TD Securities

ESG Insights

Institutional Investor Perspectives

Executive Summary

In the first half of 2022, TD Securities conducted a Sustainable Debt Market Investor Survey to better understand institutional investor perspectives on sustainable fixed income products, and the factors driving their investment decisions. TD Securities' ESG Solutions team designed and managed the analysis of the survey results. The survey is based on the team's client conversations and industry research to answer persistent questions from issuers. TD Securities' sales force distributed this inaugural survey to a global investor base. Survey results are drawn from 36 global institutional investors, spanning North America, Europe, and Asia, representing more than $6 trillion of Assets Under Management (AUM), see Exhibit 1.

Key Findings

- Use of proceeds bonds remain the debt instrument of choice for investors, with about 80% of respondents declaring the inclusion of green, social, and sustainability bonds in their ESG mandates. This preference overshadowed sustainability-linked bonds (SLBs), which only 60% of investors surveyed included in their ESG mandates (Exhibit 2). In line with this finding, use of proceeds bonds dominated the sustainable debt market in H1 2021 and 2022, whereas transition bond issuance remained limited.
- When evaluating ESG-labelled bonds, investors noted the importance of having Frameworks with a Second-Party Opinion (SPO) (28% of respondents), followed by an issuer's sustainability strategy/target (25%), and ESG ratings (22%), see Exhibit 4. This highlights the importance of issuers implementing frameworks and communicating sustainability strategies.
- Regional investor preferences were seen through the inclusion of natural gas or nuclear power in green bonds, noting European (ex-German) investors requiring additional due diligence.
- While some Multilateral Development Banks (MDBs) may view themselves as pure players, 70% of survey respondents did not agree and instead insisted that these issuers require labelling or further due diligence, see Exhibit 6.
- Investors exhibit regional differences on SLB structuring characteristics, with North American investors expressing a preference for linking Key Performance Indicator (KPI) weights to materiality and bigger step-ups.

TD Securities' ESG Solutions Team

TD Securities' ESG Solutions team is the centralized environmental, social, and governance (ESG) expert resource delivering ESG financing advisory services, ESG thematic and investor insights, and carbon markets solutions to help clients across the investment bank reach their goals. As clients consider strategic financing and transitions, our team produces a suite of ESG thought leadership and engagements to navigate evolving markets.

ESG Insights Series

The ESG Insights series presents clients with thematic trends and new findings on company valuations, investor perspectives, sustainable finance markets, and more.

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Sustainable Debt Market Investor Survey

By the start of 2022, issuers and investors alike were navigating volatile markets. The world was still recovering from the financial and economic repercussions of the COVID-19 pandemic, along with rising interest rates, changing consumer demands, ongoing supply chain constraints, inflation, and a war in continental Europe. Interest rates, which skyrocketed through 2021, persisted through Q2 of 2022 and the U.S. Bureau of Labor Statistics reported the Consumer Price Index ("CPI") year-on-year finally reached a five-year high of 9.1% late in Q2 2022.[1] This hit bondholders hard. In addition, investors and regulators engaged in a polarizing debate on the inclusion of nuclear power and natural gas in the EU Taxonomy to facilitate the transition to a low carbon economy.[2] This discussion exploded with the Russian invasion of Ukraine in February 2022, as Russia was the fourth largest producer of oil in 2021, contributing to 11% of the global oil supply.[3]

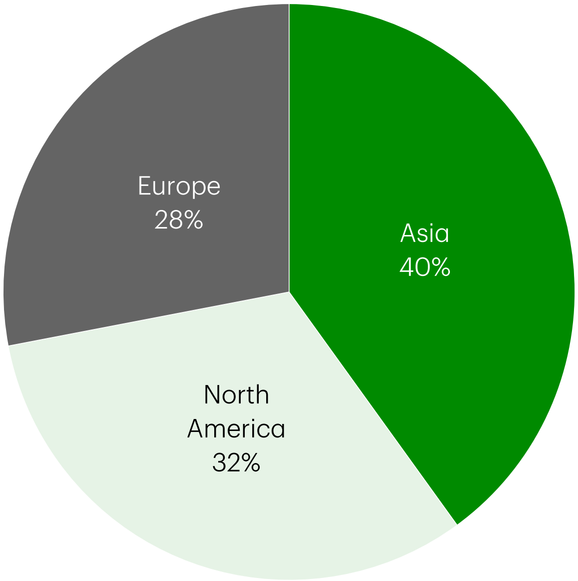
To shed light on investor perspectives during this period, TD Securities' ESG Solutions team conducted a Sustainable Debt Market Investor Survey. This effort worked to uncover investor viewpoints on the landscape of sustainable fixed income products, as well as the factors driving investment decisions. Uniquely positioned within TD Securities, the ESG Solutions team acts as the expert resource and, as such, leveraged industry expertise to design this survey. TD Securities' sales force distributed this inaugural survey to a global investor base in Q2 2022.

