

Defining KPIs for Sustainability-linked instruments

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Agenda

- » Introduction & SPOs
- » Icebreaker
- » SL instruments: raising credible debt
- » Case studies
- » Quiz and Q&A

About Morningstar Sustainalytics



- » A Morningstar business dedicated to responsible investment with more than 30 years' experience in ESG research, ratings, and data.
- » 1,600+ professional staff with more than 850 engaged in research.
- » Morningstar's ESG center of excellence, responsible for driving both the commercial success and innovation of its ESG products as well as its overall ESG strategy.

Morningstar Sustainalytics' Products & Solutions

- » Morningstar Sustainalytics' primary business is to support the world's foremost investors to incorporate Environmental, Social, and Governance (ESG) insights into their investment decision making processes.
- » As the responsible investment sector has grown and matured, there has been more demand for ESG research and products for new uses, like integrating ESG data into capital raising activities.
- » Sustainalytics' Corporate Solutions team provides services tailored for issuers, corporates and the banks who support them, in helping them answer the question: **"How can I attract responsible investors/lenders to finance my bonds or my company?"**
- » Sustainalytics is the largest Second-Party Opinion provider.

Investor Solutions

ESG Ratings

- » ESG Integration
- » Screening and sustainability benchmarking of portfolios
- » Thematic Investing for fund or index creation
- » Engagement and Voting
- » Strategy Development (ESG Integration, PRI Implementation)

Index Services

- » Provision of ESG data to create best-in-class or thematic indexes

Corporate Solutions

Sustainable Fixed Income

- » Label your issuance as green, social, or SDG through a second-party opinion from Sustainalytics
- » Confirm to investors that projects financed post-issuance are aligned with the framework
- » Report on impact of projects financed through your issuance to investors

ESG Ratings License for Issuers

- » Commercialize ESG ratings for use in debt instruments
- » Benchmark sustainability performance relative to peers
- » Create an ESG rating

Civil Society & Academia

- » Sustainability Research & Rankings
- » Academic Program

Sustainable Fixed Income

Organisational Structure

Morningstar Sustainalytics' Sustainable Fixed Income business is comprised of **Sales & Commercial**; **Research Opinions**; and **Research Standards & Guidance** teams:

Products & Solutions:

- Second-Party Opinions
- Allocation and Impact Reporting Reviews
- Bond and Loan Impact Reporting

