

GSS UPDATE FOCUS ON TRANSITION

October 2024

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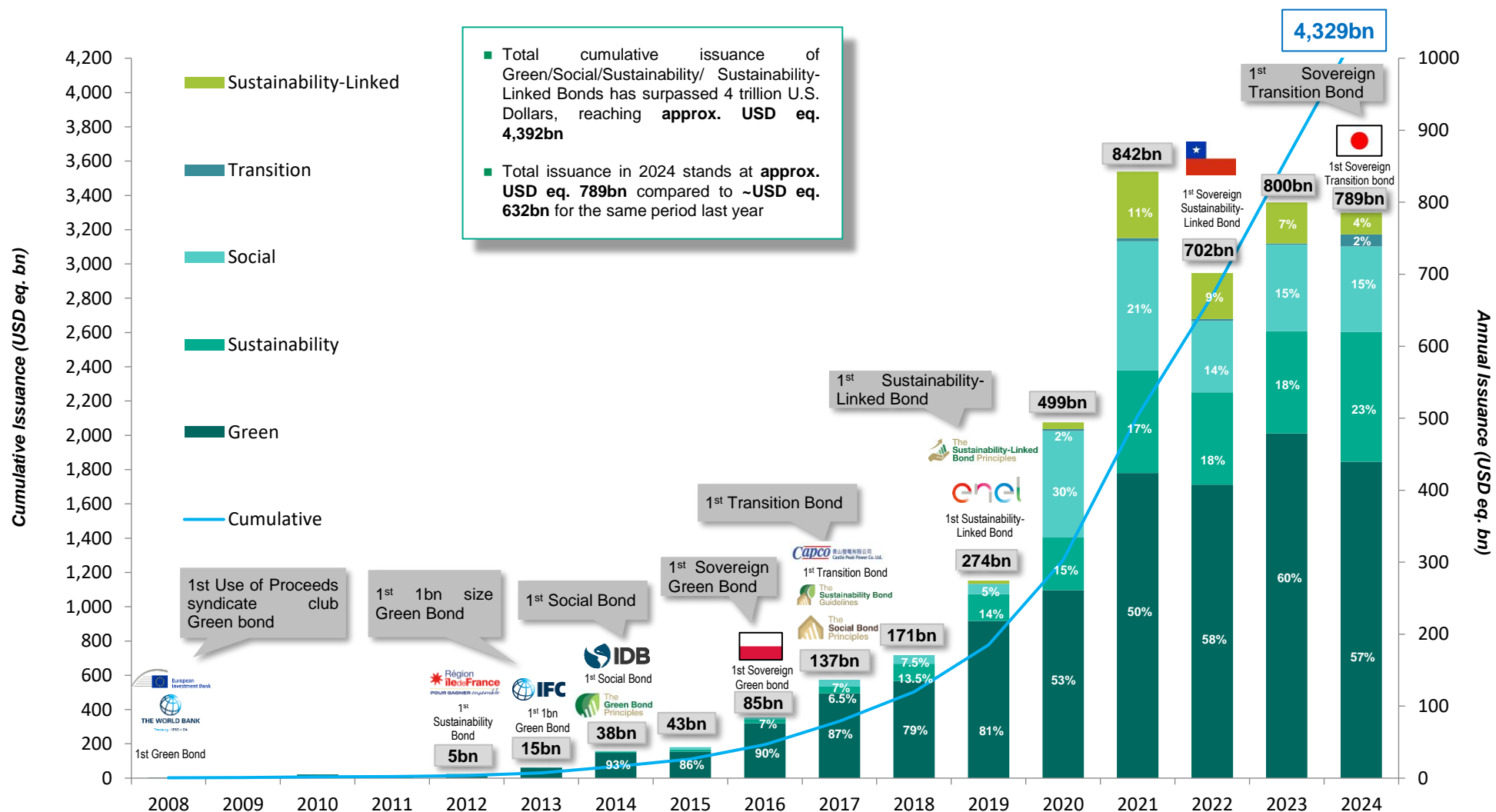


BNP PARIBAS

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Sustainable Bond market at a glance

As of end of Q3 2024, 16.4% of EMEA bonds issued were in ESG format, and 10.8% globally



