Insight INVESTMENT

INVESTING FOR IMPACT
MAKING THE MOST OF IMPACT BONDS

THE RISE, OPPORTUNITY AND ASSOCIATED RISK FOR INVESTORS

DECEMBER 2023

BNY MELLON | INVESTMENT MANAGEMENT

EXECUTIVE SUMMARY

- **Over the first nine months of 2023, $698bn[1] of impact bonds were issued**
  - Ten years on since the first corporate impact bond in 2013, the rise of impact bonds marks an important development for fixed income investors. Sovereign and supranational impact bond issuance has continued to rise, with the UK and European Commission issuing their first green bonds in 2021.

- **Investor demand and global needs continue to bolster impact issuance. While the COVID-19 pandemic caused social bond issuance to soar further than ever before the focus of the market has remained with green bonds due to high expenditure required to mitigate climate change.**

- **Against this backdrop of expanding issuance, and a lack of regulation, 'impact washing' has become an unfortunate reality.**
  - The impact-washing phenomenon refers to issuers labelling their bonds as impactful in nature, with little intention of using the proceeds toward any demonstratable impact. Out of a total of 1,235 impact bonds we have rated from end 2017 to end of September 2023, it has been concerning to see that 21% have not met our requirements to be classified as a genuine impact bond[2].

- **Positive environmental and social impact, and sustainable outcomes in fixed income, can be achieved in three ways, in our view: use-of-proceeds/impact bonds; investing in companies that generate revenue from sustainable activities; and investing in companies with capital expenditure in sustainable activities. We define impact issuers as issuers whose business activity is expected to contribute or lead to positive ESG impacts, while improving issuers are those with core investment plans that are compliant to a specified degree (depending on the specific investment mandate) with the EU Taxonomy Regulation.**

- **We welcome the introduction of high-quality green bond standards by the EU that develop the guidance set by the International Capital Market Association (ICMA) Green Bond Principles.**
  - **The adoption of the new EU Green Bond Standard provides a best-practice benchmark for disclosure and ongoing reporting. However, the threshold requiring 85% of proceeds to be aligned with the EU taxonomy is a high bar for issuers and risks the standards remaining European in focus, leading to increasing divergence in standards across geographies, rather than helping to drive improvements in international standards over time.**
  - **In addition, if too onerous, a risk remains that the standards may suffer from a lack of widespread adoption even within Europe.**
  - **The other risk is poor uptake of the standards even within Europe until more formal frameworks are enforced, it is vital for investors to carry out appropriate due diligence to avoid falling victim to impact washing. Likewise, the voluntary nature of the EU Green Bond Standard framework means we think it is vital for investors to carry out appropriate due diligence to avoid falling victim to impact washing.**

[1] Source: Bloomberg and Barclays as at 30 September 2023. [2] As at 30 September 2023.

WHY IMPACT AND WHY NOW?

THE WORLD WE LIVE IN IS CHANGING AT A RAPID RATE AND IT IS INFLUENCING HOW AND WHY WE INVEST. INCREASINGLY, MEGA-TRENDS SUCH AS THE EFFECTS OF CLIMATE CHANGE AND RISING SOCIAL INEQUALITY PRESENT SOME OF BOTH THE BIGGEST RISK FACTORS AND OPPORTUNITIES TO DELIVER IMPACT.

Finding ways to measure and analyse these risks are essential to ongoing financial success in portfolios. Yet, so pervasive are these trends that they are also causing an evaluation of whether 'financial success' should be the only metric on which investment portfolios are judged. Articulating a 'purpose' is becoming an essential part of the modern world and as such it is necessary for investors to think about the outcomes they wish to achieve beyond purely financial ones. For many investors, this will involve expressing their values in portfolios as both a way of reducing risk but also ensuring a broader positive societal and/or environmental impact.

Impact bonds allow investors to have access to clear impact key performance indicators (KPIs) such as the annual greenhouse gas emissions avoided or the new renewable energy generated annually.

By pulling this data from an issuer's impact reporting we can therefore measure the impact generated for strategies focusing on impact bonds.

INTRODUCING INSIGHT'S IMPACT-FOCUSED RESPONSIBLE HORIZONS STRATEGIES

In Insight's Responsible Horizons impact strategies, every investment (except those held for hedging or liquidity purposes) must pass our impact assessment frameworks analysing ESG performance, impact alignment, and impact reporting for impact efficacy.

The strategies broaden their impact profile and diversification strategy by looking beyond pure green issuance to incorporate other use-of proceeds impact bonds and issuance from sustainability aligned companies.

Responsible Horizons Euro Impact

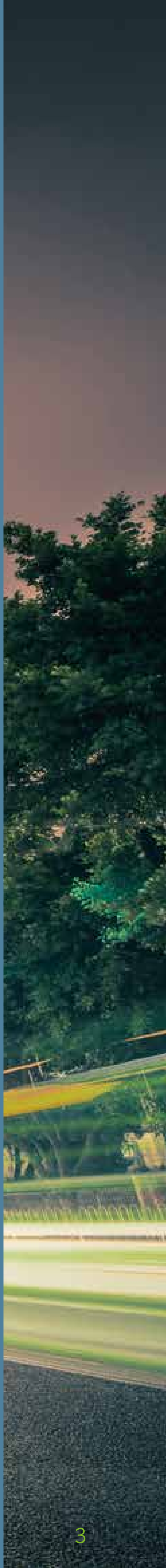
The strategy aims to achieve positive environmental and/or social impacts while generating a total return by investing in euro-denominated debt, debt-related securities and related derivatives.

The strategy aims to invest at least 75% in use-of-proceeds impact bonds. It will also seek to broaden the impact achieved by allocating to 'impact issuers' which are companies with a high level of alignment to the UN Sustainable Development Goals (SDGs).

Responsible Horizons EM Debt Impact

The strategy aims to achieve positive environmental and/or social impacts while generating a total return comprised of income and capital growth by investing in emerging market debt and debt-related securities and related derivatives.

The strategy targets the People, Planet and Prosperity themes, each mapped to the UN SDGs and EU Taxonomy. At least 50% is invested in impact bonds, with the remainder invested in bonds from impact issuers or improving issuers (or in instruments for hedging or liquidity purposes).



IMPACT OPPORTUNITIES FOR FIXED INCOME INVESTORS NOW TOTAL OVER US$3 TRILLION

Impact-driven mandates are not necessarily new but have historically been a relative backwater of the financial markets and have been focused predominantly on public and private equity markets. Despite this, significant and growing impact opportunities exist for fixed income investors. In this paper we will look at the opportunity in public fixed income markets where a fixed income investor can achieve impact.

