How to maximise impact by investing in green bonds:
Mirova's approach

mirova
Investing in sustainability

NATIXIS
INVESTMENT MANAGERS

A Manifest for Green Bonds

The IPCC's "Climate Change 2021: The Physical Science Basis"[1] report, published last summer, sadly confirmed that no country in the world would be immune to the dramatic effects of global warming. Unless the global rise in temperature remains under 1.5°C by 2100, heat waves will be increasingly frequent, hot seasons will be longer and cold seasons shorter. No region will be spared the extreme heat and its catastrophic consequences for farming and health-care systems, including countries that until now, had felt less exposed as they lie in temperate zones. Even Russia, which hoped it could benefit from global warming with the opening of shipping routes in the Arctic, is already suffering from extreme summer heatwaves, which have led to forest fires on an unprecedented scale.

Current public climate change policies will bring about a disastrous 2.7°C[2] rise in global temperatures before the end of the century unless more ambitious pledges are made. Beyond government climate policies, collective action and changes in consumer behaviour - which is no longer tenable – have become vital. Mass consumption, which has now spread to most of the world, is putting increasing pressure on the planet and its ecosystems. Today, food, sport, leisure, tourism, fashion, and

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> *Solutions that will help build a society where profit and growth opportunities can be shared by all stakeholders.*

most human activities are correlated with hyper-consumption and a dramatic exploitation of natural resources. Naturally, this behaviour is a direct consequence of the strong social pressure exerted by advertising and by social and cultural factors. Different studies[3] have shown that if everyone on the planet had the same consumer habits as those living in advanced economies, it would take several planets to sustain the needs created by this hyper consumerism.

Changing our way of life has become an absolute necessity. However, considering "negative externalities"[4] does not imply giving up on the creation of wealth and the improvement of living conditions, which would have been impossible without the industrial revolution and economic development on a global scale. Instead, it's about channeling capital to fund industries and activities that provide solutions to the environmental and energy transition, while also reducing the support given to sectors with high environmental footprints who didn't choose to transition towards a greener economy.

We all have a role to play in this transition. The financial industry and bond markets are no exception.

Investing in green bonds with Mirova is simply about supporting the solutions of the future. Solutions that will help build a society where profit and growth opportunities can be shared by all stakeholders: consumers, employees, companies, and investors. It also involves investors channelling their savings towards solutions able to combine positive impacts and financial returns.

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1. https://www.ipcc.ch/site/assets/uploads/2021/08/IPCC_WGI-AR6-Press-Release_fr.pdf
2. Source: UNFCCC report, Sept 2021
3. https://www.wwf.fr/s-informer/nos-missions/modes-de-vie-durables/documents/newsletter-empreinte-ecologique-n-4
4. Consumer and production activities generate impacts that are not directly related to the end purpose of these activities, and these effects can be positive as well as negative. For example, industry can produce air or water pollution that will have current or future impacts on residents: these are referred to as negative externalities.

Green is the new black for bond markets:

key implications and Mirova's vision

As our readers may already be aware, the history of Green Bonds is rather recent and still unfolding… The first issuance of a "Climate Awareness Bond" by the European Investment Bank (EIB) took place in 2007. Seven years later, in 2014, a consortium of investors, companies and banks established a set of voluntary best practice guidelines for issuing green bonds: this was the birth of the Green Bond Principles – GBP. Another seven years later, in 2021, the European Union took a keen interest in the Green Bond market and launched a sustainable finance strategy which included the green taxonomy[5] and the EU Green Bond Standard – EU GBS[6].

> *For Mirova, Socially Responsible Investment is not just one approach among many others: it's our only approach.*

At the same time, Socially Responsible Investment – SRI became increasingly widespread with the arrival of new (more or less) convinced and/or convincing issuers, and a number of (also more or less) demanding investors.

For Mirova, Socially Responsible Investment is not just one approach among many others: it's our only approach. We began investing in green bonds as early as 2012, keen to maximise our environmental impact and preserve the integrity of this fast-growing market. Our approach is founded upon this two-pronged challenge, both in the methodology we apply to analyse and assess green bond programmes, and in our active engagement throughout the lifecycle of the green bond.

