

PGGM Fixed Income

Green and social bond framework

December 2017



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1. Introduction

Dedicated use-of-proceeds bonds are a maturing market

On behalf of its clients, PGGM Investment Management (IM) invests in fixed income products. Internally, the Fixed Income department invests in rates products (government and SSA bonds), investment-grade credits and emerging market credits.

This framework specifies the guidelines along which PGGM Fixed Income analyses dedicated use-of-proceeds bonds. These bonds are regular bonds of which the proceeds are dedicated to specified projects. Dedicated use-of-proceeds bonds are typically split into green bonds and social bonds. Sometimes sustainability bonds are issued, which are an intentional mix of green and social bonds. The green bond market took off in 2007 after the European Council agreed that in 2020 the share of renewables in the overall EU energy consumption should equal at least 20%. Quickly thereafter the European Investment Bank was the first to issue its inaugural Climate Awareness Bond. Since 2014, when ICMA issued their Green Bond Principles (GBP), the market seriously started growing and maturing. Green bonds are issued both by corporates, financials, agencies and (supra)national/regional governments. In 2017 green bond issuance for the first time topped \$100 billion, growing significantly year after year. The social and sustainability segment has grown to over \$30 billion over the past four years, and it has gained momentum in 2017 after ICMA published the initial Social Bond Principles (SBP). Both for green bonds and social bonds new issuers are entering the markets and issuance is expected to grow further significantly in 2018 and beyond.

Specifically, this framework lays down the criteria along which we classify a bond as either green or social, or as a regular bond (sometimes referred to as a 'grey' or 'brown' bond). The scope of this framework covers our internal investments in fixed income made by PGGM's Fixed Income team.

With the introduction of this framework PGGM aims to improve transparency and governance in the market. PGGM follows relevant developments closely and will update this framework when necessary. The current version is an update to the initial framework which was adopted in October 2016. It will be effective as of January 2018.

This policy does not confer any rights to any third parties.

2. Vision on green and social bonds

Our definitions of green and social bonds are in line with ICMA

PGGM Investment Management is a member of the GBP of ICMA. We therefore seek to align our Green and Social Bond framework according to best practices as defined by ICMA's GBP and SBP. ICMA defines a green and social bond as follows. 'Green (or Social) Bonds are any type of bond instruments where the proceeds will be exclusively applied to finance or re-finance in part or in full new and/or existing eligible Green (or Social) Projects and which are aligned with the four core components of the GBP (or SBP).' The issuer itself should determine, based on the primary objectives of the underlying projects, whether a dedicated use-of-proceeds bond is classified as a green, social or sustainability bond. Finally, social projects, underlying a social bond, seek to achieve positive social outcomes especially, but not exclusively, for a target population(s).

We believe sustainable investments have an impact

Although there has been enormous growth in prosperity over the past century, stability and economic development are increasingly threatened by global issues. These include climate change, the scarcity of natural resources such as water and minerals, rising food prices and income inequality. This will impact future investment results. Sustainability and viability are therefore key to our activities over the long term.

To safeguard this, PGGM has developed three beliefs for Responsible Investment:

1. Responsible investment pays off: PGGM firmly believes that sustainability factors materially influence the risk-return profile of the investments and that this influence will steadily increase in the future.
2. No good and stable return in the long term without sustainable development: PGGM firmly believes that sustainable development is necessary in order to generate good and stable investment returns for our clients in the long term.
3. The driving force of capital: PGGM firmly believes that by leveraging the driving force of investments for our clients it can and must make a positive contribution to sustainable development through its investment decisions.

At PGGM Fixed Income we believe that green and social bonds shouldn't deviate significantly from regular bonds regarding return and risk (to which they are *pari passu*). A green or social bond should be priced in line with the existing yield curve of regular bonds for a particular issuer in order to make the instrument suitable for most asset managers, including PGGM.

Together with our clients, we identified areas of focus in which we can have an impact. This way we can give substance to the focused contribution that PGGM as asset manager wants to make to a sustainable world. These are areas of focus that our clients

and their participants consider important and developments within these themes that we believe will have a material impact on the investments for our clients. These four identified investable focus areas are Climate and environment, Water, Food and Health.

