ABN·AMRO

Marketing Communication

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ABN AMRO ESG Investor Survey – 2H 2023

- ABN AMRO conducted a second edition of our ESG Investor survey. The survey had a total of **39 questions** and **55 investors** participated. Below, we have highlighted our **key take-aways**:

- **Data quality** is seen by investors as the biggest barrier harming the growth of the green bond market. Also for their own disclosures, data quality acts as an important obstacle for the efficient implementation of the SFDR.

- Compared to last year's survey, **respondents seem to place lower relevance to the EU Taxonomy** compared to the ICMA Principles. This could be due to several reasons, including potentially the fact that transitional activities might have undermined the status of the EU Taxonomy for green investors.

- Also compared to last year's survey, **more investors are allowed to invest in Sustainability-Linked Bonds** (SLBs). However, there are still **several points for improvement in this market**, as investors want to see more inclusion of scope 3 in GHG emission targets, a larger level of coupon step-ups and more comparability. The majority of respondents also say that they still find it very hard to evaluate the ambitiousness of SLB KPIs, which comes despite the fact that almost all of these instruments receive a Second-Party Opinion (SPO) from an independent third-party. **This brings into question to what extent investors find these (SPO) assessments truly reliable,** and what the true value-added of an SPO for an SLB is.

- Although the standard practice is for issuers to report on a portfolio basis, respondents indicated that they have a **strong preference for bond-by-bond reports.**

- When evaluating ESG instruments, investors have a holistic approach, and **more respondents focus now on decarbonization strategies** compared to last year's survey.

- Most investors give preferential treatment to the ESG angle, rather than fully focus on financial returns. Overall, our survey shows that investors do not necessarily see ESG as a factor which excludes returns, but rather as a complementary or additional factor that could drive financial return.

Contents

Click on the topic to jump directly to that specific page

- **ESG Investor profile:** The majority of the respondents are portfolio managers from asset management firms located in North-Western Europe. Most respondents have either an Article 8 or 9 fund (as per SFDR).
- **Investment universe:** More investors are now allowed to invest in Sustainability-Linked Bonds (SLBs) compared to last year's survey. The primary market seems to be key to source ESG investments. Compared to last year's survey, investors seem to shift focus towards corporates for "use of proceeds" ESG bonds. Corporates in transition remain the preferred sector for SLB issuance, according to respondents. SLBs are preferred over transition bonds for companies in transition.
- **Investor behaviour:** Most ESG investors seem to give preferential treatment to the ESG angle, rather than fully focus on financial returns. On the other hand, the majority of respondents see ESG as a source of alpha/beta or believe that ESG will outperform in the long-term. Hence, these investors do not necessarily feel that they sacrifice returns in order to achieve ESG impact.
- **Investment screening:** Contrary to last year's survey, the majority of ESG investors prioritize the ICMA Principles when assessing ESG bonds, rather than the EU Taxonomy. Investors still take a holistic approach when analysing ESG instruments, including a focus on ESG strategy. With regards to respondents focus on decarbonization pathways, the Science-Based Targets initiative (SBTi) remains the most widely used criteria. Only a small minority does not have criteria to evaluate decarbonization strategies. Our survey also shows that investors still seem reluctant to invest in ESG instruments from subordinated debt and securitizations.
- **Barriers for the market:** Data quality is seen by respondents as the main issue preventing the growth of the green bond market. For SLBs, opaqueness (how hard it is to evaluate the ambitiousness of targets) and lack of comparability remain the biggest issues.
- **SLBs:** Investors seem open to other payment structures, besides the widely used coupon-step. While there is still no big preference in terms of the amount of coupon step-ups, the "standard 25bps" seems to be over used given the rising rates environment. SLB investors place a large importance in the inclusion of scope 3 emissions in either SLB Frameworks or (GHG-linked) KPIs. There does not seem to be a particular preference regarding the observation date of targets.
- **Reporting:** The majority of respondents does not have a particular preference for a preferred Second Party Opinion (SPO) provider. For those that have a preference, Sustainalytics remains the top choice. Investors seem to more and more prefer reporting on a bond-by-bond basis, albeit that being in contrast with current market practice. There is still no strong preference when it comes to lookback periods.
- **Greeniums:** Investors expect greeniums to continue, albeit without much change compared to current levels. The majority of respondents doesn't seem to have a fixed maximum greenium they are willing to accept. When assessing greeniums, investors are more focused on the issuer's ESG credentials rather than the sector.
- **Regulation:** The biggest challenge around the SFDR implementation is data quality. Most investors are not yet sure if and how they will implement the EU GBS requirements internally.

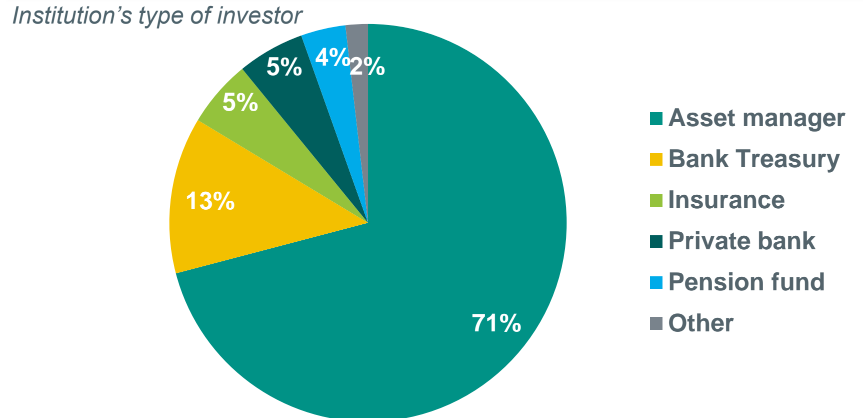
ESG Investor profile: Majority of the respondents are portfolio managers from asset management firms; responses focused on North-Western Europe

- ABN AMRO has conducted a survey with dedicated ESG investors in order to better understand their dynamics, investment behaviour, preferences and screening criteria.
- The survey had a total of 55 respondents, with the majority coming from France, The Netherlands and Germany.
- The majority of investors who responded to the survey are asset managers, which also typically manage the majority of dedicated ESG bond funds compared to other investor types.
- Also, the majority of the respondents (67%) are portfolio managers, followed by 22% of ESG analysts / strategists.

Total respondents: **55**

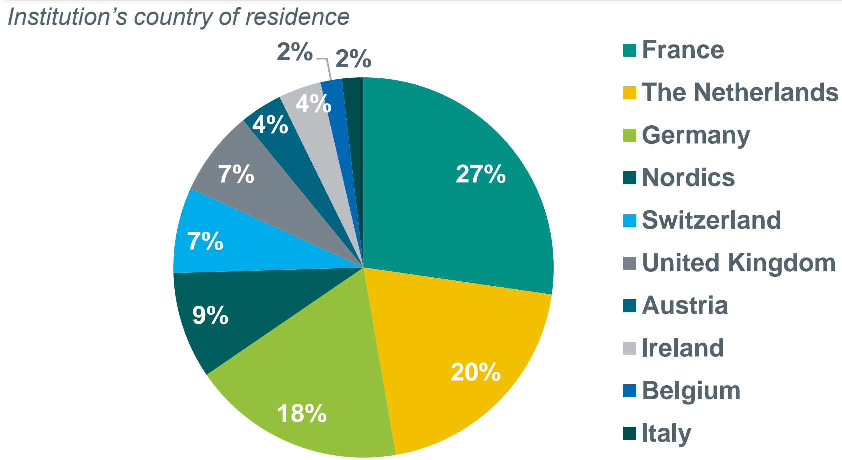
Most investors are asset managers

Institution's type of investor



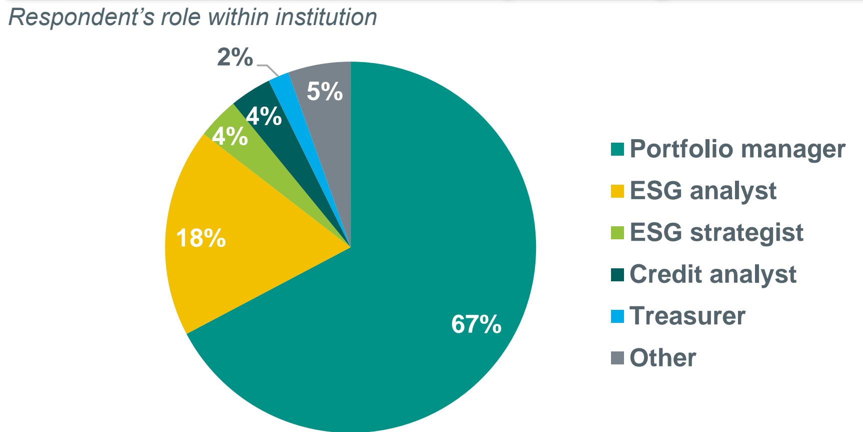
Good geographical diversification of respondents

Institution's country of residence



Most of the respondents are portfolio managers, followed by a significant share of ESG analysts / strategists

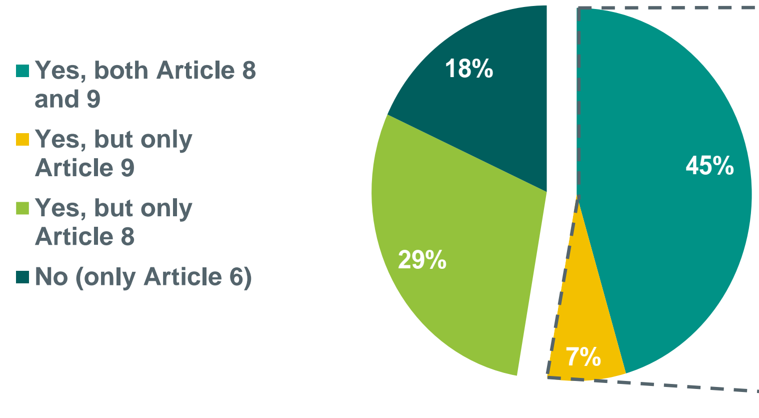
Respondent's role within institution



ESG Investor profile: Most respondents have either Article 9 or 8. The most common investment criteria for Article 9 funds is ESG screening on issuer level

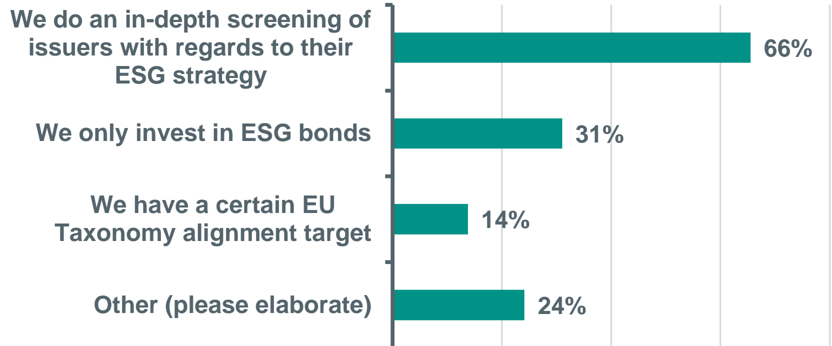
Vast majority of the respondents either has an Article 8 or 9 fund, or both

Question: Does your institution has any Article 8 or 9 funds, according to the SFDR?