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5. https://www.carbone4.com/analyse-taxonomie-europeenne

6. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/european-green-bond-standard_en

The environmental benefits of a green bond must be aligned with the issuer's broader strategy

Mirova has developed a methodology for analysing and assessing green bond programmes which draws from the Green Bond Principles[7] framework. This entails a high degree of selectivity: at end December 2020, 45%[8] of these issues were excluded from the investment universe of our Mirova Global Green Bond[9] strategy.

A STRONG FOCUS ON THE INTEGRITY AND AMBITION OF THE PROJECTS

The capital raised must fund green and/social projects. In order to maximise impact, Mirova examines the relevance and the alignment of these projects with the Sustainable Development Goals (SDGs)[10].

Furthermore, Mirova analyses and – in some cases - challenges the technical criteria established by the European green taxonomy, as well as those suggested by issuers themselves.

The environmental and/social impacts of the project must be sufficiently clear and ambitious to ensure significant progress can be made towards reaching the stated objective.

Similarly, the risks associated with environmental projects must be minimised: initiatives creating positive environmental benefits may be responsible for generating negative environmental or social externalities.

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7. https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/
8. Source: Mirova. The data reflects the situation as of 31/12/2020 and may change without notice.
9. All investments carry risks, including the risk of capital loss and sustainability risk.
10. The Sustainable Development Goals were adopted by the United Nations in 2015. For more information on our methodology, please refer to Mirova's website: www.mirova.com/fr/recherche

Mirova pays close attention to the level of detail and transparency of the impact reporting.

Traceability is an important factor, as by their very nature, the proceeds of green bonds are "tracked": particular attention is therefore paid to ensure that capital flows are channelled towards green projects, for the entire duration of the bond's investment cycle.

We also make sure that the industrial project that receives funding is aligned with the challenges faced by the industry in which the issuer operates.

Mirova examines how the projects fit into the issuer's overall and sustainable development strategy.

DISCIPLINE AND TRANSPARENCY, TWO ESSENTIAL CRITERIA FOR THE APPROVAL AND MONITORING OF PROJECTS

Issuers must set up the necessary procedures to ensure the project's various environmental and social risks are minimised and effectively managed, while also maximising its benefits. Risk management is a central aspect of our analysis; a deal that generates positive environmental benefits may also create negative externalities. For example, projects requiring the construction of infrastructure may be detrimental to local populations or biodiversity.

Issuers of green bonds must provide formal evidence of the environmental benefits created by these instruments; it is therefore essential that they produce an annual report disclosing the product's allocation until full allocation, and an impact report that will track the environmental benefits generated by the projects or activities being financed.

Furthermore, Mirova pays close attention to the level of detail and transparency of the impact reporting provided for each projects, including clearly identified performance indicators and results.

Focus on the real estate sector and the European green taxonomy

While the initial implementation of the green taxonomy was no easy task (involving a compromise between climate science, the stakeholders within each sector, and the various institutions of the European Union), it is now widely recognised and supported by Mirova. Several players in the green bond market have started to use the taxonomy as a tracking instrument for defining and selecting green assets, a decision that took place even before the technical criteria were confirmed by the EU's legal and political process, known as "delegated acts".

Nevertheless, in some sectors, the thresholds use to define "green activities" produced some lively debate due to tensions between rigorous scientific research – ensuring the activity is as compatible as possible with a pathway maintaining temperature increases below 2°C, and the need for these thresholds to be applied to existing sectors and industries.

In this debate, Mirova chose scientific rigour and maximising the fight against climate change. If we use the construction industry as an example, Mirova's research team believes that ranking among the "top 15%" highest energy efficiency buildings, or displaying a level-A Energy Performance Assessment, do not constitute strong enough criteria*.

