

# THE RISING GREEN AGENDA OF FIXED INCOME INVESTORS

AN EXAMINATION OF WHAT FIXED INCOME ESG INVESTORS LOOK FOR AND THEIR GROWING IMPORTANCE IN CAPITAL RAISING



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## INTRODUCTION

Over the past five years, there has been a tremendous increase in ESG awareness both from professional and retail investors. This has resulted in corporates having to adapt their strategies to tap into this new source of investment and more importantly to reduce risk and outperform peers. Initially, it was active equity ESG investors that dominated this space, but ESG investment has now also gained traction in the world of fixed income. Since 2015, ESG bond issuance has grown exponentially and in 2020 it reached a record high of \$745.8 billion, a 32% increase from the previous year. It is now expected that ESG debt sales will reach \$1 trillion in annual issuance in 2021 (Andrews, S.)

When it comes to ESG in the world of fixed income, green bonds come immediately to mind, but they are not the only way to gain exposure to ESG investments. In fact, transition bonds, sustainability-linked bonds, and more recently social bonds, have emerged as ESG alternatives. Indeed, COVID-19 has shown both corporates and investors how important it is to mitigate social risks, something that can be done through social bonds. ([Source](#)).

What is less known and less talked about however, is the level of ESG investment in non-ESG labelled bonds. In this paper, CMi2i examines the level of ESG investment in European non-ESG bonds to discover who the largest ESG investors are and what proportion of the total

outstanding they represent. We also examine the data for general trends. To do so, we first look at the drivers for ESG investors. Then we analyse the combined investor base of over 42 non-ESG European corporate bonds with an aggregate total outstanding of approximately EUR35.7 billion. (1)

## FIXED INCOME ESG INVESTOR OVERVIEW

When it comes to fixed income, ESG criteria are ultimately used to analyse and establish issuer creditworthiness. Unlike with equities where the main ESG focus is to capture upside potential, bond investors' main ESG focus is on mitigating downside risk. ESG issues such as carbon-intensive business models, labour disputes and fraud, are viewed as potentially systemic and event risks that can negatively impact the ability of an issuer to service its debt. For example, a corporate scandal linked to fraud will not only lead to bad press, but also to fines, consumer boycotts and regulatory scrutiny, which could result in credit rating downgrades and even in the issuer's default. The link between ESG performance and investment returns means that an increasing number of investors are applying these factors to their investment decision-making and asset allocation processes.

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Generally, ESG factors can affect bond performance in four different ways:

**Issuer risk:** This is company-specific risk.

**Sector/geographic risk:** These could stem from regulations and technological change.

**Multi-sector systemic risk:** Different sectors can be affected differently by the same risk/change.

**Indirect exposure:** Some ESG factors can affect investment returns indirectly. For example, resource scarcity can add inflationary pressure, affecting monetary policy and liquidity thus prompting investment losses. ([Source](#))

### FIXED INCOME ESG SCREENINGS

There are three common types of ESG screening generally used by fixed income investors:

**1) Negative/exclusionary screening:** Exclusion of certain sectors or companies based on specific ESG criteria.

**2) Positive/best-in-class screening:** Selection of the best sectors or companies based on positive ESG performance relative to peers.

**3) Norms-based screening:** Screening companies against minimum ESG standards ([Source](#)).

Overall, governance, especially due to its impact on debt restructurings, is generally the most prominent screen factor used by investors but different ESG lenses should be applied to different sectors. Some environmental issues such as water stress for example are only relevant to certain sectors such as food and beverage. ([Source](#))

Once the ESG screening has been conducted, the investment process remains the same for all type of issuers. ESG analysis, however, can help investors value a bond, identify improving credit stories and rank bonds with similar financial profiles. ([Source](#)) Indeed, the U.S. ESG-weighted bond index outperformed its non-ESG counterparts over the last five years, showing that integrating ESG factors can reduce downside risk or at least that incorporating ESG ratings, especially governance, help identify new risk factors. (Andrews, S. and [Source](#))

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## ESG IN THE EUROPEAN MARKET

Having established how ESG fixed income investors operate, it is now useful to look at the level of ESG investment in the European fixed income market, and more specifically at who the key players are. To do so, CMi2i has aggregated the bondholder base of over 42 non-ESG bonds for a total outstanding of approximately EUR35.7 billion. (2) Out of the total EUR35.7 billion, CMi2i was able to identify over EUR25 billion in the secondary market (72% of the total outstanding). ESG investors account for just under EUR2 billion – 8% of the total identified or 6% of the overall total across 242 funds (Graph 1). While 8% seems like a relatively small amount, compared to what CMi2i has seen across its equity clients, this amount is higher than initially expected, especially when considering that the sample does not include any green bonds or other ESG fixed income securities.