Through this report, we provide insights based on responses from 36 global institutional investors, across North America, Europe, and Asia, representing more than $6 trillion of Assets Under Management ("AUM"), see Exhibit 1. To share these investor insights with clients, we anonymized and aggregated responses at regional and global levels.

Of these survey participants, 70% are signatories to the United Nations Principles for Responsible Investing ("UNPRI"), and about 45% of the signatories joined this voluntary investor initiative before 2015, so prior to the Paris Agreement. As most of the survey participants are signatories, their ESG investing strategies have had opportunities to evolve over the years.

Investor Asset Under Management Breakdown by Region[4]

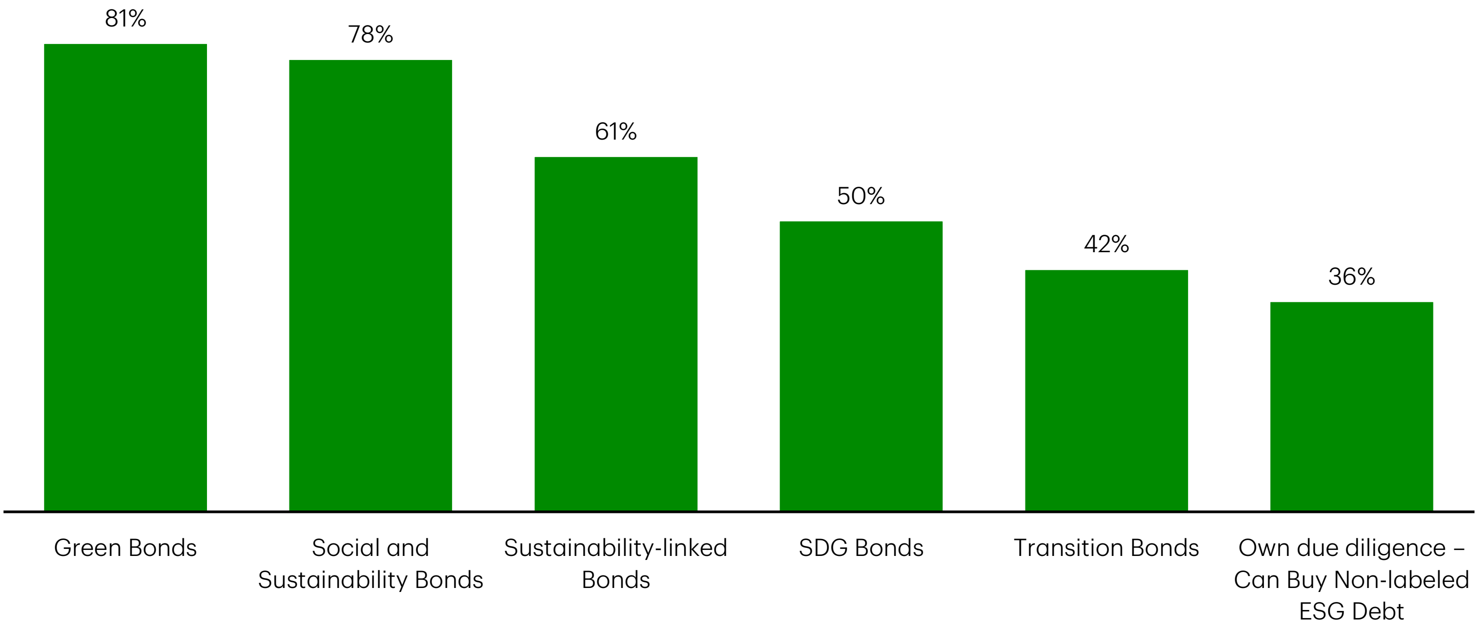
Exhibit 1



[1] U.S. Bureau of Labor Statistics, Consumer Price Index YoY index
[2] EU Taxonomy, July 2022
[3] U.S. Energy Information Administration, May 10, 2022
[4] TD's Sustainable Debt Market Investor Survey

Sustainable Debt Products Serving ESG Mandates, All Investors Surveyed[5]

