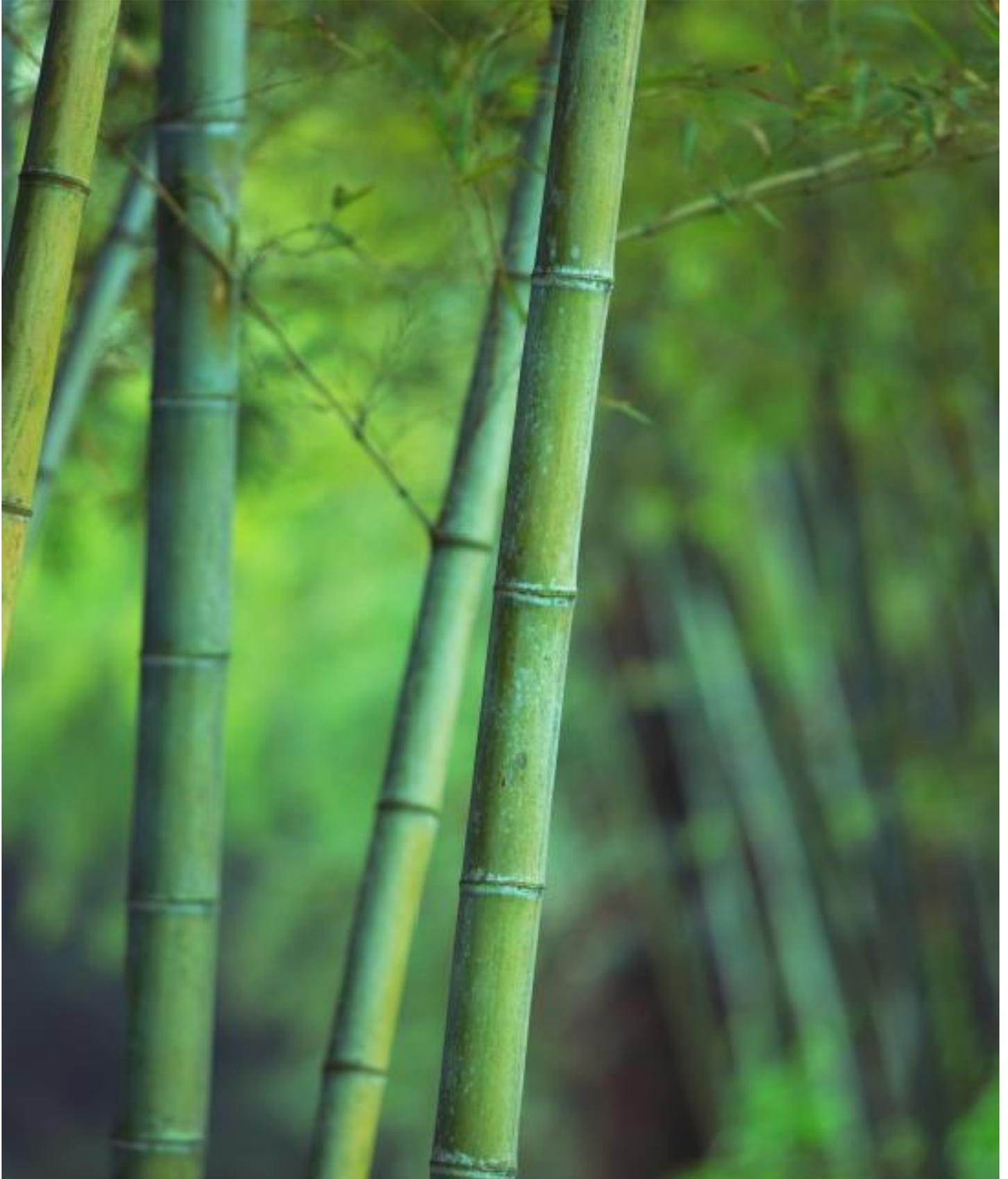


The Green Bond: Your insight into sustainable finance



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New sustainable assets

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Seeing the push to assess and re-assess the contribution of their investments to the society from both corporations and investors, I will make the claim that within the next few years the majority of investor presentations will likely be addressing companies' contributions to society
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The sustainable debt market in 2021 is off to a good start with total issuances of USD 84.3bn in January. The largest product type so far has been green bonds with USD 31.5bn of total issuance, followed by social bonds at USD 30.3b and sustainability bonds at 13.2bn. Total issuance of sustainability-linked bonds, the topic of this publication, is already USD 3.9bn – almost 40% of the total for 2020.
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As the first in the international shipping industry and first in the Nordics, Odfjell SE successfully issued a sustainability-linked bond in January 2021. The bond is also an excellent example of the common value for finance and industry that sustainable financing offers.
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The introduction of sustainability-linked bonds (SLBs) further expanded opportunities for issuers in the sustainable bond market. Given the nature and structure of this new instrument, it is essential for issuers and investors alike to ensure targets tied to the bond improve an issuer's sustainability performance.
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You know the EU taxonomy, but do you know China's? This article analyses the Chinese Consultation Draft of the Green Bond Endorsed Projects Catalogue and the EU Taxonomy for sustainable activities (November 2020 version) to identify major differences and similarities between the two sustainability classifications

Letter to the reader

When I was meeting with people 10 years ago to discuss Green Bonds, they were saying that this is the way all finance should be done. I knew that this idea had enormous potential, if we managed to quantify the economic value using time and other variables to make a financial re-assessment. To be frank, at the time I thought it was far too ambitious. However, looking at what is going on right now, seeing how all fronts and parts of society (ourselves included) are using transparency, social media, various organizations and regulations to assess and re-assess the contribution of investments to the society, and seeing the push for this from both corporations and investors, I can claim that within the next few years the majority of investor presentations will likely be addressing companies' contributions to society.

Over the past 1.5 years, expansion from Green to Transition has been a big topic in Sustainable Finance. Among other things, discussions revolved around the potential benefits of repricing transition companies. It seems like the SLL and the SLB markets are taking on a big part of that job with most corporate discussions including these elements as a core factor. As a consequence, we dedicated a large part of this edition (alongside with the Market and the Transition updates) to addressing the topic of Sustainability-Linked Debt. One core element of the transition is the repricing happening along with investors' re-assessments and there are clear signs that technology, corporations, sectors and regions' ability to position themselves in alignment with these re-assessments have a significant impact on access to capital and the price of capital.

So far, we see this predominantly in the energy transition, but we expect other SDG's to follow when the market has analyzed the economic ecosystem and manages to create financial solutions to ensure that cash-flows allow investors to get access to the economic outcome. This process is likely to take the next 3 to 5 years and during this time there should be good opportunities to benefit from re-pricing of the assets that build a better and stronger society.

Sustainability-linked, Green, Social, SDG – all growing and here to stay!

One important factor in this era is the participation of regulators. A lot of time and energy has been spent on assessing the EU taxonomy – my colleague Anne Kästner has spent the last weeks working together with the Chinese International Institute for Green Finance (IIFG) to create a comparison between the Chinese Taxonomy and the proposed EU Taxonomy – we expect harmonization to happen in the future. However, due to individual governance systems and infrastructures, it will likely take some time. In the meantime, it is important for all of us to understand how to communicate across continents. Hopefully this article can be a contribution to that.

In this edition we also have the pleasure of having Odfjell sharing the experience of their SLB Framework and Bond issuance. We also got Sustainalytics' input on SLB considerations from a reviewer's perspective – as always – we highly appreciate these external contributions from our partners!

Enjoy your reading

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Transition update

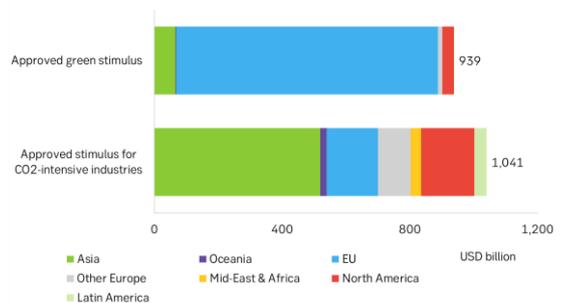
Prepare for take-off

The coronavirus pandemic has set the stage for a big change of direction in 2021 as a policy regime change now appears to be underway.

Governments and central banks will now aim for a sustained increase in inflation, with fiscal stimulus facilitated by monetary expansion. At first this will lead to a strong recovery in economic activity driven by traditional stimulus, but within a few quarters the emphasis is likely to shift towards major long-term investment in a new energy infrastructure.

However, hopes of an early reopening have been dashed since the start of the year, and growth now looks likely to be constrained by the pandemic at least through Q1. As a result, policymakers are likely to remain focused on near-term relief efforts, and investment projects may be delayed. Figure 1 shows BNEF's tally of stimulus initiatives since the start of the pandemic, and it's quite clear that sustainability has not been the top priority, even if Europe stands out with a relatively large green stimulus share. In the US, President Biden's first fiscal plan focuses mainly on pandemic relief, but a second, more long-term and more climate-oriented plan will follow later this year.

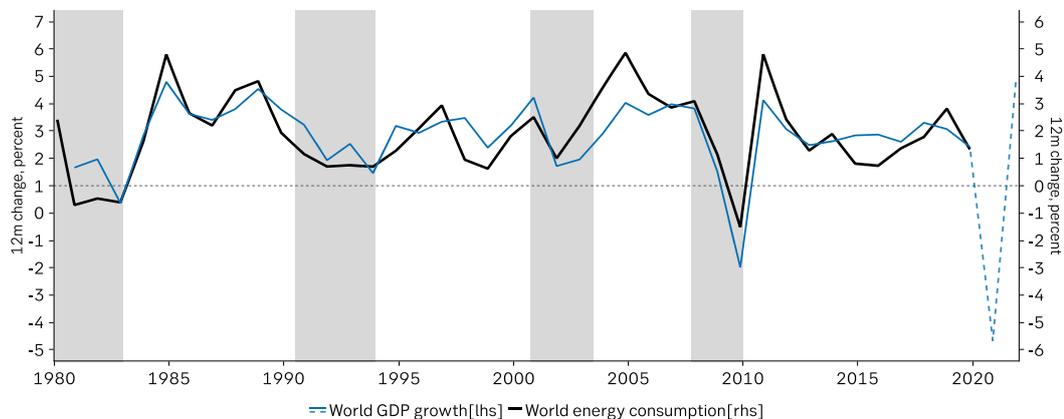
Figure 1: Approved green stimulus



Source: BNEF, SEB

From a climate perspective, the sharp decline in production over the past year also brought home another important point. Even if we ground airplanes and shut down supply chains, we hardly make a dent in the emission levels. Using our current technology, even a 30-year recession with no GDP growth would not get us close to the zero-emission target. There is simply no other realistic way to eliminate CO2 emissions than to replace the technology that generates it.

Figure 2: This is not the solution...



Source: Macrobond, SEB

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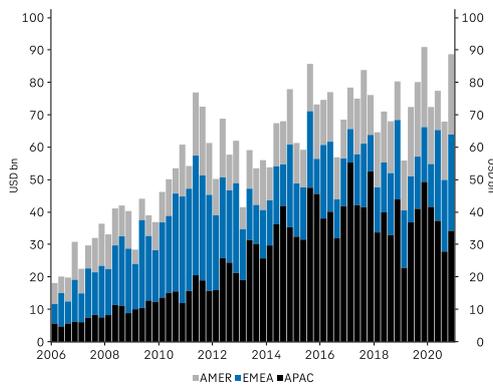
Elizabeth Mathiesen

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Accelerating the clean energy revolution

Fortunately, the technology revolution that will allow us to largely eliminate emissions without reducing global living standards continued to unfold unaffected behind the pandemic noise. Prices of renewable electricity as well as the key enabling technologies like storage continued falling, and the renewable share of world energy consumption continued rising. The advantage of the new primary technologies is now well established, investment in new supply is about to be ramped up and the focus is likely to turn to the investment needed from energy users.