There are three ways fixed income investors can achieve impact: use-of-proceeds bonds (also known as impact bonds), investing in impact issuers, and investing in improving issuers. Both societal development and regulation have led to companies becoming more transparent around their social and environmental profiles making it possible for investors, if they so choose, to allocate to companies they perceive to be having a positive influence on the world.

WHAT IS A 'USE-OF-PROCEEDS' IMPACT BOND?

Use-of-proceeds impact bonds are debt instruments that are issued with the proceeds raised being directed towards projects that will meet an environmental or social objective. This is the type of instrument that is most commonly referred to when people use the term impact bond. The three most common types of use-of-proceeds impact bonds are:

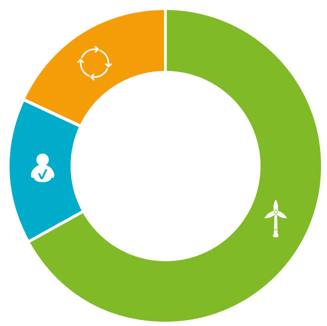
- Green bonds: the proceeds are exclusively applied to eligible green projects.
- Social bonds: the proceeds are exclusively applied to eligible social projects.
- Sustainability bonds: the proceeds are exclusively applied to a combination of both green and social projects.

As demand continues to increase, this has led to the evolution of further subsets of impact bonds. For example, growth in impact bonds has given rise to the formation of new thematic bonds. These include **blue bonds**, which have a focus on marine and ocean-based projects, and **gender bonds** that fund projects for gender equality and opportunities.

The classification of a bond as green, social, or sustainable is determined by the issuer based on its primary objectives for the underlying projects. There are some commonly used frameworks and standards that provide issuers with information on reporting, verification and bond frameworks (such as the ICMA Green Bond Principles). However, alignment with these principles is not mandatory; regulation is essentially voluntary.

Green bonds continue to dominate the market for impact bonds at this stage, but the rise in other types of impact bond issuance continues.

Figure 1: The main impact bond types (USD$bn)[3]



[3] Source: Bloomberg. Data as at September 2023.

MARKET EVOLUTION

KEY DRIVERS OF GROWTH

There are four key drivers of the expedited growth rate in the issuance of impact bonds:

1. **Shifting attitudes –** Millennials and the rising Gen-Z global investor base are increasingly seeking out companies that explicitly consider their environmental and societal impact, leading to increased demand from investors for impact issuances.

2. **Demonstrating commitment to sustainability –** Businesses recognise the importance of supporting local communities and the environment. Impact bonds are an increasingly popular way for corporate, multi-national and sovereign issuers to demonstrate their commitment to achieving their sustainability objectives and to show their alignment with wider efforts such as the Paris Climate Agreement and the UN Sustainable Development Goals (SDGs).

3. **Regulatory pressure –** In some sectors, such as utilities, regulation has threatened their business models; without changes they face uncertain futures. For example, commitments to phase out coal power requires replacement technology. In addition, the automotive sector is investing in electric vehicles due to the widespread bands on production of diesel and petrol fuelled vehicles.

4. **Ease of issuance –** It is easier than ever before to come to market with an impact bond. There is more advice and support for issuers (such as on the ICMA website) as investors are increasingly asking for impact investments.

There are several reasons for the surge in impact bond issuance, but the most significant force has been investor demand, which has driven governments and corporates alike to deliver on the premise of impactful investing.

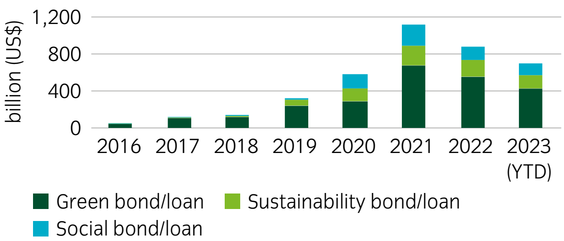
GROWTH BY TYPE

Green bonds dominate the impact bond issuance market. More than US$1.43trn[4] has been raised in green bond issuance since 2007, with more than 500 other entities to issue green bonds since then.

The European Commission issued its inaugural green bond in October 2021, raising €12bn on 15-year debt[5]. It marked a new record for a green bond issue, previously held by the UK with its £10bn issue in September. Proceeds will be used by EU member states on projects including energy and transport initiatives.

Social bonds have been following green bonds' trajectory, particularly since COVID-19. However, although issuance of social bonds in 2021 increased by 1.4 times compared to 2020, the focus of the impact bond market has now shifted to climate change. Correspondingly, issuance of green and sustainability bonds both more than doubled between 2020 and 2021 and have continued to dominate since then.

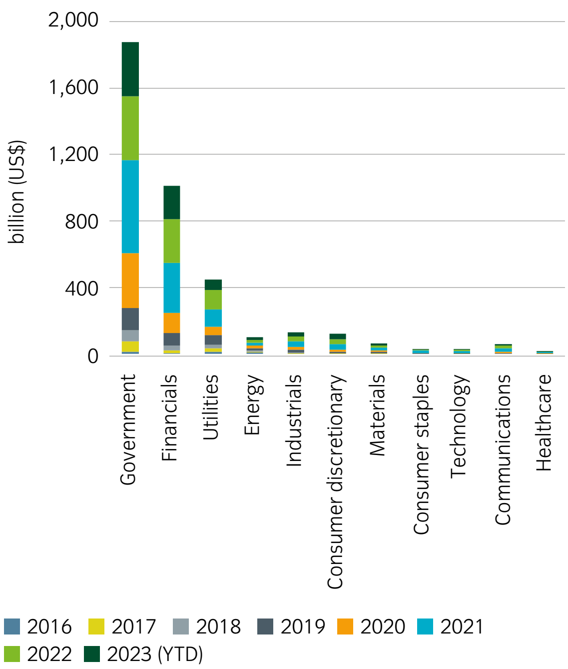
Figure 2: Impact bond issuance growth split by types[6]



GROWTH BY SECTOR

Historically, impact bonds have been issued mostly by government, financial and utility issuers. However, more sectors have begun engaging in impact bond issuance.

Figure 3: Impact bond issuance growth split by sector[7]



[4, 5, 6, 7] Source: Insight Investment, September 2023.

A FOCUS ON CLIMATE CHANGE

Since the emergence of COVID-19, we saw an uptick in COVID-19 related social bonds, where supranationals, sovereigns and agencies led the way. However, social issuances have since declined and the market's focus has shifted to climate change. Examples of this type of issuance, are provided in Figure 4 below.

