July **2024**

GREEN, SOCIAL AND SUSTAINABILITY (GSS) BONDS MARKET TRENDS

EU Green Bond Standard - a match or a clash for the Green Bond market?

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ESG Ratings

ESG Ratings ensure investors have the right tools to measure the sustainability risks of their positions. Our ESG Ratings of GSS Bonds rely, in equal weighting, on the Issuer ESG Rating and the specific sustainability analysis of the bond.

For use of proceeds bonds, Bond ESG Ratings rely on 8 variables that consider the "Projects Additionality" (i.e., the quality of the projects) and the "Sustainability of the Framework" (i.e., the quality of the governance of the bond issuance). For sustainability-linked bonds, the Bond ESG Rating leverages a set of variables that relate to 3 sub-ratings categories: "KPI Selection", "Materiality" and "Financial Accountability". The rating also depends on the performance of the issuer against their Sustainability Performance Targets (SPT), i.e., its performance.

Use of Proceeds

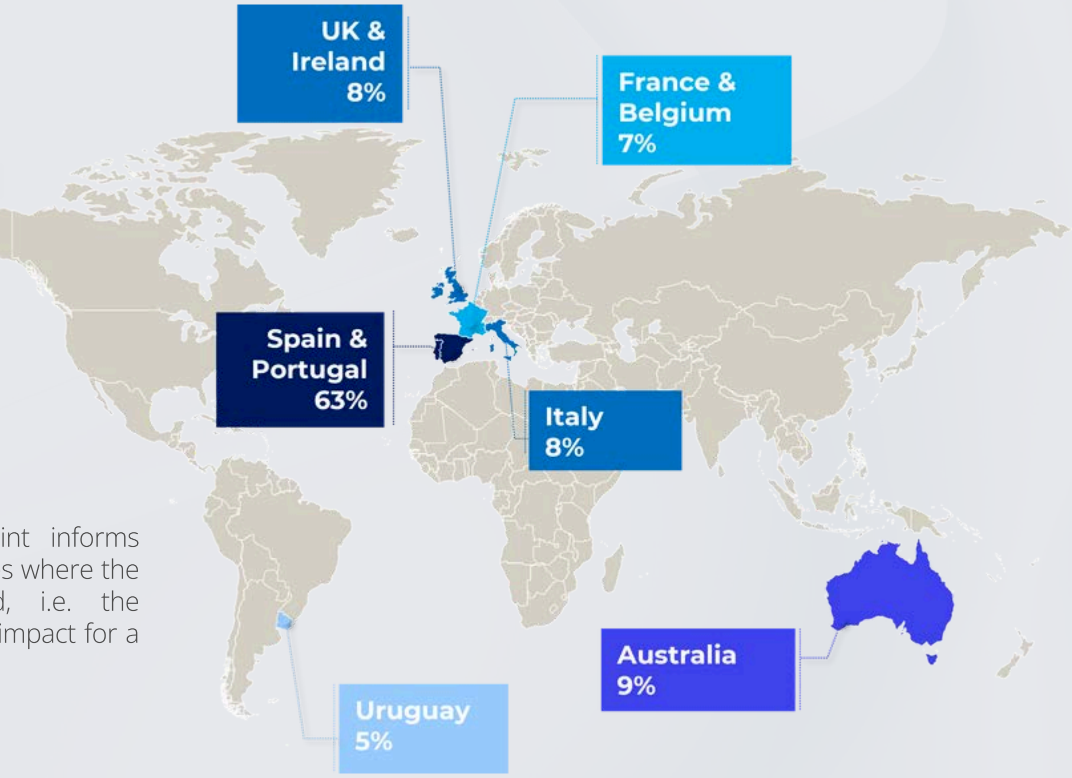
Post-issuance financial allocations provide much needed clarity around the type of assets financed with the capital raised from each individual GSS Bond.

Category

- Clean Transportation
- Energy Efficiency
- Green Buildings
- Renewable Energy
- Water Management

Geography ▶

The innovative datapoint informs investors of the countries where the projects are financed, i.e. the countries of risk and of impact for a bond.



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SDGs Alignment

The alignment of GSS Bond proceeds to the UN Sustainable Development Goals (SDG) enables investors to assess the sustainability objectives of their holdings and to aggregate them at portfolio level.

Data is provided as reported from issuers' bond documents.

Impact Results

We analyse environmental and social Impact Data of each GSS Bond reported directly by the issuer. The data is available at bond level and it can be aggregated at portfolio level based on an amount invested (as illustrated in the image below).

Taxonomy Alignment

With the European Taxonomy slowly making its way into GSS Bond documents, our tool enables investors to discover the specific activities their bonds are financing (e.g., wind energy generation), beyond the more general project categories (e.g., renewable energy).

The analyst-run assessment scans all projects and results in a percentage Alignment to the Taxonomy "Climate Change Mitigation" pillar for each Green and Sustainability Bond. Issuer-level "DNSH" and "Minimum Social Safeguards" complement the analysis.

Example of a Green Bond with Alignment = 100%

TECHNICAL SCREENING CRITERIA

Electricity generation from
Solar Photovoltaic

Electricity generation from
Wind

Activity derogated from assessment

Alignment	*Project Weight*
100%	58%

Activity derogated from assessment

Alignment	*Project Weight*
100%	42%

DNSH
(ESG Analysis)

\+

Minimum Social Safeguards
(Controversial Behaviour and Activities)

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Key Highlights

53%

In 2023 the average reported Taxonomy Alignment of European corporates increased across Capex and Opex, but decreased according to Revenue, dropping just below 10%.

In the meantime, as of the end of June 2024, **the average Taxonomy Alignment of approximately USD3 trillion in Green Bonds and Sustainability Bonds** is 53%, 62% for Green Bonds and 21% for Sustainability Bonds.

23%

Only 23% of MainStreet Partners' universe of Green and Sustainability Bonds **is in the position to claim the European Green Bond Standard (EU GBS) certification**.

Looking only at bonds issued in 2023 and 2024, however, the number jumps to 58%.

18%

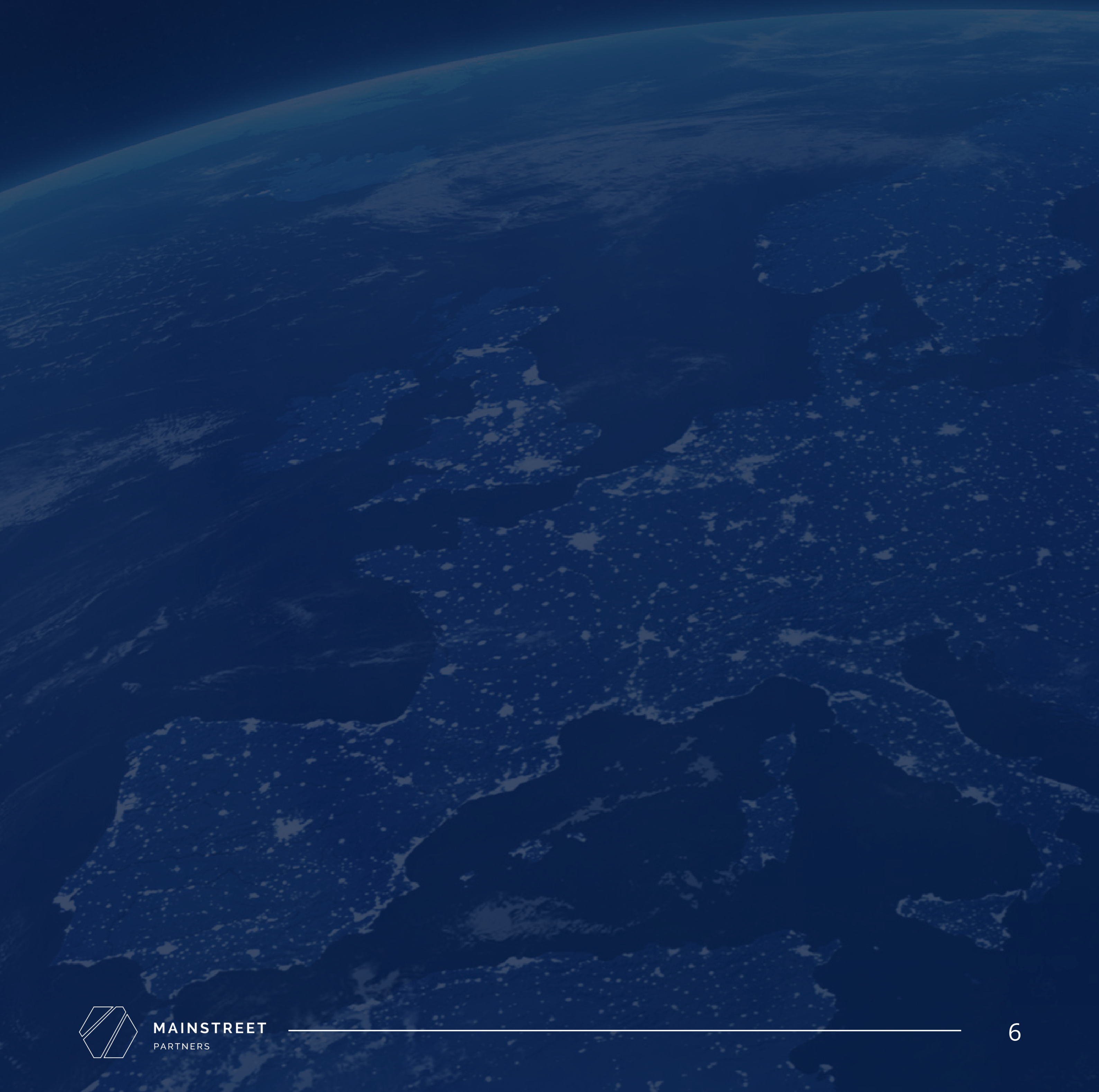
German issuers hold the largest stock of potentially EU GBS bonds. 18% of the total Taxonomy Alignment comes from projects on **"Transmission and distribution of electricity"**.