Figure 3: Global investments in renewable energy



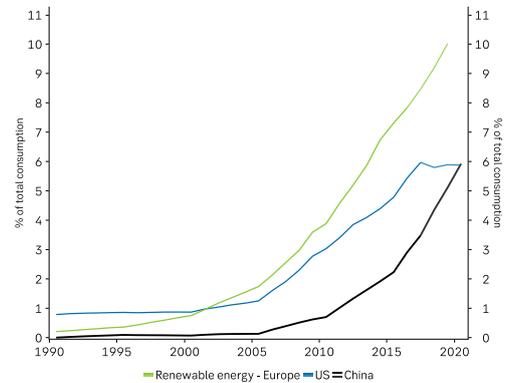
Source: BNEF, SEB

The pandemic did lead to a setback in renewable investment in 2020, extending a decade of stagnation in the amount of dollars spent on this purpose. Q4 saw a sharp rebound, indicating that this was a temporary departure from a rising underlying trend, but renewed restrictions in connection with the pandemic's second wave suggests we could see another dip in Q1. However, if we look more than a few quarters ahead, the annual investment level is likely to break clearly above USD300bn level that has been a 'glass ceiling' during the past 10 years.

The EU climate action plan is likely to lift the region's investment back to the almost twice as high level it had a decade ago once it is implemented. In the US, President Biden has set a

target of carbon-neutrality by 2050 and with Democratic control over the senate investments are likely to follow.

Figure 4: Renewable energy share, regions

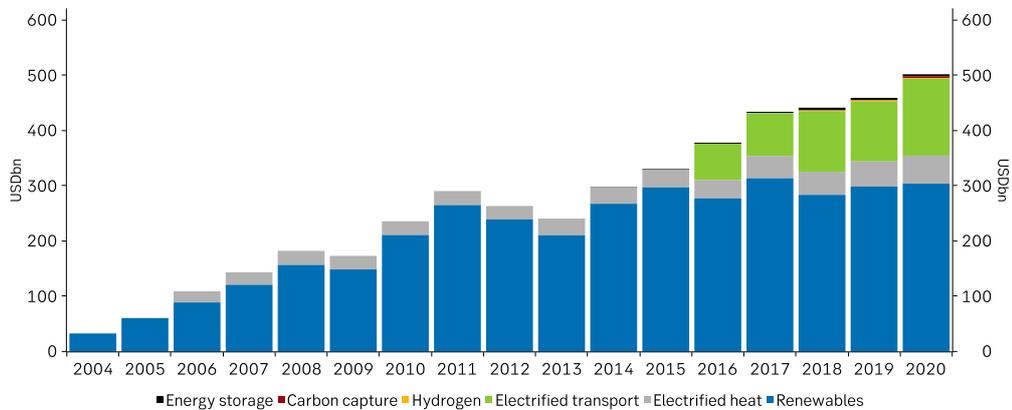


Source: BP, SEB

Due to the special nature of disruptive technologies, ramping up investment is also likely to accelerate the decline in the cost of energy. Even with investment levels stagnating in dollar terms, the supply of renewable energy has continued rising due to falling prices. A significant increase in investment will not only directly increase supply growth but will also lead to faster price declines due to the learning curve effect. The result is likely to be even faster increases in the renewable shares in Europe and China and a break with the deadlock in the US share during the Trump administration.

While renewable energy has passed the tipping point and no longer require subsidies to gain market shares, the focus is likely to turn to the other side of the transition: the technology revolution for energy users. Investment in electrified transportation technology took off in the second half of the last decade and investment in green hydrogen and energy storage technology is starting to pick up. This reflects the relatively advanced stage of the automotive technology, where EVs are close to the tipping point where subsidies no longer are needed and scale effects kick in.

Figure 5: Total transition investment



Source: BNEF, SEB

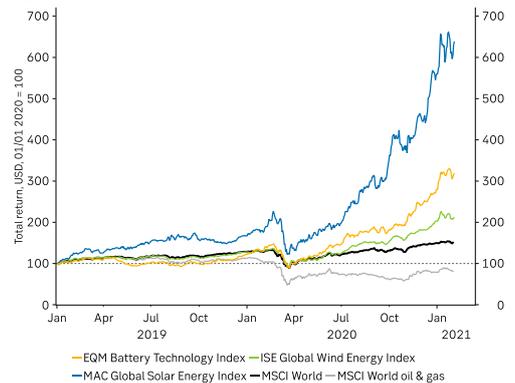
In parallel with this broadening of the investment, sustainable finance markets have also broadened the range of funding tools for green investment. Green bonds remain the dominant labelled asset class, but as other sectors start joining in with higher emission levels, the use of proceeds principle becomes a constraint. Sustainability-linked bonds, where debtors commit to KPIs for the sustainability path of the whole company in the future, are better suited for transition investment in these sectors and have seen significant increases in issuance in recent years. We expect the financial innovation to continue as the need for capital increases.

Capital needed for next transition phase

From a stock market perspective, 2020 appears to have seen a major change in the valuation of companies in the value chains of energy technologies that have passed or are close to passing the tipping point.

Companies with exposure to solar power, wind power and battery production outperformed the global market significantly, showing high correlation with other secular growth segments like the FANG+ stocks. In autos, Tesla went from a market cap that was lower than VW's or GM's to being worth more than all the world's auto producers combined in just one year.

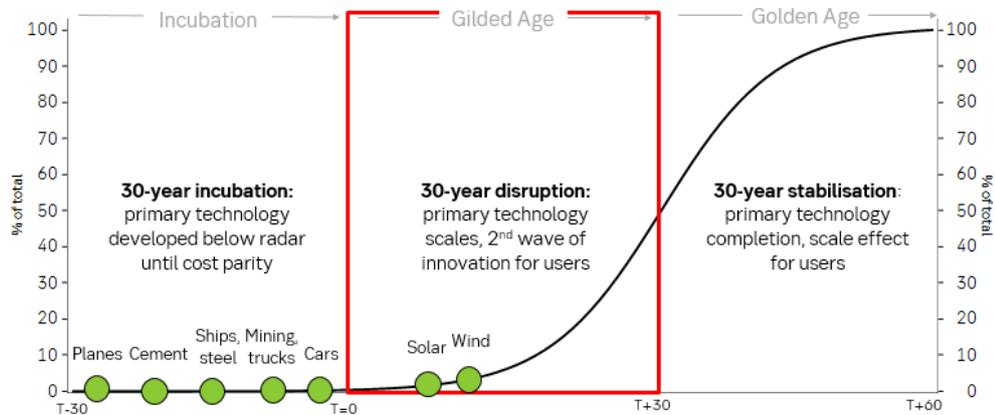
Figure 6: Solar, wind & battery index outperform



Source: Bloomberg, SEB

However, while renewable energy is already competitive and EVs are very close to besting fossil-powered cars, virtually no other CO2 intensive sectors currently have anything close to a competitive alternative to fossil fuels. Technological opportunities and major investment needs are likely to emerge at different points in time for the different sectors, depending on how difficult it is to replace the emission-generating processes. Some sectors are relatively close. Heavy trucks powered by batteries or hydrogen are already being tested. The first large hydrogen- or ammonium-powered ships are likely to arrive in the second half of the decade. Electric passenger airplanes, on the other hand, are unlikely to be deployed for much longer due to security concerns.

Figure 7: Technology diffusion (stylised example)



Source: SEB

This was a key theme in the 'Capital Replacement and Transition Arbitrage' white paper we released in January, and the result is likely to be a rolling series of investment booms as one sector after another start replacing obsolete fossil-centered technology with new technology based on electric power. Once a sector approaches the tipping point, the transition becomes a lot more capital-intensive.

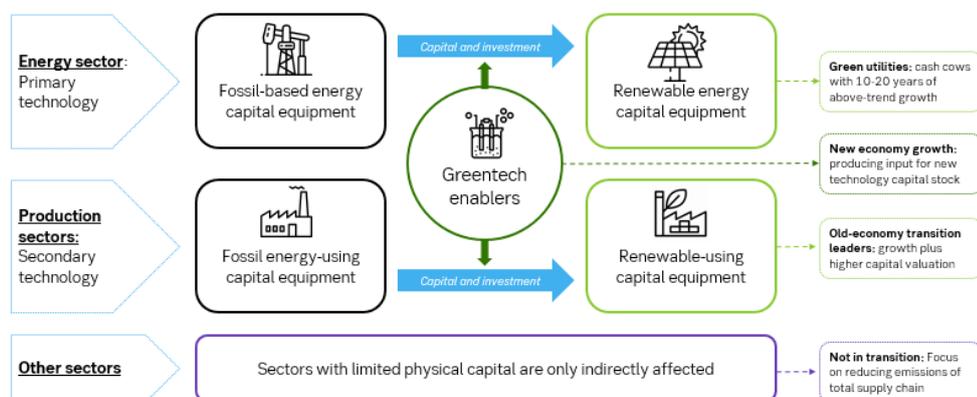
The coming years are likely to see massive investment into production of EVs alongside the accelerating investment in the energy sector. As more sectors reach the same point, investment is likely to rise and the competition for capital will intensify. The key driver of the capital that will fund this investment will be a widening valuation gap between old and new capital.

Figure 8 outlines the main capital market implications of such a capital replacement cycle.

The process is most advanced in the energy sector: even though renewable energy still supplies less than 10% of the world's energy needs, the market value of coal- and oil-producing assets has been falling for a decade, while some utilities like Denmark's Ørsted have seen a positive re-rating in the renewable space and should get more companions.

Providers of renewable energy technology like Vestas and NIBE have also achieved very high valuations while delivering strong growth, and new companies are emerging that could find a similar role. However, outside these 'pure green' segments, there are not many examples of companies in emission-intensive sectors being rewarded for successful transition apart from Tesla. As more sectors approach the same tipping point as EVs are now closing in on, early adopters are likely to offer similar opportunities.

Figure 8: Capital replacement



Source: SEB

Sustainable Debt Market Update

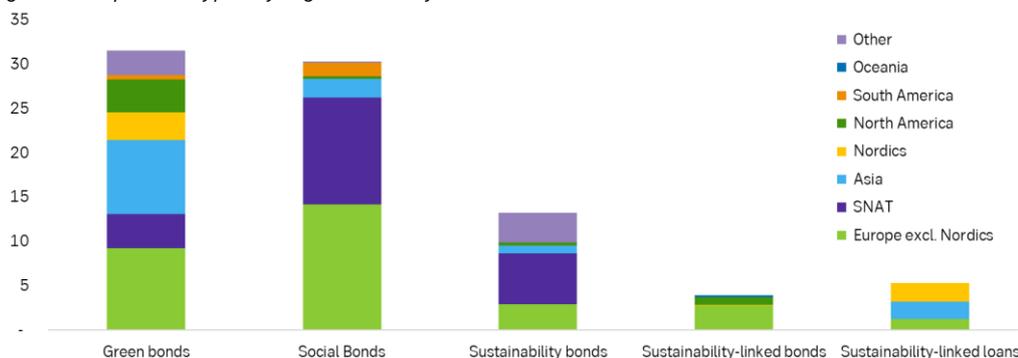
Financing the transition

January 2021 update

The sustainable debt market in 2021 is off to a good start with total issuances of USD 84.3bn in January. The largest product type so far has been green bonds with USD 31.5bn of total issuance, followed by social bonds at USD 30.3b and sustainability bonds at 13.2bn. The high

volume of social and sustainability bonds is a continuation of the trend established in 2020 of increased diversification among product types. Total issuance of sustainability-linked bonds, the topic of this publication, is already USD 3.9bn – almost 40% of the total for 2020.