In fact, Energy Performance Assessment databases are still being developed in all EU countries, and the top 15% is therefore only theoretical and estimated by most issuers based on the date the building was erected, in the absence of verifiable data at this stage. Furthermore, this performance threshold - which can only be relative - simply entails compliance with the building regulations established in the 2010s. As such, if the asset operates in a market where energy-intensive buildings are prevalent, ranking within the "top 15%" offers no guarantees that its energy performances are any better than "business-as-usual".

On the contrary, Mirova believes that the key challenge for the real estate sector is the renovation of the existing building stock, yet projects of this type only represent a small fraction of the green bonds issued by the industry.

Finally, this approach to taxonomy focuses on energy efficiency as the sole criterion for differentiating assets**. Mirova encourages a holistic approach when considering the environmental impact of buildings, which should not be solely based on their "theoretical" energy efficiency at the time of construction, but also on the active management of their energy efficiency during the operational phase.

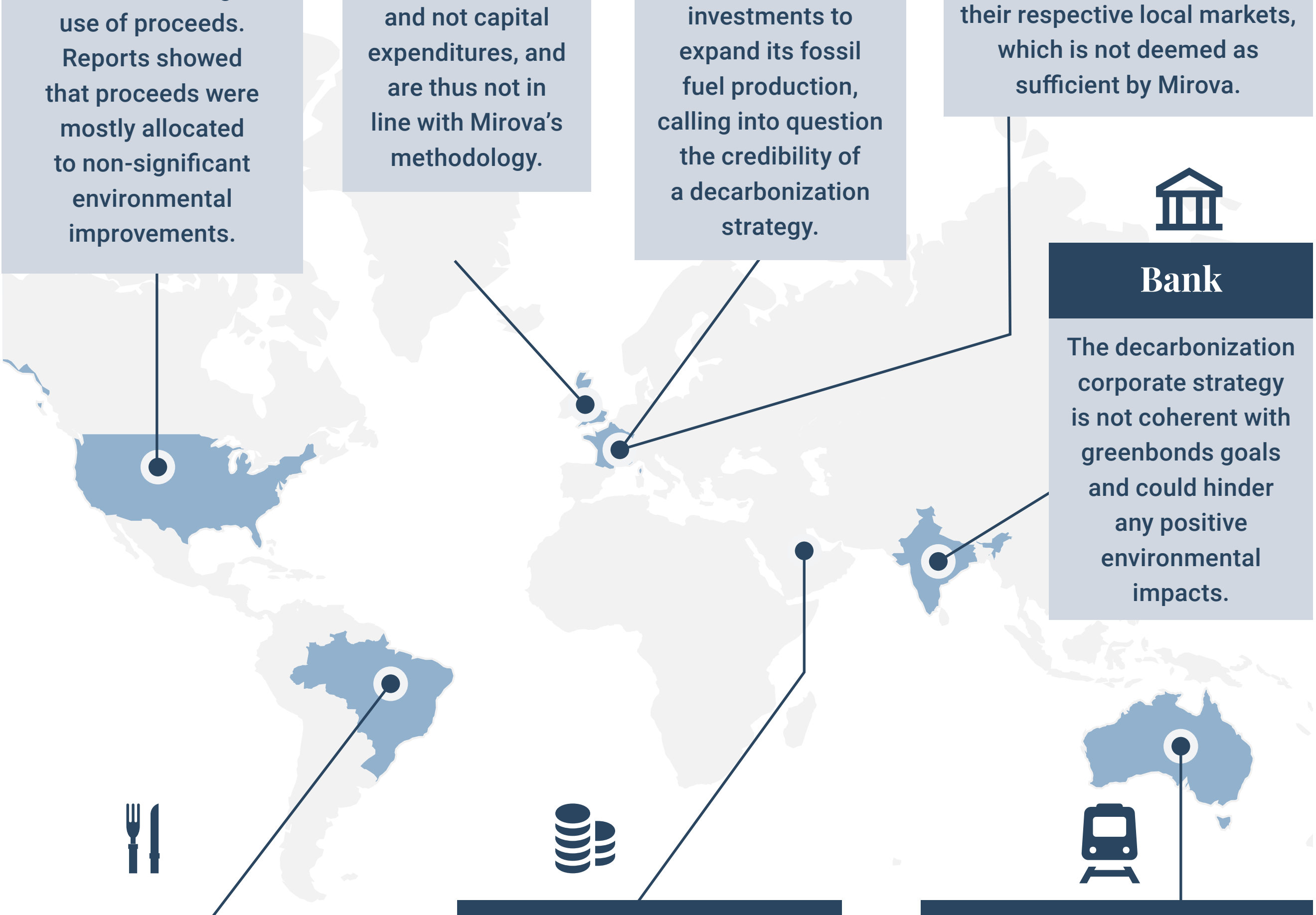
In view of this, in addition to funding real estate assets, we focus on issuances that include investments in related areas: the production of renewable energy, the development of solutions enabling access to low-carbon mobility, or the processing of waste.