Screening on issuer level is the most widely applied investment criteria for Article 9 funds

Question: What is the ESG investment criteria for your Article 9 fund?

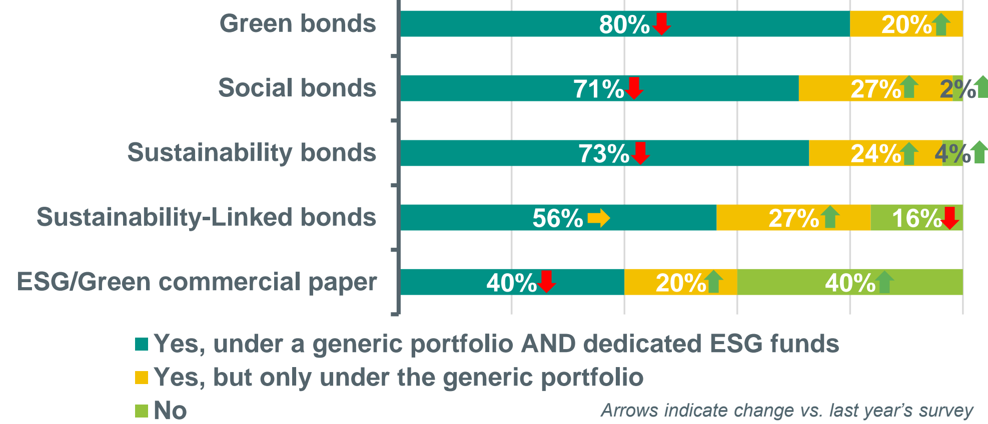


- The majority of the respondents in our ESG survey has either an Article 8 or 9 fund, or both. Only 18% of the respondents does not have an Article 8 or 9 fund (that is, they only have Article 6 funds). As per the Sustainable Finance Disclosure Regulation (SFDR), Article 9 funds are perceived as having the highest level of "greenness" (that is, their primary goal is sustainable investing) while Article 6 is the one with the lowest level of "greenness" (no ESG incorporation).
- When zooming into the investment criteria of the Article 9 funds, we see that the majority performs an in-depth screening of the issuers based on their ESG strategy. That is, they assess whether an investment is sustainable based on issuer profile, rather than the label of the bond. On the other hand, still 31% of all investors with an Article 9 fund have said that they only invest in ESG bonds. This criteria is an additional contributor to the consistent existence of a greenium in the fixed income space (see page 17).
- Also 14% of the Article 9 respondents said that they already apply a certain EU Taxonomy alignment target. That is, they are not allowed to invest in an issuer/bond that does not meet a certain pre-defined alignment threshold.
- Within the category "others", investors have mentioned some of the following criteria: alignment with certain UN Sustainable Development Goals (SDGs), the use of CO_2 (emission) targets, and minimum thresholds based on their own in-house rating criteria (which takes into account several factors).

Investment universe: More investors can now invest in SLBs. The primary market remains a key source for ESG fixed income investments

Investors still buying "use of proceeds" ESG bonds, but funds reclassification means there are less dedicated ESG funds

Question: Does your institution mandate allow for investments in any of the following ESG instruments?

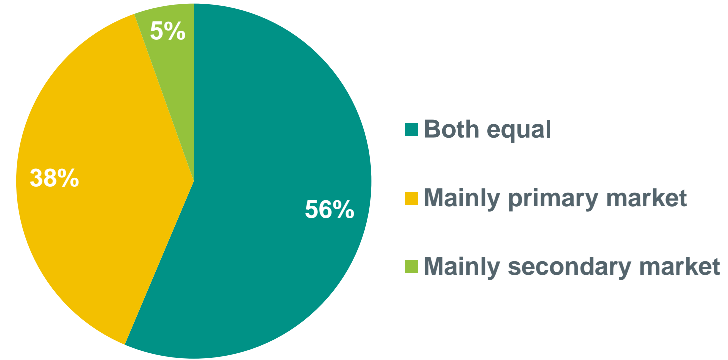


Arrows indicate change vs. last year's survey

- While on the surface, the results of our survey might indicate that the share of investors that can buy "use of proceeds" ESG bonds under dedicated ESG funds has decreased compared to last year, our analysis shows that this is purely due to the wave of fund reclassification. Last year, several investors have downgraded their fund classification (as per SFDR) from Article 9 (highest level of "greenness", i.e. dedicated ESG funds) to either Article 8 or Article 6 (lowest level of "greenness"). Morningstar estimates that until 4Q22, 300 Article 9 funds (which represent EUR 175bn of assets, or 40% of all Article 9 funds) were downgraded to Article 8.
- Hence, the survey still indicates that green remains the preferred flavour among ESG investors, followed by social and sustainability bonds.
- Interestingly as well, the share of funds allowed to invest in sustainability-linked bonds (SLBs) has increased since last year. In 2022, 21% of investors indicated that they are not allowed to invest in SLBs, vs. only 16% this year.
- The share of investors allowed to invest in ESG/green commercial paper has also decreased YoY from 69% to 60% now. However, the low acceptance of investors of this instrument could be a result of minimum duration requirements, rather than related to the ESG angle.

Investors still rely heavily on the primary market as a source for their ESG investments

Question: Where do you mainly source your ESG fixed income investments?

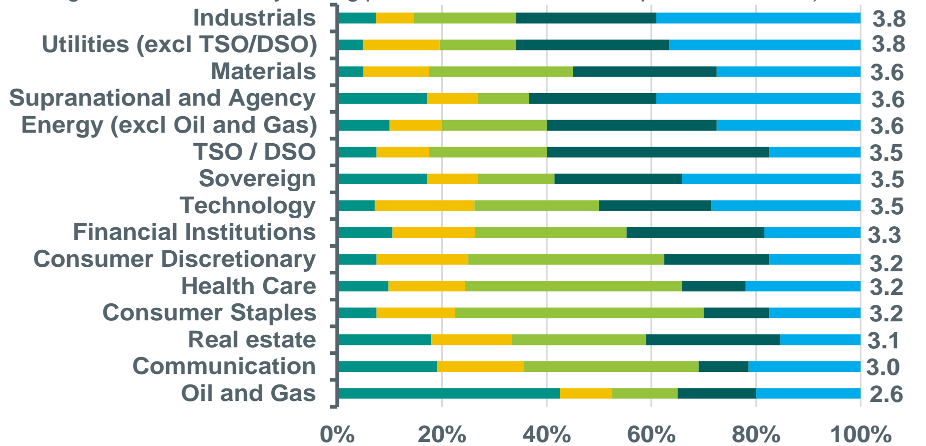


- ESG investors make mainly use of the primary market to source their ESG fixed income investments. Our survey indicates that 38% of the respondents buy the majority of their ESG bonds in the primary market, while also 56% use an equal combination between primary and secondary market. Only a small share (5%) seems to rely mainly on the secondary market to invest in ESG bonds.
- While this result could be attributed to differences in investment strategies (e.g. some investors prefer ESG bonds from the primary market given that they perform slightly better than a regular bond in secondary market, see here), one could also argue that the preference for primary market supply is also attributed to the low share of ESG bonds in the market. Hence, the sometimes difficulty to find (both in terms of liquidity but also in terms of pricing thresholds) might shift investors' attention mainly to the primary market as a source for their ESG investments.
- Still, we also point out that more than half of the respondents (56%) seem to equally make use of primary and secondary markets for their ESG investment decisions.

