September 2022

Responsible Investment

Green, Social and Sustainability Bonds

An update on our assessment framework

Climate change is one of the most critical issues facing society – it brings damaging impacts for people, communities and the natural world as well as disrupting national economies. Immediate action is required if the most catastrophic effects are to be avoided.

But while climate change and environmental challenges pose a direct risk to businesses, they also represent an unprecedented opportunity to take action.

Green bonds have emerged as a unique asset class that can help tackle climate change by financing environmental solutions. Green bonds enable investors like AXA IM to purchase debt securities earmarked for projects which aim to support a low-carbon economy. These bonds can help finance a myriad of different initiatives, including renewable energy, pollution prevention, energy efficiency and biodiversity preservation, among many others.

Through the debt capital market, investors can also find opportunities to address broader sustainability challenges. Social bonds offer investment solutions where proceeds are directed to projects that seek a broader positive societal impact. Social considerations are at the core of economic development and merit as much attention as climate change – we see the two issues as interdependent. The social projects that lie behind issuance may target an array of objectives, such as social housing, microfinance, financing for small- and medium-sized enterprises, access to education, improvements in gender equality, support for employment in underserved regions and more. Sustainability bonds can fund both environmental and social projects and assets.

The green, social and sustainability bond (GSSB) market is constantly evolving, and AXA IM is seeking to take a leadership role in this field. Therefore, we regularly update the way we evaluate GSSBs. We set out our methodology below. We also explain how we map our GSSB investments to the United Nations Sustainable Development Goals (UN SDGs). This mapping allows us to measure our contribution to the SDGs through these investments.

The GSSB market's evolution

The green bond market has rapidly developed since its debut in 2007. Early issuance was driven by development banks and local authorities, and in 2013 private players such as commercial banks and other corporate entities delivered a transformative boost. In 2016, sovereign issuance appeared – a trend which has been steadily growing, and which we expect to continue.

The first social bond was issued by the International Finance Facility for Immunisation in 2006 (raising $1bn for a vaccine programme in Africa), but it wasn't until 2015 that the first social bond was issued according to what would become the International Capital Markets Association's (ICMA) Social Bond Principles. Since then, the social bond market has grown year after year, with a notable increase during the coronavirus crisis[1]. In 2012, the first transaction aimed at financing both environmental and social projects – in other words the first sustainability bond – came to the market. As with green and social bonds, the sustainability bond market has been consistently growing since its inception.

Virtually all types of issuers – sovereign, supranational and agency (known collectively as SSAs), financials and corporates – have now entered the green bond market. Since the sector launched in Europe, developing countries and especially China have injected new impetus. In 2020, global green bonds issuance reached $269.5bn, taking the total value of cumulative green bond issuance over $1 trillion[2].

When we look at the GSSB market as a whole, we also saw a strong rise in the amount of social and sustainability bonds in 2020. Social bond issuance reached $140bn, almost 10 times the level in 2019, while sustainability bond issuance reached $65bn[3].

That puts GSSB issuance in 2020 at close to $475bn. Forecasts for GSSB issuance in 2021 range between $550bn and $700bn[4].

That includes:
- $310 - $360bn of green bonds
- $180 - $240bn of social bonds
- $60 - $100bn of sustainability bonds

The market's development has been accompanied by improved governance thanks to ICMA's Green Bond Principles and through the work of international non-profit organisation, the Climate Bonds Initiative, which together have helped to monitor the market and make it more credible. ICMA has also published the Social Bond Principles and the Sustainability Bond Guidelines. These private initiatives provide issuers with advice on the key elements needed for launching true GSSBs and help investors gain insights into what is necessary to evaluate the environmental and societal impact of the investments. Importantly however, these guidelines are only voluntary, and do not impose any rules on issuers.

Presently many disparate green bond standards coexist across different regions of the world. But one of the key elements of the European Commission's (EC) Action Plan on Sustainable Finance is the establishment of a taxonomy for green and sustainable assets and activities. It is the basis for the introduction of a European green bond standard. The EC's Technical Expert Group on sustainable finance published preliminary proposals for such a standard. AXA IM provided feedback on the consultation around these proposals and we look forward to the implementation of a European Union (EU) green bond standard.

