

KESTREL VERIFIERS

# EXTERNAL REVIEW

RBC Sustainable  
Commercial Paper  
Program

DECEMBER 2022

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# External Review

## EXECUTIVE SUMMARY

### PROGRAM MANAGER

Royal Bank of Canada

### PROGRAM

RBC Sustainable Commercial Paper Program

### FRAMEWORK

RBC Sustainable Commercial Paper Program Framework

### EVALUATION DATE

December 1, 2022

### SUMMARY

Royal Bank of Canada (“RBC”) is establishing a Sustainable Commercial Paper Program (“SCP Program” or “Program”) designed to support assets associated with positive environmental and social impacts (“Eligible Assets”). RBC’s approach is broadly aligned with the International Capital Market Association (“ICMA”) Sustainability Bond Guidelines and leverages Kestrel ESG Impact Data to assist with identifying and selecting Eligible Assets that meet criteria in RBC’s Sustainable Commercial Paper Program Framework (“Framework”).<sup>1</sup> RBC will determine whether an asset is eligible using its sole discretion based on alignment of the financed activities of each asset with the Eligible Categories defined in the Framework. A report on the Program will be provided annually with portfolio-level metrics that may include Average Kestrel ESG Impact Scores and distribution, as well as financed areas by sector based on Kestrel ESG sector assignment such as renewable energy.

RBC engaged Kestrel Verifiers to use the ICMA Sustainability Bond Guidelines as criteria to review the Program design, assess alignment with RBC’s Sustainable Commercial Paper Program Framework, and determine the potential for positive environmental and social impact.

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<sup>1</sup> While the Program broadly conforms with the four core components of the Sustainability Bond Guidelines, Sustainable Commercial Paper under the Program is not equivalent to a Sustainability Bond under ICMA’s Sustainability Bond Guidelines. This is because the uses of proceeds and financed projects are indirectly associated with an individual instrument.



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## EXTERNAL REVIEW ON THE RBC SUSTAINABLE COMMERCIAL PAPER PROGRAM

Kestrel Verifiers conducted an independent external review of the Program. This External Review used the four core components of the ICMA Sustainability Bond Guidelines (2021) as criteria to evaluate the SCP Program and associated debt instruments. The objective of the evaluation was to review Royal Bank of Canada's Framework for the Sustainable Commercial Paper Program; and RBC's proposed plans for asset selection; allocation of funds; and reporting in order to confirm alignment of the Program with best practices in sustainable finance.

Kestrel 360, Inc. ("Kestrel 360") operates two separate lines of business. Kestrel Verifiers, a division of Kestrel 360, is an Approved Verifier accredited by the Climate Bonds Initiative and an Observer for the ICMA Green Bond Principles and Social Bond Principles. Kestrel Verifiers reviews transactions in all asset classes worldwide for alignment with ICMA Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines. Kestrel Verifiers provides external reviews on many types of debt instruments, and specializes in public finance.

Kestrel ESG, a division of Kestrel 360, has ESG Data Analysts solely focused on reviewing debt instruments and assigning ESG Impact Scores. Kestrel ESG's social and environmental scientists review debt instruments in accordance with proprietary sector-specific methodologies which assess the impact of financed activities on the planet and society. Kestrel ESG will provide ongoing analysis of underlying assets in the SCP Program.

## RBC's FOCUS ON SUSTAINABILITY

RBC is the largest bank in Canada based on market capitalization with more than 17 million clients in 29 countries.<sup>2</sup> RBC provides financial services including banking, investing, insurance, wealth management, capital markets, and investor and treasury services. RBC integrates climate action and social equity into business trajectories, programs, and initiatives. This is reflected in RBC's commitment to provide more than C\$500 billion in sustainable finance by 2025 and to reach net zero emissions in lending by 2050.<sup>3</sup> As of 2021, RBC has provided more than C\$198 billion toward the C\$500 billion goal, facilitating more than C\$33 billion of financing through green, social, sustainability and sustainability-linked bonds and loans. RBC is recognized as the number one dealer in underwriting green bonds in Canada, holding the largest market share of Canadian public sector green bonds.<sup>4</sup>