Investment universe: Investors seem to shift focus towards ESG bonds by corporates; SLB remains the preferred instrument for companies in transition

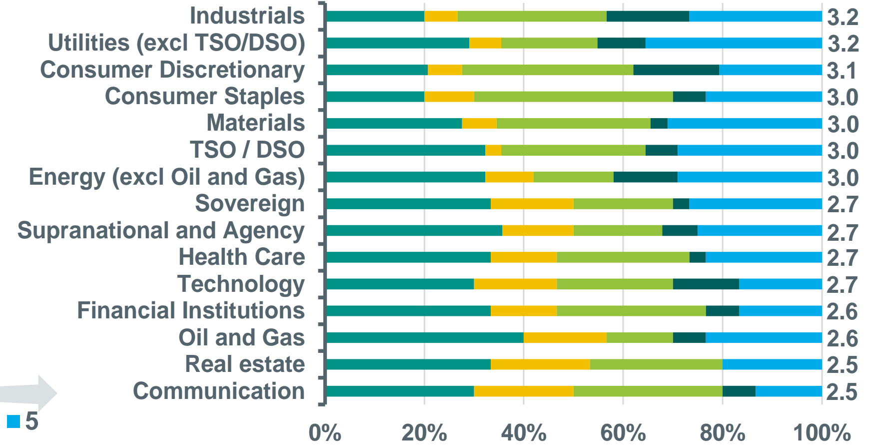
Sectors that traditionally issue "use of proceeds" ESG bonds are still the preference for ESG investors

Question: Which sectors would you prefer for "use of proceeds" ESG bond issuances?[1)] (Ranking from 5 stars = very strong preference, to 1 star = no preference at all)



ESG investors have a clear preference for SLBs coming from corporates in transition sectors

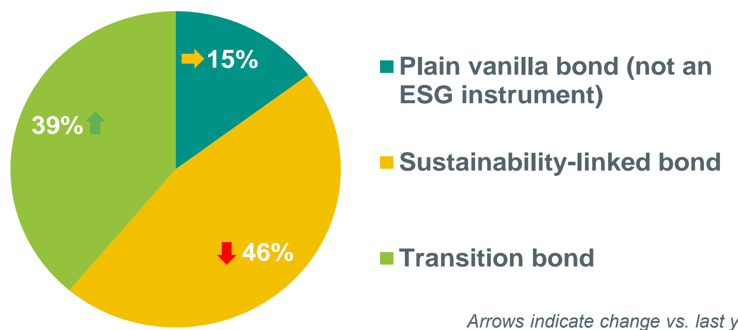
Question: Which sectors would you prefer for SLB issuances?[1)] (Ranking from 5 stars = very strong preference, to 1 star = no preference at all)



- A weighted average of the ranking chosen by investors indicates that, when it comes to "use of proceeds" ESG bonds, investors seem to be more focused now on high-impact sectors such as industrials, utilities and materials. That is in contrast with last year's survey, where investors preferred more traditional sectors, such as FIs or sovereigns. This shift can be related to changes in market conditions: in mid-2022, investors were clearly in a risk-off mode, which could have made them prioritize "safer" and higher rated sectors such as FIs and sovereigns. However, focus seems now to have shifted towards credit.
- Also for SLBs, investors prefer sectors such as industrials and utilities. Also transition sectors, such as oil and gas, have also been selected by several investors as the preferred choice, although from a weighted average perspective, this sector still ranks low within investors' preference.
- Nevertheless, the majority of respondents (46%) indicate that they would prefer transitional companies to issue SLBs. However, compared to last year's survey, investors seem to be slightly more fond of transition bonds for these companies.
- Also interestingly, investors still seem to not prefer FIs to issue SLBs and have a clear preference for corporates.

Issuers in transition should make use of ESG bonds – SLB being the preferred option

Question: For a company with a clear transition strategy, which ESG instrument would you judge to be the most appropriate one for issuance?



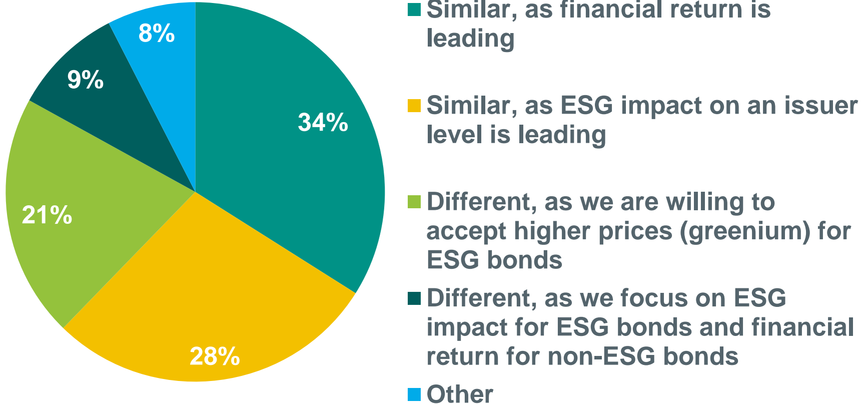
Arrows indicate change vs. last year's survey

1) Figures on the right hand side of the chart indicate the weighted average

Investment behaviour: Most investors apply some preferential treatment towards ESG. Their focus on ESG does not necessarily mean they do not prioritize financial return

Majority of ESG investors differentiate between ESG and non-ESG

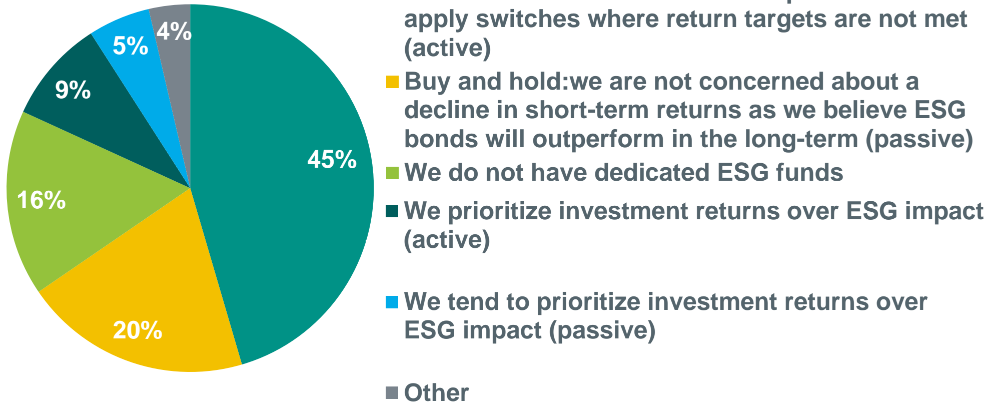
Question: How do you treat ESG vs non-ESG bonds in your general (non-dedicated ESG) portfolios?



- 30% the respondents indicated that they somehow differentiate between ESG and non-ESG bonds in their general (non-dedicated ESG) portfolios. Differentiation occurs mainly through accepting higher prices for ESG bonds. That is, these investors are willing to pay a premium if the bond to be invested in carries an ESG label (see page 17 for greeniums).
- Within the 62% of the respondents that do not differentiate between the label of the bond in their general portfolios, 28% take into account ESG impact when conducting investment decisions. That is, regardless of whether the bond is in ESG format, the investor places a special focus on the issuer's ESG impact when allocating capital.
- Overall, our results indicate that only 34% of the ESG investors focus on financial returns. The remainder applies some sort of preferential treatment towards ESG. That is albeit the portfolios not being in a dedicated ESG format.

ESG is seen by a large number of investors as a source of alpha/beta

Question: Which one of the below best describes the investment behavior of your dedicated ESG funds?

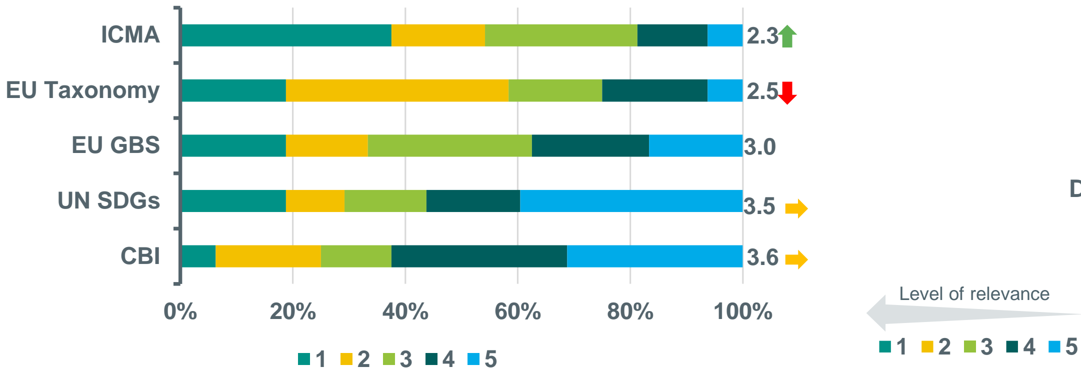


- The survey indicates that the majority of our respondents (54%) have an active investment approach, while also 16% has indicated that they do not have dedicated ESG funds. This share is slightly higher than the one indicated on last year's survey (10%), which reinforces our previous conclusion that downgrades of SFDR classifications could have impacted the number of investors that have dedicated ESG funds (see page 5).
- Furthermore, 45% of the respondents indicated that they see ESG as a driver for excess returns (alpha) and/or lower volatility (beta), while also 20% indicated that they believe ESG bonds tend to outperform in the long-term. Hence, one could conclude that investors do not necessarily see ESG as a factor that excludes healthy returns, but rather as a complementary or additional factor that could drive financial return.
- Slightly aligned with the results on the left hand side, only 14% of the respondents have indicated that they prioritize investment returns over ESG impact, either through an active (9%) or passive (5%) approach.

Investment screening: EU Taxonomy no longer the most relevant standard for ESG screening. Investors still have a holistic approach of assessing ESG bonds.