Size of green bond issuance over time ($bn)

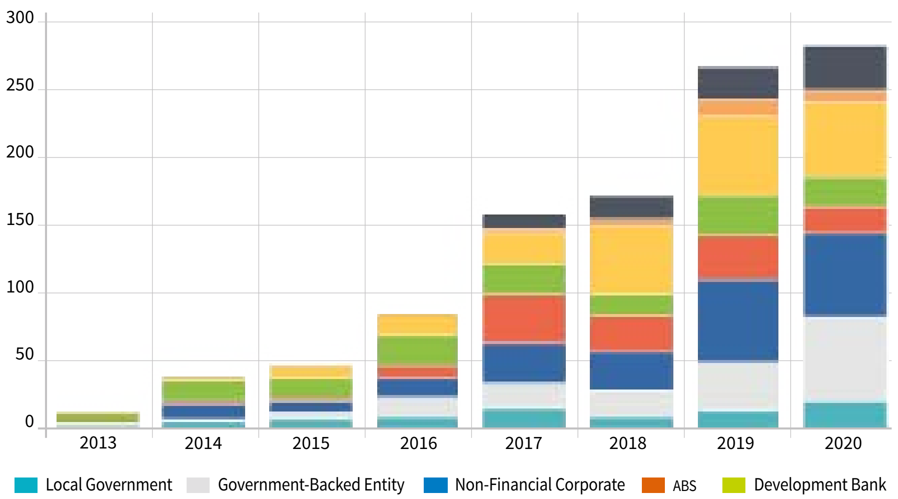


Figure 1: Source Climate Bonds Initiative, as of December 2020

[1] https://www.axa-im.com/content/-/asset_publisher/alpeXKk1gk2N/content/insight-covid-19-how-a-new-breed-of-bonds-can-help-finance-the-fight/23818
[2] Source: Climate Bonds Initiative
[3] Source: Natixis
[4] According to estimates from Crédit Agricole CIB, HSBC and Natixis

As there is no real consensus yet on what is a "true" green bond and what is not, AXA IM has developed a proprietary green bond assessment framework. We built on this to create new frameworks for social and sustainability bonds. These are very similar in terms of structure, but some aspects differ due to the specificities of social and sustainability bonds. This approach is stringent, but it is also continuously evolving and aims to fulfil three main objectives:

- Driving investments towards authentic and impactful green assets and social projects
- Raising the integrity and transparency standards of the GSSB market
- Ensuring that GSSB issuers are committed to fight climate change and to address sustainability challenges, and that this commitment is reflected in business practices and operations

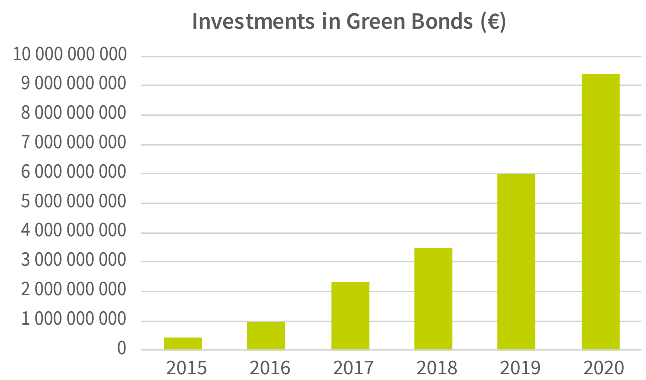
Selectivity is key in ensuring that only the most relevant and impactful green and social projects receive the necessary financing. These frameworks have so far been used to review more than 800 GSSBs, and we believe this has helped us to avoid possible misuse of funds, risks of unethical practices and greenwashing. Overall, since 2014, our green bond framework has led us to exclude around one in five bonds presented to us as green, social or sustainable.

