

## OPINION ON THE SUSTAINABILITY ASPECTS OF THREE TRANSACTIONAL BANKING PRODUCTS

November 20, 2019

### SCOPE

Vigeo Eiris was commissioned by BBVA (the “Bank” or the “Group”) to provide an independent opinion on the sustainability credentials of three transactional banking products (deposits, structured bonds and supply chain program) governed by BBVA Sustainable Transaction Banking Framework (the “Framework”).

Our opinion is established according to Vigeo Eiris’ Environmental, Social and Governance (“ESG”) exclusive assessment methodology. It is built on the review of the following components:

- I. Sustainability objectives of the products
- II. Evaluation and selection process of the issuers included in the sustainable portfolio and suppliers benefitting from supply chain facility
- III. Eligibility criteria of the concerned issuers and suppliers
- IV. Processes in place to allocate the proceeds
- V. Reporting commitments on the sustainability performance of the products

Our sources of information are gathered from Vigeo Eiris exclusive ESG rating database and from BBVA.

We carried out our due diligence assessment from November 14<sup>th</sup> to November 20<sup>th</sup>, 2019. We consider that we were provided with access to all the appropriate documents we solicited. We consider that the provided information enables us to establish our opinion with a reasonable level of assurance on its completeness, precision and reliability.

### VIGEO EIRIS’ OPINION

The objectives of the transactional banking products are clearly defined and formalised in a dedicated document, made available to investors. Nevertheless, these objectives do not appear to address precise environmental or social thematic, neither do they entail any quantitative targets.

The sustainability objectives of these products are coherent with BBVA’s approach of integrating sustainability issues into its transaction banking products’ offer.

The process for evaluation and selection of issuers and suppliers is reasonably structured and entails internal and external controls steps. One area for improvement relates to internal audit processes.

This process relies on exclusion and selection criteria that are clearly defined and transparent. We consider that these criteria are partially relevant, regarding their exhaustiveness and precision.

The rules for the management of proceeds are clearly defined.

The reporting commitment appears comprehensive, covering both the allocation of the funds and the impact of products. The public reporting process could demonstrate more precision to reflect the environmental and social impacts of these products.

## DETAILED RESULTS

### I OBJECTIVES OF THE SUSTAINABLE TRANSACTIONAL BANKING PRODUCTS

**The objectives of the transactional banking products are clearly defined and formalised in a dedicated document, made available to investors. Nevertheless, these objectives do not appear to address precise environmental or social thematic, neither do they entail any quantitative targets.**

The transactional products' objectives are disclosed in BBVA' Sustainable Transaction Banking Framework, which the Group intends to release in December 2019.

BBVA, which aims at developing three types of sustainable transactional products, has defined three sustainability objectives for these products:

- Promote corporate sustainability best practices by facilitating debt market and liquidity access for organizations which can be shown to outperform their peers in sustainability.
- Encourage the inclusion of outperformers in sustainability in BBVA CIB's bond/equity portfolio
- Offer BBVA clients the ability to invest in sustainability-linked liquidity and funding products

**The sustainability objectives of these products are coherent with BBVA's approach of integrating sustainability issues into its transaction banking products' offer.**

Such objectives are coherent with BBVA's strategy:

- BBVA is committed to the United Nations Global Compact Principles and in 2016 the Bank released a commitment to achieve the targets set by the Paris COP21 and the United Nations Sustainable Development Goals.
- In 2018, BBVA released its new strategy on climate change and sustainable development (Pledge 2025), which objective is to align the activity of the Bank to the SDGs and the 2°C scenario of the Paris Agreement. This strategy is based on a threefold commitment: (1) to mobilize Eur 100 billion (by 2025) in green finance, sustainable infrastructure and agribusiness, entrepreneurship and financial inclusion, to manage the environmental and social risk associated with the Bank's activity, (2) to minimize potentially negative direct and indirect impacts and (3) to engage all stakeholders to increase the financial sector's collective contribution to sustainable development.

Axes for improvement consist in:

- Defining, in a more precise manner, environmental and social topics to be addressed by these products. While BBVA' sustainable development strategy clearly mentions sectors to be supported by its sustainable financing efforts (sustainable infrastructure and agribusiness, entrepreneurship and financial inclusion), the sectors or fields of activity targeted by the sustainable transactional products are not mentioned in the Framework document. In this respect, BBVA states they do not wish to restrict themselves to goals mentioned in their climate change strategy because the sustainability goals of these products may go beyond this scope.
- Setting quantitative targets for the sustainability performance of these products. BBVA has released a commitment to mobilise EUR 100 billion in green finance by 2025 but does not report on the level of contribution of these products to this objective. In addition, deposits and structured bonds will be used to maintain BBVA CIB's sustainable portfolio, which entails equities and bonds of issuers considered sustainable by the Bank. Nevertheless, BBVA does not disclose information on whether it intends to measure the ESG performance of this portfolio, neither does the company disclose any ESG performance target for this portfolio. For example, the ESG performance of this portfolio could be benchmarked against a sustainability index and a target of performance against this index could be set.