Most of the investors rely on alignment with ICMA to assess ESG instruments

Question: What is for your institution the most relevant external standard when assessing ESG instruments? (1= most relevant; 5= not relevant at all) [1)]

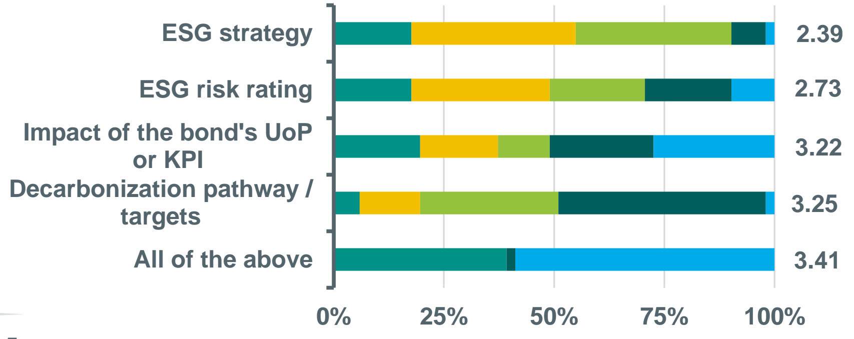


Level of relevance

1 2 3 4 5

40% of investors considers all criteria equally relevant when analysing ESG instruments

Question: When analysing ESG instruments, which of the following criteria would you judge as most relevant? (1= most relevant; 5= not relevant at all) [1)]



- A weighted average of the ranking chosen by investors indicates that the majority of investors have chosen the ICMA Green Bond Principles as the most relevant one when assessing ESG investments. This indicates a clear shift away from the EU Taxonomy, which was the top choice in last years' survey.
- However, EU GBS was first included for this year's survey, and given that alignment with the EU Taxonomy sits at the core of the EU GBS, one can argue that the EU Taxonomy remains very relevant to investors. However, even if we combine the number of respondents that have selected either EU Taxonomy or EU GBS, we can see that ICMA remains the most relevant standard.
- The lower relevance of the EU Taxonomy could be due to several reasons, such as the fact that investors became more aware of the challenges that issuers face in order to receive alignment. Also the inclusion of transitional activities might have undermined the status of the EU Taxonomy for green investors.
- While Climate Bond Initiative (CBI) certification ranked third as the preferred standard by investors last year, it ranked this year as the least preferred option. A reason for this could be the overlap that CBI's criteria has with the EU Taxonomy.
- The still significant number of respondents that selected the UN Sustainable Development Goals (UN SDGs) as the preferred option indicates that some investors are still very much focused on them when assessing ESG instruments.

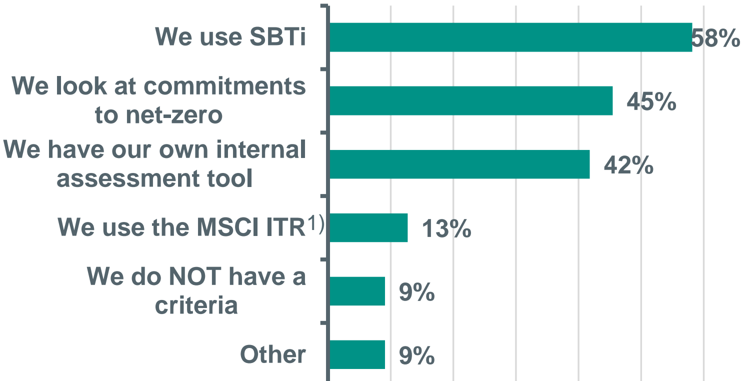
- 39% of the investors indicated that they consider all of the four criteria (ESG strategy, ESG rating, Impact, decarbonization targets) equally relevant when analysing ESG instruments.
- For the respondents that put more weight on one, there seems to be a slightly higher preference for the impact of bond's use of proceeds (UoP) or KPIs. However, while the largest share of investors have selected this option as the most relevant, from a weighted average point of view, investors still seem mostly focused on the issuer's ESG strategy and/or ESG rating. This is aligned with results of last year's survey.
- The fact that around 20% of respondents have indicated the bond's impact as the most relevant criteria comes a bit of a surprise, as we have previously assessed that green bond impact is not properly priced into markets (see here). Nevertheless, these results could also indicate that slowly investors are paying more attention to these factors, although data quality around impact has also been mentioned by respondents as the largest barrier for growth of the green bond market (see page xx).
- With regards to respondent's focused on decarbonization pathways, the Science-Based Targets initiative (SBTi) remains the most widely used criteria (see next page).

1) Figures on the right hand side of the chart indicate the weighted average

Investment screening: More and more investors developed criteria to evaluate decarbonization pathways. ESG label not seen fit for subordinated debt and securitizations

Over 90% of the investors have a criteria to evaluate decarbonization pathways / targets of issuers

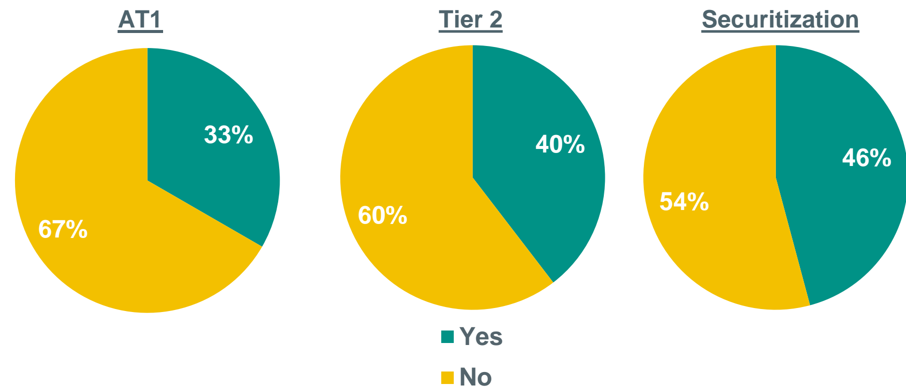
Question: Please specify your institution's criteria to evaluate decarbonization pathways / targets of issuers, if you have one. (Multiple answers allowed)



- Overall, our survey indicates that only 9% of the investors do not currently have a criteria to evaluate decarbonization pathways / targets. That is a significant contrast to last year's survey, where only around 70% of the investors indicated to use decarbonization pathways to evaluate ESG instruments. Clearly, investors are incorporating over time a more holistic view of issuers' ESG strategies. The fact that decarbonization targets are almost a must at the moment also shows that investors' are increasingly shifting their focus to more long-term analysis of issuers' ESG credentials.
- Furthermore, the investor survey indicates that the Science-Based Targets initiative (SBTi) is the most widely used criteria for evaluating issuers' decarbonization pathways (58% of respondents). However, nearly 40% of the investors indicated that they make use of the SBTi along with other criteria, such as whether the issuer has net zero commitments (13% of respondents). 15% also makes use of SBTi and the company's net zero commitments along with their own internal assessment model. Furthermore, 11% indicated that they use both, SBTi and MSCI ITR as tools.
- Within the category of "others", investors have cited ISS ESG and Carbone4 as alternative tools.

Investors still reluctant to invest in ESG instruments from subordinated debt and securitizations

Question: Do you think that the following instrument is well suited to be issued in ESG format?

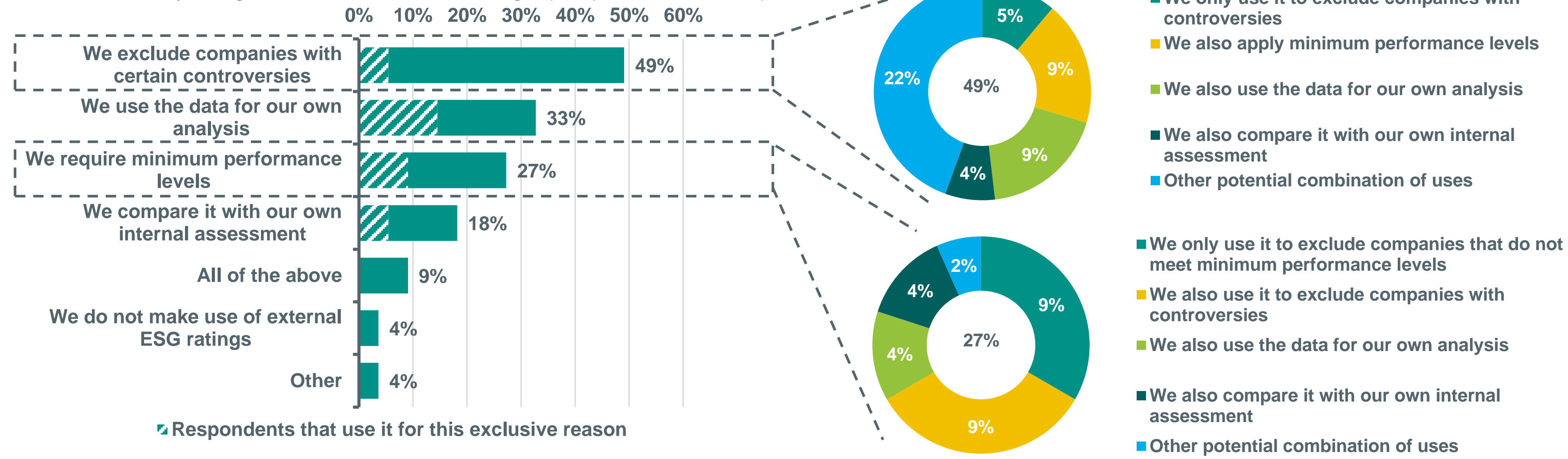


- The majority of ESG investors judges that subordinated debt and securitizations are not well suited to be issued in ESG format. More specifically, ESG AT1 seems to be the instrument least accepted by investors (67% of respondents), followed by Tier 2 (60%) and securitizations (54%).
- The fact that nearly half of the respondents indicate that they do not see a good fit for ESG in securitizations could be driven by new rules allowing the originator to include non-green assets in the securitized pool. Nevertheless, the larger acceptance towards ESG securitizations compared to bank subordinated debt could be driven by higher efforts on the regulatory side. For example, earlier this year, the three European Supervisory Authorities have submitted to the EU Commission draft Regulatory Standards on the ESG impact disclosure for securitizations under the Securitisation Regulation.
- On the other hand, the ESG market for AT1s and Tier 2s still receives some resistance by investors. Some investors argue that issuing capital instruments in ESG format is not appropriate given that (i) the capital nature of these instruments creates doubts about the "use of proceeds" approach, as capital needs differs from funding needs, and (ii) if ESG subordinated bonds are bailed in (that is, if there is a write-down trigger), bondholders might be left holding equity capital, which disconnects the link of use of proceeds to ESG assets.