+100 TONS/EURMLN

CO2 Avoided/Reduced per EURmln from EU GBS-eligble bonds vs non-eligible, on average (at 565 tons/EURmln vs. 486 tons/EURmln for non EU GBS-eligible bonds).

1.

THE STATE OF PLAY: TRENDS IN GSS BOND AND CORPORATE TAXONOMY DATA



Increasingly "Green" and "Sovereign"

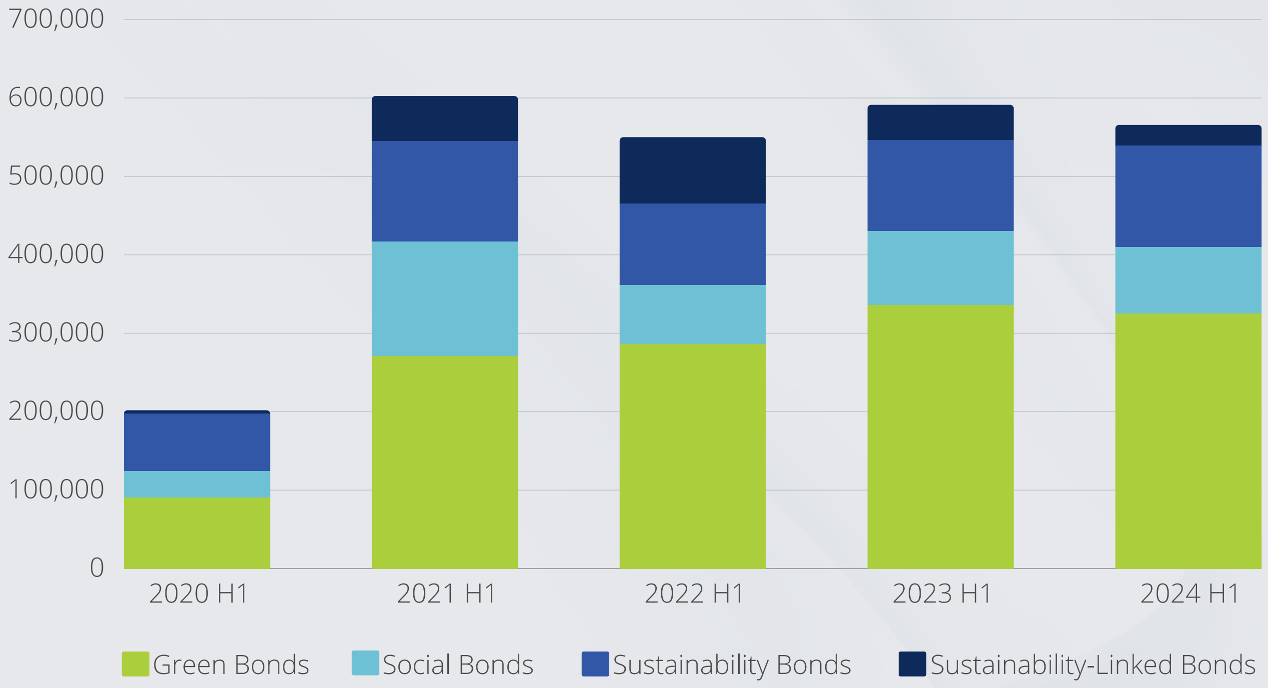
The GSS Bond market continues to represent a growing segment of the global fixed income market reaching **over USD550bn in the first half of 2024**, representing 11% of the total amount issued in global bond markets in that period. Total GSS Bonds issued since market inception are rapidly approaching USD5tn.

Green bonds continue to make the largest contribution, with total issued volume of 58% in H1 2024, compared to 52% in H2 2023. Notably, since the start of the year, several high-profile issued their debut Green Bonds, such as Australia and Japan. Issuances from Latin America and Asia have also picked up.

Source: MainStreet Partners

GSS Bond Issued in H1 between 2020 and 2024

(USD billion)



In H1 2024, European issuers accounted for over 50% of total volume issued. With the introduction of the EU Green Bond Standard at the end of 2024, European Green Bonds are expected to gain even greater relevance. More transparency about the use of proceeds and on issuers' transitions plans, as well as robust reporting standards, will be positive drivers for confidence, not only of European issuers.

MainStreet Partners provides assessment of each Green Bond and Sustainability Bond against the European Taxonomy.

Such information enables investors to discover the specific activities a bond is financing (e.g., wind energy generation), beyond the more general project categories (e.g., renewable energy).

The analysis verges upon a detailed scan of each project financed and provides a resulting percentage alignment to the "Climate Change Mitigation" objective of the Taxonomy.

Issuer-level "Do-No-Significant-Harm" and "Minimum Social Safeguards" assessment complement the analysis. As of the end of June 2024, the average Taxonomy Alignment of approximately USD3 trillion in Green Bonds and Sustainability Bonds is 53%, 62% for Green Bonds and 21% for Sustainability Bonds.

Most Recent Reported Taxonomy Data on Revenue, Capex and Opex

The European Union is widely recognized for its ambitiousness in the sustainable finance space – to become a carbon–neutral continent by 2050 it set a plan articulated on 10 actions. The set of measures, covers a range of areas – all based on the requirement of companies to report annually on the extent to which their Revenues, Capex and Opex are "sustainable."

The European Taxonomy regulation (also EU Taxonomy) has been one of the first developed globally and is now fully embedded the Sustainable Finance Disclosure Regulation (SFDR), designed for European financial market participants, and the Corporate Sustainability reporting Directive (CSRD), designed for European financial and non-financial companies.

Specifically, the EU Taxonomy requires companies to disclose both levels of Taxonomy Alignment, i.e., those items that meet the "sustainability standard," and of Taxonomy Eligibility i.e., items that could potentially meet the "sustainability standard." The percentage of Taxonomy Eligibility is always equal or greater than the Taxonomy Alignment.

As part of its data solutions, MainStreet Partners analyzed over 1,000 companies, reports as of the end of 2023 – covering most of the ~1,500 companies in scope.

Source: European Commission

What has been reported so far: a timeline

	Non-Financial Entities		**Financial** Entities	
	Taxonomy Eligibility	Taxonomy Alignment	Taxonomy Eligibility	Taxonomy Alignment
January **2022**	✓		✓	
January **2023**	✓	✓	✓	
January **2024**	✓	✓	✓	✓

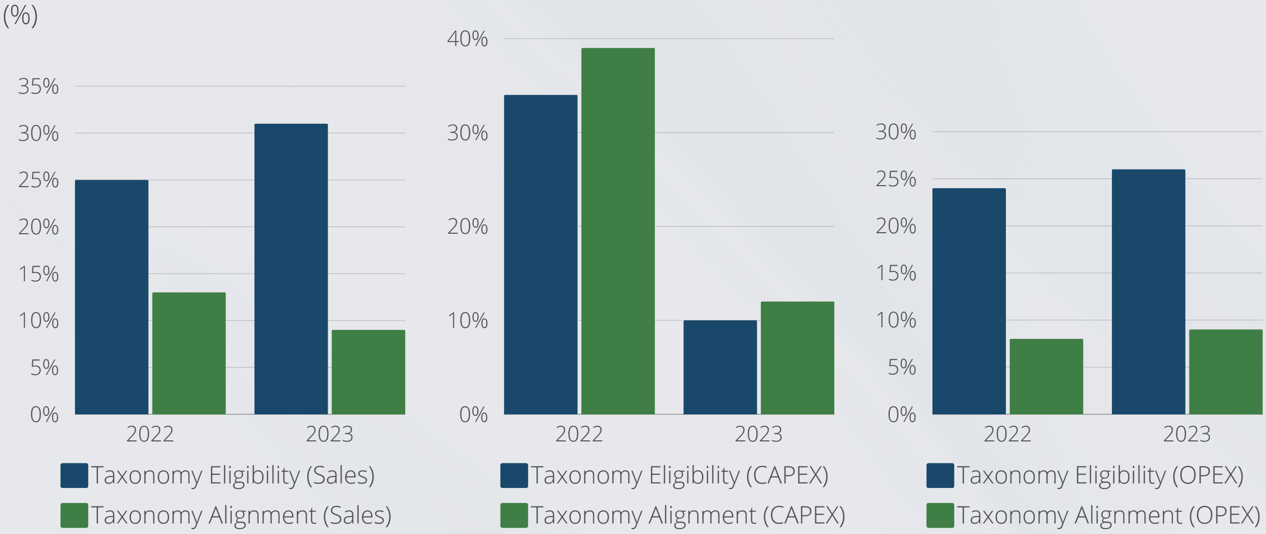
Comparing calendar year 2023 with 2022, reported Taxonomy Alignment increased across Capex and Opex, but has slightly decreased for Revenue. Average reported Sales Alignment dropped below 10%, despite Eligibility rising to above 30%.

The increase in the Average Alignment for Capex is a particularly positive result as it highlights companies' increased attention to allocating capital towards sustainable assets. Capital investments in 2024 have totaled EUR249bn against last year's EUR191bn.