50+

Research Persons

6 countries

Global presence



Sales & Commercial

Regional coverage in EMEA, Americas and APAC regions



Research Opinions

Conduct and execute Second-Party Opinions and Impact Reporting Research

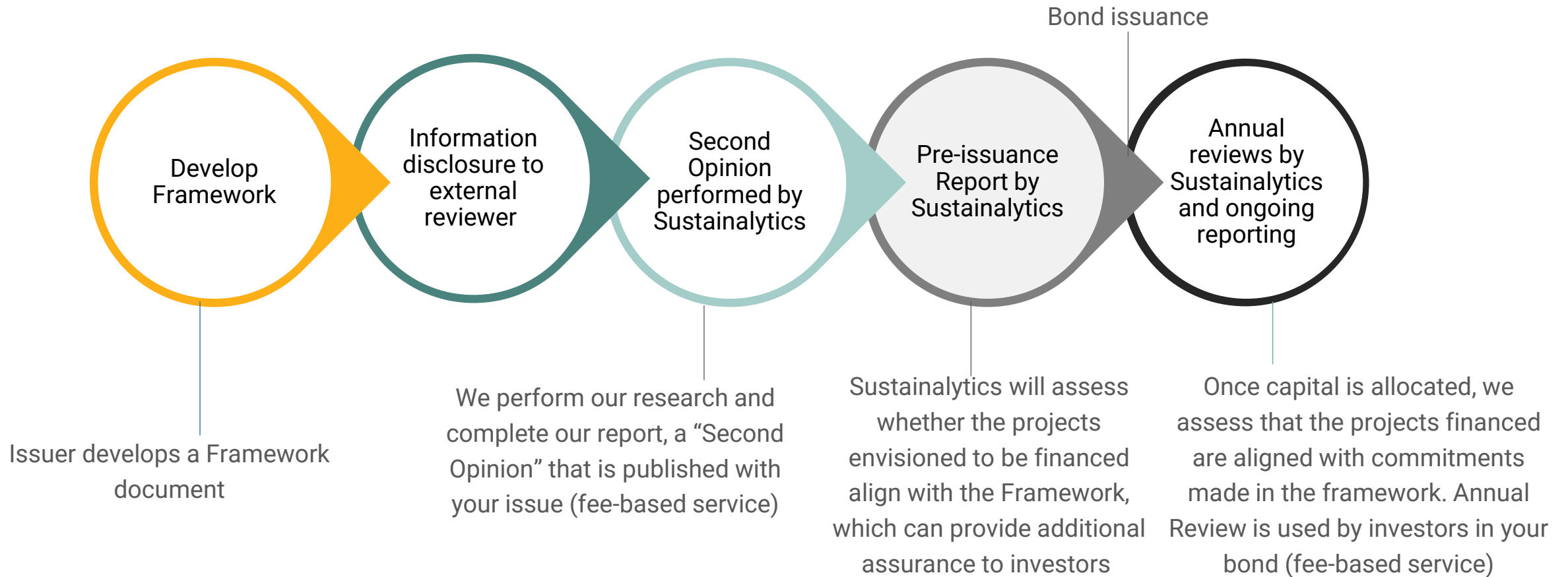


Research Standards & Guidance

Inform our methodology to assess sustainable finance instruments supported by credible market standards

Sustainable Bond Issuance Process

When an issuer should engage with a Second-Party Opinion provider



Second-Party Opinion: Sustainability Linked Bond/Loan Framework

Sections of a SLB/ SLL SPO

Section 1: Detailed assessment of the alignment with the SLB Principles

- Selection of KPIs
- Calibration of SPTs
- Bond/Loan Characteristics
- Reporting
- Verification


Section 2: Assessment of issuer's sustainability strategy

- Credibility of issuer's sustainability strategy
- Issuer's environmental and social risk management

Section 3: Impact of the SPTs chosen

- Assessment of the expected impact of the SPTs
- Assessment of contribution to the SDGs

Second-Party Opinion
**COMPANY X SUSTAINABILITY-
LINKED BOND FRAMEWORK**

**SECOND-
PARTY
OPINION**


Evaluation Summary
Sustainalytics is of the opinion that the Company X Sustainability-Linked Bond aligns with the Sustainability-Linked Bond Principles 2020. This assessment is based on the following:

- **Selection of Key Performance Indicators (KPIs):** Company X's SLB includes two KPIs: i) reduce carbon emission and ii) reduce water use (see table 1). Sustainalytics considers the carbon reduction KPI chosen to be good based on materiality of the issue, medium applicability (30%), and clear and consistent methodology. Sustainalytics considers the water reuse KPI to be an excellent KPI because it addresses a material topic, has high applicability (100%) and uses an externally recognized standard to calculate performance.
- **Calibration of Sustainability Performance Targets (SPTs)** Sustainalytics considers the SPTs to be aligned with the issuer's sustainability strategy. Sustainalytics further considers the SPTs to be ambitious based on alignment with science-based targets for the sector and best available technology. The SPTs also demonstrate a material improvement in comparison to the issuer's past performance.
- **Bond Characteristics** Company X will link the bond's financial characteristics to the achievement of the SPTs, namely it commits to increase the coupon rate by 25bp in case one of the SPTs is not met.
- **Reporting** Company X commits to report on an annual basis on its performance on the KPIs in its Annual Report. Company X commits to disclose relevant information that affect the KPI performance, such as investments in new technology. The reporting commitments are aligned with the SLBP.
- **Verification** Company X commits to have external limited assurance conducted on its KPI performance annually and at the communicated SPT deadline, which is aligned with market expectations.