Figure 9: All product types by region, January 2021



Source: Bloomberg New Energy Finance, as of 31 January 2021

Regional update

Europe excl. Nordics has been the largest region for labelled bonds (green, social, sustainability bonds, sustainability-linked bonds, sustainability-linked loans and green loans) in January with total issuance of 30.3bn, of which 47% were social bonds and 31% were green bonds. France, with total issuance of USD 12.0bn, had the highest volume in Europe ahead of The Netherlands (USD 5.2bn) and Great Britain (3.5bnbn). The sustainable debt market in Asia totalled USD 13.3bn, of which South Korea accounted for 35% with total issuances of USD 4.6bn. North America issued 5.3bn of sustainable debt in January, of which the United States accounted for USD 3.5bn.

Use of proceeds

Green Bonds

A total of USD 31.5bn worth of green bonds was issued in January, which was USD 7.5bn ahead of January last year.

The corporate sector issued a total of USD 10.6bn of green bonds. The largest issuance in Europe came from the Portuguese utility company EDP with a 60-year EUR 750 (USD 908.8m), which will be used for financing of wind and solar power plants. In Asia, South Korea had the highest corporate issuance volume due to the 5/10-year USD 2bn dual-tranche green bond issued by the semiconductor company SK Hynix with eligible projects including sustainable water and wastewater management, energy efficiency, pollution prevention and control, terrestrial and aquatic biodiversity conservation. Only USD 0.6bn of corporate green bonds in Asia were issued outside of South Korea through four minor issuances in Japan and China.

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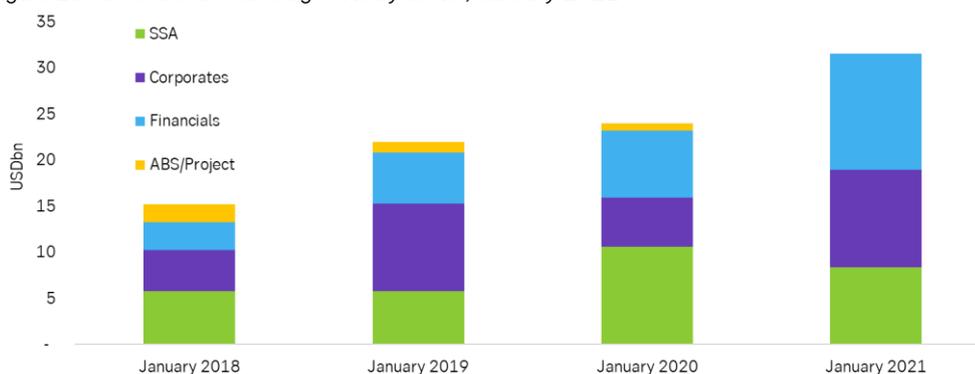
In North America, there were two corporate green bonds, both from the energy sector, for a total amount of USD 1.4bn. SK Battery America were responsible for USD 1bn of this through a 3/5-year dual-tranche green bond that will be used to fund a new EV battery plant in Georgia.

The financial sector issued a total of USD 12.6bn of green bonds in January. The largest transaction came from Dutch real estate company Digital Intrepid with a 10-year EUR 1.0bn (USD 1.2bn) whereby the proceeds will be used to finance green datacenters and other green buildings, energy and resource efficiency projects and renewable energy projects. European (excl. Nordics) issuances totaled USD

9.2bn, of which the Netherlands were the main contributor through the aforementioned transaction. North American only had one green bond issuance from the financial sector in January, which was a 10-year USD 0.5m green bond from Duke Realty. The Nordic region had five green bonds issued from the financial sector - six from Swedish real estate companies and one from Santander Consumer Bank in Norway.

Green bonds from the SSA sector in January totalled USD 3.8bn. This included issuances from European Bank for Reconstruction & Development, Asian Development Bank, and European Investment Bank.

Figure 10: Green bonds market growth by sector, January 2021



Source: Bloomberg New Energy Finance, as of 31 January 2021

Social Bonds

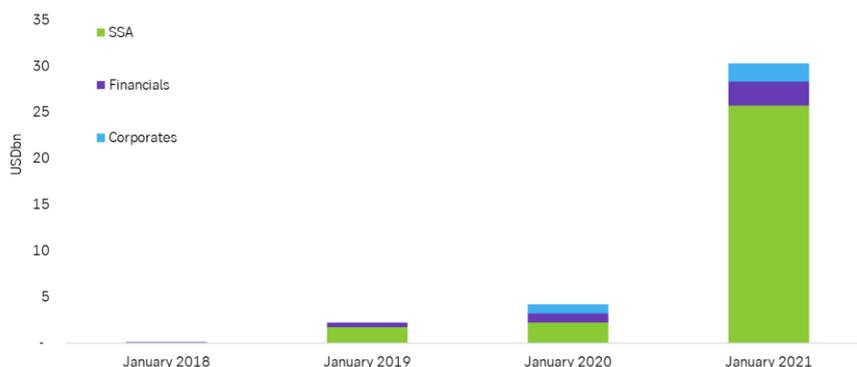
Social bonds totalled USD 30.3bn in January. SSA was the largest sector with total issuances of USD 25.7bn. This was primarily due to the French government agency CADES, who continued leading the way for social bonds with a 4/10-year dual-tranche issuance of USD 7.1bn across (GBP 1.5bn / USD 5bn) aimed at finance or refinance deficits in France's social security branch as defined in their social bond framework.

Issuers in the financial sector raised USD 2.6bn from social bonds through 7 transactions. The largest was from Landesbank Baden-

Wuerttemberg, which issued a 10-year EUR 750m (USD 911m) for the purpose of financing affordable basic infrastructure and access to essential services.

Three corporates issued social bonds in January for a total volume of USD 2.0bn. The largest issuer was the British company Motability Operations Group that operate a WAV (Wheelchair Accessible Vehicles) scheme. Their dual-tranche 7/20-year GBP/EUR social bond raised USD 1.1bn and will fund their extant fleet and new vehicles.

Figure 11: Social bonds market growth by sector



Source: Bloomberg New Energy Finance, as of 31 January 2021

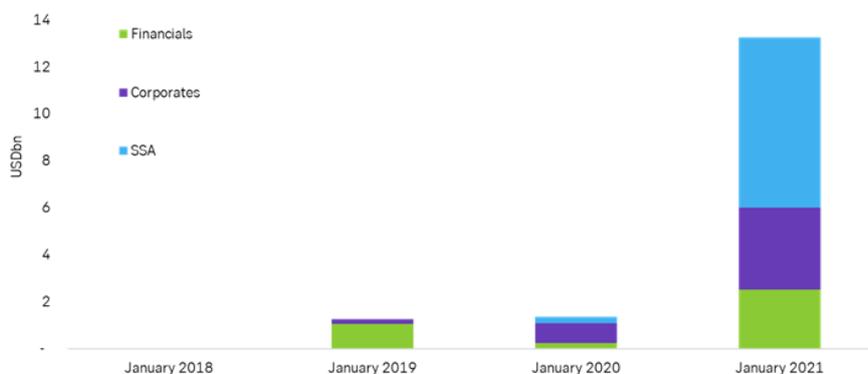
Sustainability Bonds

Sustainability bonds had a strong start to 2021 with USD 13.4bn of new issuances in January. SSA was the largest sector with total issuances of USD 7.2bn, of which supranational accounted for USD 5.7bn. AIIB (Asian Infrastructure Investment Bank) issued a 6-year USD 3.0bn sustainability bond, the second largest labelled bond issuance in January behind CADES' social bond. Corporates issued four sustainability bonds totalling USD 2.3bn. The largest was a 8-year 1.0bn (USD 1.2bn) from Telecom Italia for the purpose of financing network transformation, network optimization energy efficiency, renewable energy and circular economy projects,

which will support their target of becoming carbon neutral in 2030, and social project categories digital inclusion and response to health crisis such as COVID-19.

The financial sector issued sustainability bonds totalling USD 2.5bn through seven transactions from issuers in South Korea, Brazil, Turkey, Indonesia, Taiwan, Malaysia and Great Britain. The largest issuance was a 5-year USD 550m bond from South Korean Woori Bank, which will be used to provide lending for a wide range of environmental and social projects in accordance with their framework. Notably, the only issuances from Europe was from a 6-year GBP 250m (USD 300m) sustainability bond from the British real estate company Aster Group.

Figure 12: Sustainability bonds market growth by sector



Source: Bloomberg New Energy Finance, as of 31 January 2021

Sustainability-linked

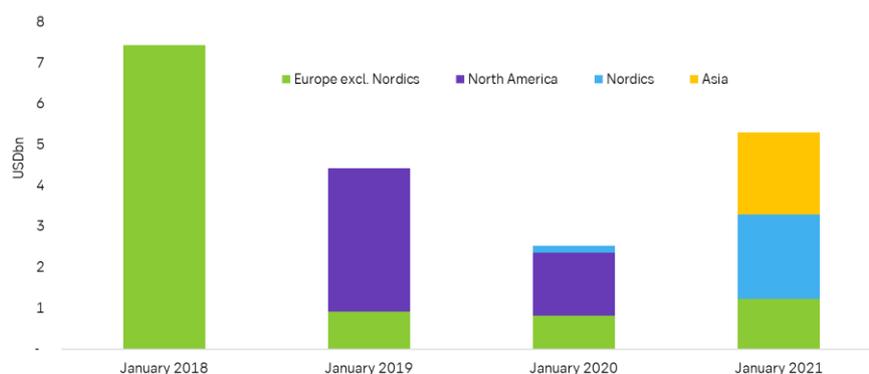
Sustainability-linked loans (SLL)

Note on data: The sustainability-linked loan market, whereby the loan margin is typically linked to a set of targets or an ESG score, is a private market with limited access to information. We use the loans listed in Bloomberg New Energy Finance or from the Bloomberg sustainability-linked league table, which we think provides a good reflection of the overall market.

Six SLLs totalling 5.3bn has been reported so far in 2021, but private loan transactions such as SLL are often registered a few weeks after closing so this figure is likely to increase.

The largest SLL in the period was Volvo Cars sustainability linked RCF at EUR 1.3bn (USD 1.6bn). The facility is linked to Volvo Car's reduction of GHG emissions, in line with their strategy of becoming climate neutral by 2040.

Figure 13: Sustainability-linked loans market growth by region



Source: Bloomberg New Energy Finance, as of 31 January 2021

Sustainability-linked bonds (SLB)

Total issuance for sustainability-linked bonds in January was USD 3.9bn. This was a record month for the product type and represented 37% of the total for 2020.

All issuances except a 10-year USD 200m SLB from real estate company NWD MTN were in the corporate sector. Within the corporate sector, it is interesting to note that industrials (USD 1.7bn) and materials (USD 500m) represented 50% of issuances. Sustainability-linked products needs a transition story in order to set ambitious and meaningful sustainability performance targets, and high emissions sectors are as such a natural fit. As described in this publication, Odfjell Shipping's NOK 850 (USD 101m) is in this regard a good example of how an SLB can be applied to solidify a transition strategy.

The two largest SLBs in January came from two Brazilian companies. Logistics company Simpar issued a 5-year USD 625m linked to the company's scope 1, 2 and 3 GHG emissions

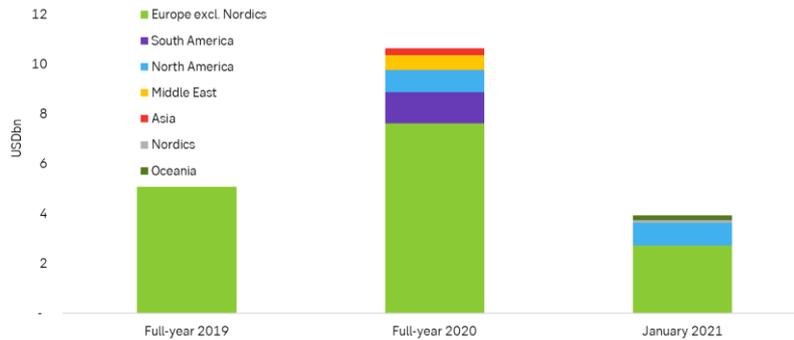
intensity. The sustainability performance target (SPT) is to reduce emissions intensity from a 2019 baseline of 134.53tCO₂e/million R\$ (net revenue) to 124.04.57 tCO₂e/million R\$ (net revenue) in 2025, which is equivalent to a 15% reduction. Container & packaging company Klabin issued a 10-year USD 500m SLB linked to three SPTs associated with the sustainable development goals. These were a reduction of water consumption of 16.7% from baseline (2018) to 2025, increase of the percentage of solid waste reused and recycled to 97.5% and the reintroduction of two extinct or endangered species to the company's forest areas.

