GAM SUSTAINABLE CLIMATE BOND FUND: GREEN BOND ASSESSMENT FRAMEWORK

Marketing material for professional / institutional / accredited investors only

The OECD estimates that USD 6.9 trillion each year to 2030 is required to meet climate and development objectives. Green bonds present an important and growing asset class for directing capital towards projects which contribute to environmental objectives from climate change mitigation to pollution prevention.

The ICMA Green Bond Principles (GBP) define a green bond as any type of bond instrument where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible green projects. They must also be aligned with the four core components of the GBP: Use of proceeds; process for project evaluation and selection; management of proceeds; and reporting.

We are proud to be a partner of the Climate Bonds Initiative, working to further develop and build the green and climate bond market.

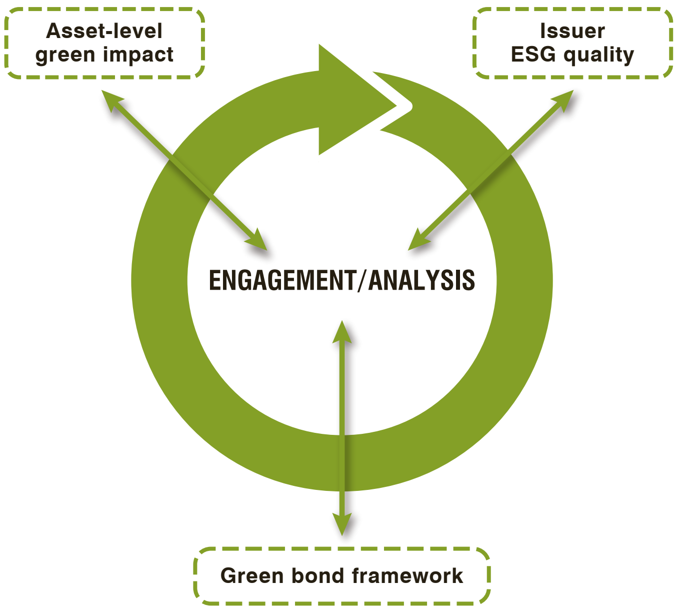
Our framework

Our green bond assessment framework is designed to identify green bonds and other 'impact' bonds that will deliver meaningful impact. Our framework recognises the ICMA Green Bond Principles (June 2021) and builds on an approach consistent with our investment philosophy – bottom-up research-intensive, and adding value through engagement.

Our framework is split into three layers of analysis – issuer, bond, and green asset level. Each is assessed individually, using both proprietary research and data from external third parties. Engagement is a key part of our investment process, both to enhance our analysis and to encourage improved standards within each pillar. All assessments are based on a best efforts basis.

- **Issuer ESG Quality:** At the issuer level, the general ESG profile of the issuer is analysed with a particular focus on environmental strategy, and expected to be aligned with the issuance of green bonds.
- **Green Bond Framework:** At the bond level, the quality of the governance and processes related to the green bonds' use of proceeds are assessed. This provides visibility on the allocation of proceeds and confidence in the environmental impact.
- **Asset-level Green Impact:** Finally, the financed green assets are assessed through a quantitative lens using comparable and consistent data to ensure meaningful impact.

Green bond assessment framework



Our three pillars

Each pillar is assessed individually within the selection and allocation process to form a holistic assessment of the impact potential of each green bond. Below is a summary of the minimum criteria for potential inclusion in the fund, and our expectations from issuers:

1. Issuer ESG Quality

We view issuers' overall ESG profile as a key component of our green bond assessment framework. This stems from our belief that issuers with strong ESG credentials which include a clear and credible sustainability strategy are more likely to:

- issue green bonds upholding the highest standards of quality, and
- have strategic reasons to issue green bonds.

Overall, we seek to invest in issuers with strong ESG credentials, including a clearly defined climate and sustainability strategy, a credible and transparent green bond framework, and support for pipeline in green assets.

Our analysis covers environmental, social and governance (ESG) factors to derive an overall assessment of the issuers' ESG profile. Given the environmental focus of green bonds, issuers' environmental profiles are a particular focus.

The analysis of issuers' ESG profile is performed internally with a proprietary scoring tool. The scoring tool assesses material ESG issues for each sector, including an assessment of any controversial elements. The output is an ESG Risk Assessment, ranging from Very Low Risk to Very High Risk. Each aspect (E, S, G) are also individually rated, from Very Low to Very High Risk.

We aim to invest in issuers with strong ESG credentials. Thus, issuers rated in a very high or high ESG risk assessment are excluded from potential investment.