Figure 4: Examples of climate-related impact bond issuance

Name	Bond type	Issuer type	Description of use of proceeds
Réseau de Transport d'Électricité (RTE)	Green	Corporate	French electric grid operator RTE issued the green bond in early 2022, with its use of proceeds split equally between electricity interconnectors and offshore wind farms. Interconnectors support the transition to a low carbon world, enabling the transmission and distribution of electricity, including from renewable sources[8].
Proximus	Green	Corporate	Belgian telecoms operator Proximus issued its first green bond in late 2021, raising €750m, with proceeds earmarked to finance projects with a positive effect on energy efficiency, renewable energy, clean transportation, green buildings, the transition to the 'circular economy' and social and digital inclusion[9].
Iberdrola	Green	Corporate	Spanish energy company Iberdrola issued a €2bn hybrid green bond in early 2021, with proceeds to be used to finance wind farms as part of the group's wider five-year €75bn investment plan[10].

[8] Why interconnectors play an essential role in our net-zero future, 3 June 2021, National Grid.
[9] Proximus successfully issues its first €750 million green bond, 10 November 2021, Proximus.
[10] Iberdrola completes the largest green hybrid bond issue in history, for 2 billion euros, 2 February 2021, Iberdrola.

BEYOND USE-OF-PROCEEDS INSTRUMENTS

While use-of-proceeds structures give a valuable and transparent tool to fixed income investors for influencing positive environmental and social outcomes, they do not provide the only investment opportunity.

In 2022, we developed an internal taxonomy for impact investing outside of use-of-proceeds structures that is briefly outlined below:

Figure 5: Insight's impact issuer and improving issuer framework[11]

IMPACT ISSUERS

Aim to allocate to issuers aligned to UN SDGs or EU taxonomy

Alignment	Do no significant harm (DNSH)	Controversy
Activity level	Strategy alignment	No environmental or social controversies

IMPROVING ISSUERS

Aim to allocate to issuers with core investment plans aligned to EU taxonomy

Alignment	Do no significant harm (DNSH)	Controversy
Investment plan	Strategy alignment	No environmental or social controversies

We define **impact issuers** as issuers whose business activity is expected to contribute or lead to positive ESG impacts. These will typically include companies whose business and economic activity lead to a positive environmental and/or social impact, measured as those that derive a significant amount of revenue from appropriate economic activities while not contributing to any significant harm. Appropriate economic activities include those that are aligned with the UN SDGs or EU taxonomy.

There are two main pillars to our assessment to define impact issuers:

1. ESG performance and 'do no significant harm' flags
2. Revenue alignment to the 17 UN SDGs and economic activity alignment to "environmentally sustainable economic activities" as defined by the EU taxonomy regulation.

This takes a thematic approach to issuers who are expected to achieve the above criteria.

For our sustainability-focused strategies with an emerging market focus we also consider investing in what we call **improving issuers**. We define improving issuers as those issuers with core investment plans that are either 20% compliant (in the case of SFDR Article 8 funds) or 50% compliant (in the case of SFDR Article 9 funds) with the EU Taxonomy Regulation. We believe this is an effective way to fund the green transition and potentially increase the impact of our clients' investments.

Sustainability-linked bonds

Sustainability-linked bonds (SLBs) are any type of bond for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined predefined sustainability objectives.

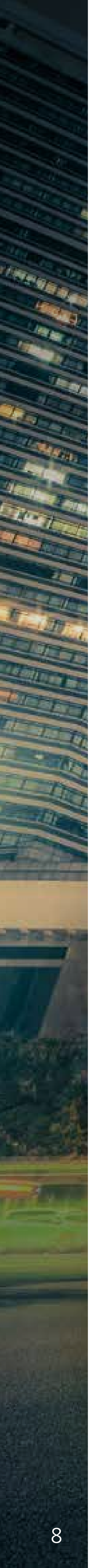
Unlike impact bonds, SLBs' proceeds are used for general corporate purposes and therefore do not fall under our definition of impact bonds for sustainable investments. If an SLB is issued by an impact issuer or improving issuer it can be classified as a sustainable investment.

Combining SLBs with use-of-proceeds bonds can prove highly impactful because bond proceeds will contribute to sustainable outcomes and the overall issuer is committing to an improvement in its overall ESG performance.

Despite not being classified as impact bonds, SLBs can still play an important role in highlighting an issuer's commitment to components of its sustainability strategy by linking its financing to it. This is an important indication of the issuer's commitment to improving its ESG performance.

SLBs are seeing a decline in issuance due to some investors not considering them as sustainable investments under SFDR regulations, increasing investor scrutiny over the quality of KPIs selected, and questions over the meaningfulness of the step ups for some issuance.

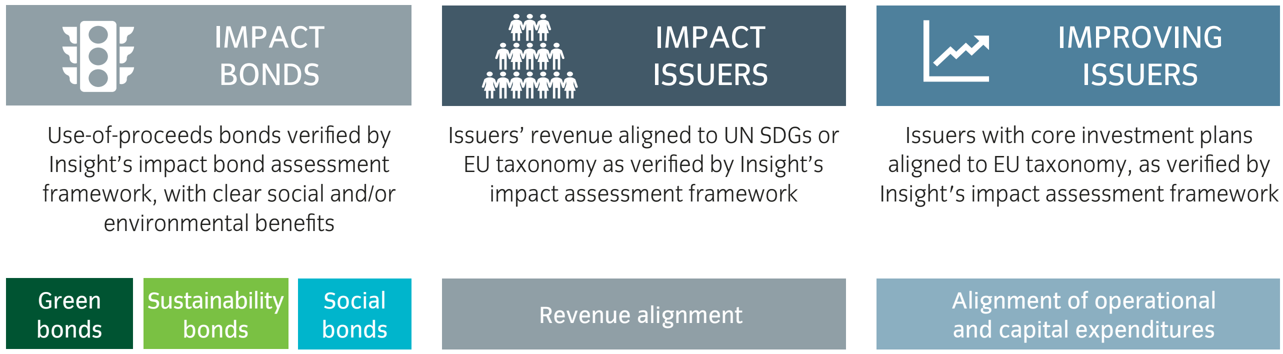
[11] For illustrative purposes only.