Another interesting development is the sustainability-linked finance framework published by H&M, which is linked to three KPIs. The first SPT is to increase share of recycled materials used as part of total materials used from 2% to 30% by 2025. This is tied to the EU environmental objective of 'Transition to a Circular Economy' and SDG Goal 12 (Responsible Consumption and Production). The second SPT is

to reduce scope 1 and emissions by 20% by 2025 from a 2017 baseline and the third SPT is to reduce scope 3 from fabric production,

garment manufacturing, raw materials and upstream transport by 10% by 2025 from a 2017 baseline.

Figure 14: Sustainability-linked bonds market growth by region



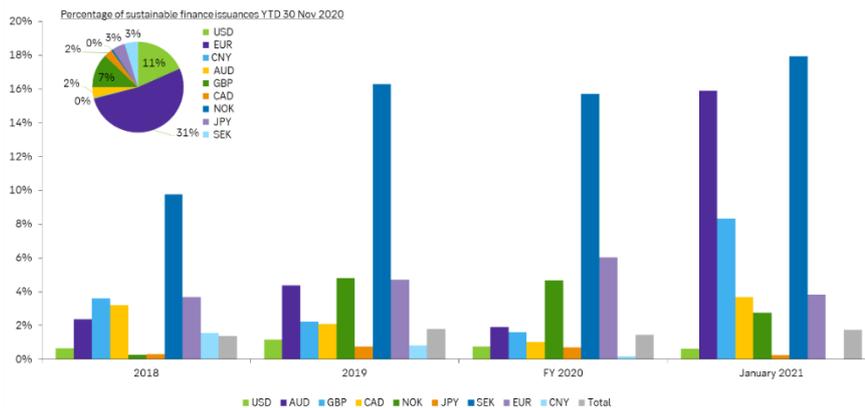
Source: Bloomberg New Energy Finance, as of 31 January 2021

Currency analysis

Figure 15 shows the ratio of green, social, sustainability and sustainability-linked bonds to total bonds within each of the currencies listed. The European currencies (EUR, GBP and SEK) are in total showing an upward trend, although EUR labelled bond issuances as a percentage of total bond issuances has been slower in January 2021 than in 2020. GBP issuance of labelled bond has

been very strong in January at 8.3% of total bond issuance, which is up from 1.6% in 2020. January is a small sample size so we could see EUR moving upwards towards its 2020 level and GBP decline closer to its historical record, but the high number of labelled issuances in GBP is nonetheless a promising sign for the market.

Figure 15: Green, social, sustainability and sustainability-linked issuance as a percentage of total bond issuance



Source: Bloomberg New Energy Finance, as of 31 January 2021

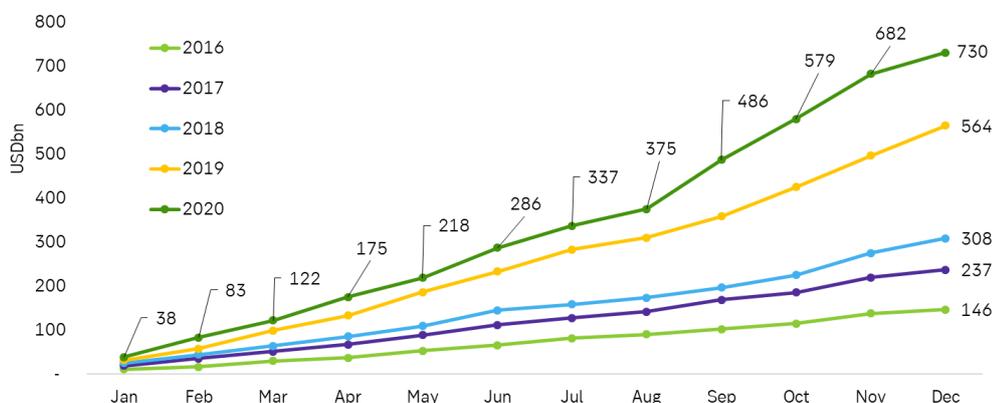
Publicly Announced Green, Social & Sustainability Bond Pipeline¹

- India Green Power mandates green bond
- H&M publishes sustainability-linked finance framework

¹ As of 3rd February 2021

Annual review 2020

Figure 16: Cumulative annual sustainable debt issuance



Source: Bloomberg New Energy Finance, as of 31 December 2020

The sustainable finance market once again achieved a record volume of debt issued in 2020 with a total of USD 730bn. As evident from Figure 16, the market accelerated in the fall of 2020 after modest year-on-year growth until August.

There has been two main story lines that have dominated the discourse in the sustainable debt market in 2020.

The first was how adaptable the use of proceeds model proved itself in the face of the COVID-19, with several social and sustainability bonds being issued for the purpose of combating challenges related to the pandemic. Social bonds were more than eight times higher than last year with total issuance of USD 147.7bn in 2020, primarily as a result of SSA issuances aimed at combating the effects of COVID-19. Eligible projects under accompanying frameworks included financial support for SMEs and unemployment benefits, and healthcare sector equipment directly aimed at combating the pandemic. The sustainability bond market also contributed to this trend with total issuances of USD 68.7bn, 82% higher than 2019, which were primarily from government agencies aimed at supporting the economic recovery following the pandemic. In addition, more than USD 330bn of pandemic bonds has been issued, although it should be noted that these do not necessarily adhere to the use of proceeds bond principles developed by ICMA.

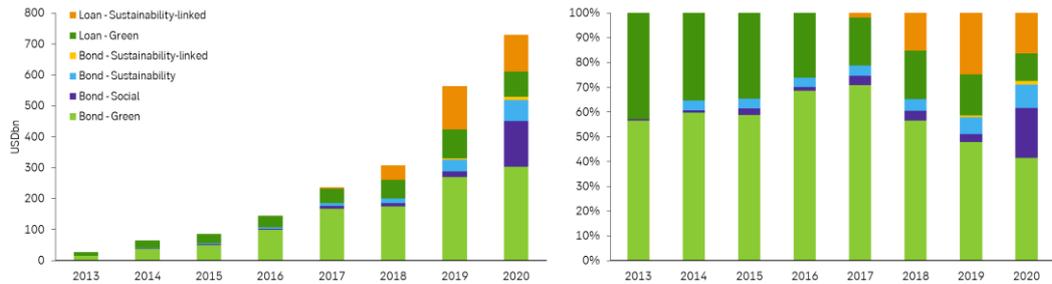
The second main story of the year has been the continued rise of sustainability-linked products. Sustainability-linked loans has established itself as the dominant product for sustainable loans. Loans of this type in 2020 is so far at USD 119bn, which is USD 20bn behind last year. However, we expect this to increase as loans are often registered late due to the private nature of the market. Sustainability-linked bonds, with total issuance of USD 10.6bn in 2020, is a high-growth product type in the sustainable debt market, particularly after the sustainability-linked bond principles were issued by ICMA (see the article *Sustainability-linked bond: what, why, how?* for more information). The first sustainability-linked bond was issued back in the fall of 2019 by Enel, but the development of these guidelines spurred market participants and led to a significant increase in new issuances as 22 of the 27 sustainability-linked bond principles issued in 2020 came in September or later in the year. It is still a very small part of the total sustainable debt market, but interest is high among both potential issuers, investors and other market participants as this issue of The Green Bond is a testament to.

The green bond market was only slightly ahead of 2019 in the first half of 2020. However, green bonds made a strong comeback in September, which was the highest recorded month to date with issuances of USD 61.9bn. This was followed by high volumes in Q4 and total issuances for the full year was as result USD 303.0bn – USD

27.7bn ahead of last year. Although this is behind Organic Evolution Scenario (Full-year green bond issuance of USD 350bn) and Green Growth Scenario (USD 375bn), it is nonetheless a

testament to the continued strength of a product type that has been the main pillar of the sustainable debt market since its inception in 2008.

Figure 17: Sustainable debt market growth by product type



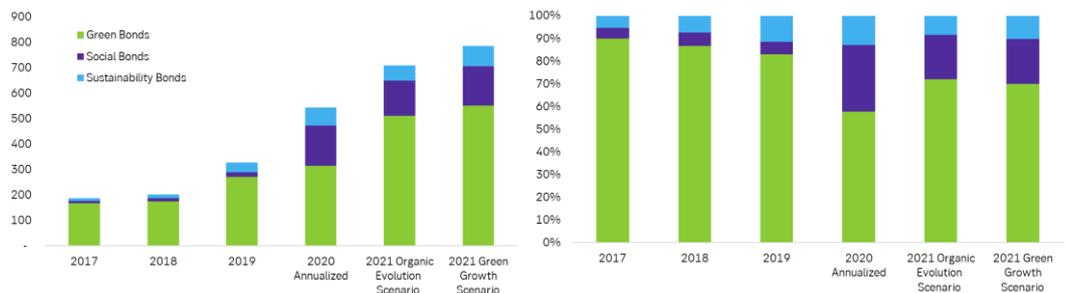
Source: Bloomberg New Energy Finance, as of 31 December 2020

Forecast 2021

As outlined in the last publication, we expect continued growth for the sustainable finance market in 2021. As such, we expect a total market size for green, social and sustainability bonds of 708.bn in our Organic Evolution Scenario and USD 786.0bn for our Green Growth Scenario. This would represent an increase of

30% and 45%, respectively, over the annualized 2020 volume of these product types at USD 543.2bn. We also confident that sustainable loans and sustainability-linked bonds will expand its role in the financing of sustainable and transition activities in 2021 but have chosen not to set a firm target for these product types due their uncertain outlook.

Figure 18: Forecast 2021 across product type (USDbn)



Source: Bloomberg New Energy Finance, as of 31 December 2020 & SEB

Sustainability-linked bond: what, why, how?

In this issue of The Green Bond, we focus on a new sustainable finance asset class: sustainability-linked bonds (SLBs), which in our view will broaden the scope of sustainability-labelled assets, making funding available to a new group of issuers who lack Green Assets or where investors will promote transition commitments.

At SEB, we have the privilege of being one of the working group coordinators of the Sustainability Linked Bond Principles – the guidelines established to provide guidance to participants and thereby facilitate harmonization of the market. This being said, we find it important to mention that the considerations and conclusions presented in this text are solely our own. While inspired by the discussions with our colleagues in the working group, we do not claim to represent the thoughts or conclusions of any other organization. The principles have in December 2020 been followed up by the climate transition finance handbook, which adds more detail.



We think this new instrument will play an important role, and not just in raising capital. Often, sustainability related dialogues are managed by communication (towards clients, regulators and investors) or by business departments (production requirements and priorities), and the wording and supporting infrastructure has been established to support these functions. When a company decides to create a sustainability-labelled financial product, it empowers the treasurer to gather intelligence across the organization and ensure that potential commitments are reviewed from a financial risk perspective.

Our impression is that by activating this process, many companies get a chance to collect, assess and review their sustainability data and supporting infrastructure and, consequently, have the possibility to redefine their steering mechanisms. Many issuers then highlight this as one of the prime achievements of the work invested in The Financial Product. Furthermore, it is the takeaways from this insight and discussions that are most appreciated by investors.