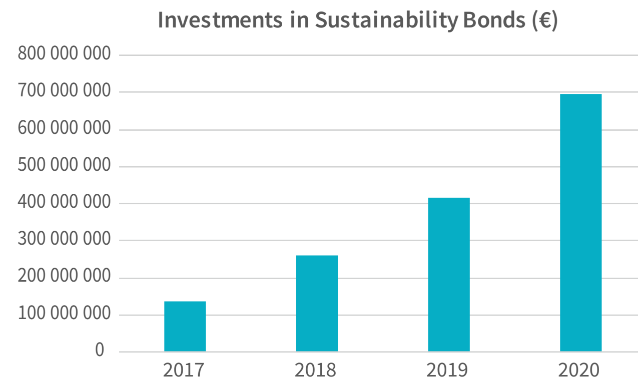
AXA IM's commitment to the green bond market

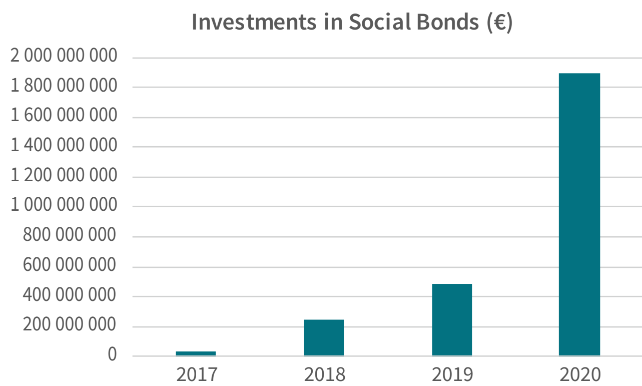
As part of our commitment to fight climate change and to contribute to the UN SDGs, AXA IM aims to be a leader in this field and seeks to play an important role in the growth and quality of the GSSB market. Since 2017, we have been a member of the executive committee of the Green and Social Bond Principles and participate actively in several working groups such as Green Projects Eligibility, Impact Reporting and Social Bonds.

AXA IM also became a Climate Bonds Partner in 2018. Through this collaboration, we benefit from broad research capabilities and expert insights into the issuers of green bonds and can easily work with our peers to share best practices, develop key learnings and drive collective progress on green and sustainable finance. We received the French GreenFin Label for our green bond funds in January 2017, guaranteeing transparency and quality of the environmental characteristics of these financial products. Our green bond funds also received the Belgian Towards Sustainability Quality Standard in 2019.

As of the end of January 2021, AXA IM has invested almost €10.3bn in green bonds, €2.2bn in social bonds and €1bn in sustainability bonds.







Our updated green bond framework, and our expectations for social and sustainability bonds

AXA IM's GSSB assessment framework is made up of four pillars:

1. **The environmental, social and governance (ESG) quality and strategy of the issuer**
2. **The use of proceeds and the process for project selection**
3. **The management of proceeds**
4. **Impact reporting**

For each pillar, our analysts review, assess and monitor several well-defined criteria, many of which are mandatory. At the very least, the issuer has to surpass our exclusion criteria and to comply with our "requirement" criteria in order to be investable. If a GSSB also meets our "expectation" criteria, it would place the issuer among the GSSB leaders, in our view. The factors outlined below are intended to be indicative and non-exhaustive. This is primarily due to the fact that individual GSSBs can vary greatly and therefore their individual assessment involves subjective criteria, as is always the case in qualitative analyses.

At AXA IM, we believe that the use of proceeds of a green bond should reflect the issuer's efforts towards improving its overall environmental strategy and its alignment with the Paris Agreement on climate change. On the social side, the issuer should also make its ambition to deliver positive societal outcomes clear. Full transparency about the projects financed and on the tracking of the proceeds is therefore essential to our assessment. We pay particular attention to impact reporting, where both qualitative and quantitative indicators are expected.

Pillar 1: ESG quality and strategy of the issuer

Our first pillar is the one that makes AXA IM's approach different from the Green Bond Principles. Within the Principles, it is not considered as a fully-fledged pillar. By considering both the ESG quality and strategy of the issuer, our assessment aims to avoid 'greenwashing' – what could be perceived as green bonds issued for public relations reasons.

The ESG quality is considered according to AXA IM's proprietary ESG scores as well as the issuer's exposure to controversies. We want to ensure that the issuer demonstrates minimum ESG commitments and properly manages environmental and social risks.

