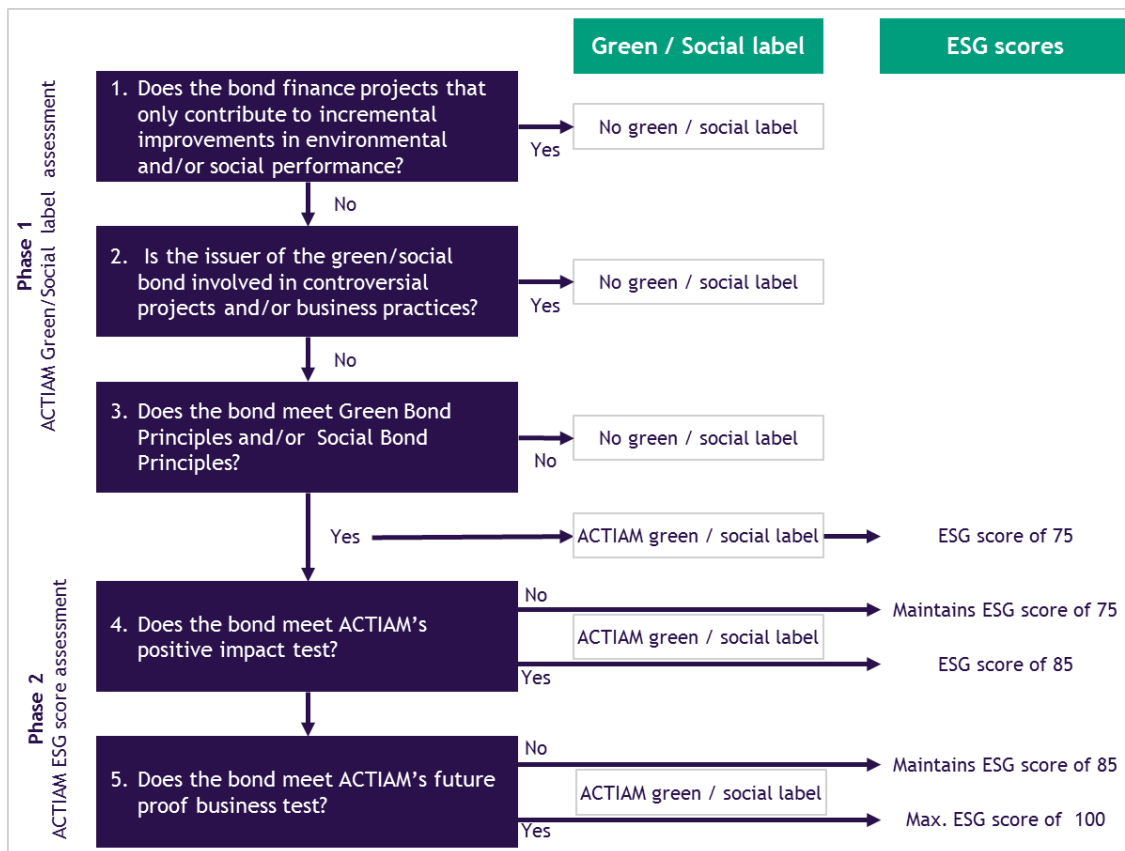
Along the journey towards more standardization, ACTIAM continues its own assessment of such bonds. This is important because once money has been lent and allocated to projects, it is locked in. This means that it can no longer be used - at least for the time being - for projects that might have had a more positive environmental impact. In the case of green bonds, ACTIAM's principle is that projects with the same type of activity or technology, the one with the most ambitious and credible climate targets should be chosen.

2. ACTIAM GREEN AND SOCIAL BOND ASSESSMENT PROCESS

ACTIAM applies its knowledge of green, social, and sustainable/SDG bonds in two phases of its regular responsible investment process. First, to assess whether to classify a bond as green, sustainable or social. Second, to assess ACTIAM's own ESG score of green or social bond investments. The ESG score reflects both the entity's policy and its actual conduct. A company may have a good policy, but this policy says little about the true situation concerning sustainability if it is not actually implemented. By combining this information with financial information, ACTIAM can invest in companies that are appealing both in financial terms and in ESG. In certain cases, where the investments are governed by specific arrangements, ACTIAM focuses on achieving the highest possible ESG score, and in any event a score that is higher than that of the relevant benchmark, to ensure that our portfolios are always more sustainable than this benchmark.

ACTIAM checks first whether the issuer of the green, social or sustainable bond complies with the Fundamental Investment Principles. If this minimum requirement has been fulfilled, Figure 1 shows the step-by-step assessment of a bond to receive a green or social label and the consequences for the ESG score (0-100) we allocate to the bond.

With regards to the first phase, the green bond and social bond assessment is based on questions regarding the extent to which the bond can be regarded green and/or social (see question 1), the green and/or social credentials of the issuer (see question 2) and the degree of transparency and assurance of the bond issuance itself (see question 3). In the case ACTIAM assesses a sustainability/SDG bond, a blend of green and social projects, obviously both dimensions should be considered to receive a sustainable label.



Concerning the second phase, the ESG score of a certain bond can be adjusted if ACTIAM assesses that it has a material positive contribution to sustainability, such as when a bond receives the ACTIAM green and social label. The ESG score for such bonds will be adjusted to 75, 85, or 100 depending on the extent to which an issuer and its use of proceeds are green, social or sustainable. Thereby making green and social bonds more attractive to invest by ACTIAM. For each requirement we will now briefly elaborate how we conduct the assessment process.