Exhibit 2



[5] TD's Sustainable Debt Market Investor Survey

Key Findings

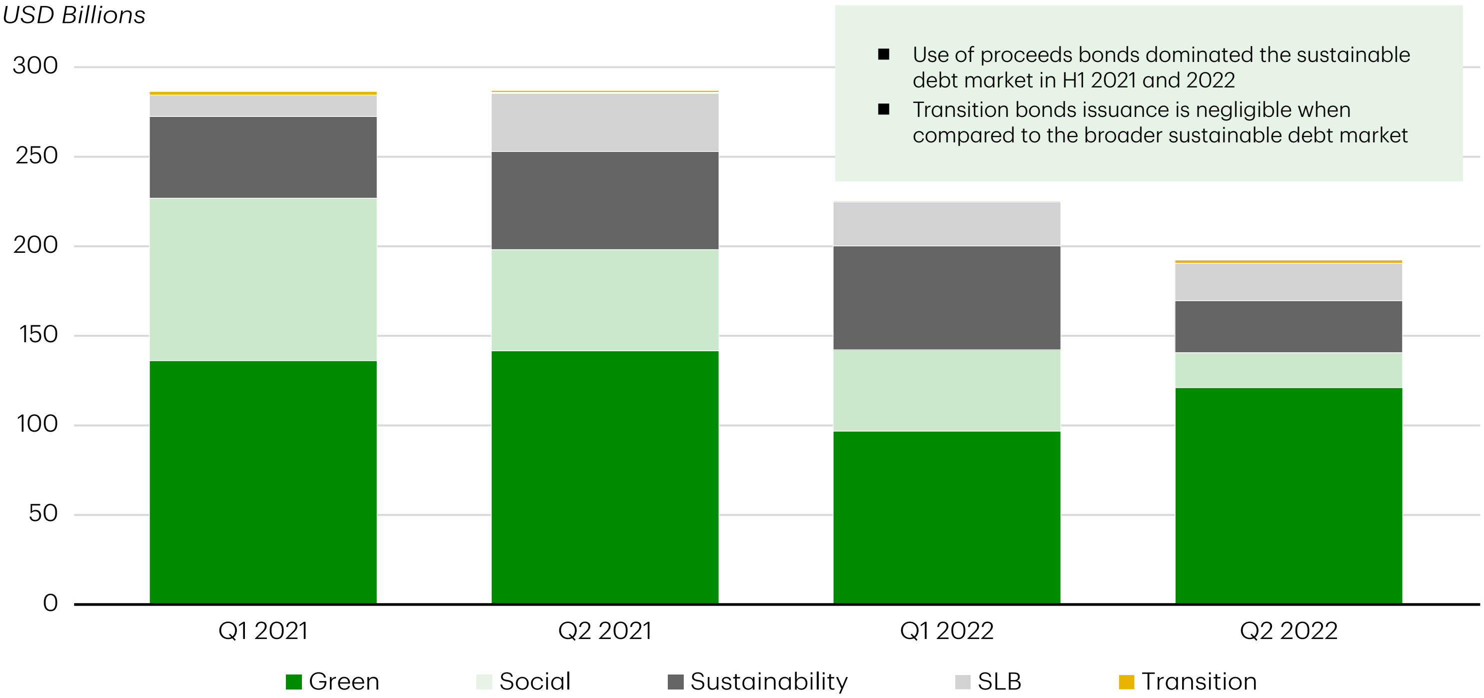
Use of proceeds bonds remain the debt instrument of choice.

- About 80% of respondents declared the inclusion of green, social, and sustainability bonds in their ESG mandates. This preference for use of proceeds bonds overshadowed sustainability-linked bonds, which only 60% of investors surveyed included in their ESG mandates (Exhibit 2).
- These results are consistent across Europe and Asia, while North American investors expressed a stronger preference for sustainability-linked bonds (85%) with a slight preference for use of proceeds bonds (77%).

Transition Bonds Not Yet Gaining Traction with Investors

Sustainable Debt Issuance in H1 2021 vs H1 2022[6]

Exhibit 3



- Use of proceeds bonds dominated the sustainable debt market in H1 2021 and 2022
- Transition bonds issuance is negligible when compared to the broader sustainable debt market

Key Findings

Despite the similarities, investors expressed a preference for SLBs over transition bonds. In fact, 61% of investor responses would include SLBs as an ESG investment, while only 42% would include transition bonds in their strategy, see Exhibit 2.

Sustainability-linked bonds and transition bonds have similar users and use of proceeds. Both types of bonds are used to finance emission reduction activities. A key difference is that second party opinion providers might not view these projects and solutions as corresponding to a low-carbon and climate resilient future, relative to a spectrum of relatively shorter-term transitional solutions.

What is going on?