Use of proceeds vs KPIs

The fundamental difference between the SLB and its close relative the green bond is the focus on the company rather than the specific investment. This is in our view a necessary development as the transition broadens and becomes both more capital-intensive and includes more sectors. This is to support companies who are committed to be a part of the transition and want to engage in a collaboration with investors, but still lack the platform and need supporting infrastructure, technical solutions from their suppliers or/and significant R&D and capex investments. They may also lack specific investment projects that would qualify under the green bond principles. These companies must commit to ambitious and material sustainability targets to meet investor requirements.

Where Use of Proceeds instruments (like Green Bonds) are established to reflect green investments (as core), and governance and strategy (as a prerequisite), Sustainability Linked products are established to track future sustainability related performance for topics that are material to the borrower. By introducing links to sustainability related topics, borrowers that still have a long journey to travel or have an “asset light” portfolio, are invited to illustrate what their organizations’ transitions towards Paris are going to look like. This is done mostly through milestone targets supported by long term commitments. There is nothing to prevent combining this approach with use of proceeds to create an even more transparent link to sustainability, but the KPIs are the defining feature of this bond compared with other labelled assets.

Bonds versus loans

As a bank, we act as both an intermediary and a lender. As an intermediary, our primary role is to advise our clients on how to create structures and ensure that they are communicated well to investors. As a lender, we become the investor and need to define our own “investment” criteria. This is complex since a bank is specialized on Finance and doesn’t have detailed expertise across its organization of all the SDGs. Consequently, most banks require some kind of Benchmarking system or expertise review to assess the level of ambition provided by the issuer.

The Sustainability-Linked market started as a loan product (Sustainability-Linked Loans or “SLL’s”) and the initial structure therefore reflected a private dialogue with mutual agreements on governance and margin adjustments in accordance with the loan documentation. This structure was easy to manage and, if necessary, easy to adjust. However, when moving to the bond market (Sustainability-Linked Bonds or “SLBs”), the underlying documentation reflects an asset that is more likely to go through many hands during its lifetime and where potential coupon adjustments per definition create price volatility. Hence, to be capable of pricing the asset, both investors holding the bonds and the interbank dealers need to understand the selected KPIs and be updated on the company’s current performance on them.

As a consequence of these differences, the loan market often structures SLL’s with a number of observation dates for KPI performance (which could trigger a margin adjustment) during the lifetime of

the loan. Meanwhile, SLB’s have so far, bearing in mind that this market is still in its infancy, typically been structured with only one trigger event, either as an adjustment of coupons sometime during the tenor of the bond or as a change to the redemption price at the end of the lifetime.

Defining Sustainability Linked Bonds

According to the principles, SLBs are thus defined as any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuers achieve predefined Sustainability/ESG objectives.

Issuers are committing to future improvements in sustainability outcome(s) within a predefined timeline. It is a forward-looking, performance-based instrument. Such outcomes are measured through predefined KPIs and assessed against agreed Sustainability Performance Targets (SPTs). The purpose of SLBs is to provide incentives for improvements on material sustainability issues.

Within these parameters, SLBs are to be used for general purposes. The Sustainability Linked Bond Principles (SLBP) provide universal guidelines to what constitutes a sustainability linked bond in the global market. The guidelines help create a homogenous global sustainability linked bond market and allow investors to set up strategies and investment targets around sustainability-linked instruments. In contrast to prior sustainable financing instruments, proceeds from SLBs can be used for general corporate purposes, although they may also specify how money is used.

The five components of the SLB framework

The SLB framework consists of five core components: 1. Selection of Key Performance Indicators (KPIs), 2. Calibration of Sustainability Performance Targets (SPTs), 3. Bond characteristics, 4. Reporting and 5. Verification. Below, we draw on the text from principles to provide a brief introduction to each component.

1. KPIs

Sustainability linked financial instruments strive to incentivise sustainability improvements and consequently it becomes important to select meaningful and relevant metrics for which improvement targets can be set. Reference points may include metrics which are core to the issuer’s sustainability strategy, represent relevant and significant sustainability challenges and

opportunities to the sector, and thus represent material sustainability aspects for the issuer. The Sustainability Linked Bond Principles state that the KPIs should be: relevant, core and material to the issuer's overall business, and of high strategic significance to the issuer's current and/ or future operations, measurable or quantifiable on a consistent methodological basis, externally verifiable and able to be benchmarked, i.e. as much as possible using an external reference or definitions to facilitate the assessment of the SPT's level of ambition.

Issuers should provide a clear definition of the KPI(s) including scope, perimeter and calculation methodology. External references are recommended where feasible, such as e.g. Global Reporting Initiative (GRI) or the Greenhouse Gas Protocol (GGP). The calculation methodology may otherwise be stated clearly or in reasonable detail and should remain unchanged during the life of the bond (alternatively until the last trigger point). Guidance and inspiration may also be found in proposed metrics for impact reporting of green / social bonds.

2. SPTs

A positive change and improvement in an issuer's sustainability performance, as measured by certain KPIs, can be achieved through setting ambitious targets. By setting such targets, the issuer is committing to improvements in future sustainability outcomes. Calibrating ambitious target levels may prove challenging but can be supported by benchmarks and reference points putting such target levels into context. In addition, these targets should be relevant in relation to the tenor of the bond, with the issuer providing information on the timing and frequency of one or several measurement points (target observation dates) reflecting trigger point(s) in relation to the performance which in turn will impact the financial or structural characteristics of the bond.

The Sustainability Linked Bond Principles state that 'the SPTs should be ambitious', which means that they must 'represent a material improvement in the respective KPIs and be beyond a "Business as Usual" trajectory', 'where possible be compared to a benchmark or an external reference', 'be consistent with the issuers' overall strategic sustainability / ESG strategy' and 'be determined on a predefined timeline, set before (or concurrently with) the issuance of the bond'.

This means that the starting point and historic performance should be stated if available (and cover at least three years where feasible) and necessary data points to evaluate the ambition level. There should also be a comparison against industry standards and peers – if relevant and possible (e.g. best-in-class or average performance), as well as references to science – external and credible references such as science-based (climate) scenarios, carbon budgets, official / industry targets, taxonomies (e.g. thresholds as stated in the EU Taxonomy of sustainable activities), Best Available Technologies and similar.

3. Bond characteristics

The Sustainability-Linked Bond Principles state that: 'The cornerstone of a SLB is that the bond's financial and/or structural characteristics can vary depending on whether the selected KPI(s) reach (or not) the predefined SPT(s), i.e. the SLB will need to include a financial and/or structural impact involving trigger event(s).

The potential variation of the coupon is the most common example, but it is also possible to consider the variation of other SLB's financial and/or structural characteristics. It is recommended the variation of the bond financial and/or structural characteristics should be commensurate and meaningful relative to the issuer's original bond financial characteristics.

The KPI(s) definition and SPT(s) (including calculation methodologies) and the potential variation of the SLB's financial and/or structural characteristics are a necessary element of the bond documentation.

Any fallback mechanisms in case the SPTs cannot be calculated or observed in a satisfactory manner, should be explained. Issuers may also consider including, where needed, language in the bond documentation to take into consideration potential exceptional events (such as significant change in perimeters through material M&A activities) or extreme events, including drastic changes in the regulatory environment that could substantially impact the calculation of the KPI, the restatement of the SPT, and/or proforma adjustments of baselines or KPI scope'.

This leads to the following practical considerations:

1. Coupon or redemption price – the bond's coupon or its redemption price are examples of what could

vary depending on whether the predefined SPT(s) are met.

2. Variation (1) – with performance-linked loans the coupon could be affected in both directions (up and down) depending on the borrower meeting the predefined SPT(s). The SLB Principles do not reject variations in both directions. However, bond investors need daily valuation. It is easier to handle the risk that the bond rises in value than if it falls in value. Hence, we expect and advise to only use step-ups in SLBs and only on one occasion.

3. Variation (2) – the movements should be meaningful enough to the issuer so that there is a financial incentive.

The market practice for SLBs is a variation in the Coupon rather than the redemption price. The accepted market practice for SLBs is that there is only a step-up in coupon price. i.e. if an issuer does not meet its SPT(s) then it will pay a higher coupon, but even if an issuer exceeds its SPT(s) by a considerable margin it will not receive any a lower coupon. The coupon is linked to a performance target referring to one or more of the EU environmental objectives and/or to one or more of the UN's Sustainable Development Goals. This is related to the ECB requirement to accept SLBs as collateral and will most likely drive issuers eligible for ECB to adjust accordingly.

4. Reporting

As with other sustainable finance instruments, in particular public instruments, issuers are expected to communicate and be transparent both prior to issuance, outlining the characteristics and features of the structure applied and the expected sustainability outcome, as well as post issuance by way of monitoring and reporting back to investors on the progress and outcome. The latter is a determinant for the trigger events of the bond and will thus have an impact on the financial and/or structural characteristics of the instrument. The Sustainability Linked Bond Principles state that issuers of SLBs should publish, and keep readily available and easily accessible:

- up-to-date information on the performance of the selected KPI(s)

- a verification assurance report relative to the SPT outlining the performance against the SPTs and

- any information enabling investors to monitor the level of ambition of the SPTs

This reporting should be published regularly, at least annually, and in any case for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the SLB's financial and/or structural characteristics.

Against this background, the following disclosures are recommended.

Pre-issuance documents (such as e.g. a framework, investor presentation, external review, website and similar) may contain detailed descriptions of the application of the five core components of the SLBP. Such communication may, apart from the definition of the KPI(s), also cover the rationale behind the selection of the KPI(s), their relevance and fit with the issuer's sustainability strategy and their materiality in the context of the issuer's operations and the industry.

Apart from the definition of the KPI(s), the motivation for the outlined SPT(s), timing and frequency, as well as outlines of available benchmarks (historic performance, peer and industry comparisons, science) the structure in relation to variations in bond characteristics, envisaged reporting format, pre- and post-issuance external review and how the verification of the reported performance against the SPTs should be communicated.

And lastly, the issuer is 'encouraged to position this information within the context of the issuer's overarching objectives, strategy, policy and/or processes relating to ESG'. In other words provide guidance on how the structure and outline of the SLB fits with the issuer's broader initiatives and work with sustainability, what means and actions are taken to improve the sustainability performance and achieve the envisaged targets, including the governance infrastructure put in place to support such improvement.

5. Verification

We can divide verification into two parts: pre-issuance and post-issuance. Pre-issuance verification is valuable for investors to assess the suitability of KPIs and their relevance, the ambition level of the targets in the context of the issuer's operations and sector and the alignment with the Sustainability Linked Bond Principles. This is only a

recommendation in the principles, but one that ECB strongly recommends. The SLB principles state that:

‘It is recommended that, in connection with the issuance of a Sustainability-Linked Bond, issuers appoint (an) external review provider(s) to confirm the alignment of their bond with the five core components of the SLBP (such as a Second Party Opinion).

In their pre-issuance Second Party Opinion, external reviewers are encouraged to assess the relevance, robustness and reliability of selected KPIs, the rationale and level of ambition of the proposed SPTs, the relevance and reliability of selected benchmarks and baselines, and the credibility of the strategy outlined to achieve them, based on scenario analyses, where relevant.

The external review is particularly recommended in the absence of clear performance thresholds and benchmarks.

The SLB principles state that ‘issuers should seek independent and external verification (for example

limited or reasonable assurance) of their performance level against each SPT for each KPI by a qualified external reviewer with relevant expertise, such as an auditor or an environmental consultant, at least once a year, and in any case for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the SLB financial and/or structural characteristics, until the last SPT trigger event of the bond has been reached.’

As opposed to the pre-issuance external review such as a Second Party Opinion, which is recommended, post issuance verification is a necessary element of the SLBP in order to assess the correctness of the stated performance against targets, including i.a. the underlying calculations, methodology assessment and comparison in relation to targets. The verification is comparable to the assurance of the green bond investor reporting, it provides an assessment of the correctness of i.a. the stated allocation of amounts to project categories and calculations of environmental benefits in the impact reporting.