11 January 2021
Evaluation Date

Amsterdam, The Netherlands
Issuer Location

The SPTs contribute to the following SDGs:



Overall Strength of KPIs and SPTs

KPI	Baseline	SPT	Strength of the KPI	Ambitiousness of SPT
Carbon emissions (in CO2e per year) defined as CO2 emissions Scope 1 and 2	0.548	20% decrease by 2025, to 3.5 tonnes CO2e per year	Strong	Highly Ambitious
Water use (in m3) defined as total amount of water extracted	15.069	50% decrease by 2025, to 1,56 m3	Very strong	Ambitious

SLB/SLL Principles

Sustainability-Linked Instruments are any type of bond/loan instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined Sustainability/ESG objectives.

We are active contributors to ICMA/LMA/LSTA Working Groups.

Sector	Sub-sector	Sustainability theme	Potential KPIs	Core vs Secondary	SDGs	Global Benchmarks for KPI
Real Estate		Biodiversity (incl. soil/land use)	Biodiversity net gain on existing buildings and new developments	Core / Secondary	15	
Real Estate		Climate change (GHG emissions and energy)	Minimum EPC rating (or equivalent local energy efficiency certification) across entire real estate portfolio by target date	Secondary	7, 11, 13	EPC (or equivalent local energy efficiency certification)
Real Estate		Climate change (GHG emissions and energy)	Percentage of certified sustainable Gross Leasable Area	Secondary	9	Area with Green Building Certification e.g. LEED, DBI Green Building Certification, BELS etc. or other Building Criteria or other benchmarks such as B
Real Estate		Climate change (GHG emissions and energy)	Percentage of supply chain which has established Scope 1-2 GHG emissions targets (aligned with SBTi methodology)	Secondary	7, 13	SBTi
Real Estate		Climate change (GHG emissions and energy)	Percentage of ZEB (Net-Zero Energy Building), ZEH (Net-Zero Energy House) in the portfolio	Core	9, 11, 13	
Real Estate		Climate change (GHG emissions and energy)	Reduction of CO2 equivalent emissions per m2 of gross leasable floor area (measured in tCO2eq/m2)	Secondary	7, 13	SBTi, TPI, ACT, SDA, ETP B2DS (IEA)
Real Estate		Climate change (GHG emissions and energy)	Scope 1, 2, 3 (including Category 15) GHG emissions reduction (in carbon intensity per m2 or absolute)	Core	7, 11, 13	Science based target initiative (SBTi), TPI, ACT, s, Decarbonisation Approach, ETP B2DS
Real Estate		Raw material sourcing and recycling (circular economy)	Percentage of sustainable materials of buildings	Secondary	11, 12	
Real Estate		Waste	Percentage of waste recycled into raw materials	Secondary	11, 12	GRI (306-4)
Real Estate		Waste	Reduction in waste to landfill in all new build & renovation projects (in absolute tons or percentage)	Secondary	11, 12, 14, 15	GRI (306-4)
Real Estate		Water	Reducing water usage across entire portfolio	Secondary	6, 12	CDP Water Security (GRI 303-3)



Sustainability-Linked Bond Principles

Voluntary Process Guidelines

June 2023

Sustainability-Linked Loan Principles

Supporting environmentally and socially sustainable economic activity



Sustainability-Linked Bond Principles Related Questions



September 2023

Morningstar Sustainability's published SPOs

Morningstar brands and products

Company

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Location

Region

Industry Group

Use of Proceeds

Project Type

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Project	Client	Location	Industry Group	Use of Proceeds	Project Type	Date	Review
Kojamo Green Finance Framework Second-Party	Kojamo Oyj	Finland	Real Estate	Clean transport, Green buildings,	Green Bond/Loan	Feb 2024	View

https://www.sustainalytics.com

Awards



Awards – SLB/SLLs Morningstar Sustainability' opined on



Sustainability-linked bond of the year - corporate: DHL Group - Deutsche Post

DHL Group commits to reduce absolute Scope 1 and 2 emissions by 42%. The company says it plans to achieve this reduction by increasing the share of sustainable fuels to over 30% by 2030 and electrifying the pickup vehicles fleet to over 60%.



Sustainability-linked loan of the year - SSAs/sub-sovereigns: Government of Uruguay

In October 2023, the World Bank approved a \$350 million sustainability-linked loan for Uruguay, which is believed to be the first sustainability-linked loan deal involving a sovereign country.