Transition bonds are not new to investors. Although the first issuance came to market in 2017, the label never took off, with total issuance hovering around $9.6 billion, as of December 2021. On the other hand, sustainability-linked bonds grew exponentially over the past few years, increasing by 10 times in 2021 and H1 22 issuance is 21% higher compared to the same timeframe in 2021, see Exhibit 3.

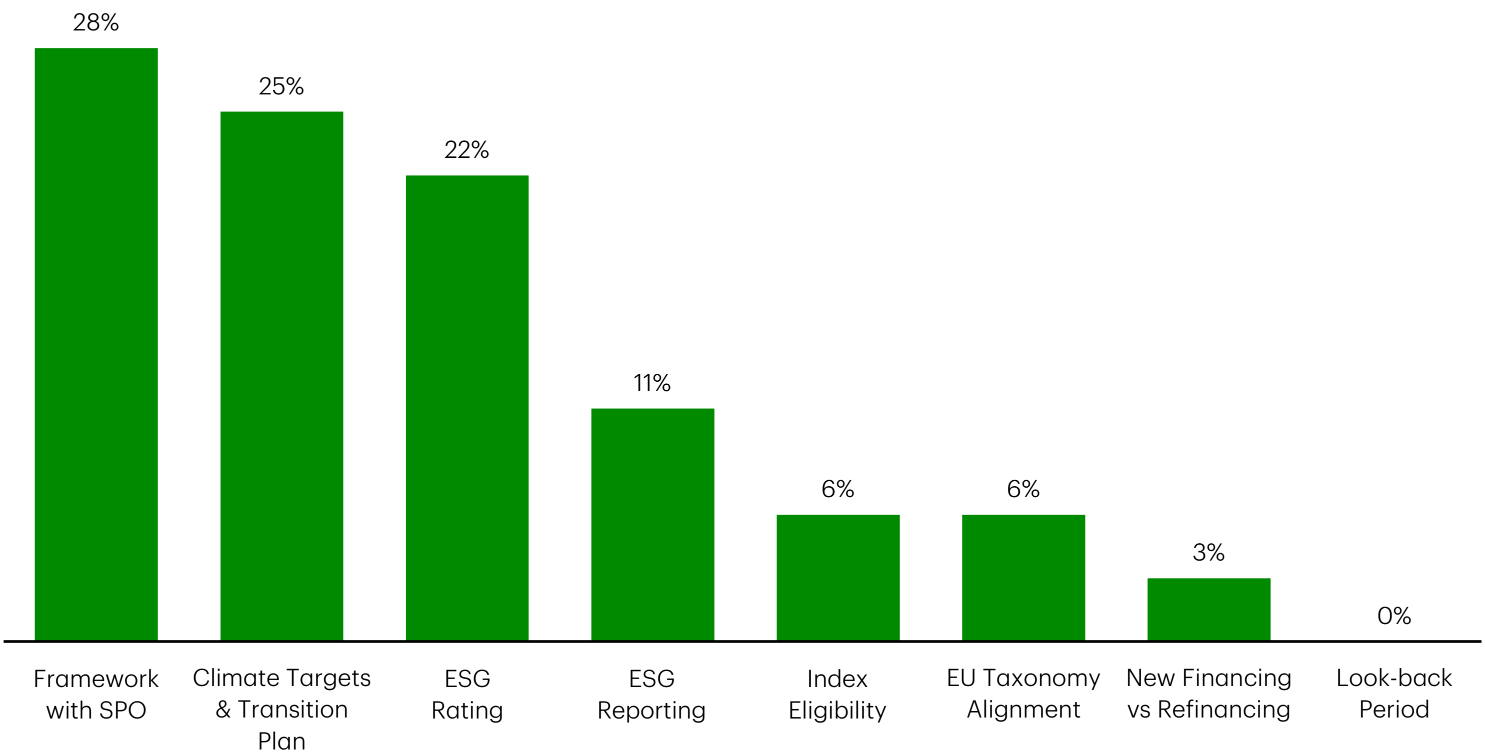
Why?

The preference for SLBs could be attributed to flexible use of proceeds, on the issuer side, as well as recognized market standard and recommendations on structuring, disclosure, and reporting, outlined by the International Capital Market Association ("ICMA"). Transition bonds can utilize recommendations made in the ICMA Climate Transition Handbook and these bonds include a climate transition plan with third-party verification but there is confusion on the definition of transition.

[6] Climate Bonds Initiative, Sustainable Debt Market Summary H1 2022, August 2022

Characteristics Considered for ESG Debt Investments, All Investors Surveyed[7]

Exhibit 4



Key Findings

Frameworks with SPO were found to be the most important element for investors buying ESG- labelled bonds (28% of investors), followed by an issuer's sustainability strategy/target (25%) and ESG ratings (22%), see Exhibit 4.