1) Refers to MSCI implied Temperature Rise

Investment screening: External ESG ratings are still widely used by investors, but the majority does not use it solely for the purpose of exclusions

Majority of investors use external ESG ratings not purely as an exclusion criteria, but rather as an additional tool for ESG integration into investment decisions

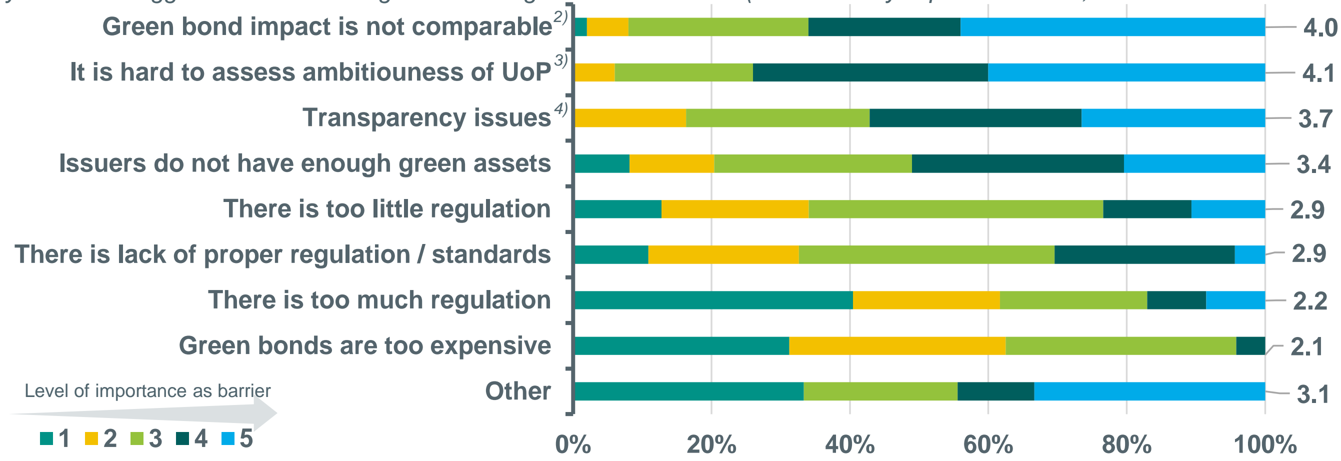


- Investors are increasingly using ESG ratings not solely as an exclusion criteria, but rather as an input for a more throughout and holistic assessment of issuers' ESG credentials. Our survey indicates that only 24% of the investors use ESG ratings as purely an exclusion tool, that is, by excluding issuers that either (i) are involved in certain controversies (6%), or (ii) do not meet certain minimum rating levels (e.g. a minimum rating of "Prime" by ISS ESG or "Low risk" by Sustainalytics) (9%), or (iii) a combination of both (9%). The remaining respondents that claimed to make use of ESG ratings indicated that they use them as an additional layer for their investment decisions.
- Furthermore, 9% of the respondents indicate that they make use of ESG ratings from all possible angles, suggesting also therefore a more mature level of ESG integration.
- Only 4% of the respondents do not make use of any external ESG rating, which could indicate either that their ESG integration is still at very infant stages, or (which we think more likely) that they have developed their own assessment tool and therefore do not rely on external ESG rating providers.
- Additionally, we see that 15% of the investors have indicated that they exclusively use external ESG ratings for the purpose of making use of the data for their own analysis, which likely feeds into internal models, allowing investors to do their own assessment and/or compute their own in-house ESG rating for the issuer.
- 5% of the investors have also indicated that they use ESG ratings exclusively with the intention to compare those with their own internal assessment, i.e. not as an exclusion *per se*, but rather as a benchmark tool and "sanity check".

Barriers for the market: Data quality remains the main issue preventing the growth of green bonds

Data quality around green bond's impact remains the biggest growth barrier of the market

Question: What are for you still the biggest barriers for the growth of the green bond market? (5 stars = very important barrier, to 1 star = not a barrier at all)[1)]



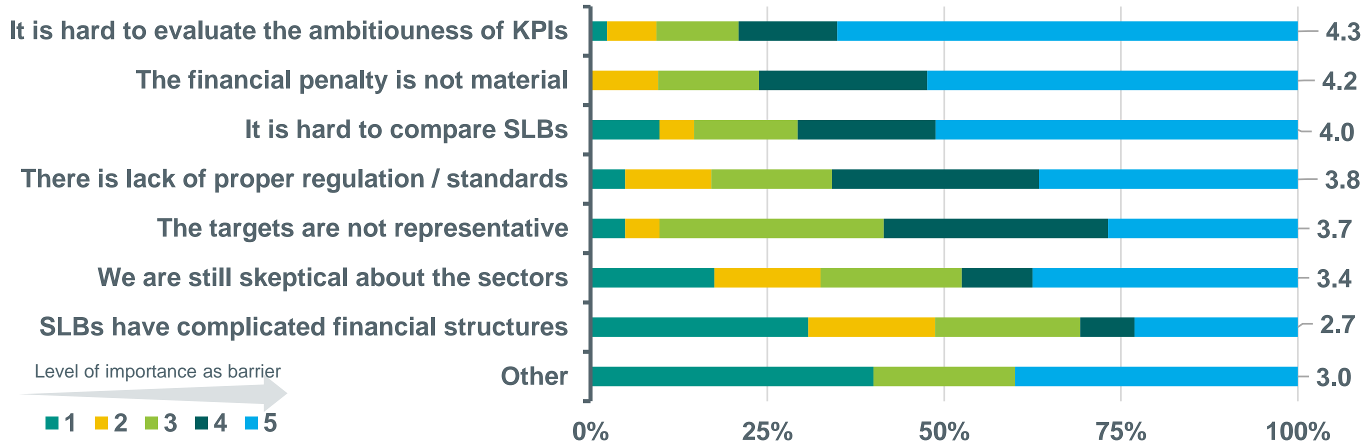
- Our survey indicates that most of the respondents claim that the lack of comparability of green bond impact is currently one of the biggest barriers harming the growth of the green bond market. Next to that, also the difficulty in assessing the ambitiousness of use of proceeds (UoP) has been selected by a large share of investors as either the first or the second biggest barrier of the market. Both factors indicate that data quality remains the biggest issue within the green bond market.
- This reinforces our previous findings that green bond impact is not yet being properly priced-into the market at the moment (see here). If investors find it hard to compare impact metrics and to assess the true level of impact of proceeds, it makes sense that this cannot yet be efficiently reflected in the prices of green bonds.
- While transparency issues (which lead to concerns around greenwashing) still appears as a somehow important barrier for the growth of the green bond market, the fact that it no longer tops the first position indicates how the market has been slowly maturing over time. That is, the focus seems to have switched to impact, rather than reliability and trust on the transparency and reporting of green bonds.
- Interestingly, not many investors seem to judge that the amount of current regulation is "too much" and that, hence, it would harm the development of the green bond market. On the contrary, investors seem to even perceive "too little regulation" as a stronger barrier. This also indicates that upcoming regulation, such as the EU GBS, should be well received by investors.
- Pricing is also not seen as a major barrier for the market growth. That aligns with our findings on page 17, where we see that the majority of investors are willing to accept a greenium when investing in ESG bonds.

1) Figures on the right hand side of the chart indicate the weighted average; 2) Data quality: green bond impact is not comparable; 3) Data quality: it is hard to assess ambitiouness level of the use of proceeds; 4) Transparency: issuers are not very transparent which leads to greenwashing concerns

Barriers for the market: Opaqueness and lack of comparability are the biggest challenges for the Sustainability-Linked Bond (SLB) market

Investors deem the difficulty in evaluating ambitiousness of targets and the lack of comparability as the biggest barrier for the growth of the SLB market

Question: What are for you still the biggest barriers for the growth of the Sustainability-Linked Bond (SLB) market? (5 stars = very important barrier, to 1 star = not a barrier at all)[1)]



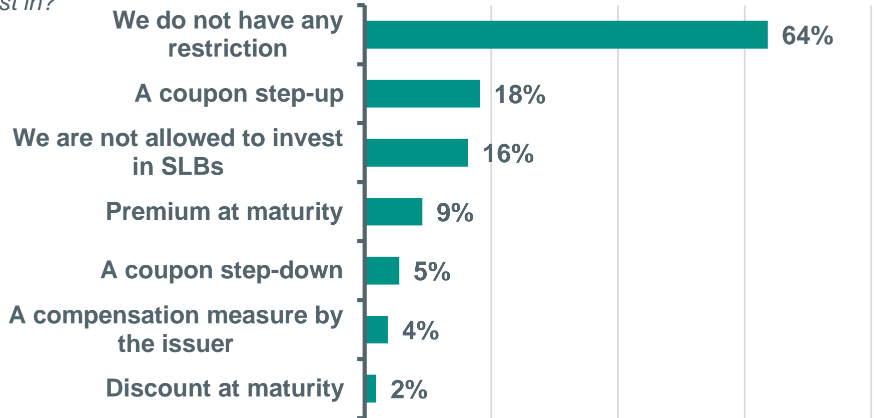
- Our investor survey indicates that the biggest barrier to the growth of the Sustainability-Linked Bond (SLB) market is the structure of these instruments. The majority of respondents cite that it is still very hard to evaluate the ambitiousness of SLB KPIs, which makes it hard for them to judge whether issuers are as strongly committed to ESG as they claim. That is despite the fact that almost all of these instruments have received a Second-Party Opinion (SPO) from an independent third-party. This brings into question to what extent do investors find these (SPO) assessments truly reliable, and what the true value-added of an SPO for an SLB is.
- Another strong barrier indicated by respondents of the survey is with regards to the financial penalty of SLBs. Investors seem to perceive that the step-up amount linked to the SLB (and triggered in case the issuer does not meet its pre-defined sustainability targets) is not material enough. That is, they expected issuers to commit to a higher financial penalty than what is currently being applied by issuers.
- These results tie well with our findings shown on page 13, where 43% of the investors indicated that they no longer see the "standard" 25bps coupon step-up as financially material. On the same page, we also show that for the investors that are allowed to invest in SLBs, 54% of them have a clear preference when it comes to the amount of step-up that SLBs should apply.
- Also a relatively large number of respondents indicated that they see the lack of representativeness of targets as a key barrier for the growth of the market. On page 14, we show that also a significant share of investors miss the inclusion of scope 3 emissions in KPIs linked to GHG emissions. Hence, one could argue that the amount of SLBs coming to the market with emission targets that do not paint a holistic picture of the issuer's carbon footprint is a reason for why investors are not (yet) fully fond of these instruments.
- Within the category "others", some investors have cited the lack of transparency as a barrier. Others have indicated that the financial structure of these instruments might make investment difficult. For example, as these might fail the SPPI test for IFRS 9 (that is, the adjustment in interest rates from the SLB has failed to comply with the criteria that the cash flow of the financial asset refer to solely payments of principal and interest (SPPI) on the principal amount outstanding of the bond).