The Climate Blueprint, originally published by RBC in 2019 and updated in 2021, outlines the bank's strategic priorities to accelerate the transition to net zero emissions, both market-wide and internally.<sup>5</sup> In 2021, RBC joined the Net-Zero Banking Alliance, a global initiative to support financial institutions in the low-carbon transition. Additionally, RBC is engaged in the net zero transition beyond the financial sector. RBC's comprehensive report, *The \$2 Trillion Transition: Canada's Road to Net Zero*, outlines results from research on sector-specific pathways to achieve net zero in Canada.<sup>6</sup> Incorporating stakeholder input from governments, regulators, clients, environmental groups, and the global finance community, RBC's research identified six pathways to net zero based on each industry's realistic ability to cut emissions and move toward a more sustainable future. This thought leadership and research supports RBC's efforts to inform and inspire a sustainable future, a key pillar in its Climate Blueprint.

<sup>2</sup> "RBC at a Glance – Q4/2022," RBC, November 30, 2022, [https://www.rbc.com/investor-relations/\\_assets-custom/pdf/rbcglance.pdf](https://www.rbc.com/investor-relations/_assets-custom/pdf/rbcglance.pdf).

<sup>3</sup> The commercial paper issued under RBC's Sustainable Commercial Paper Program does not count toward RBC's commitment to C\$500 billion in sustainable finance by 2025.

<sup>4</sup> "Task Force on Climate-related Financial Disclosures Report 2021," RBC, 2021, [https://www.rbc.com/community-social-impact/\\_assets-custom/pdf/RBC-TCFD-Report-2021.PDF](https://www.rbc.com/community-social-impact/_assets-custom/pdf/RBC-TCFD-Report-2021.PDF).

<sup>5</sup> "The RBC Climate Blueprint," RBC, February 2022, [https://www.rbc.com/community-sustainability/\\_assets-custom/pdf/RBC-Climate-Blueprint.pdf](https://www.rbc.com/community-sustainability/_assets-custom/pdf/RBC-Climate-Blueprint.pdf).

<sup>6</sup> "The \$2 Trillion Transition: Canada's Road to Net Zero," RBC Economics, October 2021, <https://royal-bank-of-canada-2124.docs.contently.com/v/the-2-trillion-transition-canadas-road-to-net-zero-pdf>.

Moreover, implementing initiatives and programs with positive social impact is important to RBC. The bank engages in partnerships to support local community organizations and sponsors multiple programs including RBC Race for the Kids and RBC Future Launch to help youth realize their full potential. Two of RBC's programs specifically support Black and Indigenous business development. The Black Startup Entrepreneur Program helps new business owners develop or grow their businesses, assisting with access to financial resources and tools. The Indigenous Peoples Development Program provides Canadian First Nations, Inuit, and Métis<sup>7</sup> college graduates with training in business and community development, as well as community-based work in organizations that support Indigenous people.

## **COMMERCIAL PAPER AND SUSTAINABILITY**

The SCP Program supports development of the sustainable finance market and, in Kestrel's opinion, is an exemplary approach to drive positive environmental and social impact and increase transparency in short-term finance.<sup>8</sup> The Program provides a supply of commercial paper that meets the liquidity pillar of Basel III and facilitates RBC's ability to support organizations and projects that are advancing sustainability.<sup>9</sup> Underlying assets in the SCP Program will primarily consist of USD denominated public finance bonds, holdings of high-quality liquid assets that support RBC's credit commitments to USD denominated public finance transactions, and other assets. Kestrel ESG Impact Scores will be used as an additional screen to select underlying assets in order to amplify positive impacts as measured by Kestrel's sustainable finance goals defined herein. The Program is anticipated to undergo continuous improvement to enhance performance and increase portfolio impact thresholds over time.