Similarly, issuers assessed as having severe controversies which are incompatible with the sustainability objectives of the fund, would also be excluded. In particular, very severe controversies, especially those assessed to be in breach of UN Global Compact principles, will result in automatic exclusion of issuers for investment. Issuers may score average or below average in certain categories, while still being eligible for inclusion in the fund. These areas will be a priority in terms of engagement with issuers.

2. Green Bond Framework

The green bond framework is the reference pre-issuance document that sets out all aspects surrounding the proceeds of the green bonds (green assets), from the eligible types of projects, to the governance and processes around the selection of assets, to reporting.

We view this as a key pillar in our green bond analysis, as there is currently no legal or regulatory requirement as to what constitutes a green bond. Without a robust framework from issuers, confidence around the ultimate impact of bonds is greatly reduced and leaves investors vulnerable to greenwashing. For this reason, we support the development of a consistent set of principles to govern the green bond market as set out in the draft EU green bond standard.

The GBP have emerged as the widely adopted voluntary standards for green bonds, and we support these standards and encourage issuers to comply with those. While these standards outline minimum requirements for bonds, we have established our own internal framework to evaluate bonds too, which builds on these Green Bond Principles.

Our internal framework provides a score (0-100%) of the quality of the green bond framework. There is a pass/fail mark (irrespective of the score), should green bonds not fulfil certain minimum criteria.

Internal ESG Scoring Framework (example using banks)

	Material issues	Risk Assessment	Overall ESG Risk Assessment
E	Exposure to high carbon industries Climate Strategy Sustainable Investments Underwriting Process Operations Controversies	Very Low Risk Low Risk Medium Risk High Risk Very High Risk	
S	Labor Management Diversity & Inclusion Employee health & well-being Human Rights Data Privacy Financial Inclusion Controversies	Very Low Risk Low Risk Medium Risk High Risk Very High Risk	Very Low ESG Risk Low ESG Risk Medium ESG Risk High ESG Risk Very High ESG Risk
G	Board & Organization Risk Management & Oversight Pay Auditors Athics Transparency Controversies	Very Low Risk Low Risk Medium Risk High Risk Very High Risk	

Internal ESG Scoring Framework (example using banks)

Use of Proceeds

Minimum Criteria
- Clear issuance purpose and sustainability objectives (typically aligned to SDGs)
- List of eligible projects
- Eligible projects aligned with GBP or EU Taxonomy
- Do no significant harm, related to other sustainability aspects of projects financed

Expectations
- Low use of refinance
- If use of refinancing, short lookback period
- Growth of green asset pool consistent with environmental strategy

Selection & Evaluation of Assets

Minimum Criteria
- Clearly defined process to select assets, including governance
- Provisions to review and replace assets in case of non-compliance

Expectations
- Third party review of processes
- Selection commitee with strong ESG credentials and involvement of senior management (C-suite preferred)
- Review of green bond label if green projects insufficient to cover green bonds issued
- Use of external certifications to confirm “green” characteristics of projects (for example forestry)

Management of Proceeds

Minimum Criteria
- Segregated proceeds of funds with internal tracking.
- Clear timeline for the investment of proceeds, consistent with life of bond and climate/environmental strategy

Expectations
- External audit of fund tracking
- Clear policy of the allocation of uninvested funds, consistent with objectives of the green bond

Reporting & Certification

Minimum Criteria
- Annual post issuance reporting until maturity including both allocation and impact (at least until full allocation if no changes to the green asset pool)
- Pre-issuance SPO from a recognized third party

Expectations
- External audit of post-issuance reporting
- Transparent methodology for environmental KPIs, based on recognized methodologies
- Adherence to stricter standards then ICMA GBP such as CBI

The assessment is split into four parts, with the overarching goal of identifying bonds where we have confidence in governance and processes, and strong visibility on the use of proceeds.

2.1. Use of proceeds

As a starting point, the issuer should have a clear purpose to issue green bonds, including the sustainability objectives targeted, relevant alignment with the Sustainable Development Goals, and a list of potential projects for inclusion. Eligible projects should be clearly defined by the issuer and aligned with either categories described in the Green Bond Principles or aligned to the EU Taxonomy (where we encourage disclosure). These should also have clear environmental benefits and should not have any harmful impact on any other sustainable aspect. This is a core conviction and failure to comply will result in ineligibility for investment.

The green asset pool of the issuer should exhibit desirable characteristics. The use of refinancing vs. finance should be clearly disclosed and limited, or the look-back period for refinancing of assets should be adequate to provide incremental impact. As we are conscious of the dilemma for issuers to both minimise the use of refinancing, but to invest proceeds from green bonds as soon as possible, we consider the use of refinancing with as short a look-back period as acceptable. Moreover, historical growth of the issuers’ green asset pool (or eligible green assets) should reflect the issuers’ strategy and incremental impact.