1) Figures on the right hand side of the chart indicate the weighted average

SLBs: Investors seem open to other payment structures; there is still no big preference in terms of the amount of coupon step-ups, but the "standard 25bps" should change

Most investors are flexible in terms of the financial structure of the SLB, but coupon step-ups seem to remain the preference

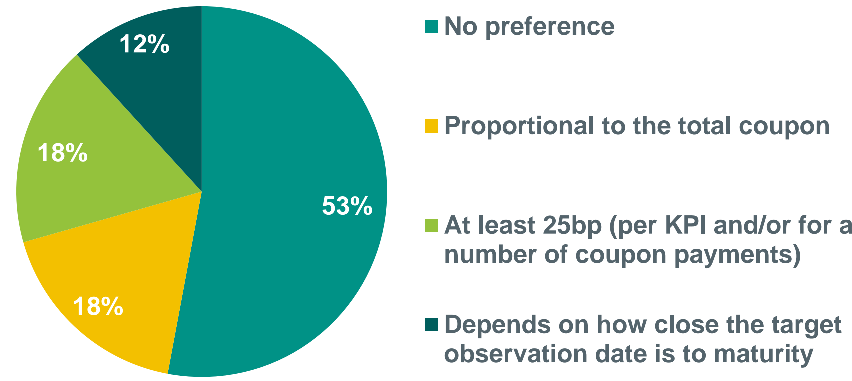
Question: Which (financial) impact linked to the bond would your institution be allowed to invest in?



- Our investor survey indicates that the majority of investors (64%) do not have any investment restriction related to the financial structure of SLBs. This represents a substantial increase since last years' survey, when only 44% of investors did not have any restriction.
- Even though most investors are flexible in terms of the financial structure of the SLB, bonds with a 'coupon step-up' option are still the preferred option among investors that seem to have a preference.
- Regarding the amount of this coupon step-up, almost 53% of respondents indicated they do not have a particular preference.
- Interestingly, it is not unanimous that the "standard" 25bp coupon step-up should change because of the rising interest rates. Only 43% indicated that the standard coupon step-up should increase, in line with the directory interest rates, while 50% of investors think that the step-up should depend primarily on the issuer.
- Combining both results, one could argue that the existing "standard" 25bps coupon step-up does not seem to hold anymore, and issuers should assess on a case-by-case basis what is the most appropriate level.

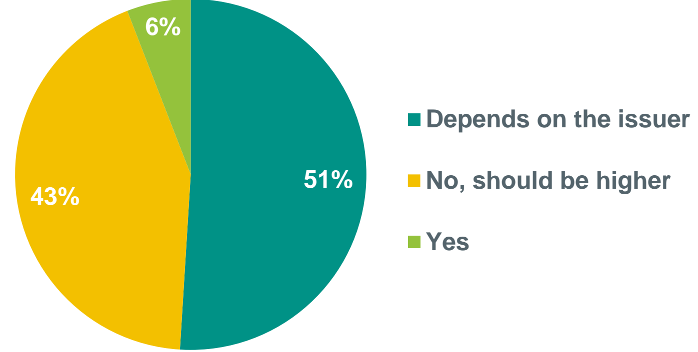
More than half of the investors does not have a preference for the amount of coupon step-up a SLB should include…

Question: Do you have a preference for the amount of coupon step-up?



…But only a small minority of respondents think that the "standard" 25bps coupon step-up is appropriate

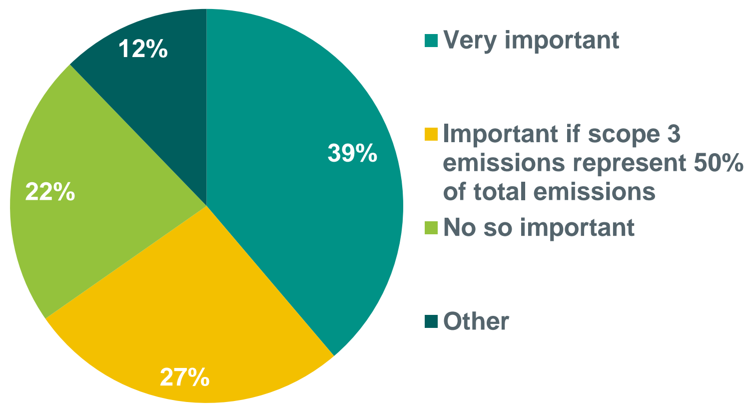
Question: Regarding Sustainability-Linked Bonds (SLBs): Given the recent rise in rates, do you still think that the "standard" 25bps coupon step-up is still sufficient and deemed as financially material?



SLBs: Inclusion of scope 3 emissions in either SLB Framework or KPI is important for investors

Majority of investors think including scope 3 emissions in SLB KPIs is important

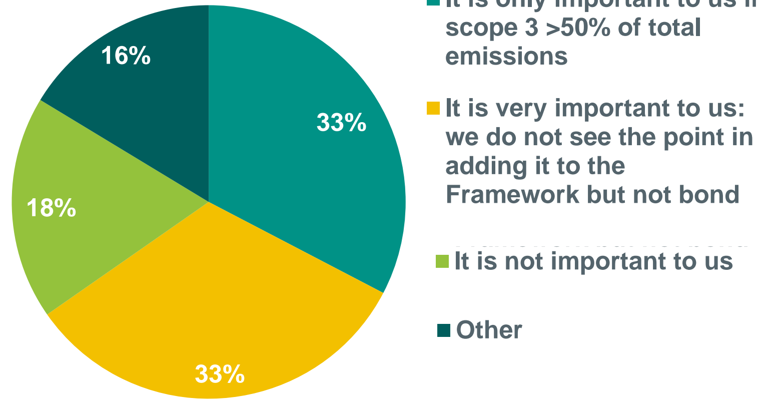
Question: Regarding Sustainability-Linked Bonds (SLBs), how important is it that scope 3 GHG emissions are included in the SLB Framework?



- Our survey indicates that nearly 40% of the respondents find it very important for an issuer to include scope 3 emissions in their SLB Framework, independently if these represent a significant (material) part of their emissions. On the other hand, 27% has indicated that scope 3 should only be included if those represent over 50% of the issuer’s total emissions. Hence, in general, almost 70% of the respondents indicated that they find the inclusion of scope 3 emissions in an issuer’s SLB Framework important.
- Our analysis indicates that while around 80% of all euro IG SLBs are tied to carbon emission targets, only 18% of the issuers have included scope 3 emissions in their Frameworks. Hence, there is clearly a mismatch between what investors want to see in an SLB and what issuers are delivering at the moment.
- Also 12% of respondents mentioned other factors when answering to this question, including that scope 3 emissions are not reliable enough yet, hence questioning also the efficacy of including those in a SLB.

If the scope 3 KPI is added to the Framework, investors think it should also be included in the SLB issuance

Question: Regarding Sustainability-Linked Bonds (SLBs), how important is it that scope 3 GHG emissions are included in the SLB's KPIs?

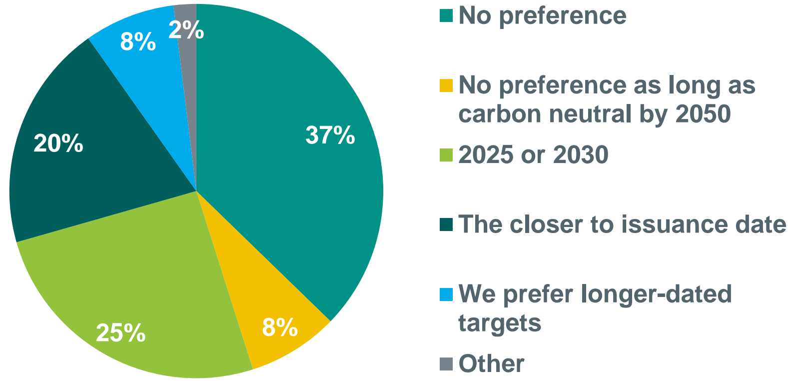


- In line with the previous question, a majority of investors indicated that they find it important for issuers to include scope 3 in their KPIs. 33% of the respondents said that if the scope 3 has been included in the Framework, then it should also be added as a KPI in the SLB.
- Another 33% agrees that it is fine to leave scope 3 targets out of the SLB if those do not represent more than 50% of the issuer’s total emissions. From the previous question, we saw that 27% of the respondents were in favour of including it in the Framework if scope 3 emissions were material. The higher share of respondents in this question is due to the fact that a few investors have flagged that while inclusion of scope 3 in the Framework is very important to them, they also think it is fine to leave it out of the SLB if these do not represent more than 50% of the issuer’s total emissions.
- Furthermore, along with the results presented on the left hand side, 18% of the respondents do not see much importance in adding scope 3 to the SLB’s KPI. We note that this share is slightly lower than the 22% that has replied that they do not see importance in adding scope 3 to the Framework in the first place. This indicates that a few investors do not find the inclusion of scope 3 in the Framework as necessarily relevant, but would still expect it in the SLB if those are emissions are material to the issuer.

SLBs: Not much consensus among investors with regards to observation date

One third of respondents does not have a preference for a target observation date

Question: Do you have a preference for a target observation date?