DEFINING IMPACT INVESTING AT INSIGHT

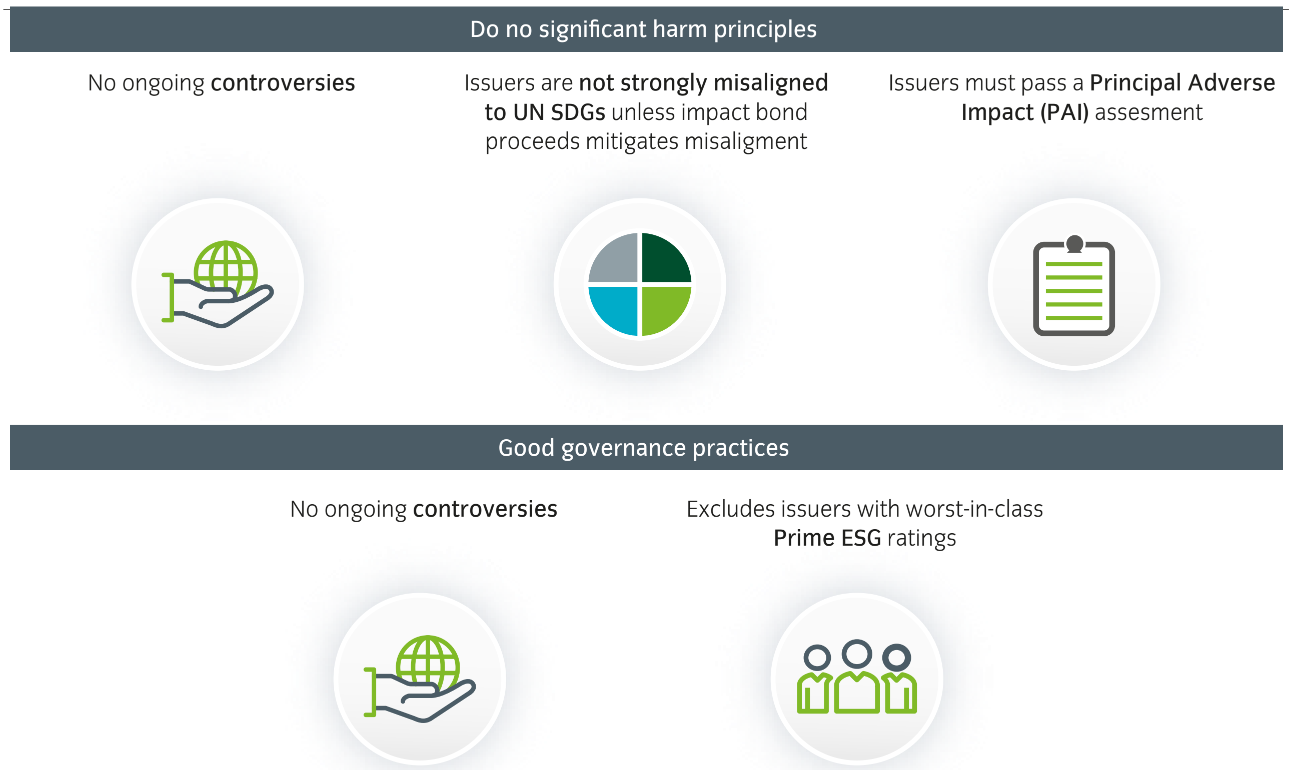
The following graphics outline how we think about impact investing and the EU's 'do no significant harm' principle, which aims to ensure that an investment promoting sustainability in one way does not cause other negative impacts, either on the environment or society.

Figure 6: Three pillars of impact investing[12]



By taking this approach, we believe we can effectively analyse whether our investments are likely to achieve a positive impact. Alongside this we can continue to encourage best practice by engaging for change.

Figure 7: 'Do no significant harm' principles and good governance practices[13]



[12, 13] Source: Insight Investment. For illustrative purposes only.

Considering impact using the SDGs

Insight uses the UN SDGs, a collection of 17 integrated objectives, as a framework for understanding and categorising impact. There are three key pillars to sustainable development: people, prosperity and the planet (see Figure 8).

Having a framework composed of these three pillars recognises the necessity of a holistic approach to sustainable development.

Sustainable development and impact consideration balance these three key pillars, as well as social, economic and environmental sustainability. While the UN SDGs intersect environmental, social and economic factors, we have tried to identify the primary type of impact contributing to each pillar.

Figure 9 illustrates an example of the type of reporting that we can produce on SDG alignment.

Figure 8: Impact themes – UN SDGs[14]