To sum up, Mirova has raised the standards required by the Green Taxonomy's "acquisition and management of assets" category: buildings ranked higher than the "top 15%" are eligible if issuers can provide evidence that they have developed a process for improving and tracking their energy consumption in the operational phase, through an environmental certification process.

*For more information on our methodologies, please visit our Mirova website: www.mirova.com/fr/recherche
**Taxonomy is currently focused on climate related topics, but should be completed by environmental objectives in the future.

Tracking down insufficient impact and ambition

Examples of projects connected with green and sustainable bond programs which have not received the green light from Mirova:



Technology

Lack of engagement, the funds allocated did not follow the original use of proceeds. Reports showed that proceeds were mostly allocated to non-significant environmental improvements.

Retail

Projects pertain mainly to operating expenditures and not capital expenditures, and are thus not in line with Mirova's methodology.

Energy

Low-carbon investments are met with far larger investments to expand its fossil fuel production, calling into question the credibility of a decarbonization strategy.

Real Estate

Banks consider Green Real Estate to be the top 15% in terms of energy efficiency in their respective local markets, which is not deemed as sufficient by Mirova.

Bank

The decarbonization corporate strategy is not coherent with greenbonds goals and could hinder any positive environmental impacts.

Food & Beverage

Financing cattle production while reducing beef consumption worldwide is a key lever to fight climate change as well as to limit biodiversity loss.

Finance Institution

Not considered green and social until more transparency and assurance is given around related environmental and social risks as migrants workers building the World Cup stadiums died.

Region

Underlined projects are green, but as regional government approved a coalmine exploitation in the region, overall actions towards protecting the environment are not considered serious.

Source: Mirova

Active engagement protects investments
from legal, regulatory and reputational risks

Over the past few years, the financial industry and companies have successfully incorporated sustainability issues. More than ever before, the decisions made by political leaders and company executives will ensure that ESG considerations and sustainable development become widespread. This trend brought in its wake various communication and marketing initiatives, including the display of ambitious targets, or the issuance of green or social debt instruments. Many companies claimed they had developed the most ambitious sustainability strategy in each of these sectors.

However, the good news - that ESG is becoming widespread - is somewhat clouded by the lack of transparency and integrity displayed by some issuers. Claiming to be "sustainable" is not enough. Hard evidence is needed. Today, the absence of standard sustainability disclosure reports and the lack of references that could be used to assess the pertinence of sustainability objectives can open the door to consumer mistrust and to growing concerns from public authorities.

Traditionally, the phrase "greenwashing" was used to depict private or public sector players seen to be communicating in an exaggerated or deceptive way on the environmental or societal benefits of their actions. Naturally, this trend has also been observed in the green bond market.

The novelty today is that "greenwashing" is no longer perceived simply as a risk for reputation or credibility. Public authorities – and regulators in particular - are starting to take a firm stance on the legal implications of this behaviour. In Europe, the Commission published its New Consumer Agenda[11] last autumn, a roadmap designed to protect the latter from any statements or so-called "green" initiatives that turn out to be deceitful or inflated. The objective of the Commission is to work with national governments in order to protect and strengthen consumer rights. For economic players, "greenwashing" has also become a legal and regulatory risk, with potential sanctions.