Sustainability-linked bond of the year - SSAs/sub-sovereigns: Republic of Chile

In June 2023, the Republic of Chile issued a \$2.25 billion dual tranche sustainability-linked bond (SLB) and followed up with a €750 million (\$813 million equivalent) SLB on the subsequent day, after being absent from the Euro market since 2021.

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Which sector do you work in?

① Start presenting to display the poll results on this slide.

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**How much do you know about
sustainability-linked instruments?**

① Start presenting to display the poll results on this slide.

SL instruments: raising credible debt

Key points:

- Transition instrument
- Performance improvement – “journey from A to B”
- Sector-specific and material KPIs
- Ambitious targets
- Linked to financial consequences

Second-Party Opinion

COMPANY X SUSTAINABILITY-LINKED BOND FRAMEWORK

SUSTAINALYTICS

a Morningstar company

SECOND-PARTY OPINION

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KPI Assessment Outcomes

A combination of six parameters leads to an outcome

1. Materiality
2. Applicability
3. Directness
4. Clear and consistent methodology
5. Following an externally defined methodology
6. Comparable to an external benchmark



Very Strong
Strong
Adequate
Not Aligned

Aligned to SLBP/ SLLP

KPI	Baseline	Strength of KPI	SPT	Ambitiousness of SPT
Scope 1 and scope 2 CO ₂ emissions per tonne of cementitious product (kgCO ₂ /t)	2020	Very Strong	Reduce scope 1 and scope 2 CO ₂ emissions to 564 kg by 2025, 513 kg by 2027, and below 454 kg by 2030 per tonne of cementitious product	Highly Ambitious
Clinker factor to cementitious (%)	2020	Strong	Reduce clinker factor to 68% by 2030	Moderately Ambitious
Alternative fuels rate (%)	2020	Strong	Achieve alternative fuels rate of 55% by 2030	Highly Ambitious

External standards to determine materiality

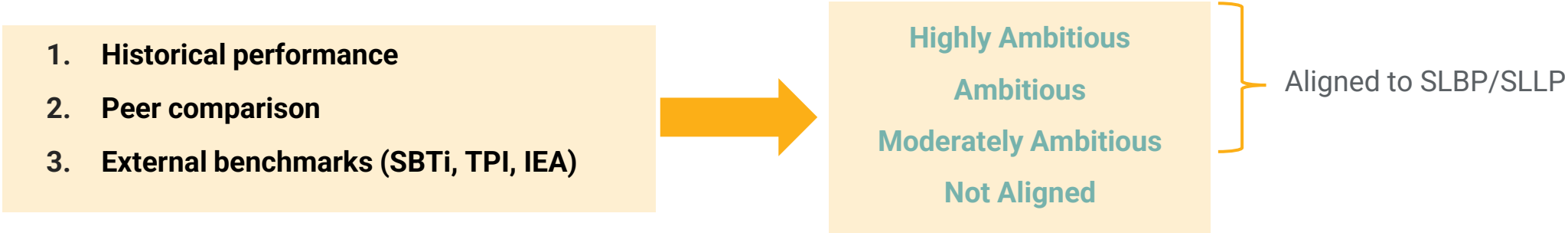
Useful sources



Morningstar Sustainalytics ESG Ratings

SPT Assessment Outcomes

A combination of three parameters leads to an assessment outcome



KPI	Baseline	Strength of KPI	SPT	Ambitiousness of SPT
Scope 1 and scope 2 CO ₂ emissions per tonne of cementitious product (kgCO ₂ /t)	2020	Very Strong	Reduce scope 1 and scope 2 CO ₂ emissions to 564 kg by 2025, 513 kg by 2027, and below 454 kg by 2030 per tonne of cementitious product	Highly Ambitious
Clinker factor to cementitious (%)	2020	Strong	Reduce clinker factor to 68% by 2030	Moderately Ambitious
Alternative fuels rate (%)	2020	Strong	Achieve alternative fuels rate of 55% by 2030	Highly Ambitious