### Market Need

While other sustainable short-term programs exist in the market, information regarding the ESG characteristics of underlying assets has been opaque. Many short-term instruments such as bond anticipation notes and short-term bank loans have received Green, Social, and Sustainability designations based on uses of proceeds, but certain short-term debt instruments fall outside the scope of widely accepted standards for sustainable debt financing options.<sup>10</sup> RBC's Program offers investors a short-term finance instrument evaluated against RBC sustainability criteria and Kestrel ESG Impact Data on individual assets, and seeks to provide investors with transparency into the underlying assets funded by the Program.

Cash and cash equivalents should not be excluded from decarbonization and just transition goals. Cash assets do not sit passively in accounts; rather, they may finance other activities that mitigate climate change or advance social equity. The SCP Program allows investors to leverage these assets to contribute to positive environmental and social impact.

### Market-wide Impact

Kestrel ESG Impact Data provides RBC with incremental, evidenced-based data that assists RBC in identifying and selecting assets with environmental and social benefits where previously, limited information was available. As of July 2022, the US commercial paper market was valued at USD\$1.2 trillion, yet scalable options for differentiating between sustainable and business-as-usual instruments are not widely available.<sup>11</sup> The Program is a novel tool that enables progress toward RBC's sustainable finance goals. RBC's Program includes a diverse pool of assets and transparency on the environmental and social impact of eligible assets. Eligible underlying collateral is defined in detail and is selected based on criteria and processes described herein.

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<sup>7</sup> First Nations, Inuit, and Métis are the three groups of Indigenous people in Canada. First Nations is a general term for several tribes, bands, or nations. Members of these specific groups are more likely to define themselves by their respective nation. Inuit and Métis are distinct, individual nations.

<sup>8</sup> Based on the fact that RBC uses Kestrel's independent ESG Impact Scores in addition to alignment with RBC's Eligible Categories.

<sup>9</sup> The liquidity pillar of Basel III requires banks to provide liquidity consisting of high-quality assets mitigating reliance on central bank assistance.

<sup>10</sup> Under Basel III, commercial paper instruments are issued for liquidity and do not fit conventional definitions of sustainable finance under ICMA and Climate Bonds Initiative standards. The underlying assets, on the other hand, are primarily traditional use of proceeds or project finance assets.

<sup>11</sup> "US Money Market Instruments Statistics," Securities Industry and Financial Markets Association, accessed August 9, 2022, <https://www.sifma.org/resources/research/us-money-market-instruments-statistics/>.

In Kestrel’s view, the Program advances strategic priorities in RBC’s Climate Blueprint and supports development of the sustainable finance market.<sup>12</sup> Priorities in the Climate Blueprint include helping clients transition to net zero, and inspiring a sustainable future. In order to advance social impact and climate goals, and avoid the most severe impacts of climate change, market participants must be able to identify *all types* of sustainable finance instruments. New frameworks and innovative approaches are fundamental to reaching global decarbonization targets.

**ALIGNMENT TO SUSTAINABILITY STANDARDS**

**The SCP Program and the ICMA Sustainability Bond Guidelines**

This External Review uses the four core components of the ICMA Sustainability Bond Guidelines as criteria to evaluate the SCP Program and associated debt instruments. While the Program broadly conforms with the four core components of the Principles, Sustainable Commercial Paper under the Program is not equivalent to a Sustainability Bond under ICMA’s Principles.<sup>13</sup> This is because the uses of proceeds and financed projects are indirectly associated with an individual instrument.