### II EVALUATION AND SELECTION PROCESS OF THE ISSUERS INCLUDED IN THE SUSTAINABLE PORTFOLIO AND SUPPLIERS BENEFITTING FROM SUPPLY CHAIN FACILITY

**The process for evaluation and selection of issuers and suppliers is reasonably structured and entails internal controls steps. One area for improvement relates to internal audit processes:**

#### 1/ Deposits and structured bonds

The Group has implemented processes for evaluation and selection of issuers that are clearly framed and entail validation steps by several teams, including external experts.

- BBVA relies on internal and external expertise for the definition of the methodology, exclusion and selection criteria for issuers included in its sustainable portfolio, as well as for data collection and analysis:
  - BBVA transaction banker and product specialists are charged with identifying business opportunities meeting the Sustainable Transaction Banking Framework's criteria.
  - The sustainability character of each business opportunity is then assessed by a team of sustainable experts. The sustainable experts' team is also responsible for the review and maintenance of the Framework for BBVA sustainable transaction banking, in collaboration with the business units.
  - The review of the portfolio constituents will be carried out quarterly by a portfolio monitoring team, composed of members from BBVA CIB Sustainable Finance and Reputational Risk Teams.
  - BBVA states that data collection and controversy research will be conducted by independent ESG research providers (including DJSI, Carbon Disclosure Project, Reprisks, etc.) and that the Group will only use ESG providers for which they have a reasonable level of assurance on the frequency of update of information.
  
- Internal and external control processes appear to be in place for the issuers' selection:
  - BBVA CIB sustainable finance team plans to validate the sustainability aspects of each transaction, after its assessment by the sustainable experts' team.
  - BBVA CIB sustainable finance team will also be charged with conducting a quarterly review of the sustainable portfolio, to ensure its components meet the requirements defined in the Sustainable Transaction Banking framework. Issuers that are found to not comply with Eligible Criteria will be removed from the Portfolio.
  - Each month, a sample of operations is discussed in the Sustainable Finance Working group, a team led by the Bank's responsible business department and entailing members from several departments, including Global Client Coverage, Global Clients Strategy, Sustainable Finance; Reputational Risk – CIB, etc
  - BBVA states that it will recourse to an external ESG rating agency to conduct an annual review of a sample of its sustainable portfolio.
  
- An additional update process appears to be in place to ensure only Eligible issuers are kept in the portfolio:
  - An extraordinary review of the portfolio will be conducted annually, after communication of DJSI results.
  
- One area for improvements relates to the implementation of internal audits processes:
  - These selection and validation processes do not appear to be audited internally, which slightly lowers our assurance on BBVA's ability to ensure these processes meet the Group' sustainable objectives.

## 2/ Supply chain program:

The Group has implemented processes for evaluation and selection of issuers that are clearly framed and entail validation steps by several teams, as well as monitoring processes.

- BBVA relies on both internal and external expertise to help buyers select suppliers eligible for a pricing benefit. BBVA's team can support buyers in developing sustainability assessment tools for their suppliers. In addition, buyers may use externally developed sustainability initiatives, industry assessments and/or certifications (such as IFC-ILO Better Work program, Responsible Alliance- Self Assessment score, CDP, DJSI, Product Standard certification such as Ecocert, etc.) as criteria to select suppliers for the sustainable supply chain program.
  
- A validation process appears to be in place:
  - the Bank states that BBVA CIB Sustainable Finance team will be in charge to evaluate whether the systems the client has in place for its suppliers are eligible for this product. BBVA also mentions the criteria taken into account to conduct this evaluation: these include client sustainability strategy, client expectations from its suppliers in terms of sustainability, client key sustainability issues and targets and metrics associated with supplier performance.