Looking at the geographic location of ESG investors provided some interesting results: around 37% of the identified ESG funds are UK based with a further 11% being French based (Table 1).

US investors on the other hand account for just under 11% or 0.9% of the total identified, below our initial expectations.

Graph 1. CMi2i Investor Universe - ESG & non ESG Investors (% Identified)

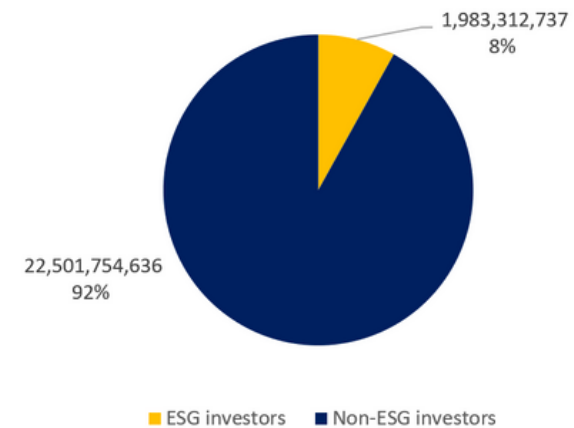


Table 1. ESG Investors by Country

ESG Investors by Country	Total Holdings in CMi2i Clients	% of ESG Investors	% Total Identified
United Kingdom	726,468,000	36.63%	2.97%
France	219,791,030	11.08%	0.90%
United States	214,014,015	10.79%	0.87%
Switzerland	202,080,000	10.19%	0.83%
Ireland	157,693,000	7.95%	0.64%
Italy	135,400,000	6.83%	0.55%
Germany	106,894,223	5.39%	0.44%
Norway	46,897,000	2.36%	0.19%
Belgium	28,400,000	1.43%	0.12%
Canada	18,158,000	0.92%	0.07%
Others	127,517,469	6.43%	0.52%

(2) The bonds have been issued through both international and local exchanges as well as DTC. They have also been issued in different currencies to ensure that the wider European market is represented appropriately.

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In terms of fund type, practically all the identified ESG funds were open-end funds, bar three exchange traded funds (ETFs). This is not surprising given how ESG fixed income ETFs are still gathering momentum and have not reached the same scale in terms of AUMs as their equity counterparts.

Looking just at the top 25 investors paints a similar picture – they are mostly European based open-ended funds that have invested around 1% of their AUMs across the sample. Indeed, there are five UK based investors, including Algebris’ Financial Credit Fund and PIMCO’s Capital Securities Fund, the largest ESG funds by investment size, with total investments of around EUR190 million each (Table 2).