11. https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2069

The investment industry is not immune to this new trend. Recently, we have seen new initiatives from market authorities targeting asset management companies and challenging their ESG strategies[12]. The implications for the responsible investment industry are huge.

Today, it takes much more than "ESG talk" to be an investor committed to sustainable development. A truly responsible investor will naturally put forward an ambitious strategy - but this strategy also needs to be transparent and credible. In the green instrument space, this entails developing an assessment methodology dedicated to these securities, together with an ambitious engagement strategy able to support companies, and notably green bond issuers, throughout the lifecycle of the bond. This is a necessary condition to ensure investments are protected against reputational, legal and compliance risks.

Mirova's answer to the issue of "greenwashing" in the green bond market is to implement a reinforced engagement strategy that harnesses the firm's entire ESG research and fixed income management teams.

Extensive knowledge of the deals and the issuers, obtained through a constructive and quality dialogue is essential: if expectations are not met, the instruments concerned are deemed ineligible or sold if they are held in the portfolio.

In order to pre-empt any greenwashing risks, Mirova has drawn up a formal engagement strategy that covers the entire investment cycle of a green bond.

12. https://www.bloomberg.com/opinion/articles/2021-08-26/greenwashing-is-a-real-risk-but-investors-shouldn-t-stop-pursuing-esg-goals

A PRE-DEAL STAGE EMPHASISING COMMUNICATION AND AWARENESS-RAISING

Mirova's teams can be contacted by potential issuers of green bonds and the latter will be encouraged to invest in projects that can maximise environmental benefits. Mirova is also frequently called upon by banks' origination teams, to share views on the terms and criteria for the structuring of green bonds.

*Focus : SNCF**

On October 19th, 2021, SNCF successfully launched the world's first ever green short-term debt instruments under its Euro Commercial Paper (ECP) programme.

Totalling €50m, these three-month debt instruments are designed to finance sustainable investments made by SNCF Group under its Green Bond Framework. SNCF Group plans to use the funds from this new debt instrument to finance sustainable investments and operations contributing to its energy transition, including recycling, decontamination, power purchase agreements for renewable energies, and more.

This short-term green bond programme will help finance increased use of rail as an alternative to individual cars, still largely powered by fossil fuels.

Mirova partnered up with SNCF to ensure that this new financing programme met the demanding standards of a top-tier specialist investor and subscribed to this first ever deal.

The new programme meets best practices defined by SNCF, including (i) additionality, which guarantees that green funds raised are used exclusively for new, sustainable investments; (ii) the calculation of assets' environmental impact over their full lifecycle; and (iii) transparency and traceability, with extra-financial performance verified by an external auditor.

*The instrument referred to above is mentioned solely for indicative purposes and this does not constitute an offer to sell, a solicitation of an offer to buy, or a recommendation of any security.

Focus : Next Generation EU – Green Bonds

The European Union recently issued its first ever Green Bonds. As part of the process, Mirova's ESG research and fixed income management teams were given the opportunity to exchange views with representatives of the European Commission a few days before the bond was issued on the primary market.

This deal is historic as it marks the beginning of an ambitious programme due to raise €250 billion euros ($297 billion) over five years, thereby turning the EU into the world's largest green bond issuer.

Mirova welcomes the use of the EU's Green Taxonomy as a reference for assessing projects submitted by member States, and as a key criterion for the allocation of funds. In practice, a project submitted by a member State that is not aligned with the European taxonomy (displaying a 0% alignment ratio with the Green Taxonomy) will not be eligible for the EU's Green Bond programme.

In addition, while Mirova's teams expressed their needs in terms of impact reporting, the European Commission's representatives confirmed their intention to publish a transparent report accounting for the allocation of capital and the environmental benefits generated by the projects being funded.

Thanks to this engagement dialogue at the primary market stage, Mirova's fixed income and ESG research teams were able to complete their assessment of the programme, convey their expectations - as an investor - to the issuer, and confirm that the deal was eligible for inclusion in our investment universe.