Based on Kestrel’s evaluation, the Program is broadly aligned with the Sustainability Bond Guidelines in the following ways:

- *Use of Proceeds:* Every underlying asset is evaluated by Kestrel ESG based on the environmental and social benefits of the financed activities. The Program utilizes the eligible Green and Social Project Categories under the ICMA Green and Social Bond Principles to define eligible assets.
- *Process for Project Selection and Evaluation:* RBC has a robust and transparent process for identifying eligible assets for the Program based on its internal processes and controls and leveraging Kestrel ESG Impact Data.
- *Management of Proceeds:* The Program requires clear tracking of the allocation of proceeds to confirmed Eligible Assets via dedicated operational booking points which are monitored by RBC’s internal functional groups including, but not limited to, risk management, finance, and compliance.
- *Reporting:* RBC has established robust and comprehensive processes for reporting on the allocation of proceeds and impacts of the Program to maintain transparency for market participants.

In addition to alignment with ICMA Principles, the Program uses a data driven approach to select Eligible Assets that leverages highly technical reviews conducted by Kestrel to identify ESG impacts of the underlying assets.

**Eligible Assets**

Eligible underlying assets (“Eligible Assets”) are identified using RBC’s internal processes and controls as well as Kestrel ESG Impact Data. Sustainable Commercial Paper proceeds will only be allocated to activities and financed projects which have environmental and/or social benefits.

Green Standard



Eligible Project Categories:

- Circular Economy
- Clean Transportation
- Climate Change Adaptation
- Energy Efficiency
- Environmentally Sustainable Management of Living Natural Resources and Land Use
- Green Buildings
- Pollution Prevention and Control
- Renewable Energy
- Sustainable Water and Wastewater Management
- Terrestrial and Aquatic Biodiversity

Social Standard



Eligible Project Categories:

- Access to Essential Services
- Affordable Basic Infrastructure
- Affordable Housing
- Socioeconomic Advancement and Empowerment

<sup>12</sup> “The RBC Climate Blueprint,” RBC, February 2022, [https://www.rbc.com/community-sustainability/\\_assets-custom/pdf/RBC-Climate-Blueprint.pdf](https://www.rbc.com/community-sustainability/_assets-custom/pdf/RBC-Climate-Blueprint.pdf).

<sup>13</sup> Sustainability Bonds are any type of bond instrument where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance a combination of both Green and Social Projects.

RBC's SCP Program Framework defines Eligible Assets that conform with ICMA Green and Social Project Categories.<sup>14</sup> Kestrel ESG impact scores will be used as an overlay to identify assets with potential for positive impact. In Kestrel's view, RBC's goals and the scope of Eligible Assets are impactful, and represent a significant shift from business as usual.

### **Kestrel ESG Impact Data**

Kestrel ESG Impact Data supports the Program's objectives by providing quantitative and qualitative evaluations of positive environmental and social impacts of financed activities. Kestrel ESG scores are rooted in highly technical evaluations of financed activities, and identify the presence or absence of sector-specific best practices to advance environmental and social goals. Kestrel ESG's robust science-based methodology complements RBC's commitment to sustainable finance and will elevate the transparency of the Program. RBC will utilize the following Kestrel ESG Impact Data fields as part of its screening process and procedures to identify Eligible Assets and report on progress:

- Alignment of assets with an ICMA Green or Social Project Category
- Sector assignment, based on use of proceeds
- Four numeric scores, each on a scale of 1-5, where high scores reflect exemplary bonds with positive impacts:
  - Environmental (E)
  - Social (S)
  - Governance (Transparency) (G)
  - Total ESG Impact Score
- Alignment to United Nations Sustainable Development Goals (SDGs) and Targets<sup>15</sup>
- Identification of potential "flashpoints" associated with the sources of repayment<sup>16</sup>

While the market tends to assign ESG materiality at the issuer or industry level, Kestrel evaluates bond-financed activities at the CUSIP level. Focused evaluation of bond-financed activities through the lens of environmental and social science increases transparency and allows for a clear understanding of positive impacts. ESG impact scores, rooted in technical, sector-specific methodologies, indicate the degree to which an asset advances five sustainable finance goals defined by Kestrel, which include:

- *Transition to a decarbonized economy,*
- *Integrate resilient and sustainable design features,*
- *Preserve, enhance, or restore natural capital,*
- *Promote an equitable society and a just transition, and*
- *Disclose activities, impacts and risks.*

More information about Kestrel ESG Impact Data is available at [kestrelesg.com](http://kestrelesg.com).