Source: Bloomberg, BNP Paribas, as of 4th October 2024

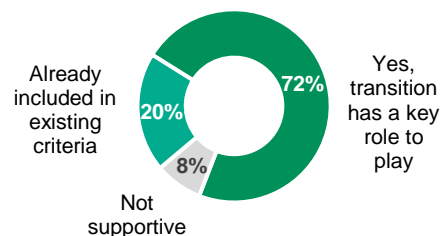
ESG Strategy | Focus on Transition

Investor mindsets are evolving and there appears to be more openness to allocate capital to sectors / companies that were previously less in focus

The rise of transition

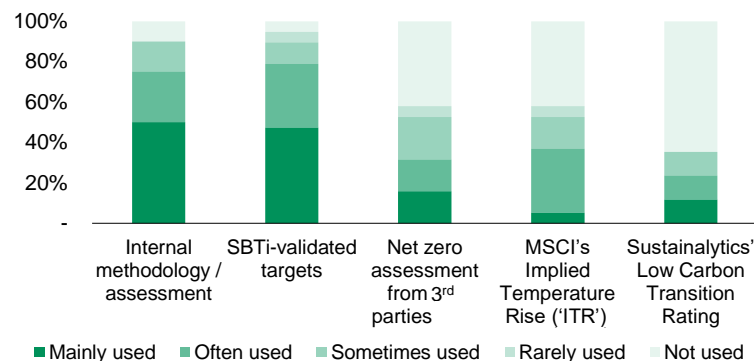
- The shift in perspective is driven by: (i) in order to meet the Paris targets, some of the more challenging / harder to abate sectors need to be supported and (ii) the fact that a lot of progress has been made with the “lower hanging fruit” (e.g. utilities sector)
- This approach also allows investors to demonstrate more tangible positive impact in their investment portfolios
- We know many of the more sophisticated ESG investors are currently incorporating transition assessments within their models
- A smaller proportion of investors are still not supportive of adjusting their approach given the potential greenwashing concerns

“Are investors more open to include transition within ESG strategies?”



Defining transition

“How is credibility of transition pathways assessed?”

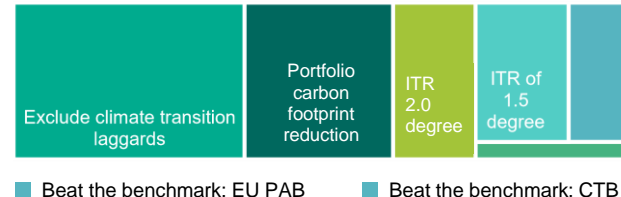


- Defining transition, however, is challenging and investors are working on both:
 1. **defining what is a credible transition path / plan** which clearly varies depending on sector, region and individual business models
 2. **defining transition activities** for direct transition financing / inclusion in labelled transition bonds
- Regarding #1, investors have been working on this for some time, most commonly defining transition internally, but also using 3rd party provider information as a way to verify or sense check their own assessment
- Regarding #2, investors are assessing what products are suitable for transition activities and we know **some investors' transition products sit outside of their Art. 8 & 9 funds**

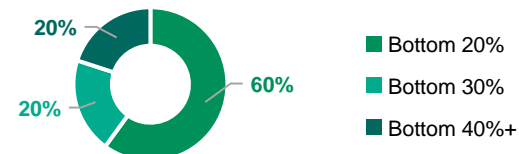
Integrating transition in fund criteria

- Once credibility of transition pathways or ESG credentials are assessed, investors then tend to define certain issuers as leaders and laggards, the latter of which are often excluded from ESG funds / strategies. When asked how investors define laggards, **60% said that they define a laggard as the bottom 20% in each industry**
- As well as excluding ESG laggards (which majority of investors employ as a criteria), other common criteria for transition funds include: **Portfolio emissions reduction & aligning to a specific temperature scenario**

“What are the most used criteria for transition strategies / funds?”



“How do you define transition laggard?”