Green (or social) bonds aren't green (or social) because an issuer says they are. Neither are regular bonds per se 'grey' or 'brown' because an issuer has not explicitly stated they are issuing a green or social bond. PGGM Fixed Income believes that we are obliged to make our own and careful analysis. Firstly whether a bond is a sound investment and second whether we label that specific issue as a green or social bond. The framework for the latter is described in the next chapter.

3. Framework

We follow the Green and Social Bond Principles

Our Green and Social Bond analysis framework is setup along the four lines of ICMA's GBP and SBP, namely 'Use of Proceeds', 'Project Evaluation', 'Management of Proceeds' and 'Reporting'. Next to the adherence to the principles, the issuer itself is assessed. In order for a bond to qualify at PGGM Fixed Income as a green or social bond the following conditions have to be met.

An issuer's ESG policy is important

In order to address potential 'greenwashing', next to adherence to the ICMA principles of a specific bond issue, PGGM Fixed Income believes that the issuing entity itself should be assessed.

- The ESG policy of the issuer should be in line with the objectives of the specific bond. A less ESG friendly issuer can still have a policy working towards a more sustainable future. In fact, the biggest ESG improvements can be made particularly by these companies. Therefore the ESG policy of the issuer should be deemed to be clearly heading towards a more sustainable future. If this is not obvious from documents and conversations we can rely on the scoring of external providers:
 - The Environmental score of the issuer, rated by Sustainalytics, should then be 'average performer' or better (when unavailable at Sustainalytics a 6 or better E-score by MSCI) when issuing a green bond
 - The Social score of the issuer, rated by Sustainalytics, should then be 'average performer' or better (when unavailable at Sustainalytics a 6 or better S-score by MSCI) when issuing a social bond

Proceeds of a bond should impact our focus areas

The environmental or social impact of the investment should be tangible. Eligible categories have to be defined and should address the following concerns. These are PGGM's identified areas of focus in which we can have an impact (all seven focus areas can be found in the appendix).

1. Climate change
 - a. Low-carbon energy generation, usage and storage
 - b. Low-carbon transport
 - c. Reducing waste and pollution
 2. Water shortage (quantity, quality and access to water)
 3. Food security and sustainable food production
 4. Access to good healthcare
- Proceeds should be allocated significantly to the above eligible categories. For a green or social bond to receive PGGM's BiO ("Beleggen in Oplossingen") label, in principle at least 75% of proceeds will have to be allocated to the four themes. PGGM's BiO taskforce will eventually decide whether an investment qualifies as a BiO investment.
 - Pure play bonds are allowed (these are general proceeds bonds issued by fundamentally environment- or social-friendly companies but not labelled explicitly as green or social bonds) and by their definition do not specifically have to address the four ICMA principles but should be very transparent in their operations. PGGM does not label these bonds green or social but a BiO investment.

Projects should be selected according to a clear process

- The issuer has to have a clear and transparent process for determining the eligibility of projects using the proceeds from the Green or Social Bond
 - Criteria for including projects
 - Environmental or social objectives
- Second party guidance and assurance is obliged (either a review, certification, rating or audit)

Transparency in tracking proceeds

- Proceeds of green and social bonds should be credited to a sub-account or portfolio or otherwise tracked by the issuer in an appropriate manner
- The issuer should be transparent on the balance and investment instruments of the unallocated proceeds
- It is encouraged that an issuer's management of proceeds be supplemented by the use of an auditor, or other third party, to verify the internal tracking method and the allocation of funds from the bond proceeds

The issuer should inform periodically on progress towards goals

- The issuer should at least annually report on projects financed with proceeds, including the amounts per project
- An estimate of environmental or social impact is highly encouraged, including transparency on the underlying assumptions and methodologies

4. Implementation

Not different from other bonds, adherence to guidelines

Green and social (dedicated use-of-proceeds) bonds are *pari passu* with general proceeds bonds of an issuer. These green and social bonds are therefore bought in the regular government bond or corporate bond portfolios. Green and social bonds are reviewed and compared to regular bonds with a comparable seniority in the debt structure of the issuer. Consequently the bonds are analysed considering regular risk versus return criteria. The bonds should exhibit the same criteria that the other investments in the mandates have to adhere to (the mandate guidelines). The issue itself and the impact on the current portfolio when investing are assessed as usual for every fixed income investment.