EXHAUSTIVE ANALYSIS AT THE TIME OF ISSUANCE ON THE PRIMARY MARKET

As part of the assessment process applied to green bonds issued on the primary market, Mirova's analysts initiate a dialogue with the issuers. Their objectives are to gain a better understanding of the positive impact associated with the issuance, to measure risk exposure, and importantly, to analyse the mitigation mechanisms developed by the projects due to be financed.

They pay particular attention to the pre-determined selection criteria applied to green instruments according to their sector: their potential alignment or breach of the European green taxonomy, the methodologies used to assess environmental and social benefits that are disclosed on an annual basis, and the contribution and consistency of the projects being funded with the issuer's overall strategy.

THOROUGH POST-ISSUANCE MONITORING

This stage takes place once we have invested in the green bonds via our portfolios. If an issuance is associated with a controversy, our analysts will initiate an engagement dialogue with the issuer in order to understand both the scale and the impact of the event. They can then assess the corrective measures that have been implemented by the issuers. If our expectations as responsible investors are not met, we shall revise our view and the score assigned to the issuance will be downgraded; this will lead to divestments from our bond portfolios.

Every year, the research team conducts a review of the impact reports on issuers that tapped the primary market eighteen months beforehand. If they uncover issues relating to the methodology used for reporting environmental benefits and/or controversies around the projects being funded, the research team will be asked to launch an engagement initiative. If the issuer fails to meet expectations, the consequences are similar to those described above.

Focus on a Bank from an emerging country

An emerging country bank recently found itself at the centre of a controversy. The bank offered up what seemed to be a high- quality green bond programme, as it had been granted an environmental certification from the market's key players. However, the deal was called into question as the industrial project being financed was misaligned with the issues affecting the sector in which the issuer operates. It turned out that while the bank had placed a particular emphasis on renewable energy infrastructure through its green bond programme, it had also financed one of the world's largest mines.

It seems totally inconsistent for a same issuer to report on avoided emissions weighing 1.6 MT CO_2 p.a through its green bond programme, while also financing a project that can potentially generate over 30 MT of CO_2 p.a. This controversy has highlighted the vital importance of ensuring the green bond programmes are consistent with the global issues affecting a given issuer.

In keeping with its engagement strategy, Mirova initiated dialogues with this bank, emphasising the inconsistencies that lie between its green bond programme and its global strategy. Unfortunately, Mirova's teams considered the outcome of this engagement initiative to be unsatisfactory; consequently, the fixed income investment team chose to sell the position.

Mirova,
a pioneer in green bonds investing

Mirova has been a pioneer of investing in green and social bonds. Our fixed income strategies, which cover the eurozone and the world, place the selection of issuers at the heart of their investment process in order to generate both financial performance and environmental and social benefits.

We are convinced of the value of debt instruments dedicated to projects with an impact, and which offer traceability, transparency and reporting on the projects financed. Our experts have supported the development of the **green bond** market by actively participating in the main market institutions, as well as by internally developing a **stringent methodology for analysing** these instruments and creating one of the **first strategies dedicated** to green and social bonds.

We have built our **fixed income investment process** around our long-term convictions. Thus, the selection of issuers is based on **financial characteristics** as well as an **ESG rating** that analyses the contribution of the issuer or the projects financed to sustainable development issues.

This rigorous selection process, combined with our forecasts regarding the yield curve and the risk factors that can affect bond yields, allows us to generate value over the long term and contribute to a more sustainable economy.

Our dedicated team has 7 portfolio managers and credit analyst: they manage nearly 5 billion € as of September 30th 2021 and benefit from the support of an ESG analyst.

Marc Briand*
Head of fixed income
Senior portfolio manager

Charles Portier*
Head of credit research /
Portfolio manager

Agathe Foussard CFA**
Portfolio manager

Bertrand Rocher*
Head of credit research /
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Nelson Ribeirinho
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Lucie Vannoye CFA**
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Jean-René Meduri CFA**
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*Marc, Charles and Bertrand are "associated persons", which means that, as US portfolio managers, they must abide by the Mirova US Code of Ethics and strict ethical rules.
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