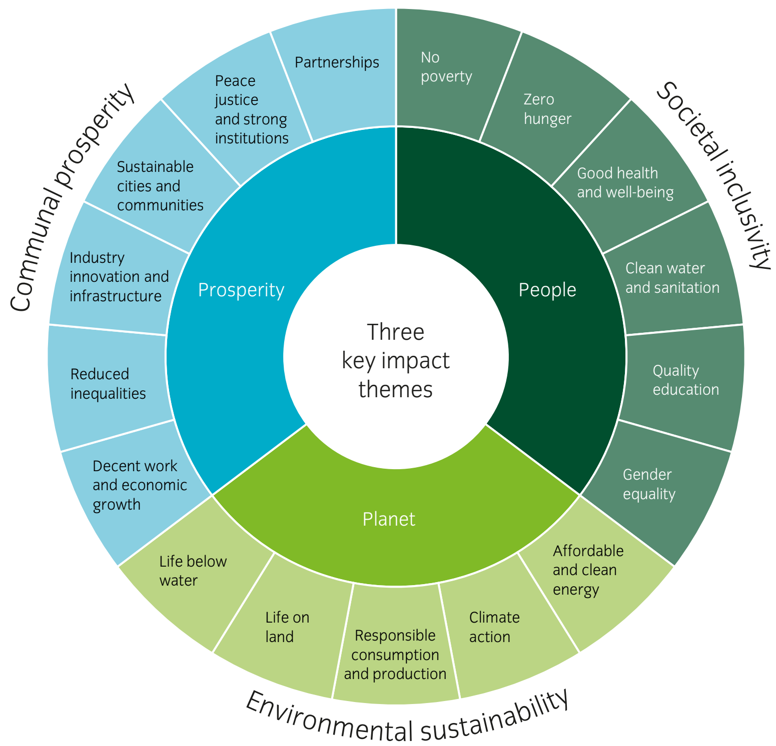
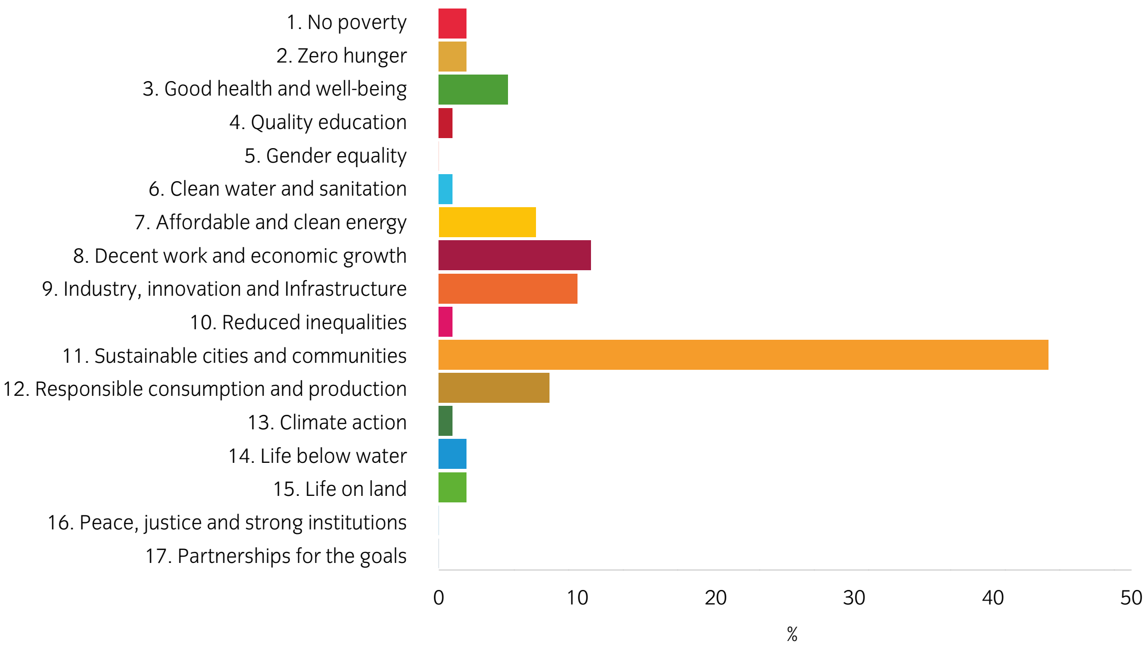


Figure 9: Impact bonds analysed by Insight in Q4 2021, categorised by UN SDG[15]



[14, 15] Source: Insight Investment. For illustrative purposes only.

ADDRESSING A KEY RISK FOR IMPACT INVESTORS: IMPACT WASHING

IN LARGE PARTS OF THE IMPACT BOND MARKET THERE ARE LOWER LEVELS OF DISCLOSURE, WHICH IS A SIGNIFICANT ENABLER OF 'IMPACT WASHING' – AN ISSUER FALSELY CLAIMING TO BE IMPACT-FOCUSED, WITH POTENTIALLY LITTLE OR SUPERFICIAL DEMONSTRATION OF POSITIVE IMPACT. THIS, IN TURN, CREATES CHALLENGES AROUND COMPARABILITY IN THE ISSUANCE OF, AND REPORTING ON, SO-CALLED IMPACT BONDS.

While there are some commonly used frameworks and standards, such as the ICMA Green Bond Principles, these are not a prerequisite for issuance. Likewise, a lack of consistent reporting renders it difficult for investors to identify whether bond proceeds are used as initially marketed or are simply impact-in-name-only.

In February 2023, EU legislators reached a provisional agreement on the European Green Bond Standard[16], which is likely to drive significant changes in the green bond market. Other examples of related regulatory activity include the US SEC's enforcement division establishing a Climate and ESG Task Force[17] and the UK FCA's focus on reducing the harm from greenwashing under its Sustainability Disclosure Requirements[18]. Meanwhile, Australia's regulator is paying close attention to related disclosures.

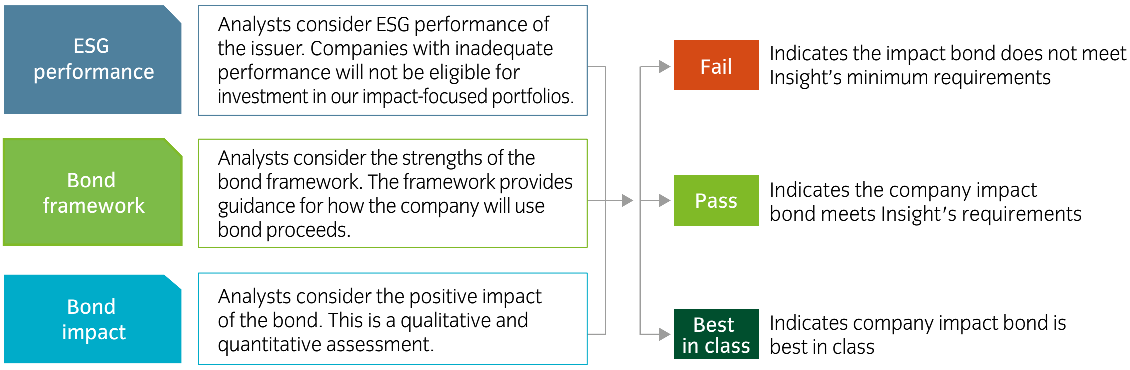
To manage sustainability objectives for our clients, Insight analyses impact bonds using its proprietary bond analyst assessment framework. We have found some misalignment in how these instruments are defined, posing issues of integrity in measuring objectives for investors. As the universe expands, these issues are likely to be compounded.

[16] https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/european-green-bond-standard_enl
[17] https://www.sec.gov/news/press-release/2021-42
[18] https://www.fca.org.uk/publications/consultation-papers/cp22-20-sustainability-disclosure-requirements-sdr-investment-labels

USE-OF-PROCEEDS IMPACT BONDS: INSIGHT'S IMPACT ASSESSMENT BREAKDOWN

The table below outlines Insight's approach to the different rating levels given to impact bonds. The rating given to an impact bond will determine its eligibility and suitability for investment.

Figure 10: Insight's impact bond evaluation process[19]



Out of a total of 1,235 impact bonds we have rated since 2017, 79% have met our requirements to be classified as a genuine impact bond[20]. Conversely, 21% received a red score meaning they did not pass the criteria in our assessment framework.

Whilst our assessment breakdown is dominated proportionally by green bonds, the table below portrays that the same theme of failing to meet our classification of an impact bond is broadly consistent across the main categories of impact bonds. 'Impact washing' does not discriminate by bond type; misleading information and a lack of clarity is rife throughout the impact bond market.