The environmental strategy refers to a forward-looking approach. The aim here is to evaluate whether the green bond fits into the issuer's environmental short- and long-term objectives. Green bond issuers should clearly exhibit a senior management and board-level commitment to align wider commercial strategy and activities with helping meet the COP21 Paris Agreement goals. We also expect green bond issuers to take action in order to align their business models with a global warming scenario below 2°C. An overall coherence between the environmental strategy and the green bond issuance is necessary.

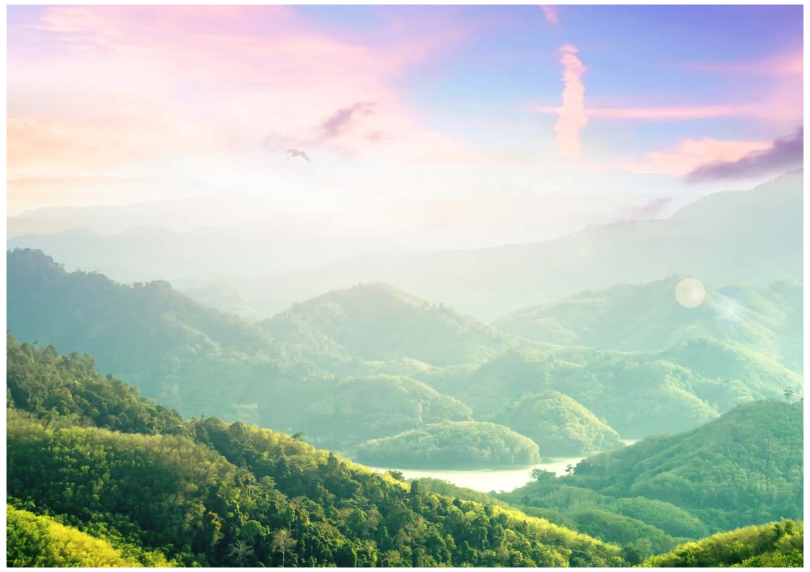
Requirement	Expectation	Exclusion criteria
▸ Clear definition of the issuer's environmental strategy and commitments ▸ Alignment of the green bond with its sustainability policies and processes	▸ Quantified short- and long-term environmental targets	▸ Weak ESG score ▸ Severe controversy

Pillar 1
for social bonds:

The assessment process for social bonds is similar, except for expectations. We want to ensure consistency between the social bond and the issuer's social strategy to avoid any opportunistic-only issuance that wouldn't lead to a lasting change. We also want to be assured the issuance is not only a public relation exercise.

Pillar 2: The use of proceeds and the process for project selection

Our second pillar focuses on how the proceeds of a green bond are used. It merges the first two pillars of the Green Bond Principles. Our aim here is to control the quality of the eligible projects by understanding the selection process and the eligibility criteria. More importantly, we focus on projects or assets delivering additionality and impact. Our process rewards projects that are innovative, impactful and going beyond the issuer's "business as usual". AXA IM's green taxonomy is based on technical criteria from the EU Taxonomy and the Climate Bonds Initiative to ensure alignment with the Greenfin Label requirements.



Requirement	Expectation	Exclusion criteria
▸ Clear description of the eligible assets and the category they belong to ▸ Compliance with AXA IM's taxonomy ▸ Disclosure of the eligibility criteria for each category of eligible projects ▸ (At least) indicative or expected breakdown of the proceeds allocation to the eligible projects ▸ Disclosure of the process used to select and evaluate the eligible projects	▸ Description of how environmental and social risks and potential rebound effects related to the eligible projects are taken into consideration ▸ Estimated share of financing new assets versus refinancing existing assets, plus look-back period for existing assets ▸ Establish a qualified and diversified internal committee to select green projects ▸ Description of how eligible projects bring additionality (e.g. through financial incentives applied to green assets)	▸ Any project related to fossil fuel or nuclear energy production, regardless of where it stands in the value chain ▸ Large new hydropower projects

Pillar 2
for social bonds:

There are no specific exclusion criteria for our social bonds investments up to now. On the breakdown of the proceeds per project, we can be more flexible as our experience shows issuers are often not in a position to give any indicative split before the first anniversary of the social bond issuance.

The additionality aspect is key but poorly reported in the social bond market. While this is not a requirement, issuers who can justify the additionality of their social projects are viewed more favourably.