External benchmarks

Useful sources



SCIENCE
BASED
TARGETS

DRIVING AMBITIOUS CORPORATE CLIMATE ACTION



Transition
Pathway
Initiative



International Energy Agency

Financial Characteristics: incentive to meet targets

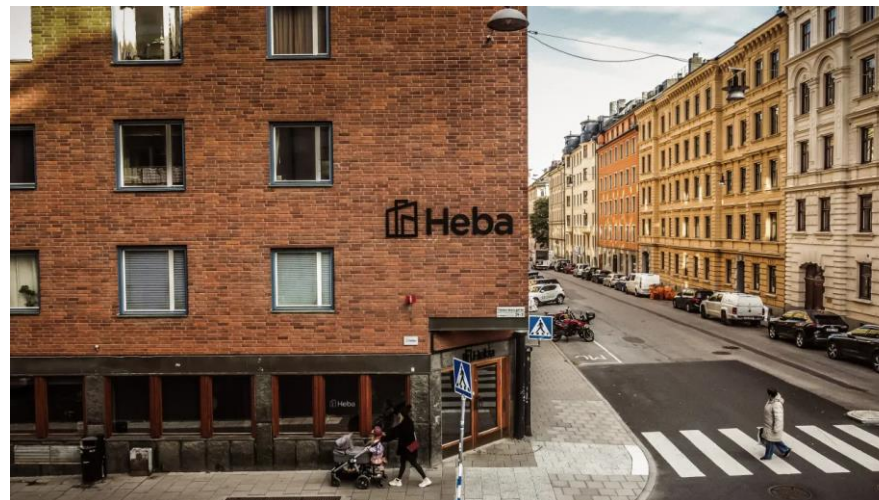
Considerations in the SLBP and SLLP	Morningstar Sustainalytics' Approach
The bond's financial and/or structural characteristics should vary depending on whether SPT(s) are achieved.	Confirm link between achievement of target(s) and bond/loan characteristics
It is recommended that the variation of the bond financial and/or structural characteristics be commensurate and meaningful relative to the issuer's original bond financial characteristics.	Not assessed

Case studies

Heba

Real estate management company

- Business profile:
 - Owns, manages and operates 56 residential real estate properties in the Stockholm region and Uppsala.
 - Headquartered in Stockholm, Sweden.
- Highly Material issues per the Sustainability Accounting Standards Board and based on research from the International Energy Agency:
 - Energy management
 - Embodied carbon emissions
- Relevant benchmarks:
 - Science Based Targets initiative



Credit: Heba's website

Real estate company

Morningstar Sustainalytics' opinion

KPI	Strength of the KPI	SPT	Ambitiousness of SPT
KPI 1: GHG emissions from Heba's own operations (scope 1 and 2) 6%	Very Strong	Reduce GHG emissions from Heba's own operations (scope 1 and 2) by: SPT 1.1: 41% by 2024 SPT 1.2: 43% by 2025 SPT 1.3: 44% by 2026 SPT 1.4: 46% by 2027 SPT 1.5: 47% by 2028 SPT 1.6: 49% by 2029 SPT 1.7: 50% by 2030	Highly Ambitious 1.5 °C
KPI 2: GHG emissions from Heba's construction activities (scope 3) 65.8%		Reduce GHG emissions from construction activities (scope 3) by: SPT 2.1: 10% by 2024 SPT 2.2: 20% by 2025 SPT 2.3: 30% by 2026 SPT 2.4: 35% by 2027 SPT 2.5: 40% by 2028 SPT 2.6: 45% by 2029 SPT 2.7: 50% by 2030	

Ahold Delhaize

Global food retail company

- Business profile:
 - Operates supermarket and e-commerce businesses.
 - Serves more than 63 million customers each week, in Europe, the United States and Indonesia.
 - Headquartered in Zaandam, the Netherlands, 402,000 employees, 7,700 stores and 1,800 grocery pick-up points.
- Highly Material issues per SASB, Sustainalytics ESG Rating:
 - Scope 3 GHG emissions
 - Waste management
- Relevant benchmarks:
 - Science Based Targets initiative