- Investors responding to this survey clearly ranked three components above ESG reporting, while ranking four components below: index eligibility, EU Taxonomy alignment, preference for new financing vs. refinancing, and the presence of a look-back period.
- Half of all respondents ranked "Index Eligibility" as the least important characteristic considered when analyzing sustainable debt investments. While ESG ratings are not universally standardized, this finding suggests that investors are weary of the added layer of ESG interpretation by each index provider for their respective indices. Moreover, this may reflect the survey respondents' comfort with active over passive strategies.
- Investors are not researching issuers themselves; they are relying on imperfect ESG ratings for guidance. Even as ESG ratings continue to experience growing pains, ESG ratings remain key to assessing an issuer's ESG outcomes. Research indicates that investors tend to use more than four ESG ratings providers in their analysis to account for the different methodologies. No one ESG rating or data provider is seen as perfect but rather investors are leveraging various types of ESG ratings to evaluate investments.[7]
  - Investors and issuers alike are watching the ESG ratings and ESG data space. The tightening of the regulator environment is anticipated to facilitate further standardization around company disclosure (see for example the EU Taxonomy requiring companies to report the percentage of Taxonomy- aligned revenues, Capex and Opex), and de facto creating a more rigorous alternative to ESG ratings.

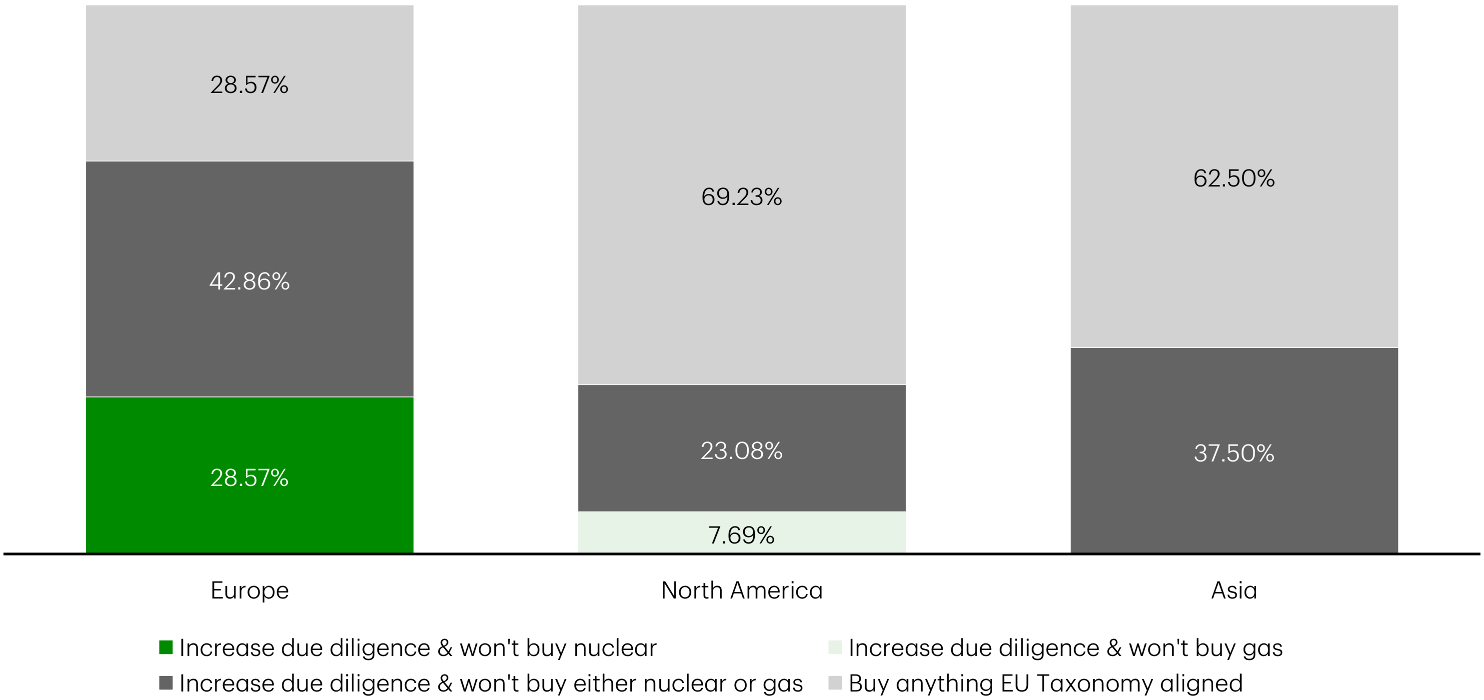
6 TD's Sustainable Debt Market Investor Survey