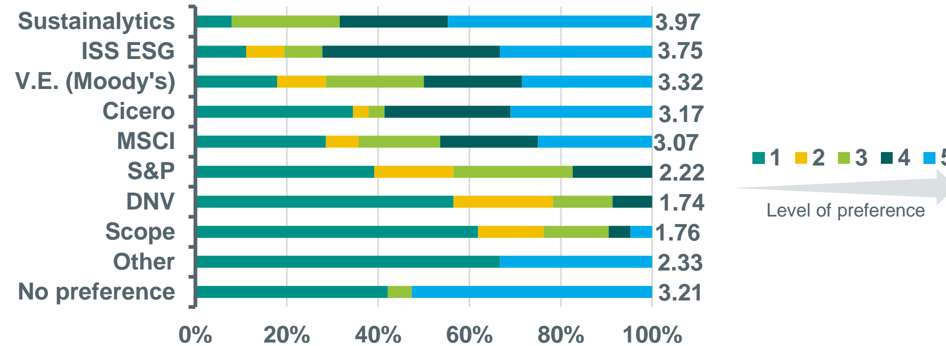


- Overall, there does not seem to be much consensus from investors when it comes to a particular preference regarding an SLB target observation date. A slight majority (37%) has indicated that they do not have a particular preference. On top of that, also 8% indicated that they do not have a preference, but the targets need to lead to carbon neutrality by 2050. The focus on carbon neutrality of only a few investors is a bit in contrast to the fact that 45% of the respondents indicated they take into account net zero targets when evaluating decarbonization strategy of issuers (see page 9).
- Also 25% of the respondents said that they would prefer targets linked to either 2025 or 2030, perhaps because these allow investors to more easily compare SLB ambitions.
- There seems to also be a preference towards more shorter dated targets by some investors. 20% has indicated that "the closer [to issuance date], the better", while only 8% said that they would prefer more longer-dated targets.

Reporting: Largest SPO providers retain investors' preference

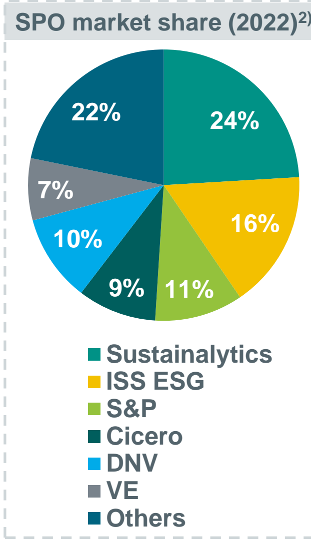
Sustainalytics as the preferred SPO providers by investors

Question: Please indicate your preferred Second Party Opinion (SPO) providers for the assessment of ESG bonds? (1= not preferred at all; 5= preferred option)[1)]



- Almost 20% of investors have indicated they do not have a particular preference when it comes to SPO providers. Of those who have a preference, Sustainalytics seems to be the top choice, aligned also with last years' survey, followed by ISS ESG. These are also the providers with the largest market share.
- In December 2022, S&P announced the acquisition of Cicero, which ranks fourth in the most preferred choice of investors. Nevertheless, combining both Cicero and S&P results would still place the company ranked as the #4 choice, behind Sustainalytics, ISS ESG, and V.E. (Moody's).
- As it was with last year's survey, we do not see a particular relationship between investor's geographical location and its SPO preference,
- Within the category "Others", investors mentioned Bloomberg and Upright.

SPO market share (2022)[2)]

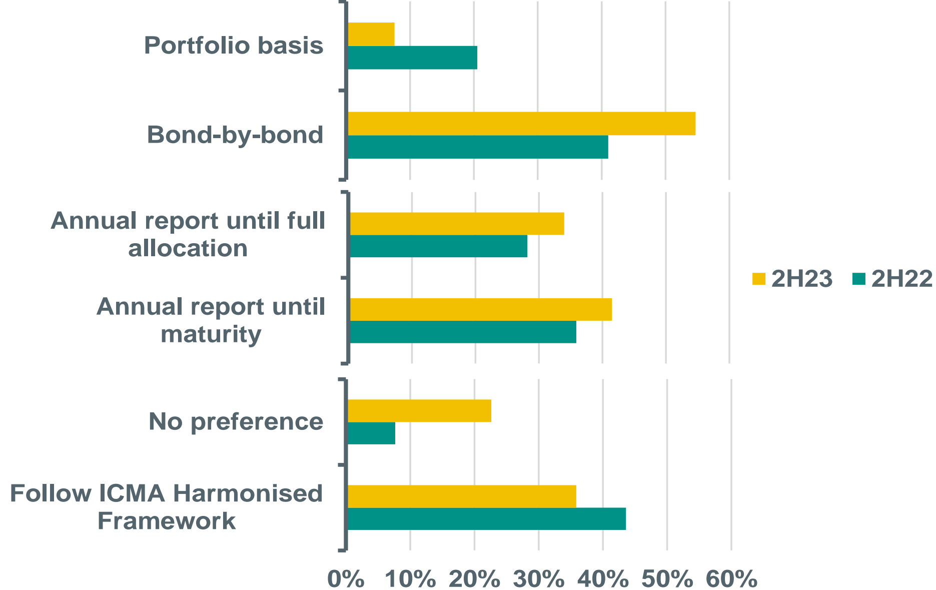


1) Figures on the right hand side of the chart indicate the weighted average. 2) As per Environmental Finance, based on the number of SPOs issued

Reporting: Investors demand more bond-by-bond reporting; there is still no hard requirement for lookback periods

ESG investors more and more keen to see post-issuance reports on a bond-by-bond basis

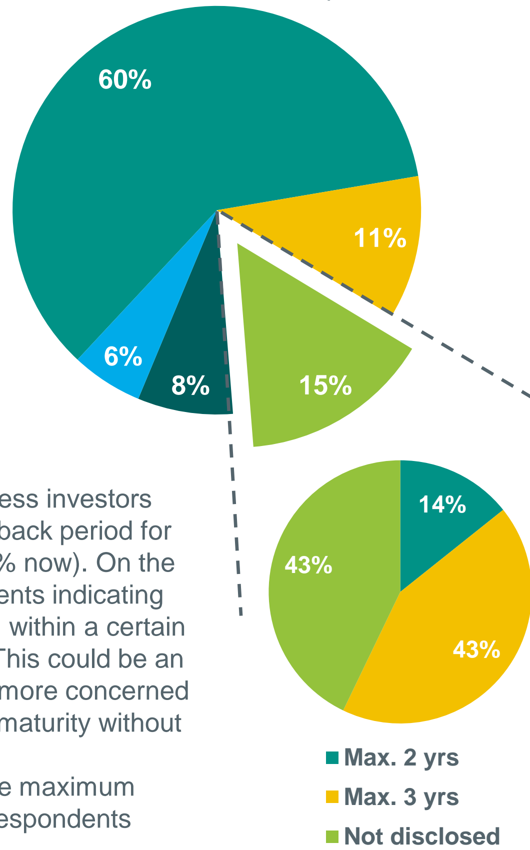
Question: What is your preference with regards to impact and allocation reporting of "use of proceeds" ESG bonds? (Multiple answers allowed)



- Compared to last year's survey, investors seem to be even more eager to see post-ESG bond issuance reports on a bond-by-bond basis, rather than on a portfolio basis. This could be due to developments in the EU GBS, where EuGB issuers can only make use of the portfolio approach if proceeds of the bond are used to finance financial assets (see our note here). Nevertheless, as it was last year, these results are in clear contrast to current market practices, where most issuers apply reporting at portfolio level.
- Furthermore, there seems to be a stronger preference for annual reporting produced until the maturity of the ESG bond, rather than until full allocation of proceeds (which is currently the most commonly form of reporting).
- The share of investors that want reports that follow the ICMA Harmonised Framework for Impact Reporting has decreased from 44% in 2H22 to 36% now. This could be due to the fact that other initiatives are gaining traction in Europe.

Investors still seem flexible when it comes to lookback period

Question: Do you have any requirements in terms of allocation of "use of proceeds" ESG bonds?

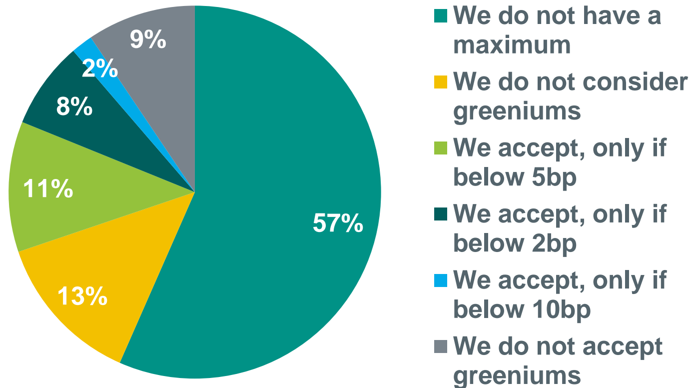


- Compared to last year's survey, less investors seem to require a maximum lookback period for ESG bonds (28% in 2H22 vs. 21% now). On the other hand, the share of respondents indicating that they require a min. allocation within a certain number of years has increased. This could be an indication that investors are also more concerned about ESG bonds that approach maturity without having reached full allocation yet.
- When asked to specify what is the maximum lookback period, the majority of respondents indicated 3 years.
- Within the "other" category, investors have highlighted that there is a preference for either a maximum lookback period or a minimum number of years until full allocation, but those are not a hard requirement.
- Overall though, it is fair to assume that investors still seem flexible when it comes to lookback period of ESG bonds.

Greeniums: Investors expect greeniums to continue, albeit without much change compared to current levels

Greeniums will remain present in the fixed income world…

Question: What is the maximum greenium you are willing to accept when investing in ESG bonds?[1)]



- Around 70% of the respondents of our survey indicated that they do not focus too much on greeniums when investing in ESG bonds. While 57% of investors do not have a maximum greenium that would restrict them to invest in ESG bonds, 13% said they do not even consider those at all (likely indicating that their focus is on other factors, such as ESG impact).
- Furthermore, only 9% of the respondents said they do not accept a greenium at all, implying that those investors do not really differentiate between labelled (ESG) bonds and regular bonds. Those investors are either likely more focused on assessing ESG from an issuer perspective, rather than a label one, or they are not willing to sacrifice financial returns in order to invest in ESG bonds.
- Furthermore, for the investors that indicate they have a maximum greenium threshold, the majority said that this would be up to 5bps. Only a very small share (2%) said they would be willing to accept up to 10bps.
- Overall, one can conclude that greeniums will remain sticky, as investors are willing to accept higher bond prices depending on the issuer / bond label.