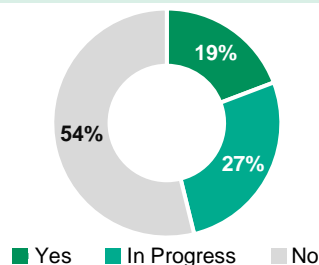
ESG Labelled Issuance | Transition bonds

In order to facilitate investing in the transition, the market is working to define activities that should be eligible for transition bonds

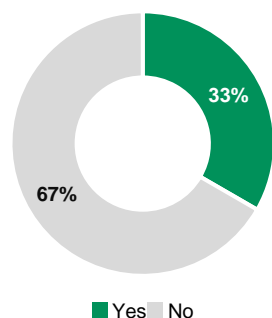
Defining transition activities

- ICMA are contributing to this through their transition workstream. The LMA are defining a list of eligible activities for their loan transition label. Some countries are implementing Transition Taxonomies (Australia, Canada, Singapore, Japan etc.)
- Some investors are beginning to draft their own transition activity frameworks that they can reference as the market evolves. In our survey, **19% of investors said they already have such a dedicated framework while 27% said that they were in the process of developing one**

“Do you have a dedicated framework for assessing transition bonds?”



“Would transitions qualify as a sustainable investment?”



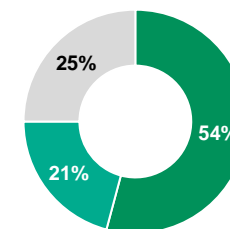
- One important consideration is defining DNSH (“Do No Significant Harm”) and mitigating greenwashing. Whilst there are standards emerging on how to define this (e.g. PAB/CTB exclusions, SRI labels) investors view on what is acceptable for certain labels / funds will vary. In this respect, **only 33% of investors surveyed said that a transition bond would, in their view, qualify as a sustainable investment**
- This further supports the call for increased transparency on transition strategy and reporting at both asset and company level and will ensure investors get the comfort they need to invest

Which sectors are more likely to be more eligible...

... for ‘transition’ vs ‘green’?

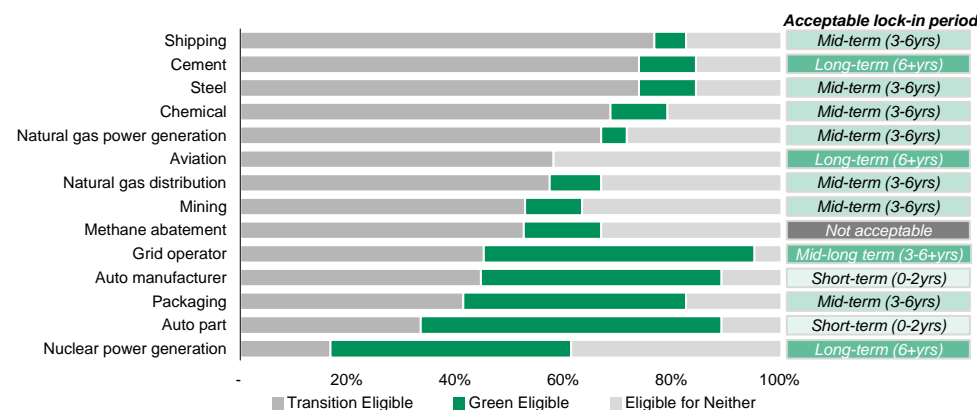
- The eligibility of different activities and sectors for “transition” varies from investor to investor. In fact, only 25% of the investors asked stated that their transition strategies are focused on hard to abate sectors, with most investors (54%) seeing transition as more general (transcending sectors and geographies) and 21% focusing their strategies on emerging markets

- Transition strategy applied broadly
- EM focused transition strategy
- “Hard to abate” focused transition strategy



“Which sectors would you consider as transition eligible?”

- Investors view the most transition eligible sectors as shipping, cement, steel, chemicals, natural gas and aviation
- Opinions also differ on what is an acceptable timeframe to ‘lock in’ ⁽¹⁾ transition assets. Sectors where investors are more tolerant of locking in transition assets longer term (6yrs+) include nuclear, aviation, grid operators and cement



⁽¹⁾“lock-in” typically refers to when high-emitting infrastructure or assets continue to be used, despite the possibility of substitution with low-carbon alternatives



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| 5