Credit: Ahold Delhaize's website

Global food retail company

Morningstar Sustainalytics' opinion

Overview of KPIs and SPTs

KPI	Baseline	Strength of KPI	SPT	Ambitiousness of SPT
KPI 1: Absolute scope 1 and 2 GHG emissions (ktCO ₂ e)	2018	Very Strong	SPT 1a: Reduce absolute scope 1 and 2 GHG emissions by more than 38% by 2025 from a 2018 baseline	Highly Ambitious
			SPT 1b: Reduce absolute scope 1 and 2 GHG emissions by 50% by 2030 from a 2018 baseline	
KPI 2a: Absolute scope 3 FLAG GHG emissions (MtCO ₂ e)	2020	Very Strong	SPT 2a: Reduce absolute scope 3 FLAG GHG emissions by 30.3% by 2030 from the 2020 baseline	Highly Ambitious
KPI 2b: Absolute scope 3 energy and industry (non-FLAG) GHG emissions (MtCO ₂ e)	2020	Very Strong	SPT 2b: Reduce absolute scope 3 energy and industry (non-FLAG) GHG emissions by 42.0% by 2030 from the 2020 baseline	Highly Ambitious
KPI 3: Food waste per food sales (t/EUR million)	2016	Adequate	SPT 3a: Reduce food waste per food sales by more than 40% by 2025 from a 2016 baseline	Moderately Ambitious
			SPT 3b: Reduce food waste per food sales by 50% by 2030 from a 2016 baseline	

1.5 °C

Paper & Forestry

Circular economy & biodiversity KPIs

KPI	Strength of the KPI	SPT	Ambitiousness of SPT
KPI 1a: Absolute scope 1 and 2 GHG emissions (million tCO ₂ e)	Very Strong	SPT 1a: Reduce absolute scope 1 and 2 GHG emissions by 50% by 2030 from a 2019 baseline	Highly Ambitious
KPI 1b: Absolute scope 3 GHG emissions (million tCO ₂ e)	Very Strong	SPT 1b: Reduce absolute scope 3 GHG emissions by 50% by 2030 from a 2019 baseline	Highly Ambitious
KPI 2: Technical recyclability of products	Strong	SPT 2: Achieve 100% technical recyclability of products by 2030	Ambitious
KPI 3: Birch seedlings planted	Strong	SPT 3: Increase birch seedlings planted to 3.4 million by 2030 relative to a 2021 baseline	Ambitious

Commercial bank

Social KPI & Financed emissions intensity reduction

Overview of KPIs and SPTs

KPI	Baseline	Strength of KPI	SPT	Ambitiousness of SPT
KPI 1: Number of unbanked and underserved individuals given access to credit	2021	Adequate	SPT 1: Increase the number of unbanked and underserved individuals given access to credit by 531% by 2025 from a 2021 baseline	Ambitious
KPI 2: Financed emissions intensity (tCO ₂ e/COP mn)	2021	Adequate	SPT 2: Reduce financed emissions intensity by 25% by 2025 from a 2021 baseline	Ambitious

Electric utility company

Generating more low-carbon energy

KPI	SPT	Strength of the KPI	Ambitiousness of SPT
Share of green electricity production	Increase the share of green electricity production to 73% of the total electricity production by 2030	Strong	Highly ambitious

What makes SL instruments credible?

Takeaways:

- Significant performance improvement – “journey from A to B”
- KPIs are quantifiable and measurable on the consistent basis
- Meaningful transition angle
 - Highly material and relevant KPIs
 - Highly ambitious targets, when possible, aligned with science

Second-Party Opinion

COMPANY X SUSTAINABILITY-LINKED BOND FRAMEWORK

SUSTAINALYTICS

a Morningstar company

SECOND-PARTY OPINION

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Quiz time

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Which external sources can help you define a credible KPI?

① Start presenting to display the poll results on this slide.



What external references can help you set a credible target?

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How many KPIs do we need to develop a robust SL framework?

① Start presenting to display the poll results on this slide.



**A bank selects the KPI on Scope 1&2 emissions.
How material is this KPI, in your opinion?**

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Audience Q&A Session

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