- BBVA CIB Sustainable Finance will also validate each proposed suppliers' eligibility for a pricing benefit. BBVA reports that this team will meet at least monthly to define the list of selected suppliers.
- Regular monitoring appears to be ensured throughout the process:
  - BBVA commits to require its clients to communicate their corporate social responsibility and environmental strategy at the time of signing the deal and to provide annual reports on the sustainable supply chain finance project, entailing an indicator reflecting the impacts of the program.
  - BBVA states that information collected in the frame of the Supplier Evaluation will be compiled in a report entailing a brief overview of the company's activity, its sustainability profile and the list of eligible suppliers with their selection criteria and reporting indicators.
- Internal controls processes appear to be in place:
  - Each month, a sample of operations is discussed in the Sustainable Finance Working group, a team led by the Bank's responsible business department and entailing members from several departments, including Global Client Coverage, Global Clients Strategy, Sustainable Finance; Reputational Risk – CIB, etc.
- One area for improvements relate to the reinforcement of internal audits processes:
  - These selection and validation processes do not appear to be audited internally, which slightly lowers our assurance on BBVA's ability to ensure these processes meet the Group' sustainable objectives.

- **III. ELIGIBILITY OF THE CONCERNED ISSUERS AND SUPPLIERS**

1. Deposits and structured bonds

The process relies on exclusion and selection criteria that are clearly defined and overall transparent. We consider that these criteria are partially relevant, regarding their exhaustiveness and precision.

The **exclusion criteria** are transparent and exhaustive, although area of improvement remains with respect to their precision.

- Initial exclusion criteria are transparent and exhaustive.
  - In the Sustainable Transaction Banking Framework, BBVA clearly states that the funds obtained through any product under this Framework will not be used under any circumstance in any project of for any company related to any of the following activities: nuclear power generation, defence, civilian firearms, mining, carbon related, oil & gas, tobacco, gambling, pornography'. In another document, BBVA refers to 'companies involved' in those activities.
- Initial exclusion criteria could demonstrate more precision.
  - BBVA does not specify what is meant by 'any project or for any company related'. Indeed, 'any activity' is not clear if there is no clear definition of what is taken into account in each activity. For instance, is a company that produces cigarette paper involved in tobacco or not. Moreover, not setting thresholds may lead to the exclusion of companies having a very minor percentage of income (for instance 0.01%) from an indirect participation (through subsidiaries) in a controversial activity. Finally, BBVA states that it 'will use and rely primarily on information provided by the client, and on any other information available from generally recognized publicly accessible sources without having independently verified it.' This could mean that involvement is such activities is evaluated by the screened companies themselves, with a 'yes' or 'no' answer, so based on self-acknowledgement, without relying on research done by external providers.
- Controversies exclusion criterion is partly transparent and exhaustive.
  - BBVA states that its CIB Sustainable Finance team will use RepRisk to search the Eligible Companies for controversies. 'A controversy is defined as a large scale, public event which calls into question the integrity and ethics of a company or an NGO or investor campaign concerning a certain ESG issue such as cases of gross negligence or blatant disregard for laws and industry best practices. These types of events would make a company ineligible.' The use of an external provider of controversies affecting companies give some assurance to the detection of controversies.
- Controversies exclusion criterion could demonstrate more precision:
  - BBVA has not indicated how any event affecting companies will be considered as matching its definition of a controversy. Wordings like 'large scale', 'public event' remains vague. Moreover, there is no reference in BBVA's documentation to a severity scale that would apply to distinguish minor from major controversies. Also, no reference is provided to the number of controversies or the recurrence of the same controversy that would be taken into account to assess a company's exposure to controversies. In addition, it is not clear from BBVA's documentation how long an event will be taken into account and after what period a controversy will be considered as expired. Finally, it is not clear whether corrective measures carried out by companies could be taken into account to mitigate the negative assessment of controversies and possibly allow company to remain eligible.

The **selection criteria** are transparent and exhaustive, although partially relevant **regarding their exhaustiveness and precision**:

- Bonds and equity chosen for inclusion in a sustainable deposit must be issued by a company that complies with one of the two criteria:
  - o Member of a Sustainability Index (DJSI, FTSE4Good, CDP, MSCI...).
  - o Above industry average CSR score from CSR Hub or other recognized ESG rating provider.

BBVA communicated to Vigeo Eiris that, at the moment, the only two references it is using as criteria for Eligible Companies are companies listed in the DJSI or companies with an above average score from CSR Hub.

These criteria are transparent and precise: both Robeco SAM and CSR Hub disclose their selection methodology.

They are partially exhaustive: Given that CSR Hub screens about 18,000 companies, setting the eligible threshold higher than 'above industry average' would enable to select best in class companies.

## 2. Sustainable supply chain finance.

The process relies on selection criteria only that are clearly defined and transparent. We consider that these criteria are partially relevant, regarding their exhaustiveness and precision.