PHASE 1: ACTIAM GREEN AND SOCIAL LABEL ASSESSMENT

1. Does the bond finance projects that only contribute to incremental improvements in environmental and/or social performance?

ACTIAM makes a substantive assessment of green designated bonds as it explicitly screens whether the use of proceeds could (potentially) extend the lifetime of fossil fuel-based assets. In cases where energy efficiency measures for any fossil-fuelled facility will be financed (e.g. retrofit or otherwise upgrades for extraction, processing and power plants), the issuer must ensure *long-term environmental benefits* through deep, rapid and sustained reductions in carbon emissions. If the issuer is not able to address this, ACTIAM considers such investments only as a driver for *incremental* improvements and therefore unsuitable for financing by means of a green bond.



Moreover, Bonds earmarked for financing activities, projects or technologies that occur on the list of exclusions of the Climate Bonds Taxonomy are rejected by ACTIAM.¹ Also, for the following use of proceeds - where according to CBI more work is required - ACTIAM will ask for more clarification on the potential environmental benefits (the list is not exhaustive):

- Waste energy capture
- Bioenergy and biofuels
- Large hydro power facilities
- Fuel efficient vehicles
- Desalination projects

Once social standards like CBI have been formulated and adopted for social bonds, this assessment methodology will be modified.

2. Is the issuer of the green and social bond involved in controversial projects and/or controversial business practices?

ACTIAM also checks whether the issuer of the green and social bond has been involved in controversies connected with one of the green and social project categories as noted by the GBP/SBP guidelines. For social bonds these categories include, but are not limited to affordable basic infrastructure, access to essential services, affordable housing, SME financing and microfinance, food security, socioeconomic advancement and empowerment. For green bonds these categories include, but are not limited to renewable energy, energy efficiency, pollution prevention and control, sustainable management of natural resources and land use, biodiversity conservation, clean transportation, sustainable water and wastewater management, climate change adaptation, eco-efficient and/or circular economy adapted products and green buildings.



For green bonds in specific we also focus on the extent to which issuers in the mining and energy industries are already switching to low-carbon business practices. In specific, coal-based utilities that issue a green bond will be screened on their current strategy and investments required for a transition to sustainable business practices. Banks can also play an important role in the financing of these industries and will therefore be screened against (possible) commitments to stop financing coal-based utilities and coal mining. For reputational reasons, ACTIAM awards no green label if the bond issuer has been involved in such controversial business practices without having a credible phase out strategy for coal-related business or finance.

3. Does the bond meet GBP and/or SBP guidelines?

In this step ACTIAM verifies whether a green and social bond meets the four core components of the GBP/SBP for process transparency: (1) use of proceeds, (2) process for project evaluation and selection, (3) management of proceeds, and (4) reporting². ACTIAM does not classify a bond as green and social if there is insufficient evidence of process transparency.



ACTIAM will award a green and/or social label and increase the ESG score already allocated to the green and social bond to a minimum of 75 when the issuer positively addresses these three questions.

¹ <https://www.climatebonds.net/standards/taxonomy>

² <https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/>

PHASE 2: ACTIAM ESG SCORE ASSESSMENT FOR GREEN AND SOCIAL BONDS

After the first phase, in which bonds are assessed on the extent to which they are expected to generate a positive, long-term social and environmental impact, the second phase aims to address the question to what extent the bond is green or social and allocate a corresponding ESG score.

4. Does the bond meet ACTIAM's positive impact test?

In this step ACTIAM first tests whether the green or social bond issuer pre-defines specific impact or outcome indicators at issuance. In addition, they should illustrate the expected environmental and social impact (in qualitative or quantitative terms) made possible by the projects to which green and social bonds proceeds have been allocated. Subsequently, ACTIAM tests whether the expected environmental and social impact appears ambitious, which is relatively challenging to objectivize. We aim to assess whether the use of proceeds accelerates or only follows the issuer's efforts to shift its activities towards greener and social activities. For example, by assessing whether the issuer defines quantified upfront hurdle rates/eligibility thresholds that go beyond national standards and regulations requirements. Moreover, CBI certification adds an external validation of the green ambition of the issuance. Finally, we test whether the issuer has room to grow its green and social funding, rather than only refinancing existing projects.



ACTIAM will increase the ESG score of a green and social bond to 85 when the issuer channels green or social bonds towards new and ambitious projects and when there is evidence that the pool of eligible projects is expected to grow over time. Such eligible projects should be accompanied with the above mentioned pre-defined impact/outcome indicators.

5. Does the bond meet ACTIAM's future proof business test?

As a final step, ACTIAM decides whether the issuer should receive a maximum score of 100 for its green or social bond issuance. ACTIAM assesses whether the green or social bond issuer provides new business models or new products and services, underpinned by transformational leadership, which disrupt existing industries or realign them with the SDGs. For example, this applies if a utility company replaces its fossil fuel investments in line with the rapid reduction in emissions that is needed for the transition to a sub-2-degree Celsius world. So, we assess structural change on the issuer level that is required for a sustainable future, as opposed to the positive impact of a green or social bond investment as assessed in the previous step.



ACTIAM will increase the ESG score of a green and social bond to 100 when we see the issuer shifting its business to achieve transformational impact.

3. DISCLAIMER

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