Source: MainStreet Partners

Average Taxonomy Eligibility and Alignment for Calendar Year 2023

(%)



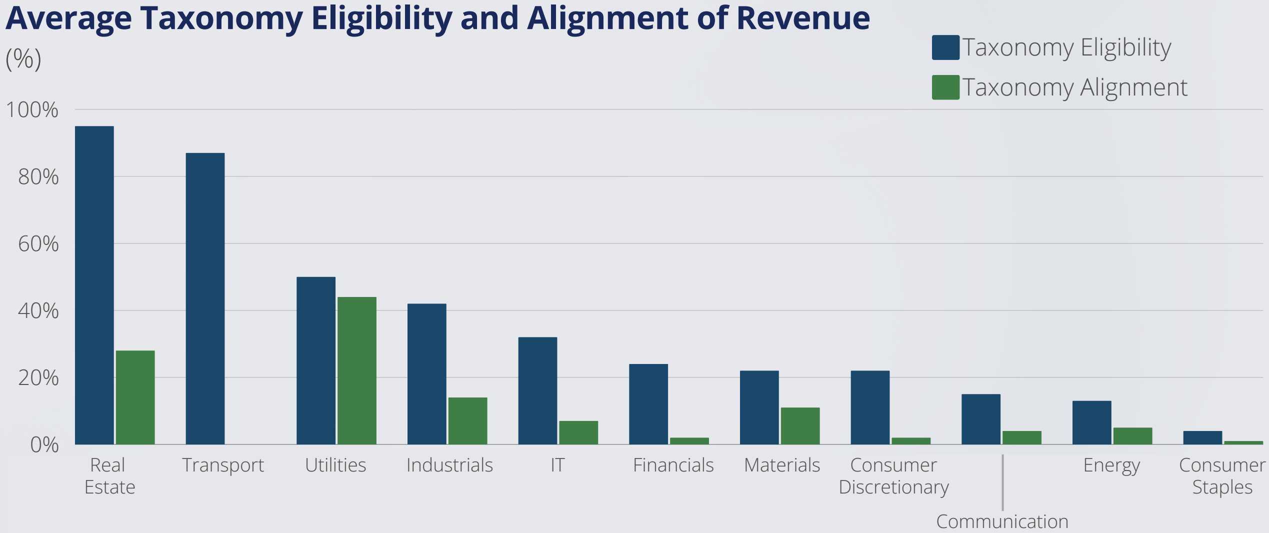
Given the wide range of Eligibility and Alignment identified within sectors, averages do not necessarily capture the core information reported. Some sectors, such as Transport and Utilities, have activities that can contribute to the environmental objectives of the EU Taxonomy as they are responsible for a large share of emissions in the value chain. Real Estate, Transport and Utilities still lead the way when it comes to eligible activities, with utilities displaying the highest percentage Alignment across Revenues and Capex. The highest capital investments currently are being made by Utilities, with around 73% of existing Capex being aligned, equivalent to over EUR130bn in 2024 alone.

Capital expenditure plays a particularly crucial role, as they are expected to be signals of a shift towards businesses with higher Revenues Taxonomy Alignment. Utilities, encompassing energy production and distribution, are at the forefront of the shift to more renewable sources of energy. In the case of real estate activities, Eligibility and Alignment seem to be very concentrated – which may suggest that they are all involved in similar activities covered by the Taxonomy.

Source: MainStreet Partners

Average Taxonomy Eligibility and Alignment of Revenue

(%)



As widely reported by the European Commission, investments in energy and transport will need to reach at least EUR1.5tn on average from 2031 to 2050, considering the 90% net emissions reduction target by 2040 (compared to 1990). Issuers from both sectors, in fact, are among the most active in the European Corporate GSS Bond.

Interestingly, sectors with traditionally low Alignment with the EU Taxonomy are beginning to show improvement, albeit gradually.

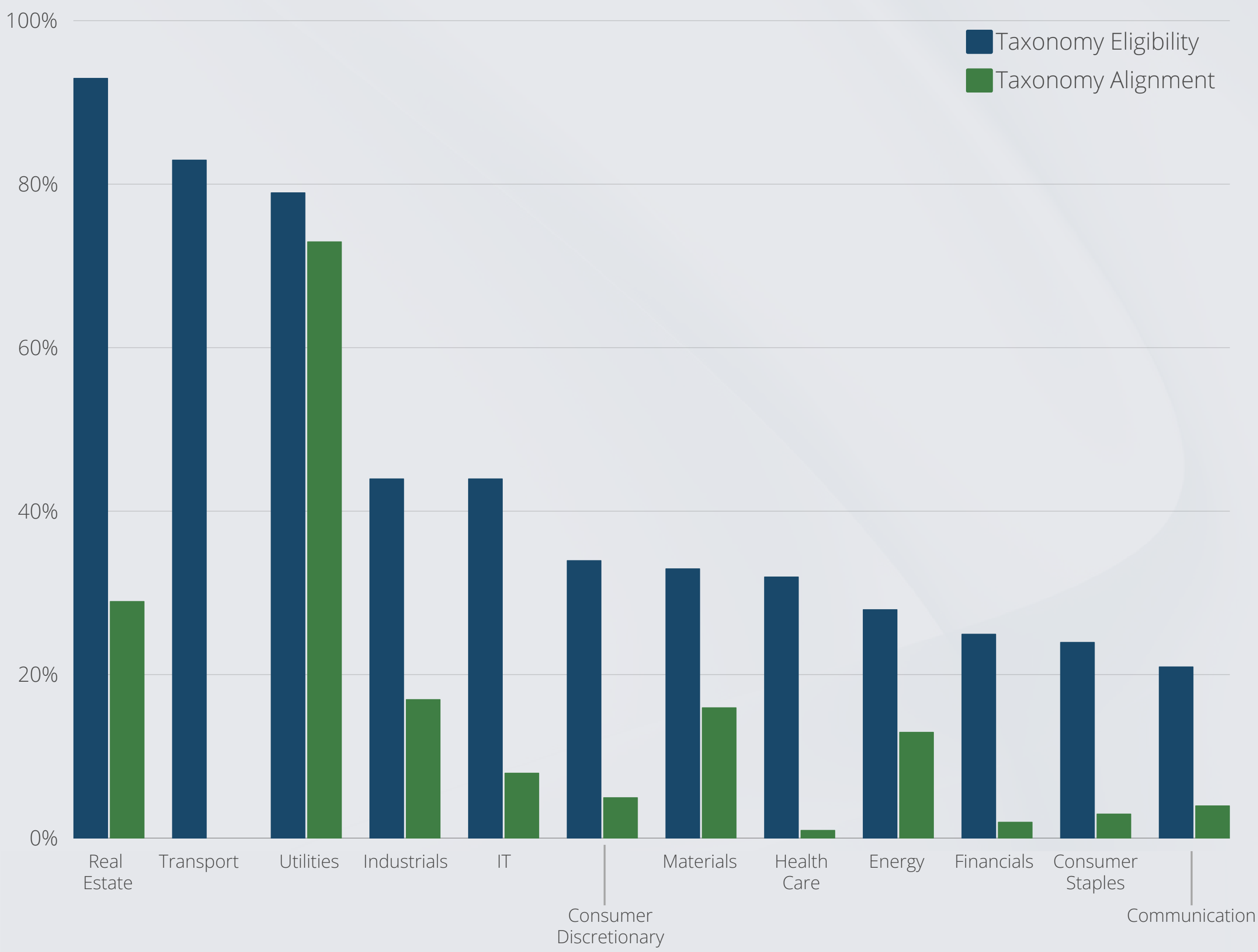
Industries such as Consumer Discretionary, and Materials are making incremental progress in aligning with the Taxonomy.

The shift indicates a growing recognition of the importance of sustainable practices and the long-term benefits of compliance. As these sectors continue to invest in green technologies and sustainable methods, their Alignment with the EU Taxonomy is expected to increase, contributing to a more comprehensive and unified approach to sustainability across the European economy.

Source: MainStreet Partners

Average Taxonomy Eligibility and Alignment of Capex

(%)