- Selection criteria are partly transparent and exhaustive.
  - BBVA states there are various approaches a Buyer can take to establishing the sustainability criteria/standards and that its product should finance all manner of approaches. BBVA provides two examples it may expect to see:
    - 1. Buyers may have in place or will develop with BBVA's help, already established sustainability assessments for their suppliers or sustainable initiatives that suppliers can participate in.
    - 2. Buyers may choose to reward suppliers that participate in certain industry assessments or certifications. In its documentation, BBVA provides a list of possible options, which is non-exhaustive. Additionally, when a certification is used, BBVA will ensure the certification is market-recognized and reputable.
    - BBVA states that, in order for a supplier to be eligible for a pricing benefit, the systems the Buyer has in place to classify and rank suppliers must be well defined and credible. The BBVA Sustainable Finance team will be in charge of the revision to evaluate whether the systems the client has in place for its suppliers are eligible for this product. This evaluation will be based on a review of several features, such as the client expectation of its suppliers, key sector issues, targets and metrics.
- Selection criteria could demonstrate more precision.
  - BBVA states this product should finance all kinds of approaches and gives two examples it may expect to see. However, even if BBVA stipulates that its 'Sustainable Finance team will be in charge of the revision to evaluate whether the systems the client has in place for its suppliers are eligible for this product', BBVA does not clearly states what will be the minimum requirement to become eligible, which allows much room for interpretation. In the first example, one could understand that any sustainability assessment would be acceptable and BBVA does not clearly state what kind of measures (for instance as integration of sustainable issues into contractual clauses, risk assessment, supplier questionnaires, external audits, etc) would be required to be considered credible. In a reaction to this remark, BBVA has provided Vigeo-Eiris with additional comments, which clarify that BBVA's process aims at continuous improvement and that it will depend on company size and sector, sophistication of suppliers, and supplier location. We suggest that BBVA puts this additional explanation in the framework document.

## IV PROCESSES IN PLACE TO ALLOCATE THE PROCEEDS

**The rules for the management of proceeds are clearly defined but limited information is disclosed on means enabling a documented and transparent allocation process.**

The rules for the management of proceeds for sustainable deposits and sustainable structured bonds are clearly defined:

- The proceeds will be used to invest in bonds and equity from companies deemed sustainable based on the Eligibility Criteria. The proceeds of the sustainable deposits will be matched to Eligible Assets. The volume of outstanding deposits will not exceed the collateral of Eligible Assets. A buffer will be established to ensure sufficient collateral to cover all outstanding deposits. These rules are clear and exhaustive. One suggestion could be to report on a maximum period for the reallocation of funds in case of divestment from a company.

A structure in charge of monitoring the allocation of funds has been defined:

- The sustainable specialist team will be in charge of monitoring the fund allocation and reporting on this allocation to the CIB Sustainable Finance team. The CIB Sustainable Finance team will be in charge of communicating on the components of the portfolio each quarter.

External controls are planned to be allocated to ensure a transparent allocation process:

- BBVA states that it will request on an annual basis a limited assurance report of the allocation of the proceeds or guarantees of the sustainability transactional products by its external auditor or another suitably qualified provider

## REPORTING COMMITMENTS ON THE SUSTAINABILITY PERFORMANCE OF THE PRODUCTS

**The reporting commitment appears comprehensive, covering both the allocation of the funds and the impact of products. The public reporting process could demonstrate more precision.**

- Reporting to clients: In the case of sustainable deposits, previous to the operation, BBVA will put the inclusion criteria at prospective client's disposal. At the end of the deposit term, BBVA will put the composition of the portfolio including number of companies, industries and geographies at the client disposal. This reporting appears quite comprehensive.
- Public reporting: BBVA will publish in its Annual Report, an annual consolidated report including the allocation of the funds and the impacts of the transactional products. This reporting appears comprehensive as well. We could however suggest BBVA defining a formalized list of relevant ESG quantitative indicators that would be representative of such impacts and would allow the follow up of such impacts over time. Since it is BBVA's intention that an external party annually reviews transactions carried out under the framework, a set of relevant ESG indicators would be of interest for such review. In reaction to this remark, BBVA has indicated to Vigeo-Eiris that the number of sustainable suppliers and the percentage of CO2 reduced through the sustainable portfolio could be published. We suggest that BBVA indicates such example in its documentation.

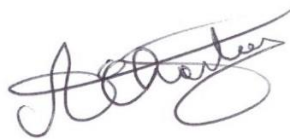
*This Opinion is limited to the structured bonds, deposits and supply chain program, as of the date of the Opinion.*

Paris, November 20<sup>th</sup>, 2019



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