7 Harvard Law School Forum on Corporate Governance, SquareWell Partners.

Investors Rely on Labels Mapped to Regulation

North American and Asian Investors are Apt to Buy EU Taxonomy-aligned Investments[8]

Exhibit 5: Regional breakdown, additional decimal points provided for clarity on regional totals



Key Findings

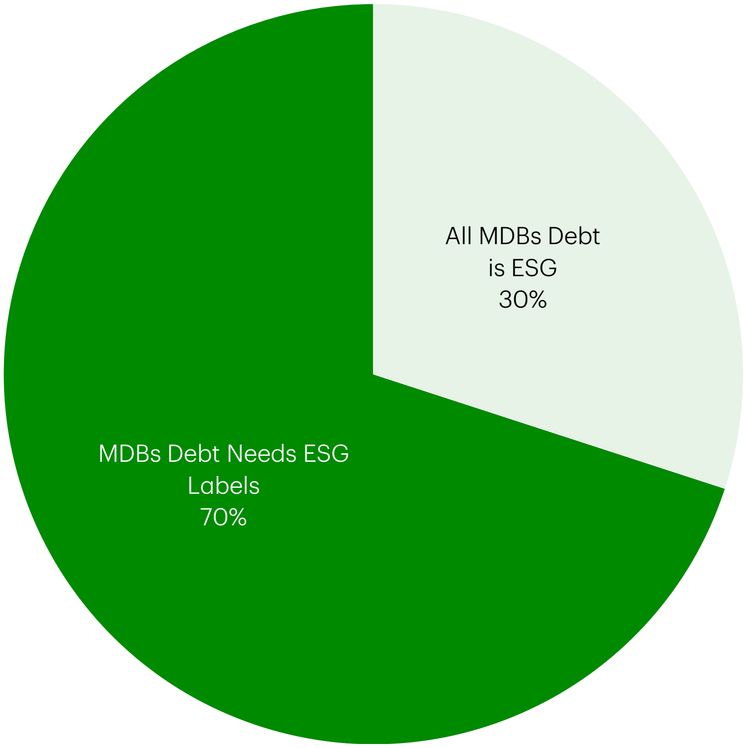
- In this survey, most investors (about 60% of all investors in the survey) responded that they would buy anything that is EU Taxonomy-aligned, regardless if the green bond finances nuclear or natural gas projects, see Exhibit 5.
- This consensus is driven by North American (69%) and Asian (63%) investors.
- While only 29% of European investors accept the inclusion of nuclear and natural gas projects, 43% of European investors would increase due diligence to avoid buying securities with proceeds allocated to either nuclear or gas.
  - German investors have been vocal in their opposition to financing nuclear and it is important to note that no German investors responded to this survey. This indicates that there are European investors outside of Germany avoiding exposure to nuclear.[9]
- After a fervent debate throughout the beginning of 2022, by the second half of 2022, certain natural gas and nuclear activities were included in the EU Taxonomy to accelerate decarbonization. These changes fielded pushback from some European investors, raising concerns of a bifurcation of investors, which could send mixed signals to issuers.[9] Additionally, at the time of the survey, the war in Ukraine was impacting energy supply and supply chains on the European continent and globally.

[8] TD's Sustainable Debt Market Investors Survey
[9] IIGCC publishes open letter calling for gas to be excluded from the EU Taxonomy, January 2022

Investors Do Not View Multilateral Development Banks (MDBs) as Pure Players

Majority of Investors Surveyed Demand MDBs Debt to be Labelled, Regardless of Region[10]