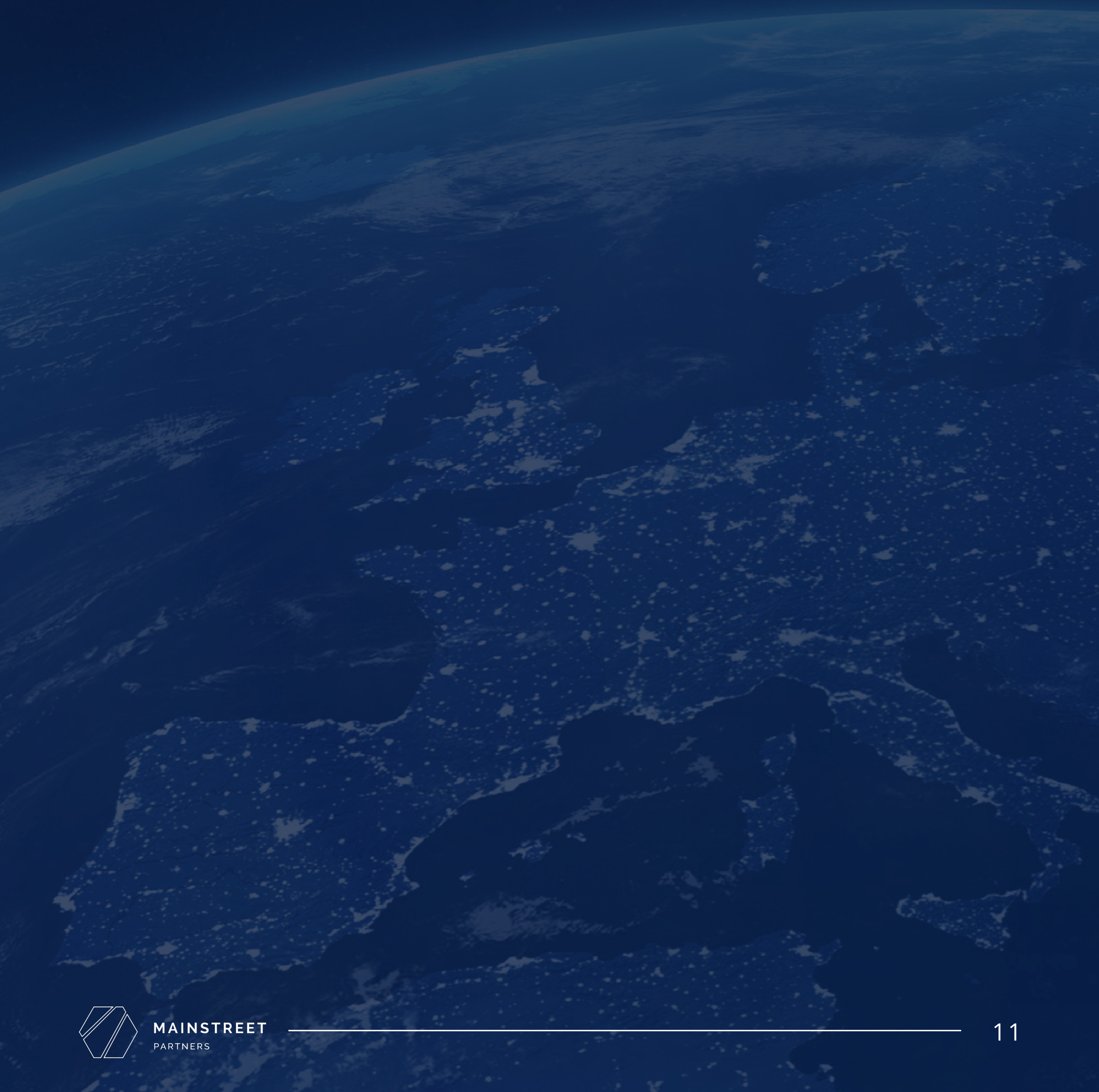


The reported data highlights that companies are increasingly using the EU Taxonomy for their business strategies, transition planning and investing. Critical to the growth of green investments will be the availability of financing, whether from the private or public sector.

Through reporting against the EU Taxonomy, issuers are already setting the stage for improved disclosed performance against the EU Taxonomy in the future, and the EU Green Bond Standard is set to propel it.

2.

5 MONTHS TO GO: THE EU GREEN BOND STANDARD AS THE NEXT MILESTONE FOR GREEN BONDS



A “gold” label for Green Bond issuers

We are midway through the transition year of the European Regulation on European Green Bonds (EuGB). The awaited “gold standard” applies from 21st December this year.

The EuGB standard, part of the European Commission’s 2018 Sustainable Action Plan, aims to enhance transparency, credibility, and coherence of Green Bonds by aligning them with the European Taxonomy and encouraging standardised reporting practices.

To earn the EuGB certification, issuers of Green Bonds would need to (voluntarily) comply with specific requirements.

The regulation’s key requirements include use of proceeds’ Alignment to at least one Taxonomy’s Environmental Objective (e.g. Climate Change Mitigation). Regulators agreed on leaving a 15% margin for non-Alignment with the Taxonomy for activities not yet fully disclosed. Additionally, proceeds would also need to comply with the “Do-No-Significant-Harm” and “Minimum Safeguards” criteria.

Proceeds can be allocated to non-financial assets, CAPEX (Capital Expenditures) and OPEX (Operating Expenses), incurred within 3 years pre-issuance, as well as financial assets funded up to a maximum of 5 years before issuance.

Source: European Commission, elaboration by MainStreet Partners

Use of Proceeds

- **Fixed non-financials assets**
- **CAPEX**
- **OPEX** - <3 years from bond issuance
- **Financial Assets** - <5 years from bond issuance

At least 85% aligned with one of the EU’s eligible activities:

- CCM - Climate Change Mitigation
- CCA - Climate Change Adaptation
- CE - Circular Economy
- BIO - Biodiversity Ecosystem protection and restoration
- PPC - Pollution Prevention and Control
- WTR - Water Management and Treatment

+

- **DNSH - Do Not Significant Harm**
- **Minimum Safeguard**

As disclosed in Article 8, issuers must also ensure that if proceeds are allocated somewhere not initially planned, not allocated proceeds, or those which are not aligned (or at risk of) not being aligned and are covered by a Capex plan, must be realigned no later than seven years after the date in which the criteria were altered.

Issuers required to publish plans ensuring their business is compatible with the transition to a sustainable economy, particularly Article 8 and Article 9 funds and those who do so voluntarily, must disclose in the factsheet, allocation report, or optional pre- and post-issuance templates on how the proceeds contribute to funding these aims.

Source: European Commission, elaboration by MainStreet Partners

Transition

Article 8 and Article 9 funds must state how the proceeds align with their strategy to the transition to a sustainable economy.

Change of Plans

The initial technical screening criteria is changed:

- **Not allocated proceeds**

or

- **Proceeds covered by a Capex plan that are not aligned** (or at risk of not being).

Must be realigned no later than 7 years.

From a reporting perspective, pre-issuance, issuers would need to publish a standardized factsheet. Post-issuance, the expectation is of annual Allocation Reports (until full allocation of proceeds), and of at least one Impact Report.

The Impact Report should include quantitative and qualitative indicators on projects. Both annual Allocation Reports and Impact Reports require external verifications by reviewers accredited by ESMA (European Securities and Markets Authority).

Source: European Commission, elaboration by MainStreet Partners

Pre-Issuance

Green Bond Factsheet: Standard framework detailing strategy, proceeds allocation, and environmental objectives. This document aids investors in comparing different bond strategies. An external review is mandatory.

Post Issuance

Impact Report: Explains the alignment of the environmental impact with the projects funded by the bond. It must be published after full allocation and before maturity.

Allocation Reports: Published annually starting one year after issuance and continue until full allocation of proceeds. These reports disclose the alignment of funded projects with EU taxonomy activities. An external review is required.

3.

FIRST OF A KIND: FEASIBILITY ASSESSMENT OF GSS BONDS AGAINST THE EU GBS

Strong level of EU Taxonomy reporting positions EU GBS for a strong start

Based on MainStreet Partners analysis of over 4,000 GSS Bonds (covering approximately 75% of the market), only 18% could obtain the European Green Bond Standard (EU GBS) certification.

Excluding Social and Sustainability-linked Bonds the share of "EU GBS-eligible" bonds stands at 23%.

MainStreet's definition of an EU GBS-eligible bond is based on:

- More than 85% of the bond's proceeds being **aligned with the EU Environmental Taxonomy** (Mitigation);
- The issuer having set quantitative **environmental targets at issuance** (within the issuance framework);
- The issuer pledging at issuance to publish at least one **post issuance report**.

Due to the scarcity of available data, the requirement to disclose the share of proceeds refinanced has not been accounted for at this stage.

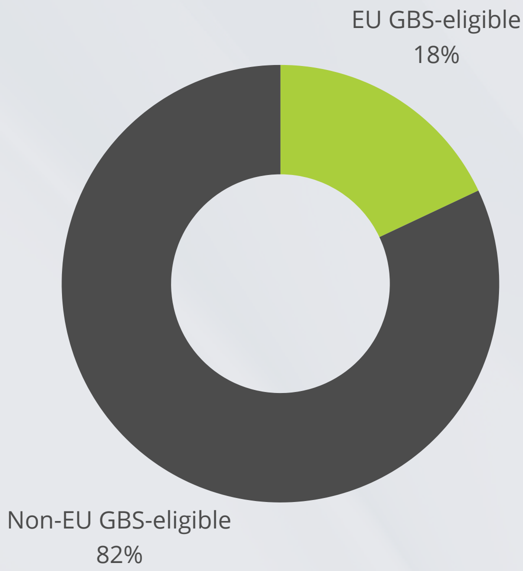
Nevertheless, the parameter will become more widely available as companies increasingly align to the EU GBS disclosure requirements.

The low market share occupied by EU GBS-eligible bonds as defined above is not surprising given that issuers are still adapting both in terms of business operations and in terms of reporting.

As issuers gain understanding of the certification and adapt to the disclosure requirements, we expect this figure to increase.

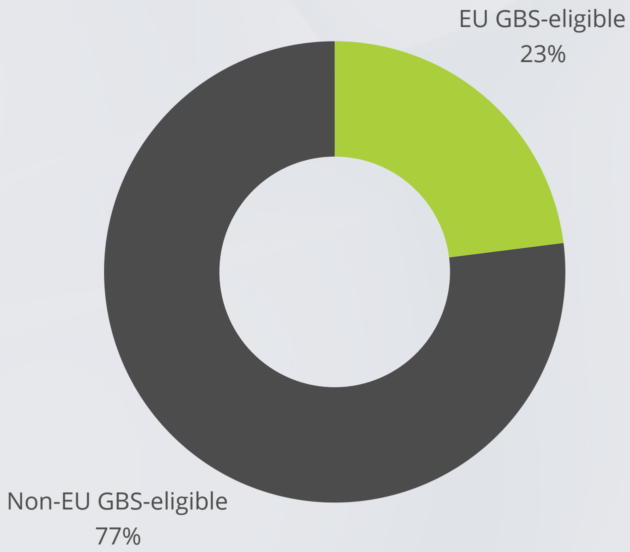
Source: MainStreet Partners

Market share of EU GSB-eligible GSS Bonds
Excl. Social and Sustainability-linked Bonds
(%)



Source: MainStreet Partners

Market share of EU GSB-eligible GSS Bonds
(%)