We nevertheless expect social bond issuers to apply relevant and robust criteria to define the target populations and areas that they aim to support through funded projects. This is very important to ensure that we will finance impactful social projects.

Pillar 3: The management of proceeds

Our third pillar, similarly to the third of the Green Bond Principles, relates to the management of proceeds. It aims to verify that the issuer has sufficient guarantees in place to control the allocation of proceeds to eligible projects. We are looking to ensure that the green bond proceeds will effectively finance eligible projects.

Requirement	Expectation
▸ Description and transparency of the internal process used to track the proceeds	▸ External/independent verification of the proceeds allocation ▸ Segregation of the green bond proceeds in a separated account or portfolio

Pillar 3
for social bonds:

The assessment process for social bonds is the same.

Pillar 4: Impact reporting

Our fourth pillar, also similar to the Green Bond Principles, focuses on reporting. While the principles only encourage issuers to provide impact indicators, it is a mandatory criterion within our assessment process. It allows us to measure our positive impact and the environmental benefits of our green bond investments.

Requirement	Expectation	Exclusion criteria
▸ Allocation report to eligible categories, and balance of unallocated proceeds ▸ Provide relevant qualitative and quantitative key performance indicators (KPIs), at least for each eligible category ▸ Disclose details on the methodology, assumptions and baselines used to calculate the impact	▸ Rely on an independent third party in the calculation of the environmental impact ▸ Provide KPIs on a line by line basis	▸ No publication of an impact report

Pillar 4
for social bonds:

The assessment process for social bonds is similar. We are particularly sensitive to the quality and clarity of impact reporting, which we know is more challenging in the social bond market.

As impact reporting in the green bond market matures and improves, we are also encouraging green bond issuers to enrich their impact reporting with social KPIs when doable (e.g. when green projects have a positive social impact on surrounding communities).

Of note, we can downgrade our opinion if we notice a breach in comparison to what was announced at the time of issuance.

Mapping our GSSB investments with the SDGs

At AXA IM, we pay particular attention to the way our investments can help us contribute to the UN SDGs. The high level of transparency that we expect from the GSSBs we invest in allows us to know what type of green and social activities we fund.

Again, there is no consensus yet on the way to approach the SDGs in the GSSB market. We therefore decided to build our own methodology and to map the SDGs against our GSSB taxonomy. By doing this, we made a split between the green and social activities that directly contribute to some of the SDGs, and those that only align with it.

Environmental Projects / SDGs	1 No Poverty	2 Zero Hunger	3 Good Health and Well-Being	6 Clean Water and Sanitation	7 Affordable and Clean Energy	8 Decent Work and Economic Growth	9 Industry, Innovation and Infrastructure	11 Sustainable Cities and Communities	12 Responsible Consumption and Production	13 Climate Action	14 Life Below Water	15 Life on Land
Renewable Energies			✓ Alignment		✓ Direct Impact	✓ Direct Impact	✓ Alignment	✓ Alignment		✓ Alignment		
Energy Efficiency					✓ Direct Impact	✓ Direct Impact	✓ Direct Impact	✓ Alignment		✓ Alignment		
Green Buildings								✓ Direct Impact		✓ Alignment		
Low-Carbon Transportation			✓ Alignment				✓ Alignment	✓ Direct Impact		✓ Alignment		
Water Management				✓ Direct Impact				✓ Alignment	✓ Direct Impact		✓ Direct Impact	✓ Alignment
Waste Management				✓ Alignment		✓ Alignment		✓ Direct Impact	✓ Direct Impact		✓ Alignment	
Sustainable Land Use			✓ Alignment						✓ Direct Impact		✓ Alignment	✓ Direct Impact
Adaptation Infrastructure	✓ Alignment	✓ Direct Impact					✓ Direct Impact	✓ Alignment		✓ Direct Impact		
Biodiversity Conservation		✓ Alignment		✓ Direct Impact							✓ Direct Impact	✓ Direct Impact