2.2. Selection & Evaluation of Assets

The issuers’ selection process is paramount in order to ensure that governance and processes are robust and bondholders’ interests are safeguarded. As a minimum, we expect issuers to have a clearly defined selection process, including appropriate governance and oversight. We expect issuers to set up a selection committee with appropriate expertise to select and review projects – representing both strong ESG credentials and representatives from senior management. Best practice dictates the use of third-party reviews for the selection of assets and processes. Moreover, the use of certifications or other external metrics used to evaluate the “green” eligibility of projects should be disclosed where possible, and in particular for projects where the eligibility is less well-defined (such as for forestry projects).

In addition, we expect issuers to have strict provisions in case green assets become non-compliant (no longer deemed to fit within green asset categories). This includes a policy for the replacement of projects, periodical review of asset eligibility, and even a review of the ‘green’ bond label in case green assets become insufficient to fully cover green bond issued amounts.

2.3. Management of Proceeds

In line with the objectives of the green bonds, we expect issuers to have proceeds from green bonds clearly segregated with the flows of invested cash closely tracked. Here again, external audit of the internal tracking of funds is a positive and is encouraged.

Moreover, issuers should communicate a clear timeline for the full investment of proceeds. We expect issuers to communicate a clear time horizon, consistent both with the issuers' climate/environmental strategy, but also with the life of the bond.

Finally, we expect issuers to have a clear policy on the allocation of uninvested funds. We expect these to be consistent with the ESG objectives of the green bonds and avoid conflicts of interest when buying securities. We also expect a disclosure of those instruments which can be used for unallocated funds.

2.4. Reporting & External Certifications

Reporting is key for green bond investors, both to have visibility on the proceeds, as well as to have quantitative assessment of their impact.

We require issuers to provide post-issuance reporting on at least an annual basis until the bond reaches maturity. Reporting should cover both allocation with a granular split by project category and geography, and impact with key KPIs for their environmental impact. We also encourage reports to be verified by third parties to improve transparency.

Where environmental KPIs are provided, we expect the issuer to provide a transparent methodology around calculations and assumptions. The use of widely-recognised methodologies or third party review of new methodologies to calculate environmental impacts is preferred.

At the pre-issuance level, we require issuers to have second party opinions on ICMA GBP compliance from a recognised assurance entity as a minimum requirement. We also encourage adherence to stricter standards such as the Climate Bond Standards of the Climate Bond Initiative.

Ultimately, where bonds meet minimum criteria for inclusion in the fund, the rating of the green bond framework is considered in the overall assessment of the green bond. The output of the green bond framework assessment also helps steer engagement efforts. For eligible issuers with areas of weakness which do not force exclusion, discussions will be held to strengthen areas of concern. For issuers that do not meet minimum criteria, we aim to engage where relevant in order to voice our views on why upholding high standards is paramount for a well-functioning green bond market.

3. Asset-level Green Impact

The final step of our framework to assess green bonds is at the green asset or project level. Bonds eligible for investment after screening at the issuer and green bond framework levels provide investors with visibility on the allocation of proceeds and key KPIs for environmental impact.

One of the key challenges for green bonds investors is the lack of comparable and consistent data on reported environmental KPIs by issuers. The methodologies and assumptions used can vary significantly, leading to difficulties in comparing KPIs. Whilst we support efforts to provide granular information on the climate impact of their green bonds, there remains a need for comparable data.

We aim to select green bonds with meaningful positive environmental impact, and our approach also includes a quantitative assessment of environmental indicators. Given the current lack of harmonised and comparable methodology in disclosed indicators, we have decided to use an independent third party to re-estimate the green bonds' environmental KPIs provided by issuers. Working with Carbone 4, a specialised climate data provider, we will work them with a robust methodology and extensive database to re-estimate environmental KPIs. The aim is to both benefit from an unbiased and comparable dataset across green bonds, as well as a third-party estimate of their environmental impact.

As we strive to invest in those with meaningful impact, this step offers greater confidence in these green bonds' environmental credentials.

Layer	Minimum Criteria
Issuer ESG Quality	• Adequate sustainability strategy including climate strategy • ESG and Environmental Profile risk assessment: Medium • No severe controversies incompatible with the sustainability objectives of the fund (especially in breach of UN Global Compact Principles)
Green Bond Framework	• Aligned with ICMA GBP or stricter standards (for example Climate Bond Standards) • Best-in class governance and processes • Granular impact reporting, using transparent third-party methodologies • Aligned with ICMA GBP • Post-issuance allocation and impact reporting
Green asset impact	• Meaningful positive environmental impact using third-party quantitative data • Aligned with Paris Agreement targets