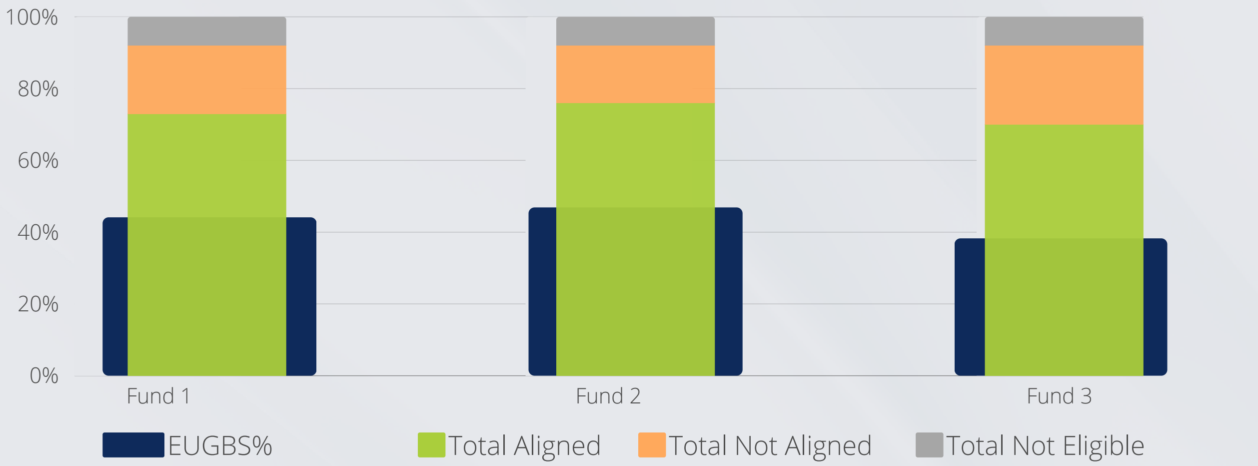


Screening a sample of the largest Green Bond funds against MainStreet's GSS Bonds database highlights robust Taxonomy Alignment, well above 70%. Only about 40% of the same holdings fall in MainStreet's definition of EU GBS-eligible bond.

Source: MainStreet Partners

Funds Taxonomy Alignment Distribution

(%)



Although the adoption of the EU GBS will give companies a pretext to keep improving the Taxonomy Alignment of their projects as well as the respective reporting and disclosure, progress has already been recorded in the last couple of years.

For instance, a time-series analysis of the share of EU GBS-eligible frameworks over total Green and Sustainability Bond volume suggests that there has been consistent improvement during the years – this is also reflected in the consistent increase in the share of volume issued that is EU GBS-eligible.

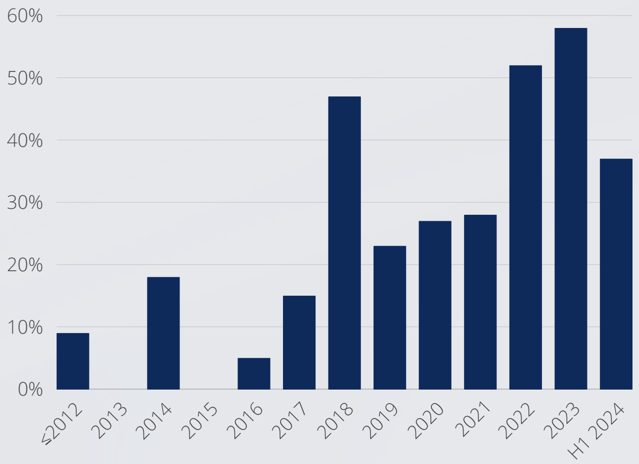
Frameworks published in 2023 and 2024 reached a record high of 58% eligibility to the EU GBS certification.

Nevertheless, the fact that based on the same analysis only 679 GSS Bonds are eligible for this certification shows that the EU GBS is defining a new, niche category of Green Bonds. The following section will articulate answers to questions such as, how diversified is the current eligible universe of bonds, and which Key Performance Indicators (KPIs) are already available to demonstrate their environmental impact?

Source: MainStreet Partners

Share of EU GBS Bonds Issued

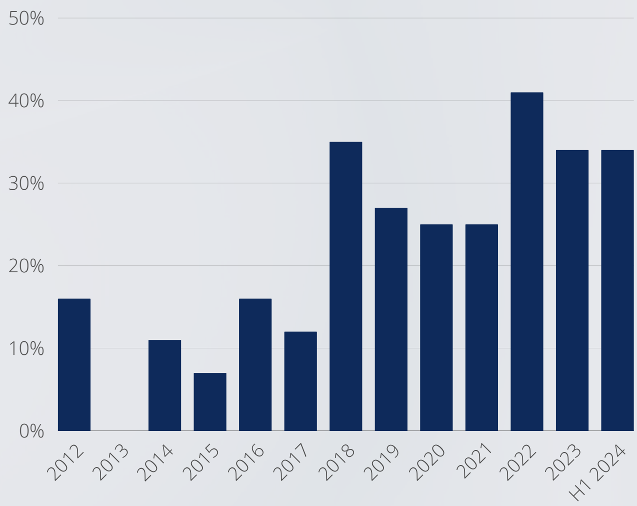
(by framework year)



Source: MainStreet Partners

Share of EU GBS Volume Issued

(by issuance year)



EU GBS-eligible and non-EU GBS-eligible bonds: same activity, different outcome

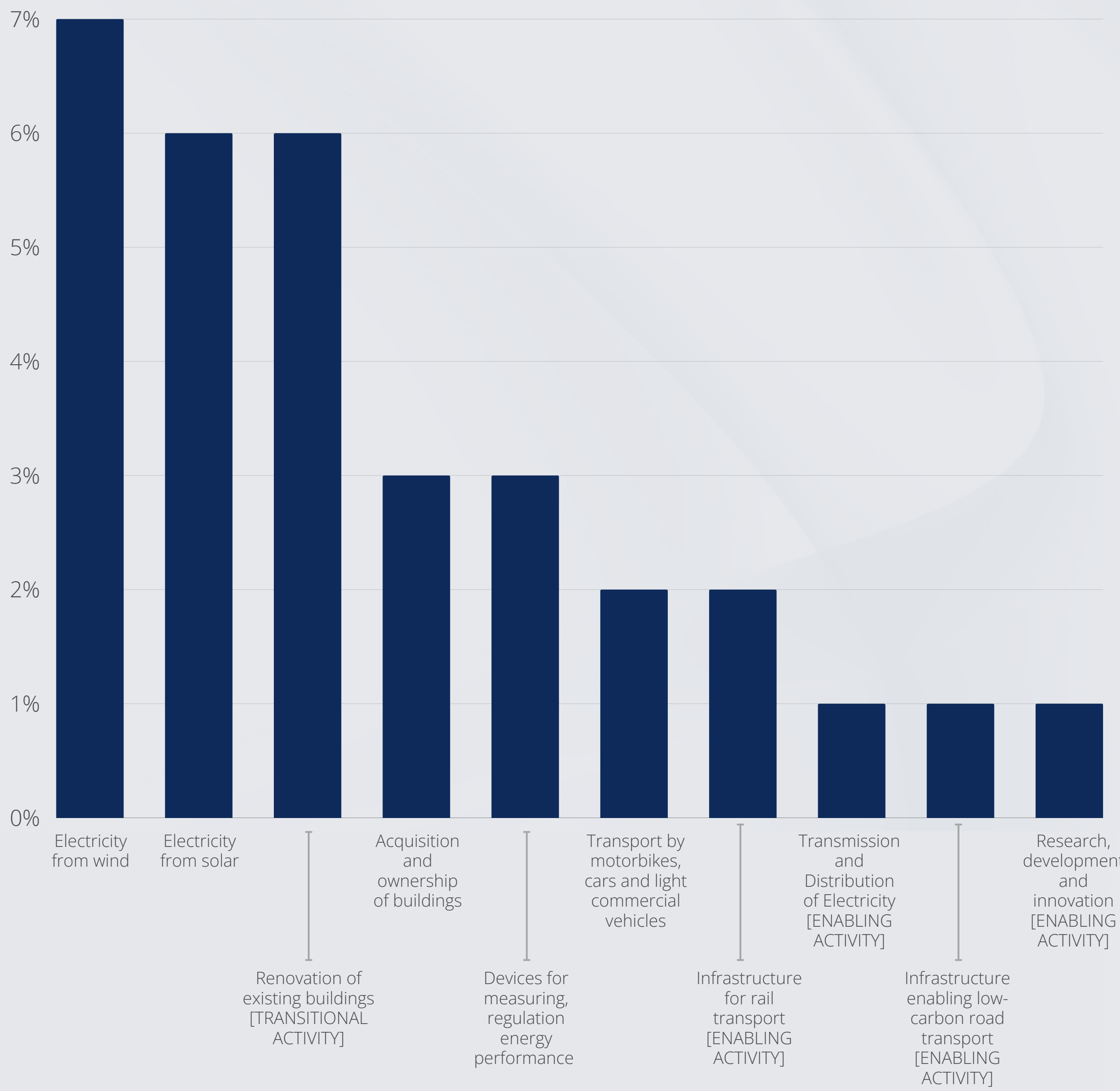
The key characteristic of EU GBS-eligible bonds is that at least 85% of the bonds' proceeds must be aligned with the Technical Screening Criteria (TSCs) of the EU Environmental Taxonomy for each activity funded. Some activities are more stringent than others – for instance, "derogated activities" are deemed aligned without the need to meet any quantitative criteria (e.g. renewable energy generation with wind power).

When comparing our database of Green and Sustainable Bonds' Taxonomy-aligned Activities, there is a clear difference in the underlying distribution of funded activities between EU GBS-eligible and non-EU GBS-eligible bonds, as shown in the following charts.