Figure 11: Assessment breakdown[21]

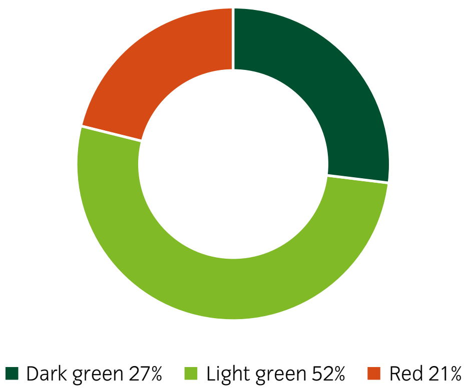
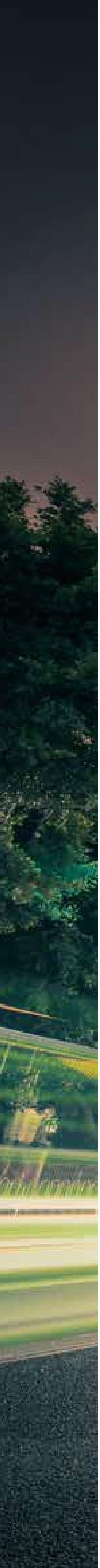
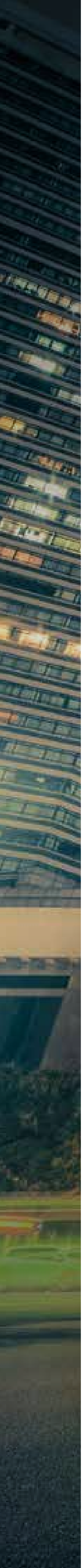


Figure 12: Assessment breakdown split by bond type[22]

	Green		Social		Sustainability		Other	
	Total count	Total %	Total count	Total %	Total count	Total %	Total count	Total %
Dark green	251	28%	34	32%	28	14%	15	45%
Light green	433	48%	66	62%	134	68%	10	30%
Red	215	24%	6	6%	35	18%	8	24%
Number of bonds assessed	899		106		197		33	



[19] Source: Insight Investment. For illustrative purposes only.
[20] As at September 2023.
[21] Source: Insight Investment. As at September 2023.
[22] Source: Insight Investment. Data as at September 2023.



INSIGHT'S IMPACT BOND ASSESSMENT FRAMEWORK

For mandates with a sustainability and impact emphasis, there can be a focus on considering the impact of investments on the environment and/or society.

Below is Insight's assessment framework, which specifically pertains to impact (also known as use-of-proceeds) bonds. We also have a separate framework to assess sustainability-linked bonds.

In 2022 we updated our impact bond assessment framework to consider impact bonds issued by impact issuers and strengthened our enhanced due diligence related to 'do no significant harm' criteria.

Each impact bond will be given a red, light green or dark green rating, as explained in Figure 13.

HOW INSIGHT GENERATES RATINGS FOR IMPACT (USE OF PROCEEDS) BONDS

There are three main areas that impact bonds are assessed against: ESG performance, bond framework principles and bond impact. This is aligned with the ICMA Green Bond Principles, Social Bond Principles and sustainability bond principles.

ESG performance

- As part of the assessment, we review an issuer's overall ESG performance which includes assessing their sustainability strategy, impact revenue generated (meaning that if we classify the issuer as an impact issuer, we will measure revenue aligned with the UN Sustainable Development Goals), and enhanced due diligence is conducted to assess any significant harm being conducted.

In this review, we consider the following:

- Insight Prime ESG rating.
- Insight Prime climate risk rating.
- Controversies and associated material ESG risks in the past 12 months.
- Alignment with Principal Adverse Impacts (PAIs) as outlined by SFDR.
- Sustainability strategy – compared to peers and relevance of impact financing.
- Net-zero alignment and targets – particularly relevant for climate-focused green bonds.
- Alignment of issuer's revenue with the UN SDGs.
- Impact issuers as defined under Insight's sustainable investment definition.

Companies deemed to exhibit inadequate performance will not be eligible for classification as a sustainable investment and are not eligible for investment in Responsible Horizons strategies and may not be eligible for other sustainability-focused mandates. Insight's analysts pay close attention to companies with:

- High-profile controversial events.
- Weak history of ESG activities.
- Lagging ESG performance versus peers.
- Sustainability strategy, commitments and targets.
- Net Zero Misalignment and Targets.
- Misalignment with PAIs and UN SDGs.

Impact bond framework principles

We consider the overall framework associated with the bond, based on the ICMA Principles for green, social and sustainability bonds. We aim to take this a step further to encourage best practice and ensure a positive impact is being achieved.

In their framework we require an impact bond to have sufficient information in the following categories:

- **Use of proceeds (UoP):** At a minimum, we expect UoP categories, and a description of what projects would be considered within each category, to be provided. To strengthen the framework, we would expect there to be appropriate minimum levels/thresholds for categories and whether they are aligned with any official or market-based taxonomies. We typically look for UoP to be aligned with the ICMA Principles' project mappings and UN SDGs to ensure the validity of projects. Sector-specific considerations will be taken into account. Explicitly outlining activities that are excluded also help to strengthen frameworks. For social projects appropriate target populations must be outlined.
- **Project evaluation and selection:** At a minimum, a robust and independent process should be noted as part of the framework, including a description of the steps that are taken to evaluate and select eligible projects. This should include a set of criteria for exclusions or management of ESG risks and negative impacts associated with UoP; this can include details of the issuer's internal policies and specific due diligence steps undertaken.
- **Project evaluation committee:** To manage the selection and monitoring of UoP, we would prefer issuers to have a separate working group or separate committee to effectively manage the process. A clear description of the sustainability expertise and appropriateness of those responsible for project evaluation and selection should be communicated.
- **Management of proceeds:** A clear description of how proceeds will be managed and tracked by the issuer to ensure proceeds are allocated towards eligible projects should be provided. This can either be on a bond-by-

bond approach or portfolio approach. A high level of transparency is required here and verification by an independent third party to attest to the robustness of the internal tracking quality. Also, the timeline for full allocation and the process for reinvestment should be outlined.

- **Financing/refinancing:** Our preference is for the proceeds to be used for new financing projects, but we recognise that certain projects may require refinancing. Fully refinanced projects will be considered alongside the impact associated with the use of proceeds, but typically will lead to a light green rating. If it is full refinancing or if the split isn't known, then attention will be paid to the maximum lookback period (how old a refinanced project may be under the framework).
- **Reporting:** At a minimum, issuers must provide complete transparency on the use of proceeds and the associated impact through reporting relevant KPIs, we expect this to be supplied 1 year after issuance. Our preference is for independent verification and for impact reporting to be aligned with the ICMA Harmonised Framework for Impact Reporting.