### **Process for Asset Selection**

RBC will determine whether an asset is eligible using its sole discretion based on alignment of the financed activities of each asset with the Eligible Categories defined in the Framework. All Eligible Assets linked to the SCP Program will be aligned with ICMA Green or Social Project Categories, as indicated by RBC's Framework. Kestrel ESG Impact Data will inform alignment of an asset with Eligible Categories. Eligible Assets will be identified based on a minimum ESG Impact Score greater than 3.0. Kestrel ESG Impact Scores will be used by RBC in addition to alignment with ICMA Green or Social Project Categories in order to identify positive impacts of the Program beyond business as usual. The RBC Sustainable Commercial Paper Working Group ("SCP Working Group" or "Working Group") is responsible for oversight of the Program and application of the criteria for Eligible Assets. Representatives in the Working Group include individuals familiar with public finance, treasury, principles of sustainability, sustainable finance, and Green, Social, and Sustainability Bonds.

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<sup>14</sup> Kestrel ESG Impact Data will also be used to meet Exclusionary Criteria defined in the Framework.

<sup>15</sup> Discussion of Kestrel ESG Impact Data and UN Sustainable Development Goals is included in Appendix A.

<sup>16</sup> Kestrel assesses the funding sources for repayment as "Generally Acceptable" or "Potential Flashpoint." Potential flashpoints identify red flags or possible friction points for certain investors and investment strategies.

## **Management of Proceeds**

A portion of the Program's proceeds may be used to fund a portion of RBC's Basel III Liquidity Coverage Ratio high-quality liquid asset pool. The Program requires clear tracking of the allocation of proceeds to confirmed Eligible Assets via dedicated operational booking points which are monitored by RBC's internal functional groups including, but not limited to, risk management, finance, and compliance.

RBC's information management systems will be equipped to track the Program proceeds and Eligible Assets. The composition of the Sustainable Commercial Paper portfolio ("SCP Portfolio") will change on an ongoing basis.

## **Reporting and Assurance**

Annual Impact Reporting on the SCP Program will provide quantitative and qualitative metrics on the characteristics of the SCP Portfolio. Quarterly allocation reporting will not include updates on individual underlying assets. The Working Group will make annual reports available on [rbc.com](http://rbc.com).

Portfolio-level impact metrics within Impact Reporting may include (i) financed areas by sector based on Kestrel ESG sector assignment, (ii) average ESG Impact Score and distribution, (iii) a list of UN Sustainable Development Goals and Targets supported by the Eligible Assets, and (iv) featured Eligible Assets with unique characteristics that align with RBC's sustainability commitments. Additionally, RBC may request limited third-party assurance on the allocation of RBC's SCP proceeds to Eligible Assets.

### Impact Accounting at Appropriate Scale

RBC does not intend to report traditional performance metrics associated with financed projects or activities with respect to the SCP Program because the quantitative impact of underlying Eligible Assets and their financed activities should be associated with the debt instrument which directly funds the Eligible Assets or the final capital market instrument, not the Sustainable Commercial Paper that provides liquidity. For example, reduced greenhouse gas emissions associated with a new 20-MW solar array should be linked to the instrument supporting the direct financing for the project rather than the Sustainable Commercial Paper under RBC's SCP Program. Instead of traditional project or issuer level performance metrics, RBC will report portfolio-level metrics related to financed areas by sector, average ESG Impact Scores and distribution, and UN SDGs supported.

### Avoidance of Double Counting

There is potential for investors to "double count" the impact associated with sustainable investments when considering short-term instruments because the cost of a physical asset, a solar array, for example, may be counted first as a short-term instrument and a second time as a long-term instrument. RBC's Sustainable Commercial Paper Program avoids double counting because the impact of the SCP is treated as distinct from the impact of the underlying Eligible Assets.