Source: MainStreet Partners

Projects contributing to non-EU GBS-eligibile bonds' Taxonomy Alignment

(%)

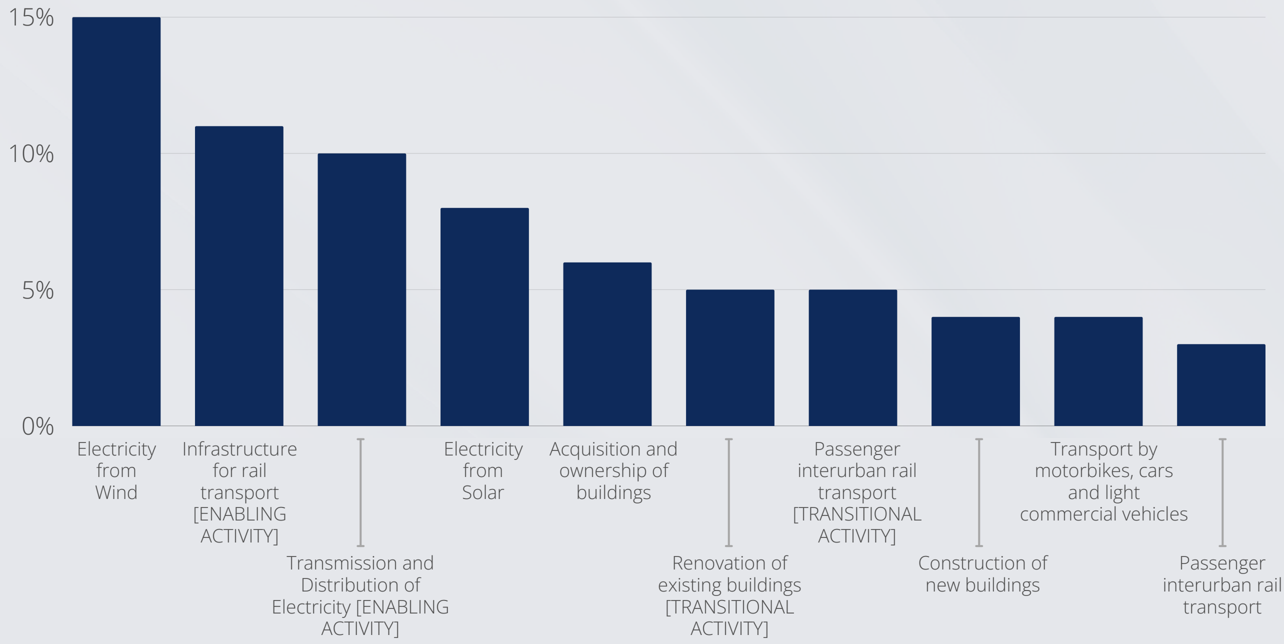


For the EU GBS-non-eligible segment of the database, Electricity generation from Wind Power is the favourite project, sitting at just over 7% of aggregate funding. Despite the fact this activity is derogated under the EU Taxonomy and should therefore be easier to achieve compliance to the EU GBS, in this case the other criteria are not met, such as, for example, the lack of relevant long term sustainability targets of the issuer.

Source: MainStreet Partners

Projects contributing to EU GBS-eligibile bonds

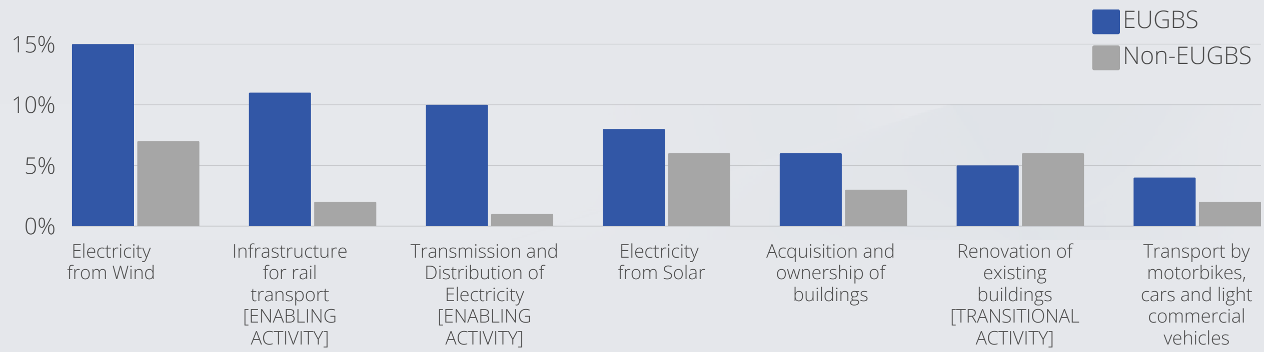
(%)



Source: MainStreet Partners

Top 7 projects contributing to EU GBS-eligible bonds

(%)



The largest discrepancies occur with activities that typically achieve high Alignment, as any activity that consistently meets the TSCs will be included in the EU GBS set when the database is segmented with Taxonomy Alignment greater than 85%.

In terms of the concentration of Alignment within the top 10 activities for each set, the top 10 segment in the non-EU GBS-eligible set account for 83% of the total Alignment. This figure is 74% for the EU GBS set. It's important to note that while the non-EU GBS-eligible set has a higher concentration within the top 10 activities, its total Alignment is 38%, indicating lower absolute Alignment levels compared to the EU GBS segment, which has an average Alignment of 98%.

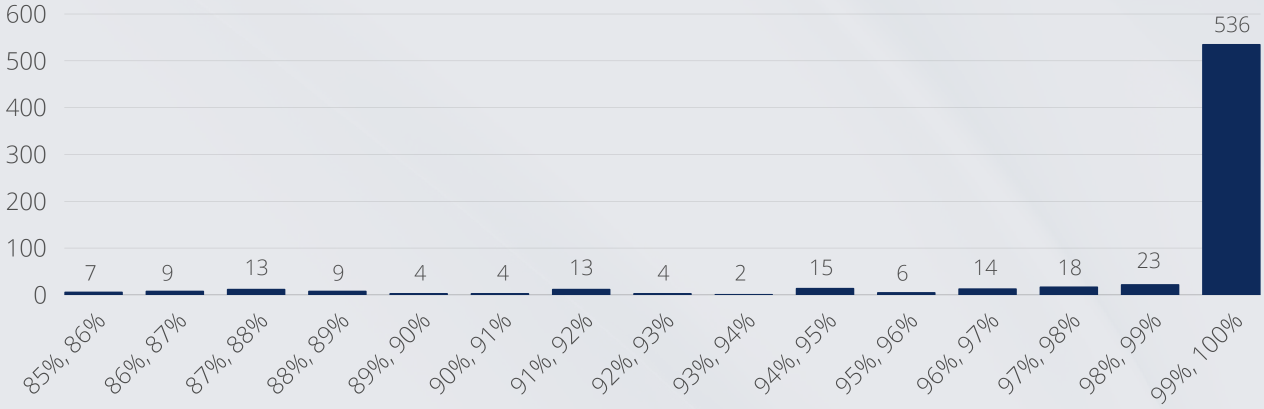
Taxonomy Alignment: project types as the main determining factor

Notably, due to this minimum Alignment threshold, the EU GBS segment tends to capture more of the bonds that are solely focused on renewable energy (i.e. 100% of proceeds allocated to the renewable energy category). Seeing as the most favoured categories in this field are wind and solar, which are derogated, this leads to a large clustering at the 99-100% interval, which is what produces such a high average Alignment figure for EU GBS-eligible bonds. Given the prevalence of Electricity generation of Wind within the non-EU GBS segment, it would appear that derogation is a key factor in producing aligment, suggesting that the majority of issuers still have some ways to go towards full integration of reporting against the EU Taxonomy effectively.

Source: MainStreet Partners

Percentage Alignment of EU GBS-eligible bonds

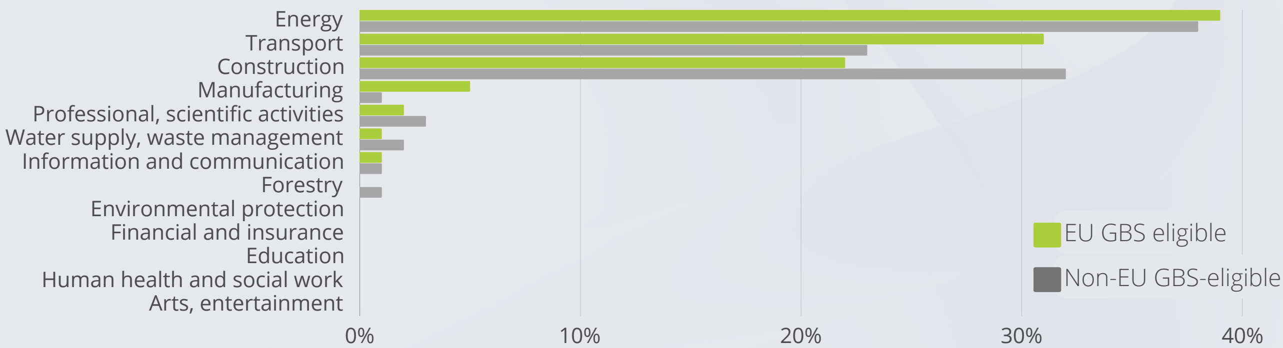
(by count)



Source: MainStreet Partners

EU Taxonomy Alignment sector analysis: EU GBS-eligible vs Not-EU GBS-eligible

(%)



As widely expected, there are three main types of projects contributing to the Alignment of EU GBS bonds: Energy, Transport and Construction. These contribute 39%, 31% and 22% for EU GBS-eligible bonds, and 38%, 23%, and 32% for EU GBS Non-eligible bonds, respectively.

There are three project sector categories with significant discrepancies between EU GBS and non-EU GBS bonds: Manufacturing, Construction and Transport.

In the case of **Manufacturing**, this category plays a larger role in the EU GBS-eligible segment, constituting approximately 5% compared to 1% in the non-EU GBS-eligible. For **Construction** the opposite is true. There is a higher prevalence of explained Alignment in the non-EU GBS category, implying a wider range of Alignment levels, with a larger portion sitting below the 85% threshold.