Figure 19: The Sustainability-Linked Bond Principles provide international guidelines

The five components	Considerations
<p>1 Selection of KPIs</p>	<ul style="list-style-type: none"> Relevant, core and material to the issuer's overall business, and of high strategic significance to the issuer's current and/or future operations; Measurable or quantifiable on a consistent methodological basis; Externally verifiable; and Able to be benchmarked, i.e. as much as possible using an external reference or definitions to facilitate the assessment of the SPT's level of ambition.
<p>2 Calibration of SPTs SPTs should be ambitious</p>	<ul style="list-style-type: none"> One or more Special Performance Targets (SPTs) calibrated per KPI, the SPTs must be set in good faith and the issuer should disclose strategic information that may decisively impact the achievement of the SPTs. The target setting exercise should be based on benchmarking approaches involving the issuer's previous performance, the issuer's peers and reference to science.
<p>3 Bond characteristics</p>	<ul style="list-style-type: none"> The cornerstone of a SLB is that the bond's financial and/or structural characteristics can vary depending on whether the selected KPI(s) reach (or not) the predefined SPT(s), i.e. the SLB will need to include a financial and/or structural impact involving trigger event(s).
<p>4 Transparency Reporting</p>	<ul style="list-style-type: none"> Issuers should publish regularly, at least annually, and keep readily available and easily accessible information relating to the SLB. Reporting should be published in any case for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the SLB's financial and/or structural characteristics.
<p>5 Verification Assurance through independent third party</p>	<ul style="list-style-type: none"> Issuers should seek independent and external verification (for example limited or reasonable assurance) of their performance level against each SPT for each KPI by a qualified external reviewer with relevant expertise, at least annually, and in any case subject to alterations, until after the last SPT trigger event of the bond has been reached.

Source: ICMA Group (SLBP)

Sustainability Linked Bond Principles: <https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/>

Climate transition finance handbook: <https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/climate-transition-finance-handbook/>

The first Sustainability linked bond in shipping



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As the first in the international shipping industry and first in the Nordics, Odfjell SE successfully issued a sustainability-linked bond in January 2021. With a close link to Odfjell's long-term climate targets, the bond marks another milestone in Odfjell's ambitious work to reduce shipping's environmental impact. The bond is also an excellent example of the common value for finance and industry that sustainable financing offers.

Situation

Global shipping represents about 2,9% of global greenhouse gas emissions². Shipping was not directly included in the Paris Agreement in 2015, but the UN International Maritime Organization (IMO) agreed in 2018 a new strategy³ to reduce greenhouse gas emissions from ships. This strategy sets some clear targets for reducing international shipping's carbon intensity by 40% compared to 2008 and reducing absolute emissions by 50% from 2008. The strategy also sets out targets for how new vessels should be designed.

Shipping is today the most environmentally friendly way of transport over large distances. More than 80%⁴ of traded goods are carried over the oceans. As such, the oceans provide the main transport arteries for global trade. This comes with opportunities and challenges. The efficiency of maritime transport is no excuse for not acting.

To achieve the Paris agreement's ambitions and the IMO strategy, shipping will need to transform to low carbon emissions, or better, zero-carbon. Sustainability and climate change should be high up on the agenda for the shipping industry.



Source: Odfjell

Odfjell SE is a company specializing in worldwide seaborne transportation and storage of chemicals and other specialty bulk liquids. The Odfjell fleet comprises around 90 ships in total. Odfjell has a wide range of customers, from the oil majors and largest chemical manufacturers to smaller logistical companies and traders. The tank terminal division consists of six tank terminals, located in Belgium, USA, South Korea and China. Odfjell has offices in 13 locations around the world, and is headquartered in Bergen, Norway. Odfjell SE is listed at Oslo Stock Exchange

The company employs around 2,300 people and posted annual gross revenue of USD 872 million in 2019. Read more on Odfjell.com

² IMO: Forth IMO GHG Study 2020 July 2020

³ IMO: Adoption of the initial IAMO strategy on reduction of GHG emissions from ships an existing IMO activity related to reducing GHG emissions in the shipping sector. April 2018

⁴United Nations Conference on Trade and Development (UNCTAD) The Review of Maritime Transport Nov 2020

Odfjell achievements and targets

Sustainability for Odfjell is about acting today for a better tomorrow. It is about having a long-term perspective of our business, from profit, to people, and to the planet. Our 106-year old history, with continuous improvement and development, is probably the best testament to the way we think of sustainability. Sustainability is a part of our DNA.

Efficiency and emission reduction is not only good for the climate but also business. Odfjell has since 2008 improved the fleet's efficiency by more than 30% and reduced carbon intensity by 26%. As part of our work to meet IMO targets and meet our ambitions, we conducted a thorough fleet review and transition plan that was completed in 2020 (the Fleet Transition Plan). Based on this plan, we realized it would be possible for us not only to achieve the IMO targets but also to go beyond that. We decided to set some ambitious climate targets based on the planned technical improvements and retrofits and operational improvements, and digitalization efforts. We want to reduce the intensity by 50% in 2030 compared to 2008, which goes beyond the IMO target. To achieve a 50% absolute reduction target, we must reduce the intensity by more than 70-80%. We decided then that we would again go beyond the IMO target and set a target to be climate neutral in 2050.

Odfjell has, with these targets, set clear ambitions, with a clear and documented plan to reduce CO₂ emission and support the decarbonization of shipping.

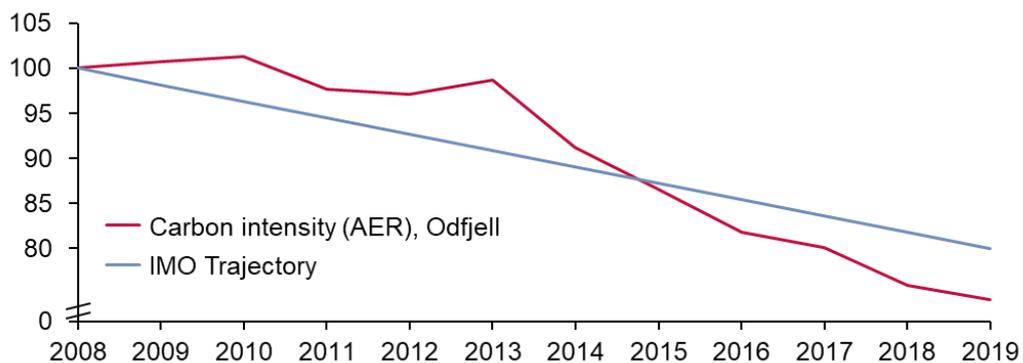
Climate risk and finance

The World Economic Forum presented its 16th edition of the Global Risk Report on January 21. Five of the highest risk are related to the environment, where climate action failure comes out on top. Climate risk represents a risk to societies and businesses, and it is vital to act now. In 2018 Odfjell launched the initial Sustainability strategy under the theme "Acting today – for a better tomorrow." For Odfjell, setting clear targets and action plans is not only about compliance and continuous improvement. It is also about mitigating risk.

Since 2015, Odfjell has completed the most extensive fleet renewal in the history of the company, transforming the fleet to a more efficient and more environmentally friendly fleet. With a modern fleet and clear ambitions to continuously improve to reduce emissions and operate with high standards, we believe this is good risk management for the company for the benefit of our various share- and stakeholders. Further, being a frontrunner in sustainability creates opportunities, and because of this, we started looking into how to link our sustainability ambitions and actions with financing.

Odfjell's climate targets: 1) Odfjell will cut greenhouse gas emission by 50% by 2030 compared to 2008 2) Odfjell is dedicated to pursuing a zero-emission strategy and will only order vessels with zero-emission technology from 2030 3) Odfjell will have a climate-neutral fleet from 2050 4) Odfjell will actively support initiatives to develop technology and infrastructure for zero emissions and support international regulation to drive zero-emission for our industry 5) Intensity target, Emissions based on transport work, and Annual Efficiency Ratio (AER)

Figure 20: Indexed carbon intensity 2008-2019



Source: Odfjell

The process of Sustainability Linked framework

The process to link ESG ambitions with financing started in 2019 as we explored and learned about the various KPIs and pricing mechanisms appearing in the early sustainability-linked loans market.

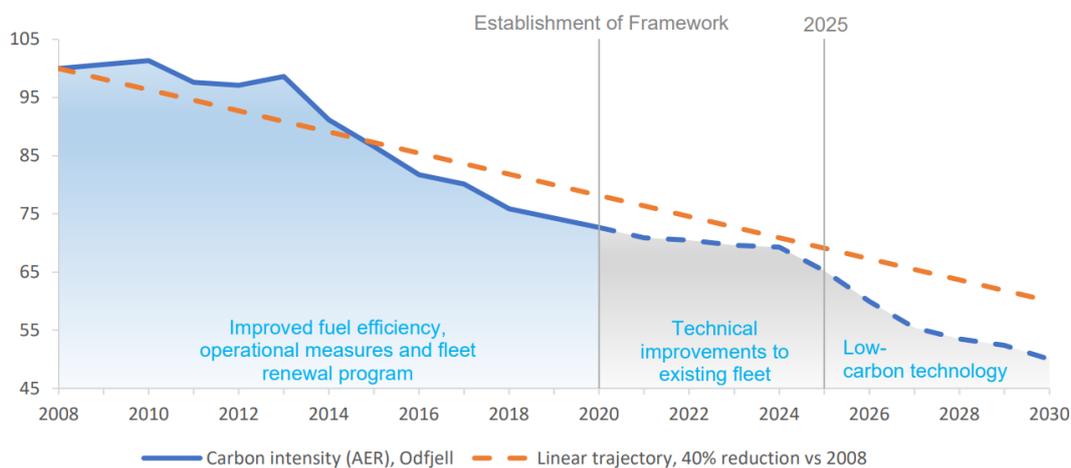
Following the world's first SGD-linked bond issued by Enel in September 2019, we became more focused on the bond market, and in January 2020, we engaged with SEB and their debt capital markets and sustainable finance teams and decided to move forward with a framework for a sustainability/ESG linked bond. At the time, there were no principles in place for such a structure, so SEB's guidance and experience were instrumental. When ICMA published their principles⁵ in July 2020, we were well prepared. In August 2020 two more banks joined the team to support the development of our Sustainability-linked Finance Framework, and DNV GL was engaged as second opinion provider. DNV GL has substantial technical insight and was given full access to the fleet transition plan and calculations behind our emission reduction performance and our AER trajectory towards 2030.

Our initial thoughts were to link a broader range of our ESG ambitions in the framework, however the

focus soon turned to one climate-related Sustainability Performance Target (SPT)⁶. The SPT is the carbon intensity reduction target, and the KPI is the intensity indicator AER. AER was used as intensity metric as we believe it will become the industry norm and better reflection our operations over time.

With good help from the sustainable finance teams of SEB and others, and good cooperation with DNV GL, the framework was scoped as a general document, not linked to a single security or type of loan. Still, a potential bond issuance was a clear ambition, and this process was run in parallel. The second party opinion from DNV GL confirmed alignment with the sustainability-linked bond principles set out by ICMA and the sustainability-linked loan principles set out by the various loan market associations⁷. Further, it concluded that the target of a 50% reduction in carbon intensity compared to our 2008 baseline is more ambitious than the envisaged 40% reduction in carbon intensity compared to IMO's foreseen 2008 baseline⁸.

Figure 21: Historical and projected AER trajectory for the Controlled Fleet, indexed



Source: Odfjell

⁵ ICMA, Sustainability-Linked Bond Principles, Jun 21

⁶ The ICMA Principles opens up for any Sustainability target can be used as SPT, both Environmental, Social and Governance targets.

⁷ APLA, LMA, LSTA *The Sustainability Linked Loan Principles (SLLP)*, May 2020

⁸ Framework and opinion can be found on <https://www.odfjell.com/about/our-stories/contemplated-sustainability-linked-bond-issue/>

The framework for sustainability financing and Pricing mechanism

The sustainability-linked finance framework is a testament to our commitment to deliver on the ambitions set out in the Fleet Transition Plan. The framework describes Odfjell's perspectives on sustainability and why we are committed to linking our ambitions with financing.