The 'green- or socialness' is continuously challenged

Only after a decision has been made to invest in a bond, based on the above criteria, follows the labelling as a green or social bond. The investment manager proposes, based on this document's framework, to label (or not) the investment in the bond as green or social. Consequently this proposal is challenged within the investment team and later through a monthly meeting with experts on green and social bonds from PGGM's Emerging Markets Credits team, Investment Grade Credits team, Rates team and Responsible Investment department. PGGM's Responsible Investment department has concluded that all bond investments labelled green or social according to this framework, with at least 75% of the proceeds spent on the four BiO areas, belong in principle to its "Beleggen in Oplossingen" process. All green and social bond deals are stored in a database in which the pricing, characteristics and adherence to this framework are written down.

5. Annex

On which areas do we focus our responsible investments?

PGGM has identified, together with its clients, focus areas in which it can have an impact. These are (1) Climate and environment, (2) Water, (3) Health, (4) Food, (5) Sustainable financial system, (6) Corporate governance and (7) Human rights. The first four focus areas are deemed to be the investable focus areas.

Investments in green bonds can help make an impact particularly in the Climate and Water categories. ICMA, in its GBP, has provided a broad (but not exhaustive) overview of categories for which the proceeds of green bonds might be used:

- Renewable energy (including production, transmission, appliances and products)
- Energy efficiency (such as in new and refurbished buildings, energy storage, district heating, smart grids, appliances and products)
- Pollution prevention and control (including waste water treatment, greenhouse gas control, soil remediation, recycling and waste to energy, value added products from waste and remanufacturing, and associated environmental monitoring)
- Environmentally sustainable management of living natural resources and land use (including environmentally sustainable agriculture; environmentally sustainable animal husbandry; climate smart farm inputs such as biological crop protection or drip irrigation; environmentally sustainable fishery and aquaculture; environmentally-sustainable forestry, including afforestation or reforestation, and preservation or restoration of natural landscapes)
- Terrestrial and aquatic biodiversity conservation, (including the protection of coastal, marine and watershed environments)
- Clean transportation (such as electric, hybrid, public, rail, nonmotorized, multi-modal transportation, infrastructure for clean energy vehicles and reduction of harmful emissions);
- Sustainable water management (including sustainable infrastructure for clean and/or drinking water, sustainable urban drainage systems and river training and other forms of flooding mitigation)
- Climate change adaptation (including information support systems, such as climate observation and early warning systems)
- Eco-efficient and/or circular economy adapted products, production technologies and processes (such as development and introduction of environmentally friendlier products, with an eco-label or environmental certification, resource-efficient packaging and distribution)
- Green buildings which meet regional, national or internationally recognized standards or certifications

Investments in social bonds can help make an impact particularly

in the Health and Food categories. ICMA, in its SBP, has provided a broad (but not exhaustive) overview of categories for which the proceeds of social bonds might be used:

- Affordable basic infrastructure (e.g. clean drinking water, sewers, sanitation, transport)
- Access to essential services (e.g. health, education and vocational training, healthcare, financing and financial services)
- Affordable housing
- Employment generation including through the potential effect of SME financing and microfinance
- Food security
- Socioeconomic advancement and empowerment

Examples of target populations include, but are not limited to, those that are:

1. Living below the poverty line
2. Excluded and/or marginalised populations and /or communities
3. Vulnerable groups, including as a result of natural disasters
4. People with disabilities
5. Migrants and /or displaced persons
6. Undereducated
7. Underserved
8. Unemployed

Not all of the above categories for social bonds automatically belong to PGGM's focus areas. E.g. affordable housing is an often used objective for social bonds, but does not fit in the focus areas PGGM has defined.

In the case of either ambiguity or potential new categorization, PGGM's Responsible Investment department is consulted by the investment teams whether the proceeds of such a green, social or sustainability bond actually contribute significantly to the identified focus areas.

For more information on PGGM's Green and Social Bond framework please contact our Fixed Income team (rates@pggm.nl, BetaIGCredit@pggm.nl, emc@pggm.nl) or visit our website www.pggm.com

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