✓ Direct Impact ✓ Alignment Source: AXA IM and United Nations

Social Projects / SDGs	1 No Poverty	2 Zero Hunger	3 Good Health and Well-Being	4 Quality Education	5 Gender Equality	6 Clean Water and Sanitation	7 Affordable and Clean Energy	8 Decent Work and Economic Growth	9 Industry, Innovation and Infrastructure	10 Reduced Inequalities	11 Sustainable Cities and Communities
Affordable Basic Infrastructure						✓ Direct Impact			✓ Direct Impact		✓ Alignment
Access to Financial Services	✓ Direct Impact							✓ Alignment		✓ Alignment	
Access to Education	✓ Alignment			✓ Direct Impact				✓ Direct Impact		✓ Alignment	
Access to Energy	✓ Alignment						✓ Direct Impact			✓ Alignment	
Access to Healthcare	✓ Alignment		✓ Direct Impact							✓ Alignment	
Access to Telecommunications	✓ Alignment								✓ Direct Impact	✓ Alignment	
Affordable Housing	✓ Alignment									✓ Alignment	✓ Direct Impact
Microfinance	✓ Direct Impact										
SMEs Financing								✓ Direct Impact	✓ Alignment		
Food Security/ Sustainable Farming		✓ Direct Impact									
Socioeconomic Empowerment	✓ Direct Impact									✓ Direct Impact	
Women Empowerment					✓ Direct Impact					✓ Direct Impact	

Employment Generation

✓ Direct Impact ✓ Alignment Source: AXA IM and United Nations

With this mapping, we aim to measure our contribution to the SDGs through our GSSB investments. We also pay great attention to doing "no harm" to some SDGs while helping achieve others.

To ensure that, we rely on the two first pillars of our assessment framework – the ESG quality and sustainability strategy of the issuer, and the use of proceeds and process for project selection.

Looking forward: Our vision for the GSSB market

Forecasts for green bond issuance in 2021 range from $310bn to $360bn. This would represent substantial growth of the green bond market, which we welcome. However, it pales in comparison to the estimated $6.9trn investments needed per year in infrastructure to help limit the rise in global temperatures within 2°C above pre-industrial levels as envisaged under the Paris Agreement[5]. Still, this situation leaves the door open to great innovation across the green bond universe.

If quantity matters and is critical to meet the Paris Agreement goals, the growth of the green bond market should not take place at the expense of its quality. AXA IM's green bond assessment framework is built to ensure that our expectations for green bond issuers are met. Our analysts aim to select green bonds that are in line with our clients' ambitious environmental strategies. AXA IM's call for transition bonds reflects our view that the green bond market should keep its standards in terms of quality and integrity.

Since then, we have seen positive developments on this topic. We co-chaired ICMA's Climate Transition Finance working group, which published the Climate Transition Finance Handbook in December 2020. We have seen several transition bond issuances – in our view these transactions will be needed to help issuers to align their business models with the objectives of the Paris Agreement. We also welcome the development of sustainability-linked bonds[6], which are innovative tools to finance the transition to a more sustainable economy. As these products are different from GSSBs, one of our key objectives for 2021 is to build and publish a dedicated assessment framework for transition and sustainability-linked bonds.

We are also looking forward to the continuing growth of the social bond market. With the EU coming to the market to finance its €100bn SURE (Support to mitigate Unemployment Risks in an Emergency) programme through social bonds by end-2021, the importance of the social bond market is poised to grow, and its weighting will likely be revised upward. At AXA IM, we are committed to playing our part and to being a leading voice in the development of this asset class.

To help the GSSB market grow both in terms of quality and quantity, our analysts continuously engage with issuers. We meet them before issuance to discuss their framework, share our expectations and make clear what we consider to be good practice. This enables to set out our quality standards for green, social or sustainability bonds.

In addition, we monitor the GSSB market and perform ongoing dialogue with issuers after issuance. The aim here is to help them improve their GSSB offering. We therefore focus on GSSB issuers which did not fully meet our expectations initially. Through this comprehensive process we try to promote the integrity and quality of the market in the near future, which we hope will pave the way for even greater issuance, more take-up by investors, and ultimately a beneficial impact on people and planet.

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5 OECD (2017), Investing in Climate, Investing in Growth, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264273528-en

6 See more here: https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Sustainability-Linked-Bond-Principles-June-2020-171120.pdf

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