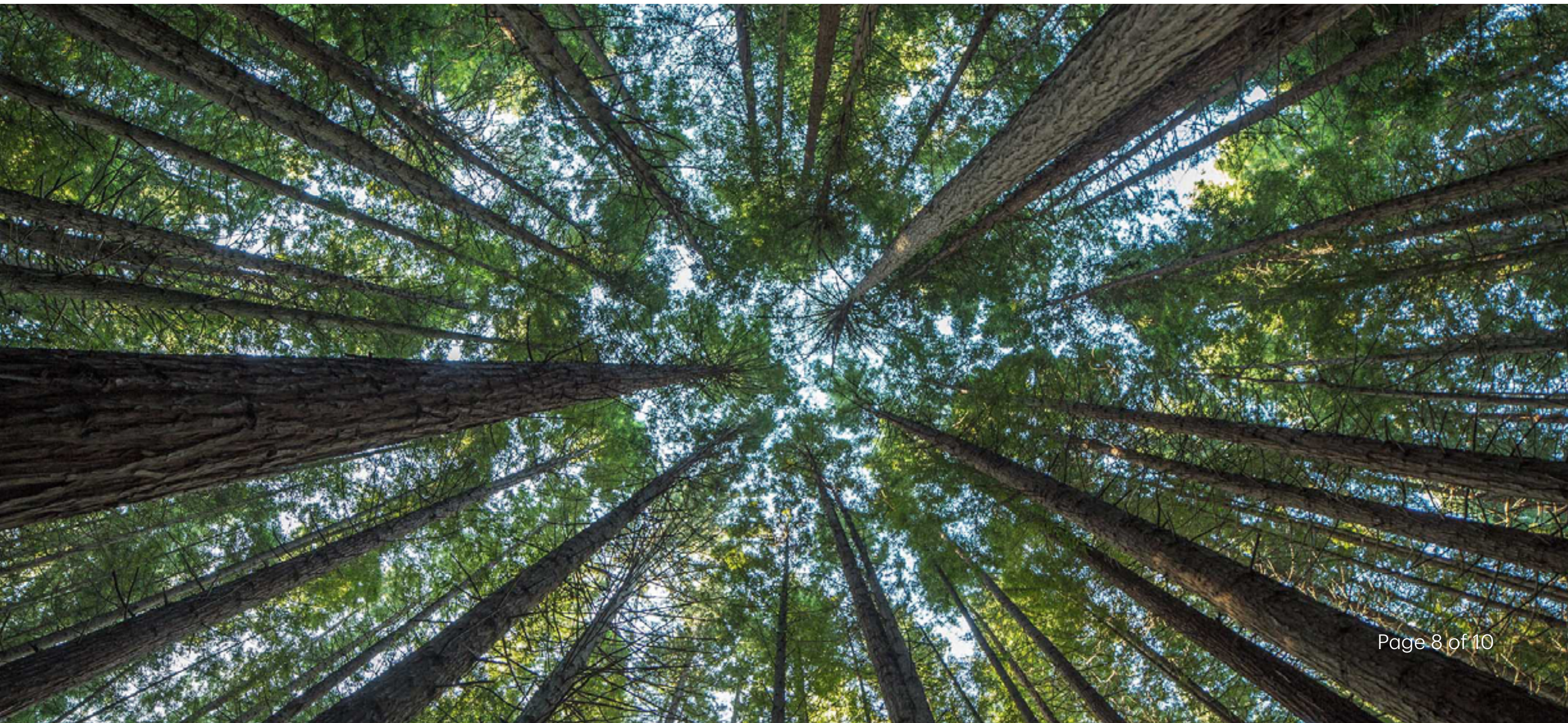
Exhibit 6



Key Findings

- Multilateral Development Banks ("MDBs") were the first to issue green bonds starting in 2008 and have become prolific issuers since then, dominating issuance with 46% of the Green, Social, Sustainable bond market in 2021[11]. Many MDBs, sub-sovereign, and some corporates consider themselves "pure players," which was the impetus for this survey question.
- Investors in this survey disagreed with MDBs. Almost 70% of investors stated that MDB debt should be labelled, or that their debt would require further due diligence, see Exhibit 6.
- Investors appear to be balancing their demand for transparency with their desire to use trusted labels. Investor responses report using trusted labels, as an efficiency measure, to navigate the complex and evolving sustainable debt market landscape.

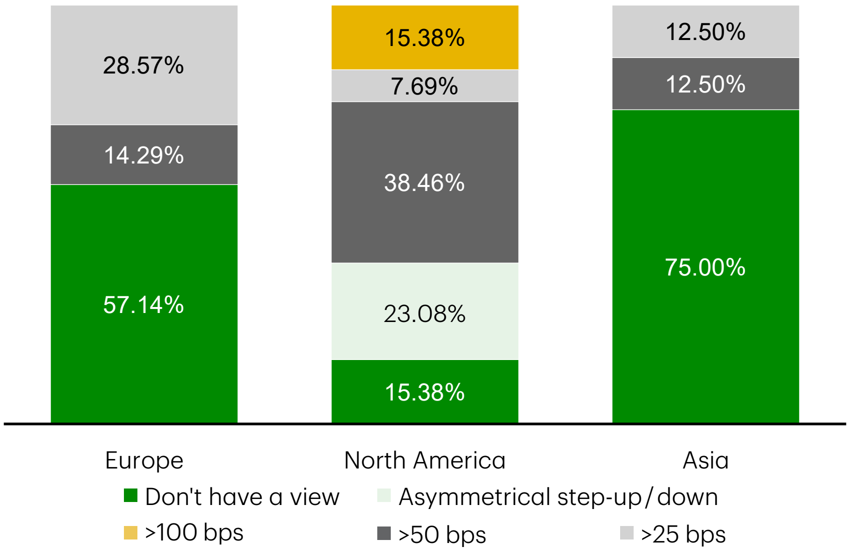
[10] TD's Sustainable Debt Market Investors Survey
[11] From Evolution to Revolution: 10 Years of Green Bonds