The purpose of Sustainable Commercial Paper is to provide a supply of short-term instruments with underlying sustainable activities, and the impact exists in the value of harnessing and leveraging cash flows that enable sustainable investments. In this way, the true value of RBC's Sustainable Commercial Paper Program is the transparency it adds to RBC's approach to sustainability. The Program enables RBC to prioritize sustainable underlying assets while excluding certain assets, and provides the cash flows necessary to facilitate RBC's ability to support organizations and projects that contribute to a sustainable future.

## **CONCLUSION**

Based on our independent external review, the RBC Sustainable Commercial Paper Program broadly conforms with the ICMA Sustainability Bond Guidelines (2021). The underlying Eligible Assets align with Green or Social Project Categories in the ICMA Green Bond Principles and the ICMA Social Bond Principles and therefore align with the ICMA Sustainability Bond Guidelines.

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## ABOUT KESTREL VERIFIERS



For over 20 years Kestrel has been a trusted consultant in sustainable finance. Kestrel Verifiers, a division of Kestrel 360, Inc. is a Climate Bonds Initiative Approved Verifier qualified to verify transactions in all asset classes worldwide. Kestrel is a US-based certified Women's Business Enterprise. For more information, visit [kestrelverifiers.com](https://kestrelverifiers.com).

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### Verification Team

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## DISCLAIMER

This External Review aims to explain how and why the discussed Program aligns with the ICMA Sustainability Bond Guidelines based on the information that was provided by RBC or made publicly available by RBC and relied upon by Kestrel only during the time of this engagement (July - November 2022), and only for purposes of providing this External Review.

We have relied on information obtained from sources believed to be reliable, and assumed the information to be accurate and complete. However, Kestrel Verifiers can make no warranty, express or implied, nor can we guarantee the accuracy, comprehensive nature, merchantability, or fitness for a particular purpose of the information we were provided or obtained.

By providing this External Review, Kestrel Verifiers is neither addressing nor certifying the credit risk, liquidity risk, market value risk or price volatility of the assets and instruments in the Program. It was beyond Kestrel Verifiers' scope of work to review for regulatory compliance, and no surveys or site visits were conducted by us. Furthermore, we are not responsible for surveillance, monitoring, or implementation of the Program, or use of proceeds of underlying assets.

The External Review delivered by Kestrel Verifiers is for informational purposes only, is current as of the evaluation date, and does not address financial performance of the Program or its associated instruments. This External Review does not make any assessment of the creditworthiness of any Sustainable Commercial Paper issued by RBC in this Program, nor its ability to pay principal and interest when due. This External Review does not address the suitability of Sustainable Commercial Paper as an investment, and contains no offer, solicitation, endorsement of the Program nor any recommendation to buy, sell or hold the associated instruments. Kestrel Verifiers accepts no liability for direct, indirect, special, punitive, consequential or any other damages (including lost profits), for any consequences when third parties use or have relied on this External Review either to make investment decisions or to undertake any other business transactions.

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## Appendix A.

### UN SUSTAINABLE DEVELOPMENT GOALS

#### **Kestrel ESG Impact Data and the United Nations Sustainable Development Goals**

RBC's Sustainable Commercial Paper Program addresses the UN SDGs by improving market visibility of activities with positive environmental and social impacts. The Program reports on alignment with the UN SDGs and Targets, which will support various ESG investment strategies such as thematic and impact investing.

Kestrel ESG's core approach to SDGs is to focus on the primary purpose of the underlying asset and to align the direct impacts of financed activities at the Target level. Kestrel ESG anticipates that the Program will advance multiple Goals, as well as specific Targets within those Goals. Additional information is available on the United Nations website: [un.org/sustainabledevelopment](https://un.org/sustainabledevelopment)