… But investors do not expect to see much change in current greenium levels

Question: In general, what are your expectations with regards to the "greenium" in 2H23?[1)]

Arrows indicate change vs. last year's survey

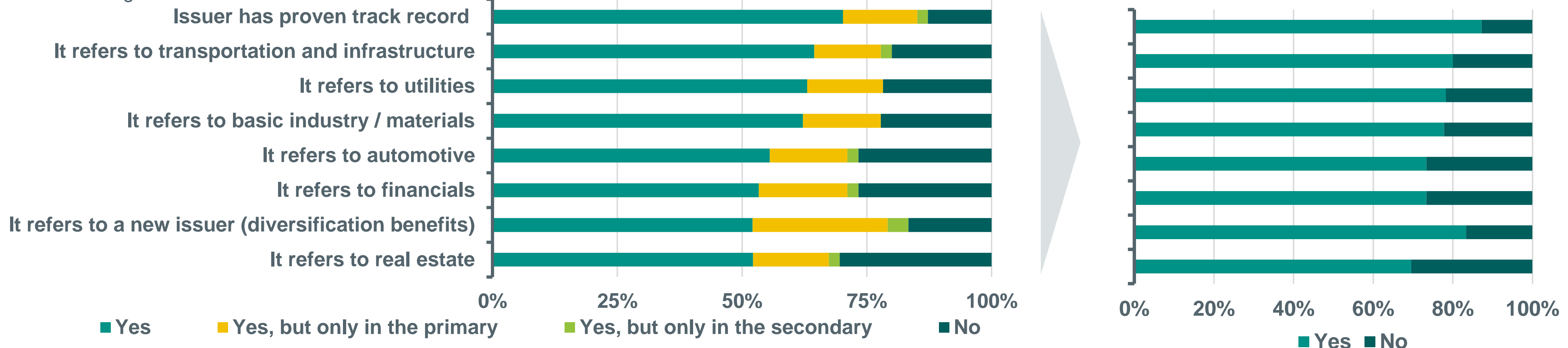
- Our survey indicates that the majority of investors (51%) expects the greenium to remain the same in 2H23 vs. 2H22. This is a clear contrast to last year's survey, where the share of respondents expecting a stable greenium was only 33%. On the other hand, 25% of the investors indicated that they expect the greenium to decrease, but remain positive, which is also slightly higher than the share of 21% in last year's survey.
- Most notably, while last year 31% of the investors expected a higher greenium for 2H22, this share has been reduced to less than half this year (14%).
- Interestingly, the results of last year indicated that there did not seem to be a clear agreement on the direction of the greenium in the market, given the (almost) same share of investors across the different degree of responses (greenium will increase/stay the same/decrease). However, this year's results show that there seems to be a stronger consensus among investors that the greenium will remain relatively stable.
- Still, as also seen last year, market participants seem to expect the greenium to remain positive for the time being.

1) "Greenium" refers to spread differential between green bonds and non-green (that is, regular) bonds for the same issuer. If the spreads of a green bond trade inside an issuer's curve, the greenium is positive.

Greeniums: Investors are more focused on the issuer's ESG credentials rather than sector when assessing greeniums

Investors are mostly focused on the issuer's ESG credentials and "novelty" factor when deciding whether to accept a greenium or not

Question: Given the foreseeable market conditions (weak economic backdrop, continued tight monetary policy by central banks) would you be willing to accept a primary/secondary greenium in the following circumstances:[1)]



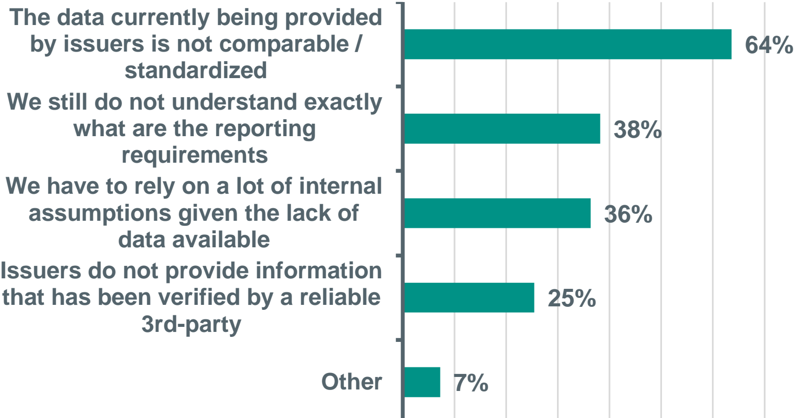
- Our survey indicates that the investors who are willing to accept a greenium, seem to be more focused on the issuer's profile / ESG credentials, rather than the sector the issuer belongs to.
- Overall, and aligned with results presented on page 17, our survey indicates that a majority of investors are still willing to accept a greenium.
- Furthermore, it seems that investors are most willing to accept a greenium if the issuer has a proven (ESG) track record and/or it is refers to a new issuer, which can provide the investors with diversification benefits. That would also imply that perhaps ESG impact from a pure sector perspective is not the dominant point of attention of ESG investors.
- Another interesting highlight from these results is that the share of investors that are willing to accept a greenium exclusively in the secondary market is significantly lower than the share that is willing to accept it exclusively in the primary. That ties very well to findings on page 5, where we see that the majority of ESG investors make use of either only the primary, or both, primary and secondary, to source ESG bonds.
- From an industry perspective, we can see that the majority of the investors are willing to accept a greenium if it refers to transportation / infrastructure, utilities and basic materials. On the other hand, greeniums for bonds by real estate issuers seems to be least accepted by ESG investors. While one could attribute that to an ESG perspective, the low acceptance of greeniums in this sector could also likely be to the fact that these bonds trade currently at distressed levels. Hence, investors are not willing to further sacrifice returns in order to invest in an ESG bond by a real estate issuer.

1) "Greenium" refers to spread differential between green bonds and non-green (that is, regular) bonds for the same issuer. If the spreads of a green bond trade inside an issuer's curve, the greenium is positive.

Regulation: The biggest challenge around the SFDR implementation is data quality; most investors are not yet sure if and how they will implement the EU GBS requirements

Data quality remains the biggest issue around SFDR reporting

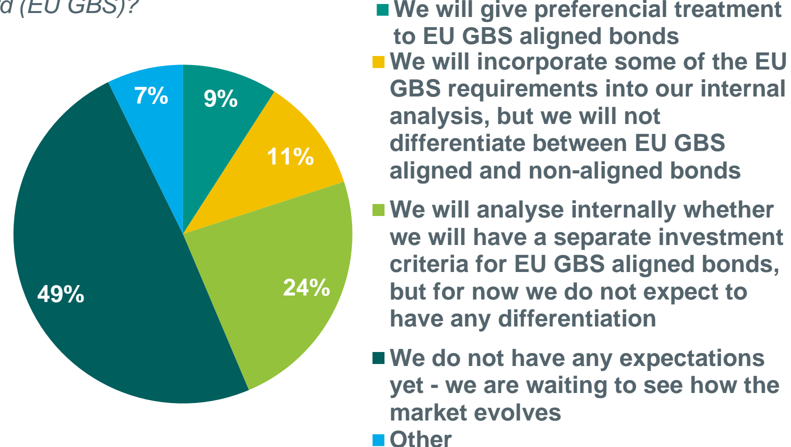
Question: What is your institutions' biggest challenge when it comes to regulatory transparency requirements (as per the SFDR)?[1] (Multiple answers are allowed)



- The majority of the respondents indicated that data comparability remains the biggest challenge when it comes to SFDR reporting requirements. 64% of the investors have flagged that the data currently being provided by issuers is not very standardized and that does not allow the investor to properly compare the information across issuers. Also 25% of investors point out that a lot of the information currently being provided by issuers has not been properly verified (or has not received an assurance from a third party), which brings into question the reliability of this data.
- Also 36% of the respondents said that lack of data availability still remains a big issue, which requires investors to rely on internal assumptions.
- Both these points (lack of data quality and data availability) lead to granularity in terms of investors' reporting. In our ESG Fixed Income Outlook 2023 (see here), we flagged that we thought these would be one of the biggest issues investors would face this year.
- 38% of the respondents have also indicated that reporting requirements are still unclear, implying that still a significant share of market participants rely on more clarity from regulators in order for apply the SFDR efficiently.

Most investors are in a "wait and see" mode with regards to applying the EU GBS internally

Question: What are your expectations with regards to the upcoming EU Green Bond Standard (EU GBS)?



- Only 20% of the respondents have indicated that they are already positioned for the upcoming EU GBS. However, from this figure, only 9% has also flagged that they will give preferential treatment to EuGB bonds. The remaining 11% has indicated that they will incorporate some of the requirements of the EU GBS, but as long as these requirements are met, they would not be willing to "punish" regular (ie non-EuGB) green bonds.
- Also 24% of the respondents said that they will evaluate internally whether a separate investment criteria will apply for EuGB bonds, but no differentiation between green and EuGB bonds is expected for now.
- The vast majority (49%) seems to be in a "wait and see" mode with regards to the EU GBS. Those investors do not yet know whether they will incorporate some of the EU GBS requirements and/or whether they will apply some level of differentiation across EuGB and green bonds. Hence, one can conclude that the usability and applicability of the EU GBS will likely depend on how the EuGB market evolves into the future.
- Within the category "other", investors have mentioned they already know that they will continue with current criteria and will therefore not apply any differentiation across bonds.

1) SFDR refers to the EU Sustainable Finance Disclosure Regulation

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