A second-party opinion must be provided by all issuers to ensure the overall bond framework has had independent verification under the ICMA Principles.

Bond impact

Our analysts will consider the positive impact of the bond. This is a qualitative and quantitative assessment.

A qualitative assessment will consider:

- Tangible change in strategy and the 'ambitions' of the issuer
- Links to organic growth versus business as usual
- If the bond will increase impact-related revenue, capital expenditure would be preferred over operating expenditure
- Comparison to sector peers and whether the framework is appropriate for the sector
- Whether processes are in place to mitigate any material ESG risks to ensure the impact bond is aligned with 'do no significant harm' criteria

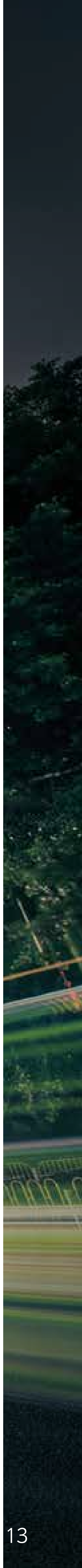
A quantitative assessment will consider:

- Business synergies, capital increase from green activities
- Positive sustainability activity, including efficiencies and appropriateness of individual metrics
- Negative sustainability activity, including individual metrics

Figure 13: What Insight's impact bond ratings mean: typical characteristics that drive the ratings[23]

Rating	Approach
Red	• The issuer fails to provide sufficient information regarding their impact bond framework and has no second-party opinion. • Proceeds are being used for full refinancing of projects and largely target operating expenditures or no information has been provided. Proceeds are financing projects that are considered to have weak impact. • Unallocated proceeds may be used to pay back existing debt and there is no commitment to allocation/impact reporting. • The issuer fails our 'do no significant harm' screen and enhanced ESG due diligence on the issuer and the proceeds from the bond do not mitigate these negative impacts. • Overall impact of the use of proceeds is low relative to peers.
Light Green	• The issuer has an impact bond framework, aligned with ICMA standards, in place along with a second-party opinion. • The majority of projects being financed are well defined and will provide some positive environmental and/or social impact. • Proceeds are being used for full/partial refinancing, but limited information is provided on the split. • The issuer has committed to annual allocation and impact reporting with limited information on key performance indicators for reporting. • Or a company is defined as an impact issuer with an impact bond framework and second-party opinion in place. • Overall impact of the use of proceeds is good relative to peers, but some information may be missing with some weaker aspects.
Dark Green	• The issuer has provided detailed information on their framework along with a second party opinion and has provided a rough split on the expected level of financing/refinancing with a maximum look back period for any refinancing <2 years. • The issuer has a project evaluation committee in place to select, evaluate and monitor use of proceeds and clear transparent process to manage proceeds effectively. • The issuer has committed to annual allocation and impact reporting, with relevant KPIs, which has been independently verified by a third party. • The issuer passes our 'do no significant harm' screen and has an appropriate sustainability strategy in place that the impact bond is clearly contributing to. • Overall impact of the use of proceeds is strong relative to peers.

[23] Source: Insight Investment.



Our impact bond coverage increased in 2022

We rated 331 unique impact bonds in 2022 capturing 168 issuers, which grew our database of impact bonds by 64% compared to 2021.

We also engaged with issuers and sovereigns on their impact bond frameworks. This allows us to provide feedback to issuers on where we would like to see improvements and enhanced disclosures in relation to their impact bond. These engagements allow us to dig deeper into the decision-making process behind the framework and provides us with additional information to feed into our ratings.

Figure 14: Insight impact bond ratings 2022[24]

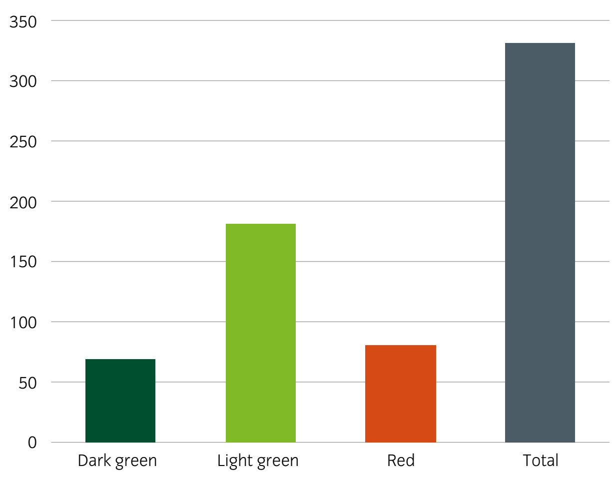
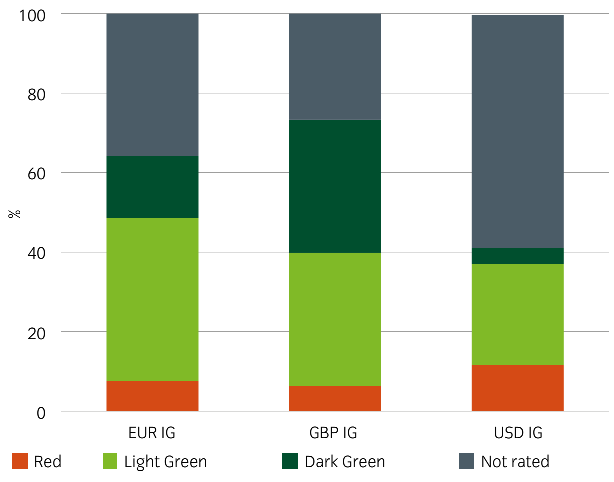


Figure 15: Insight impact bond rating coverage 2022[25]



[24, 25] Source: Insight Investment, September 2023.

<u>Illustrative examples of Insight's impact bond assessment in action</u>

Bond type	ESG performance met?	Bond framework criteria met?	Impact criteria met?
Social	✓	✓	✓

Analyst assessment: The bond's proceeds may be used for granting access to essential education services (including teaching, technology, study materials and curriculum development for free online education) and socioeconomic advancement and empowerment (including the development of vocational certification services for underserved/underemployed learners). A specific group will be responsible for project evaluation, selection and reporting on allocation and impact. An ESG risk assessment will be carried out as part of the due diligence of projects for data privacy, safeguarding, corruption etc., alongside ongoing controversy and reviews of projects. An internal information database will be used to monitor and account for the allocation of proceeds. Unallocated capital will be lent in the short term to operating companies until recalled for investment.