The framework SPT is to reduce carbon intensity by 50% by 2030 compared to 2008. To allow for shorter dated securities to be issued under the framework, an AER trajectory was calculate based on more than 100 various energy-saving initiatives planned across our fleet in the years to come. For the bond issued on 21 January, there is a "hard" target of AER performance of 8.18 or lower, to be measured on 30 June 2024 (the Target Observation Date). To ensure continued alignment with the principles and best market reporting practices, Odfjell will also obtain an external and independent verification of actual AER performance and an assessment of the Fleet Transition Plan and its viability, annually and on the relevant Target Observation Date. If Odfjell fails to meet the AER target and/or fails to deliver the supporting verification and review, there will be an increase in the redemption price of the mentioned bond by 150bps. The framework allows for various pricing mechanisms. Indeed, a margin adjustment, typical of the sustainability linked loans market, was long considered for the mentioned bond, however a redemption price adjustment was considered the best fit given the four-year bond period and time to implementation of our fleet transition plan.

Meeting investors and closing

Work on the framework and second opinion was finalized in November 2020, and the bond refinancing process was being run in parallel. As this would be the first sustainability-linked bond in the Nordic high yield space across industries, it was important to engage with investors along the way to get their view on the potential product. Thus, during the framework process and prior to launch, we had several informal meetings with ESG focused credit investors to understand better materiality, requirements, and preferences for a sustainability linked structure. This dialogue gave us valuable

input and extra motivation during the framework process.

The bond issue was launched on the 7th of January 2021, and over the next few days we met with more than 50 investors through global investor calls and one-on-one meetings. The issue attracted significant interest and the sustainability-link was a key success factor as we saw several new and ESG focused investors, and investors that had been actively reducing their shipping exposure of late, make out a substantial part of the book. More than 1/3 of the investors is thought to be entirely or significantly dependent on the sustainability link.

The book opened and closed on the 14th of January 2021. Total issue size was set to NOK 850 million, the pricing was NIBOR +575bps, and it was substantially oversubscribed. SEB and the other joint sustainability-structuring advisors played a vital role throughout the process in finding the right balance between our climate ambitions, investor focus, alignment with principles, and legal requirements, and this was well reflected in the final result.

Why sustainable financing

Odfjell wants to support and be at the forefront of the sustainable finance market developments, including the broader social and environmental progress that this type of financing can advance. We want to develop further the vital role that debt markets can play to encourage companies to contribute to sustainability. We believe that sustainable financing will become the norm of the future with a clear(er) alignment between capital and corporate commitment.

The bond issue in January 2021 was not only the first sustainability-linked bond for shipping, but it was also Odfjell's first security issued under our framework. We are encouraged by the interest received from investors and lenders since publishing the framework and DNV GL's second opinion and expect to expand our sustainability-linked finance portfolio in the years to come. Access to capital has always been critical in shipping. Now, perhaps more than ever, it is also key to the decarbonization of shipping.

SLB Opinions: Considerations for External Reviewers



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The introduction of sustainability-linked bonds (SLBs) further expanded opportunities for issuers seeking entry into the ever-growing sustainable bond market. The first issuance of its kind was placed by Italian utility Enel in 2019. ICMA published the Sustainability-Linked Bond Principles in June 2020. Since then, issuers from diverse industries including forestry, real estate, pharmaceuticals and shipping have issued SLBs to some fanfare.

Instead of defining specific use of proceeds as with green or social bonds, SLBs tie bond characteristics to the issuer's achievement of a pre-determined sustainability performance target. Since the proceeds can be used for general corporate purposes, SLBs allow a wider array of companies, including those from "brown" industries to access the market while being incentivized to improve their performance in key areas of sustainability.

Given the nature and structure of this new bond instrument, it is essential for issuers and investors alike to ensure targets tied to the bond actually improve an issuer's sustainability performance. This is where opinion providers, such as Sustainalytics, can play a role in creating market trust through second-party opinions. In reviewing SLB transactions and SLB frameworks, opinion providers can help to ensure the bonds coming to market are credible and impactful. To do so effectively and reliably, opinion providers must navigate a unique set of considerations when evaluating SLBs.

The Added Value of SLB Second-Party Opinions

As the green and sustainable bond market has matured, so too have investor expectations of issuers seeking financing. Engaging an external reviewer for an opinion on the bond and/or bond framework has become market practice as it can provide investors with greater confidence in the credibility of the bond.

For SLB issuers, a second-party opinion provides additional assurance to investors that the bond aligns with the five core components of the Sustainability-Linked Bond Principles (the Principles). Of particular importance for the credibility of the bond and issuer are the first two components:

1. The selection of Key Performance Indicators (KPI)
2. The calibration of the Sustainability Performance Targets (SPT)

Second-party opinion providers add value by offering an independent assessment of the strength of the KPIs chosen and the ambitiousness of the targets.

According to the Principles, the KPIs selected for the bond should be relevant, core and material to the issuer's overall business and to its sustainability and business strategy. An external reviewer with expertise in the evaluation of corporate sustainability and ESG materiality should be well-equipped to opine on the strength of the KPIs selected by the company.

External reviewers' expertise in corporate ESG and sustainability assessments can also help them to evaluate the ambitiousness of the issuer's SPTs. Knowledge of best practices within an issuer's industry and the management and performance of the issuer's peers in the target area allows reviewers to assess whether the SPTs selected are truly ambitious and impactful. The review from an independent party can provide a level of confidence to investors that issuers have not cherry picked KPIs and SPTs that are either irrelevant or do not represent a true improvement.

Along with providing assurance to investors on the credibility of an SLB, a second-party opinion can also offer value to issuers in other ways. The process of obtaining a second-party opinion, and with that the evaluation of the SPTs and KPIs, allows issuers to better understand sustainability considerations before going to market. This may be especially valuable for issuers from industries new to sustainable finance investors or issuers that have not issued linked instruments before. With the introduction of new industries and proceeds used for general corporate purposes instead of explicitly green or social projects, investors are putting the commitments and targets outlined in SLBs and other labelled bonds under more scrutiny.

SLB Opinions: Considerations for External Reviewers

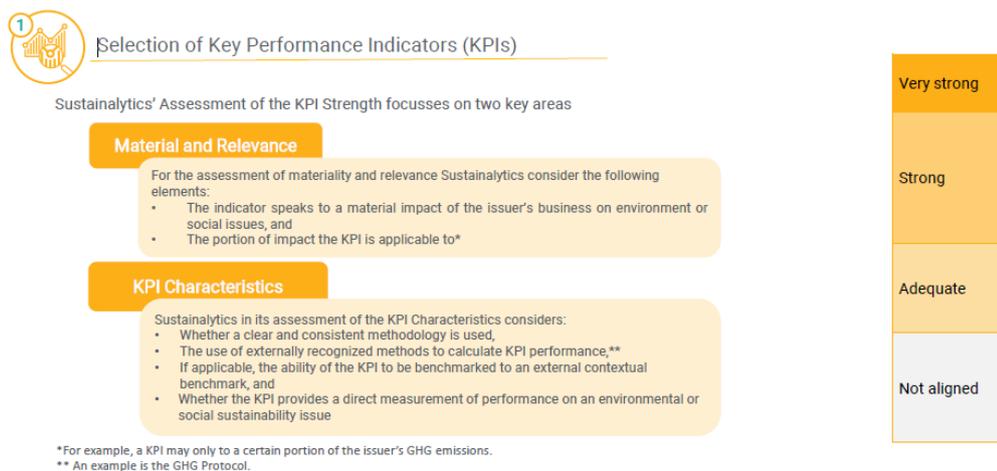
For opinion providers, major consideration is given to the issuer's sustainability performance targets and key performance indicators when evaluating the merits of a SLB. Alignment with the Principles is fundamental as they outline investors' baseline expectations of SLB issuers. However, the Principles are intentionally broad to allow for market development and innovation. Thus, the role of second-party opinion providers is to help align the issuer's stated sustainability strategy and performance with sustainability considerations and investor expectations.

For SLBs specifically, opinion providers need to fill in the nuances on the overall strength of a KPI and the ambitiousness of the SPTs as relevance, materiality and level of ambitiousness vary depending on where the issuer is in its sustainability journey and the sector in which it operates.

When evaluating the overall strength of the KPIs chosen, our assessment of their alignment with the Principles focuses on two major aspects of the KPIs:

1. The relevance and materiality of the KPIs for the issuer
2. The general KPI characteristics

Figure 22: Selection of Key Performance Indicators



Source: Sustainalytics

To assess relevance and materiality of KPIs, we rely on our 25 plus years of experience in evaluating corporate sustainability performance and a methodology that is based on materiality.

The general KPI characteristics focus on the clarity of a KPI, the methodology used to calculate KPI performance as well as alignment with externally recognized standards for calculating the KPI performance.

When assessing the ambitiousness of SPTs, Sustainalytics relies on the three types of comparisons recommended by the Principles:

1. Comparison to historical performance
2. Comparison to peers
3. Comparison to science

The method of comparison used depends on whether the KPI can be benchmarked against peers or science. As SLBs are forward-looking performance instruments, at a minimum issuers need to show improvement compared to their historical performance. When assessing the level of ambitiousness, we distinguish between four levels, with the highest level given to issuers whose targets position them as sustainability leaders in their industries. However, acknowledging that issuers are at different stages of their sustainability journeys, our methodology also accounts for the effort an issuer asserts to achieve the envisioned targets.

The assessment of KPIs and the ambitiousness of SPTs are based on information available at that

specific point in time. Developments in an issuer's business environment may lead to changes in its business model, sustainability strategy, and thus, its assessment over time. Sustainalytics offers an assessment on a SLB issuance or framework that can be used for multiple issuances within a 24-month period. Providing this flexibility to issuers while guaranteeing the validity of the assessment elevates investor confidence in the credibility of the bonds issued.

After the 24 months, we recommend completing an update of the opinion, which assures investors that the opinion is up-to-date and reflects the most recent developments of the issuer. The opinion update also assures the issuer that recent efforts on its sustainability strategy and performance are taken into account.

Outlook

Although the SLB market is still in its infancy, we expect it to grow rapidly over the coming years. With the importance of sustainability considerations increasing among investors, consumers and policy makers, sustainability will naturally come into greater focus for issuers when seeking capital. We also anticipate continued innovation within the sustainable finance market, with the introduction of new instruments broadening opportunities for investors to tap into sustainable investments. We are enthusiastic about the prospect of continued market growth, issuer diversification, market advancement, innovation, and ultimately, positive sustainability outcomes.

A comparison of the Chinese and European sustainable finance classifications



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This article analyses the Chinese Consultation Draft of the Green Bond Endorsed Projects Catalogue (2020 Edition) and the EU Taxonomy for sustainable activities (November 2020 version) to identify major differences and similarities between the two sustainability classifications. The aim is to enable investors to better understand the Chinese and the European approach to sustainable finance.

On the global scene, China and the EU are actively advocating for green finance. In 2020, regulators in both economies released new definitions of sustainable economic activities. The aim of this article is to compare the Chinese and European classification systems for sustainability to identify the largest similarities and differences. The authors hope that this enables Chinese and European investors to better understand each other when it comes to sustainable investments. For Chinese entities acting in Europe, and vice versa, this can be a guideline to check if their framework and their investment strategies are aligned with the respective classification system or what would be required of a certain issuance or collaboration to be aligned. The article first introduces the Chinese and European frameworks before comparing them to each other. Thereafter, challenges for Chinese and European investors are discussed before the findings are summarized.