A geographical breakdown of EU GBS-eligible Bonds

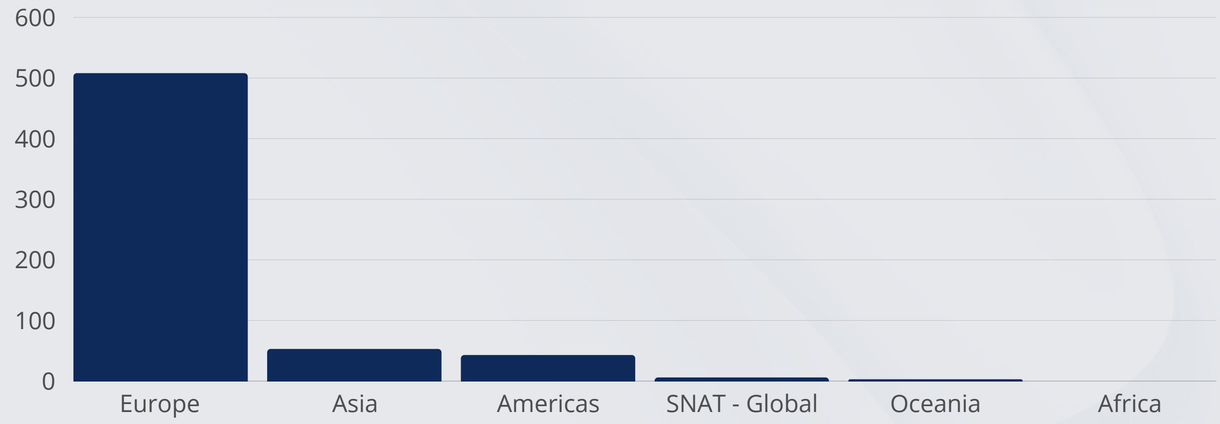
The next order of business is whether the EU GBS-eligible market segment presents the same geographical patterns of the general market, or whether it is more concentrated in certain regions. Although the general market is already heavily skewed towards European-based issuers, with 54% of Green and Sustainability Bonds – the EU GBS-eligible segment takes this phenomenon one step further, with 83% of volume issued coming from European issuers.

This result is no news: given the European origin of the regulation it is only natural that European governments, inter-governmental institutions as well as corporates will be more inclined to comply.

What is surprising, however, is that the Asian continent, which lags the Americas in terms of total issuance, has a higher volume that is eligible for the EU GBS certification, 9% and 7%, respectively. One explanation for this is that some Asian countries, such as China, Singapore and Hong Kong have developed their own environmental taxonomies, which overlap with the European Union's.
By contrast, we find the US faces a slower market development with regards to EU GBS-eligible issuances. This is likely due to the lagging regulatory environment when compared against European issuers.

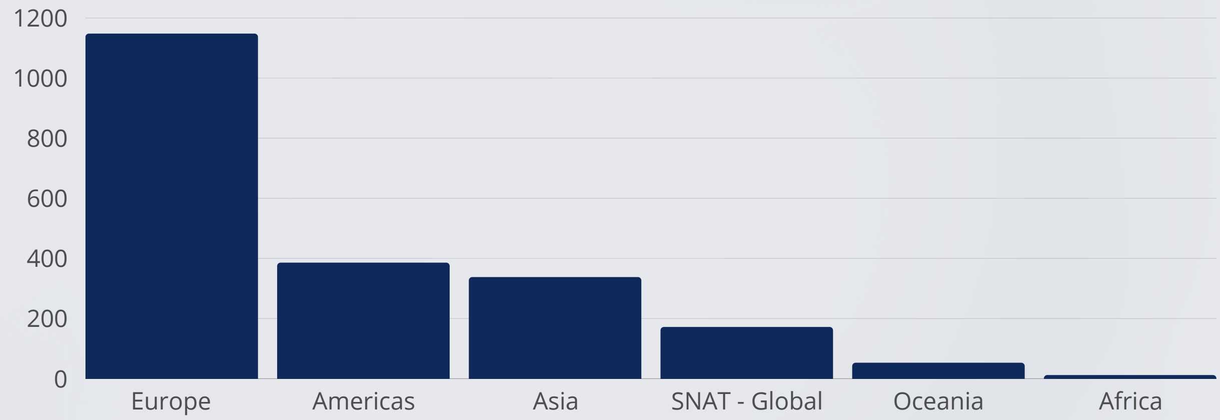
Source: MainStreet Partners

EU GBS-eligible proceeds by region
(USD bn)



Source: MainStreet Partners

non-EU GBS-eligible proceeds by region
(USD bn)



Zooming into the geographies at a country level, we can see that Germany and France are leading the charge of EU GBS-eligible bonds with market shares of 16% and 12%, respectively.

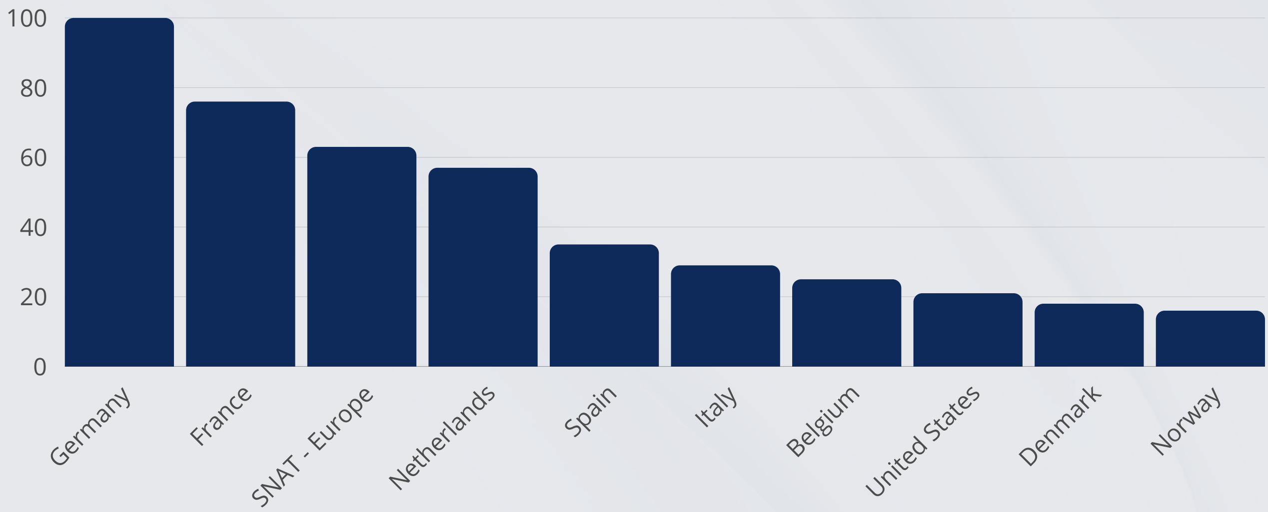
In the non-eligible market segment, the two countries are tied in first place with 10% of the market each.

Please note that these market segments only consider Green and Sustainability Bonds, given that Social and Sustainability-linked bonds cannot be measured against the European Taxonomy. When considering the whole GSS Bonds market, French Issuers, which are recurrent Social Bond issuers, still lead the way.

Source: MainStreet Partners

EU GBS-eligible proceeds by country

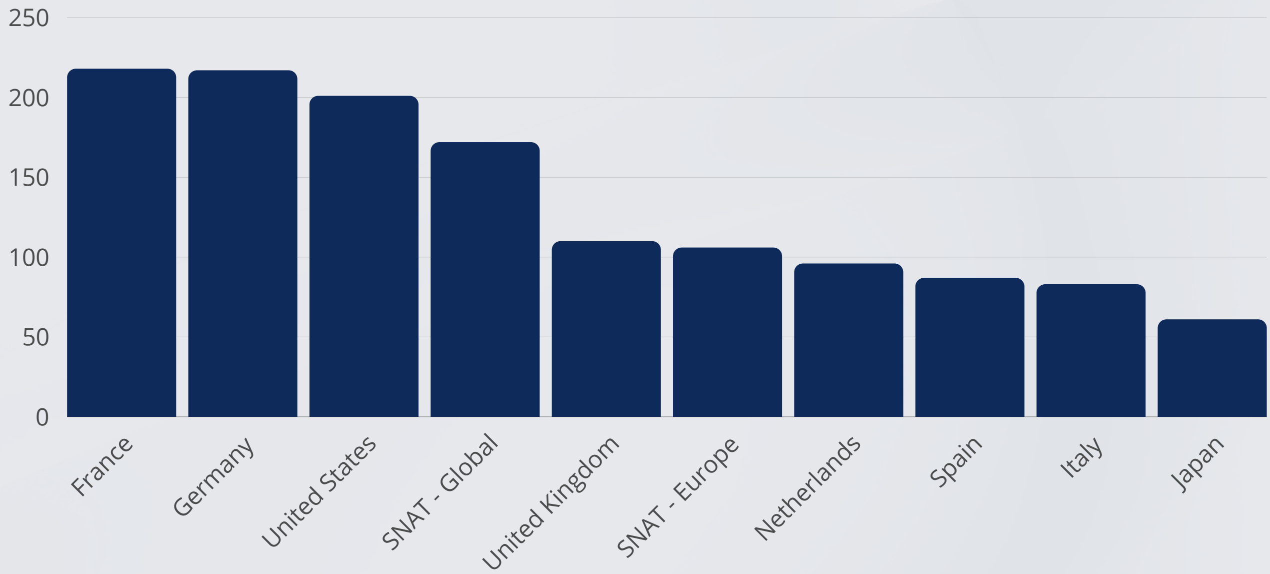
(USD bn)