Best in class The bond has clear criteria for projects that could create a positive social impact and is aligned with the social bond principles. The issuer could have provided more information on exactly which category the proceeds would be used for and the extent of financing vs refinancing. However, this is an example of a best-in-class issuer and a strong process for evaluation of eligible projects, justifying the rationale for a green rating.

Green	✓	✓	✓

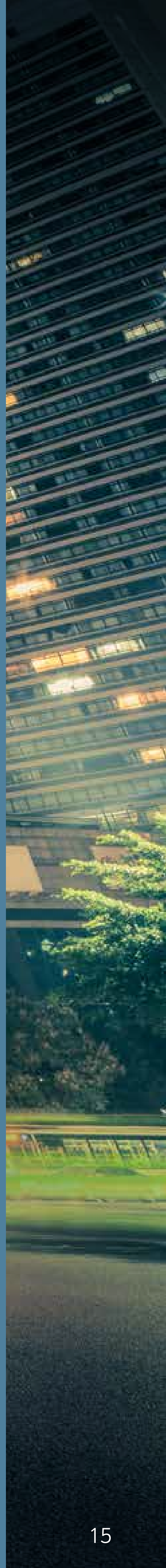
Analyst assessment: The bond's proceeds will go towards projects in a range of categories, including renewable energy projects (specifically wind and solar), power purchase agreements, energy efficiency, green buildings, sustainable water management, and biodiversity and conservation. A specific group will be responsible for project evaluation and selection, with clear processes in place. An environmental and social risk assessment will be incorporated to ensure any ESG risks are identified and managed. The process to manage the use of proceeds is clearly outlined and there is a process and commitment for reinvestment. Full allocation is expected within three years. There is a commitment for annual verified allocation and impact reporting with appropriate KPIs.

Pass We are confident the categories will deliver a positive environmental impact and are aligned with the issuer's overall sustainability strategy. We noted some categories could be strengthened through improved standards or thresholds for eligibility, and there is a lack of detail on the maximum lookback period for any refinancing.

Sustainable	✓	✗	✗

Analyst assessment: The bond's proceeds may be used for non-profit hospitals/skilled nursing facilities to provide treatment for COVID-19 patients, healthcare equipment/supplies for testing for infection/prior infection, diagnosis of disease progression/evaluation of symptoms, treatment of infection/related symptoms and prevention through PPE or vaccines. Unallocated proceeds are to be held in cash/cash equivalents. There will be an annual allocation report with independent verification. Impact indicators are noted but it is unclear how often impact reporting will be provided and whether it will actually include the indicators.

Fail There is a lack of information concerning how much of the proceeds will go to financing vs refinancing. Some of the wording around impact is not very clear on reporting frequency and some KPIs are noted but it is vague if/when they will provide reporting/include KPIs rather than just case studies alone. Compared to other COVID-19 social bond issuances, the framework itself lacks detail and the ambiguity of the impact reporting is not sufficient to showcase the overall impact of the bond. A positive is that the use of proceeds is more specific compared to others, but that alone is not a strong enough case for a higher rating.



SEEKING AUTHENTICITY FOR IMPACT INVESTORS

As investor demand and global needs necessitate continued growth in the sector, the previously niche impact bond market is now expanding into ever-more nuanced impact offerings.

However, against this backdrop of expanding issuance, and a lack of regulation, 'impact washing' has become an unfortunate reality. The new EU Green Bond Standard and the EU taxonomy should introduce more market standardisation and give access to more complete information that will be genuinely relevant to investors. For issuers, alignment with the ICMA Green Bond Principles, along with external verifications, will support them with avoiding any unintentional impression of impact washing.

In the meantime though, until more formal frameworks are enforced, it is vital for investors to carry out appropriate due diligence to avoid falling victim to impact washing.

Insight endeavours to continue to lead the way in distinguishing the impactful from the not-so. Through our qualitative assessments, alongside persistent stakeholder engagement, we strive to create a positive impact and protect the intentions of our impact investors.

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

ASSOCIATED INVESTMENT RISKS

Fixed income
Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

ESG
Investment type: The application and overall influence of ESG approaches may differ, potentially materially, across asset classes, geographies, sectors, specific investments or portfolios due to the nature of the specific securities and instruments available, the wide range of ESG factors which may be applied and ESG industry practices applicable in a particular investable universe.

Integration: The integration of ESG factors refers to the inclusion of ESG risk factors alongside financial risk factors in investment analysis and research to judge the fair value of a particular investment and may also include the monitoring and reporting of such risks within a portfolio. Integrating ESG factors in this way will not typically restrict the potential investable universe, but rather aims to ensure that relevant and material ESG risks are taken into account by analysts and/or portfolio managers in their decision-making, alongside other relevant and material financial risks.

Ratings: The use and influence of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on a number of factors including the nature of the asset class and the structure of the investment mandate involved. For an investment portfolio with a financial objective, and without specific ESG or sustainability objectives, a high or low ESG rating may not automatically lead to a buy or sell decision: the rating will be one factor among others that may help a portfolio manager in evaluating potential investments consistently.

Engagement activity: The applicability of Insight firm level ESG engagement activity and the outcomes of this activity relating to buy, hold and sell decisions made within specific investment strategies will vary, potentially significantly, depending on the nature of the asset class and the structure of the investment mandate involved.

Reporting: The ESG approach shown is indicative and there is no guarantee that the specific approach will be applied across the whole portfolio.

Performance/quality: The influence of ESG criteria on the overall risk and return characteristics of a portfolio is likely to vary over time depending on the investment universe, investment strategy and objective and the influence of ESG factors directly applicable on valuations which will vary over time.

Costs: The costs described will have an impact on the amount of the investment and expected returns.

Insight applies a wide range of customised ESG criteria to mandates which are tailored to reflect individual client requirements. Individual investor experience will vary depending on the investment strategy, investment objectives and the specific ESG criteria applicable to a Fund or portfolio. Please refer to the investment management agreement or offering documents such as the prospectus, Key Investor Information Document (KIID) or the latest Report and Accounts which can be found at www.insightinvestment.com and where applicable information in the following link for mandates in scope of certain EU sustainability regulations https://www.insightinvestment.com/regulatory-home/sustainability-regulations/; alternatively, speak to your main point of contact in order to obtain details of specific ESG parameters applicable to your investment.

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