Investors Display Regional Perspectives on the Mechanics Behind Sustainability-linked Debt

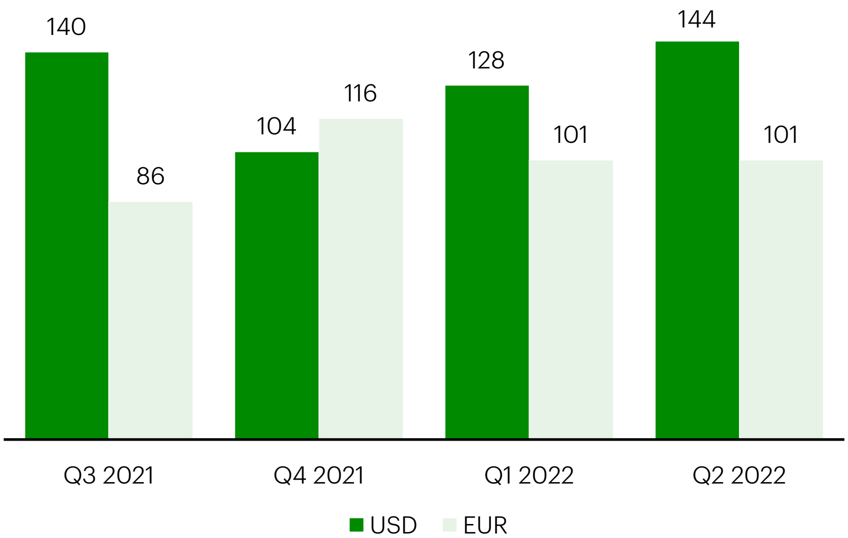
Investors' Views on the Adequate Size of the Step-up/Down in SLBs[12]

Exhibit 7: Regional breakdown, additional decimal points provided for clarity on regional totals



Average Cumulative Step-up Increases to Record Highs in the USD SLB Market While it Remains In Line with Historical Average in EUR SLB[12]

Exhibit 8: Expressed in Basis Points



Key Findings

- In the case of SLBs, globally 60% of investors indicated that they were apathetic to the weighting of different KPIs, but this consensus is largely driven by European and Asian investor responses. In contrast, 85% of North American investors noted that KPI weighting should be specifically linked to materiality (not seen in graph).
- There is also no clear preference between one-way and two-way price adjustments on SLBs, with 61% of all investors surveyed preferring the former while 58% the latter (not seen in graph).
- Moreover, 50% of respondents declared they do not have a view on the size of step-up or on the inclusion of a step-down. Yet, as Exhibit 7 shows, regional investors are not in consensus. Particularly North American investors in 2021 and 2022 expressed a preference for step- ups larger than 50 bps.
- These results are consistent with the characteristics of SLBs issuance across the USD and Euro markets over the last four quarters.
  - In the USD SLB market, the average cumulative step-up, expressed as the average of the sum of the step-ups over the life of a bond, increased to record highs due to longer dated SLB and continued focus from investors on significant penalties for missed targets, see Exhibit 8, which support the survey findings.
- While, in the more established Euro SLB market, coupon step sizing has remained constant over the last year with a modest increase of total maximum coupon step to 45 bps over Q2 2022, see Exhibit 8. Shorter tenors and premium payment structures are more common in the Euro SLB market versus USD, making the average total cumulative penalty also smaller comparatively.[13]

[12] TD's Sustainable Debt Market Investors Survey
[13] Please note that premium payment structures were not included in our survey

Conclusion

Investors continue to ask for further transparency and standardization in the sustainable debt market and ESG space more broadly, while they are relying in the meantime on ESG ratings and labels as the only available tools of the trade. The only exception remains the transition label, where investors seem to attribute a stigma even if they are willing to buy other transition instruments. In addition, investors are paying attention to issuers developing frameworks checked by SPOs and communicating their sustainability targets and strategies. As market conditions continue to change, economies recalibrate from the pandemic, and recover from war, it will be important to stay tuned to investor perspectives on sustainable-linked debt and related issues.

TD Securities' ESG Solutions team is committed to surveying investor perspectives on this evolving market to help issuers better connect with financing. We look forward to hearing from you and speaking about our findings. For more information, contact ESGSolutions@tdsecurities.com.