Source: MainStreet Partners

EU GBS-eligible proceeds by country

(USD bn)



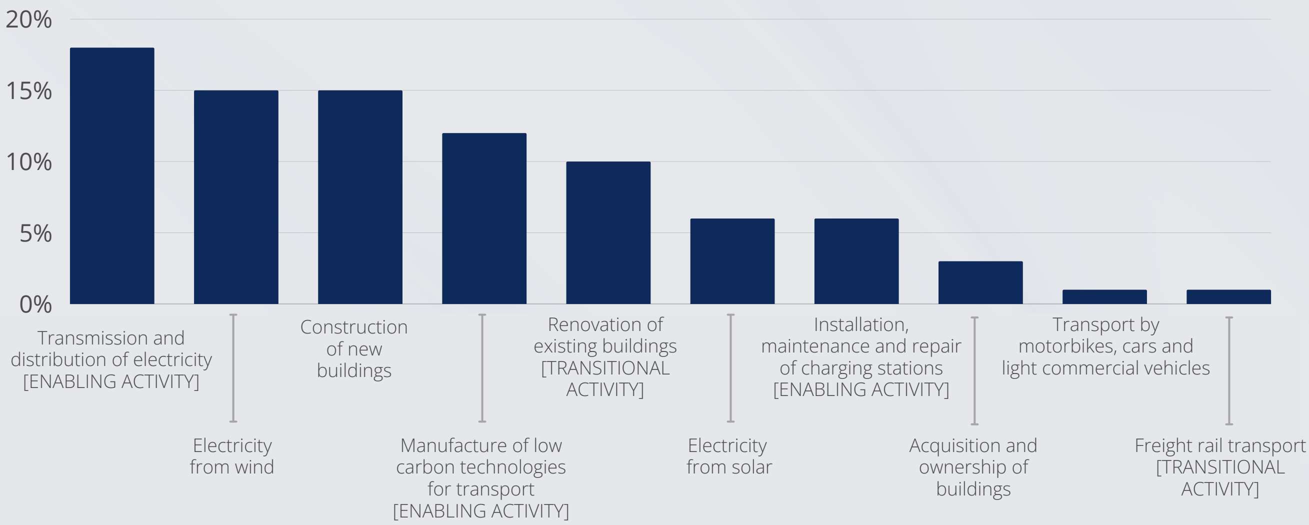
Germany: leading by example on Taxonomy-ready Green Bonds

Taking a closer look at the underlying activities funded by German issuers, which have issued the largest volume of EU GBS-eligible bonds, we can see the predominant category is Transmission and distribution of electricity, primarily linked to the expansion of German grid infrastructure to facilitate more connections of renewable sources of energy, contributing around 18% of the displayed EU Taxonomy Alignment, as shown below:

Source: MainStreet Partners

Germany - Top 10 financed activities

(%)

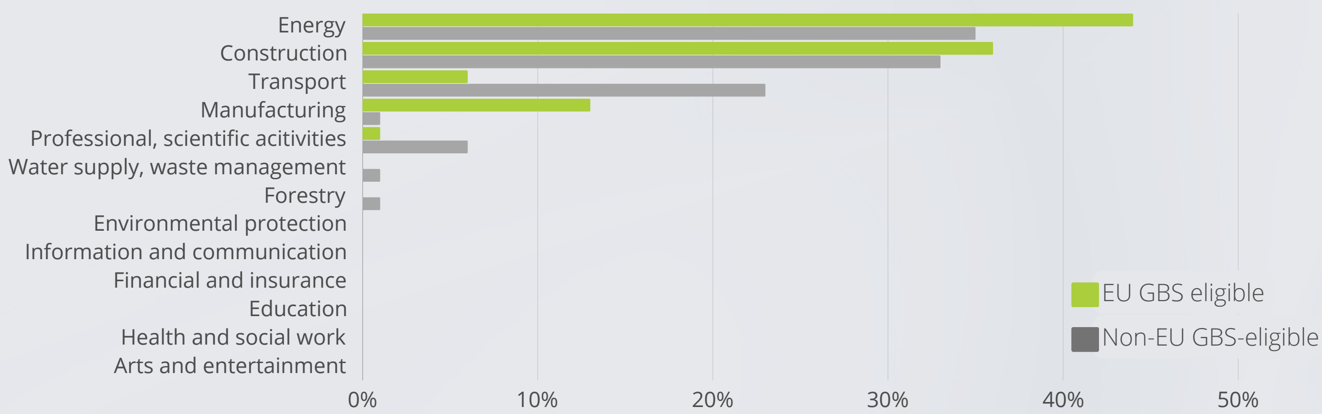


Electricity generation from wind power, unsurprisingly, contributes around 15% of the overall Alignment. More generally, these two categories are part of the Energy segment of the EU Taxonomy, which is the largest contributing segment to German bond issuers' Taxonomy Alignment, as shown by the graph below.

Source: MainStreet Partners

Germany - Project contributing to EU GBS-eligible bonds

(%)



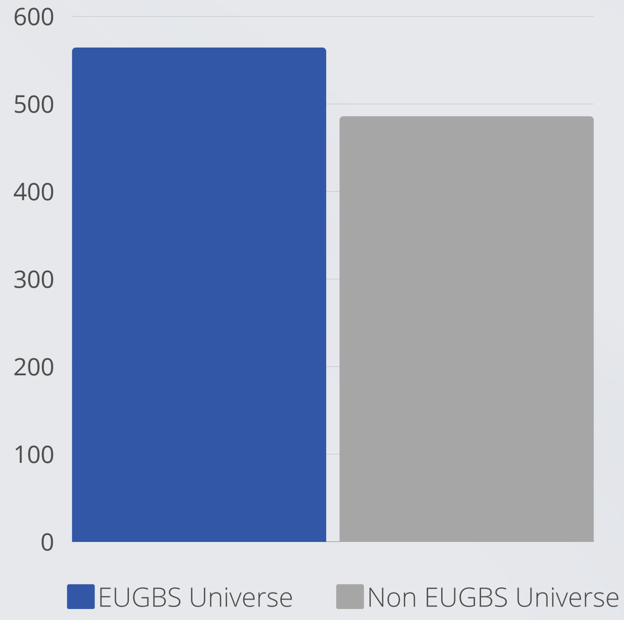
Seemingly the trends seen when comparing the overall EU GBS segment against the non-EU GBS segment hold up with respect to German issuers, which it follows is likely due to the fact that Europe as a region is likely to be the vast majority of the driving force behind these trends, with Germany featuring as one of Europe's main countries of issuance.

Impact Results – still relevant?

The only question that remains unanswered is whether investors interested in thematic investments look for concrete, measurable impact can rely on enough EU GBS bonds and avoid frustration once Impact Results are published "ex-post." Preliminary results are mixed. Only some Impact Results (e.g. CO2 Avoided/EURmln) show a clearcut improvement when averaged for a EU GBS-eligible universe of bonds, compared to a non-eligible universe.

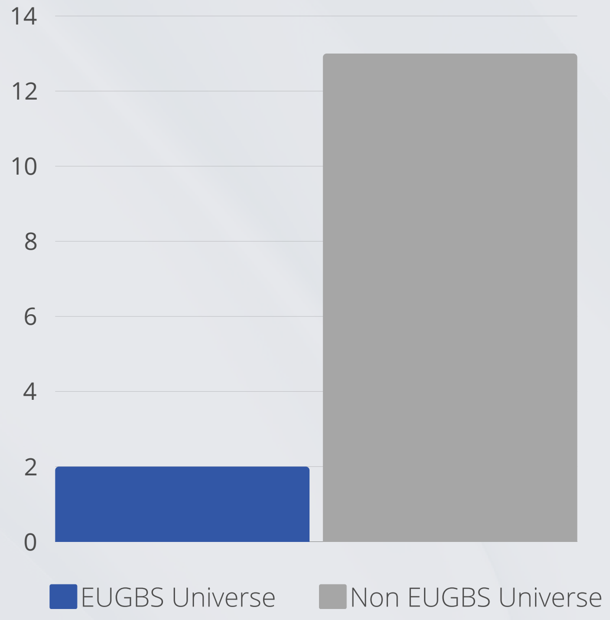
Source: MainStreet Partners

CO2e avoided/reduced
(tons/EURmln)



Source: MainStreet Partners

Land reforested/restored/certified
(hectares/EURmln)



CO2 Avoided/Reduced is one of the Impact Results that is, on average, higher for EU GBS-eligible bonds compared to the rest. For instance, the average EU GBS-eligible bond reports an annual figure of 565 tons of CO2 Avoided/Reduced per million euro invested, whilst the average non-EU GBS-eligible bond reports an annual figure of 486 tons/EURmln.

This result, however, is a direct consequence of the prevalence of Renewable Energy projects within the EU GBS-eligible universe. For instance, as previously stated, Renewable Energy activities are derogated and therefore dominate the EU GBS subset of bonds. Further, Renewable Energy projects have by far the highest Impact Results in terms of CO2 Avoided/Reduced, resulting in EU GBS-eligible portfolios having high CO2 Avoided/Reduced figures.

Nevertheless, there are categories of Impact Results for which the non-EU GBS-eligible bonds have higher figures. One example is the Land Reforested/Restored result, which is on average 14 hectares/EURmln for non-EU GBS bonds, whilst only 2.2 hectares/EURmln for EU GBS-eligible bonds. The reason for this is simple: reforestation and afforestation projects are rarely successfully covered by the Climate Mitigation Pillar and therefore will tend not to be eligible for EU GBS certification.

In summary, this means that investors must keep an eye out for which kind of theme they are pursuing with their portfolios; and from this starting point, they can understand whether the EU GBS is a good indicator of quality for what they are looking to invest in.

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