Introduction to the Chinese green bond market standard system

Green finance is strictly regulated in China, with high reporting requirements and extensive definitions. However, China's bond market has been in a multi-supervision situation. The green bond market has been plagued by inconsistencies in both the definition and the identification of green bonds, especially the inconsistency between project standards adopted for green enterprise bonds and other types of green bonds. The key regulatory authorities of China's green bond market include the People's Bank of China (PBoC), the National Development and Reform Commission (NDRC), the China Securities Regulatory Commission (CSRC), and the Ministry of Finance (MoF). Additional guidance is provided by semi-regulatory organizations, the National Association of Financial Market Institutional Investors (NAFMII), an industry association under the PBoC, as well as the Shanghai and Shenzhen Stock Exchanges, which are overseen by the CSRC. The result is that China's green bond market has multiple regulatory authorities providing oversight over different parts of the market (see Table 1). This is partly a reflection of how the financial system has historically developed in China, which was marked by regulatory competition among authorities.

Table 1: Overview of standards and regulations of the China green bond market by bond types

Bond Type	Financial	Corporate, ABS	Non-Financial Debt Instrument	Enterprise
Supervisors	PBoC	CSRC/Stock Exchanges	NAFMII	NDRC
Eligible Projects	Green Bond Endorsed Project Catalogue (PBoC)	Green Bond Endorsed Project Catalogue (PBoC)	Green Bond Endorsed Project Catalogue (PBoC)	NDRC 2019 Green Industry Guiding Catalogue
Allocation of proceeds	Unallocated proceeds must be invested into green bonds issued by other firms.	Issuers can use up to 30% of the bond proceeds to repay bank loans and invest in working capital.	Unallocated proceeds must be invested into green bonds issued by other firms.	Issuers can use up to 50% of the bond proceeds to repay bank loans and invest in working capital.

On July 8th, 2020, the People's Bank of China, the National Development and Reform Commission and the China Securities Regulatory Commission jointly issued the Consultation Draft of the Green Bond Endorsed Projects Catalogue (2020 Edition) (hereafter referred to as *Green Bond Catalogue 2020*). According to *Green Bond Catalogue 2020*, green bonds are uniformly defined as marketable securities issued in accordance with legal procedures and with agreed principal and interest repayments, which are specially used to raise funds to support green industries, green projects or green economic activities in the prescribed conditions. This catalogue is applicable to the certification of all types of green bonds, solving the problem of non-uniform standards of supporting projects.

The draft of China's Green Bond Catalogue 2020

The *Green Bond Catalogue 2020* unifies the standards for the certification of various types of green bonds. It is based on the Green Industry Catalogue issued by the National Development and Reform Commission (NDRC) and other ministries and commissions in 2019, the Green Loan Special Statistical Regulation (2019 Edition) published by the People's Bank of China, and the Green Financing Statistical Guidelines (2020 Edition) issued by the CBRC. This makes the assessment of green projects within the market basically uniform. The change will enable different participants to make more consolidated assessments of green projects, which will both facilitate the judgment of green projects in China and achieve fairer competition for green financial business market entities.

For specific sectors, the *Green Bond Catalogue 2020* defines projects with marked environmental benefits. The projects are differentiated into six Level-1 categories: Energy Saving and Environmental Protection Industry, Clean Production, Clean Energy Industry, Ecology and Environment-related Sector, Green Upgrade of Infrastructure, and Green Services. According to the project types, the *Green Bond Catalogue 2020* further specifies Level-2, Level-3 and Level-4 sub-categories. In total, there are 204 level-4 project categories detailed in the catalogue.

The revision of the catalogue not only achieves the unification of various green bond assessment standards and other green finance standards (such as green credit) in China, but also aligns with international green project standards. Projects like clean coal utilization, thermal power generation and other internationally controversial categories were removed from the *Green Bond Catalogue 2020*, which will facilitate the establishment of a more common green finance language between China and rest of the world. More international capital could be attracted to China, which will further promote the development of China's green industries. The formal launch of the *Green Bond Catalogue 2020* will promote the in-depth development of green finance in China and achieve better integration with international standards.

The EU's sustainable finance strategy

In March 2018, the EU Commission adopted the EU Action Plan on Financing Sustainable Growth to facilitate the connection of finance with

sustainability. The action plan had three goals, (1) to reorient capital flows towards a more sustainable economy, (2) to mainstream sustainability into risk management and (3) to foster transparency and long-termism.⁹

In the EU Green Deal framework, the sustainable finance strategy was revised so that it now contributes to the objectives of the European Green Deal Investment Plan as well as the EU target of reducing greenhouse gas emissions by 50-55% by 2030 and being the first climate-neutral continent by 2050. The new strategy builds heavily on the Action Plan from 2018.

Introducing the European classification system

The European classification system for environmentally sustainable economic activities – better known as the EU Taxonomy – was the first action point on the European Commission's Action Plan. To channel investments towards sustainable projects and activities and to implement the Green Deal, a common language and a clear definition of sustainability was needed.

The EU Taxonomy established six environmental objectives:

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems

For an economic activity to qualify as environmentally sustainable, it must substantially contribute to at least one of these six objectives. The Taxonomy details specific criteria on how an economic activity can substantially contribute to an objective, i.e. by setting life cycle greenhouse gas (GHG) emission thresholds for the climate change mitigation objective. Furthermore, activities cannot substantially harm any of the other environmental objectives (DNSH criteria) and need to fulfil minimum safeguards related to human and labor rights.

As of today, the EU Taxonomy is still under development. The Technical Expert Group on Sustainable Finance released their final report in March 2020. Since then, the Taxonomy regulation has been approved and entered into force in June 2020. The European Commission is now working on setting the final details and criteria for the first version of the Taxonomy in a so-called delegated act, a legal procedure to implement the definition. A draft of this delegated act was released in November 2020, but a final version does not exist yet. The expected date of application for the Taxonomy is January 1, 2021.

The first version of the Taxonomy only covers the climate change mitigation and the climate change adaptation objective. Criteria for the remaining four objectives are expected sometime next year. In total, criteria for 101 different economic activities – defined by NACE, the European Industry Classification Standard – are currently under discussion.

Comparison between the Green Bond Catalogue 2020 and the EU Taxonomy

As described above, both classification standards have six high-level categories or environmental objectives. However, those are by no means similar. The Green Bond Catalogue 2020 starts by grouping economic activities (e.g. Ecology & environment-related sector) and then defines green projects for a certain activity (green fishery or protection of natural forest resources). The EU starts from the environmental objectives and filters out economic activities that can significantly contribute to accomplish those objectives. In a second step, specific criteria for those broad activities are set to determine the significant contribution, e.g. life cycle GHG emission below 100g CO₂e/kWh for electricity production.¹⁰ The Taxonomy defines, just as the Green Bond Catalogue, “dark green” activities but does also include transitioning activities (that are not 100% sustainable yet) as well as enabling activities. The latter two activity classes are unique to the EU Taxonomy. This methodological difference to the Green Bond Catalogue can be partly explained by a different utilization of the two classifications.

⁹ EU Commission, 2018. https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en

¹⁰ The DNSH and minimum safeguards concept is also distinctive to the EU Taxonomy.

Utilization

The EU Taxonomy will be used by regulators as well as financial market participants to report the alignment of their financial products.¹¹ Large European companies will also have to disclose how much of their activities align with the Taxonomy definition. On the other hand, the *Green Bond Catalogue* has been developed for green bond issuers and regulators to identify and disclose the financing of projects which are sustainable.

Covered activities

The Chinese Green Bond Catalogue and the EU Taxonomy align with each other in most categories, with the 2020 version of the *Green Bond Catalogue 2020* further bridging the gap between the standards by deleting the utilization of clean coal as well as coal-fired power projects. All six European environmental objectives are to some extent covered in the *Green Bond Catalogue 2020*. Another similarity is that both the standards are focused on already existing

environmental regulation when defining criteria or targets.

However, the EU Taxonomy has introduced detailed metrics including for example carbon emissions for many activities, whereas the *Green Bond Catalogue* often does not refer to any specific threshold. Instead, the catalogue specifies the projects that are deemed green on a more granular level. In terms of included projects or activities, there are still some differences between the two catalogues as shown in Table 2, which are – amongst other things – caused by diversified resource endowments and economic structure. It is important to mention that under the category of "Resource recycling equipment manufacturing" in the *Green Bond Catalogue 2020*, a sub-category labelled "energy minerals" (which is fossil fuel related) does still exist. This sub-category is not in line with the EU Taxonomy or other international green definitions.

Table 2: Comparison between the *Green Bond Catalogue 2020* and the EU Taxonomy

Categories	EU Taxonomy	The <i>Green Bond Catalogue 2020</i>
Nuclear power	✘	✓
Production of electricity from natural gas	✓	Only supply of combined heat/cool and electricity from natural gas
Production of electricity from hydropower	All	Large hydropower plants
Bioenergy	Only biomass from forest or agricultural rest products	All
Environmental protection equipment manufacturing	✘	✓
Resource recycling equipment manufacturing	✘	✓
Pollution prevention and treatment	✘	✓
Passenger rail transport	✓	✘
Manufacture of cement, aluminum, steel	✓	✘ Only energy improvement measures for plants are covered
Green services	Only engineering & consultancy dedicated to climate adaptation and professional services related to building energy performance	✓ Including a number of certification activities and evaluation of environmental impacts
Education for climate adaptation	✓	✘
Insurance (Underwriting of climate-related perils)	✓	✘

¹¹ Financial products offered in Europe. Disclosure requirements will differ depending on asset class and product type, as detailed in the Taxonomy Regulation (EU) 2020/852.

Note: "✘" means not included, "✓" means included

Some of those differences might disappear when the other four environmental objectives of the EU Taxonomy are fully developed with corresponding screening criteria. For example, a larger number of pollution prevention and treatment activities that are described in the *Green Bond Catalogue 2020* might be included in the EU Taxonomy under the fifth environmental objective.

Challenges for Chinese and European investors

The biggest challenge for investors is the respective understanding of the other classification system. In Europe, knowledge about the Chinese green finance regulation framework is still scarce. Without trust in China's definition of sustainability, investors will not want to engage in the Chinese market. We hope that this article contributes to the better understanding of China's detailed *Green Bond Catalogue*. For European investors, the most challenging part of the Chinese definition might be the inclusion of nuclear energy as well as projects regarding energy minerals and fossil fuels. Besides classification differences, the limited availability of investment channels is also a barrier for European investors given that foreign investors only own 3% of the total Chinese bond market. Fortunately, with the trend of Chinese capital market liberalization, Bond Connect and direct CIBM trade via local custodians have become more popular methods for international institutions to invest in China's onshore green bond market.

From the IIGF point of view, the current yield of European bonds might not be attractive for Chinese investors, since the coupon of an RMB

bond is much higher than a EUR bond under quantitative easing. Besides, understanding the expectations of European investors linked to those new regulatory requirements when issuing green bonds or promoting financial products can pose a challenge for Chinese institutions and corporates wanting to engage on the European market. A further harmonization of the classifications to ensure seamless compatibility, especially for cross-border issuances of green bonds, is desirable to scale up sustainable finance globally.

Summary

The differing approaches to define sustainability from a project (China) versus an environmental objective (EU) angle complicated the analysis and prevents full comparability between the *Green Bond Catalogue 2020* and the EU Taxonomy. The view on what constitutes a sustainable activity is largely harmonized between the two classification systems. The most notable difference might be the inclusion of nuclear power as green energy source as well as the inclusion of fossil fuels into several project descriptions in the Chinese but not the European catalogue. From SEB's point of view, the collaboration with the Chinese IIGF has enabled us to get a better understanding of how to guide our institutional and corporate clients more effectively. We hope that this paper will provide some clarity on how Chinese and European entities can collaborate and where adjustments are required for cross continental activities. We look forward to continuing the dialogue and will be following the development of both standards with great interest – it remains to be seen if they align even further with each other in the future.

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This report was published on 4 February 2021

Cut-off date for calculations was 31 January 2021, unless otherwise stated.

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