Table 2. Top 25 Holders

Top 20 ESG Fund	Total Holdings in CMi2i Clients	Type	City	Country	AUM
Algebris UCITS Funds Plc - Financial Credit Fund	190,575,000	Open-End Fund	London	United Kingdom	7,546,424,363
PIMCO Fds. Glb. Invst. Series Plc - Capital Securities Fund	190,100,000	Open-End Fund	London	United Kingdom	7,538,270,506
Fonditalia - Financial Credit Bond	157,693,000	Open-End Fund	Dublin	Ireland	2,387,082,285
GAM Star Fund Plc - Credit Opportunities (EUR)	148,291,000	Open-End Fund	Geneva	Switzerland	2,336,696,526
iShares plc - EUR High Yield Corporate Bond UCITS ETF	146,900,000	Exchange Traded Fund	London	United Kingdom	921,290,627
Invesco Funds - Pan European High Income Fund	141,480,000	Open-End Fund	Henley-on	United Kingdom	7,915,138,639
Vanguard Intermediate Term Corporate Bond Index Fund	122,078,000	Open-End Fund	Malvern	United States	36,870,000,000
BNP Paribas Funds - Enhanced Bond 6M	70,700,000	Open-End Fund	Paris	France	2,763,142,936
Muzinich Funds - Enhanced Yield Short-Term Fund	55,600,000	Open-End Fund	London	United Kingdom	10,995,880,990
PIMCO Fds. Glb. Invst. Series Plc - Global Invest. Grade Credit	55,396,000	Open-End Fund	Newport	United States	19,145,260,470
Eurizon Fund - Bond High Yield	53,700,000	Open-End Fund	Milan	Italy	4,258,086,982
GAM Star Fund Plc - Credit Opportunities (USD)	51,189,000	Open-End Fund	Geneva	Switzerland	1,686,230,000
Uninstitutional Euro Reserve Plus	30,000,000	Open-End Fund	Frankfurt	Germany	4,919,087,674
Storebrand Global Kreditt IG	26,245,000	Open-End Fund	Lysaker	Norway	1,929,707,528
Arca Obbligazioni Europa	18,300,000	Open-End Fund	Milan	Italy	1,421,802,386
Universal Invest Global Flexible	18,000,000	Open-End Fund	Antwerp	Belgium	7,862,469,273
RBC Global Corporate Bond Fund	17,700,000	Open-End Fund	Toronto	Canada	N/A
Amundi 12 M	15,704,000	Open-End Fund	Paris	France	4,026,987,155
Euromobiliare Progetto 2022 Atto I	14,400,000	Open-End Fund	Milan	Italy	605,335,030
UniEuroRenta Corporates	12,768,000	Open-End Fund	Frankfurt	Germany	875,252,362
<b>Total</b>	<b>1,536,819,000</b>				<b>126,004,145,732</b>

Interestingly, the top 25 investors account for almost 80% of all the ESG sample. This is a higher concentration than CMi2i expected. However, their aggregated AUMs, which amount to EUR126 billion (almost half of the total ESG AUMs) partially explains this. Such high level of concentration can be explained by the fact that fixed income ESG is still in its native phase – as this universe grows, investor concentration is likely to decrease. Given this high concentration, corporates that wish to attract ESG investors should embark in a carefully planned targeting exercise.

## CONCLUSION

The ESG fixed income world might still be in its nascent phase but it is certainly growing at a rapid pace. This is not only driven by ESG activism alone but also by the demonstrated link between ESG screenings and increased portfolio performance, not just across ESG bonds, but the whole fixed income universe. As shown in this paper, fixed income ESG funds already represent a significant portion of European corporate bonds. However unlike the rest of the fixed income market, ESG AUMs are more homogeneously held amongst a concentrated group of investors. This means that it is especially important for any corporate wishing to tap into this new source of capital to carefully plan their investor outreach and carry out a detailed and planned targeting exercise.

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## ABOUT CMi2i

CMi2i provides unique capital markets intelligence and guidance to issuers and their advisors.

CMi2i is known for the world's most accurate share and debtholder identification service, supporting both corporates and their advisors with investor relations, M&A, shareholder activism, capital restructuring and proxy solicitation. Our team has provided intelligence and advice to over 500 of the largest, most structurally complex companies in the world, and supported numerous corporate transactions and general meetings. As a result, we offer clients a unique combination of skills, experience and methodologies within the following areas:

- Capital Market Intelligence & Investor Relations Support
- Corporate Governance & ESG Advisory
- Proxy Solicitation
- Capital Markets Advisory & Engagement

Contact [info@cmi2i.com](mailto:info@cmi2i.com) for more information on our services.



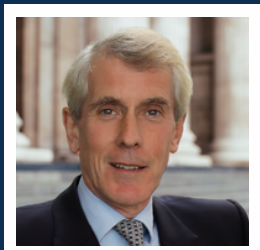
## CORE TEAM

The CMi2i core team have worked together for over a decade, performing bondholder and shareholder identification and mobilising holders to vote in support of proposed issuer items at AGMs. We have worked for more than 500 of the largest companies across the globe on hundreds of corporate transactions, proxy battles, activist defences, and general meetings.



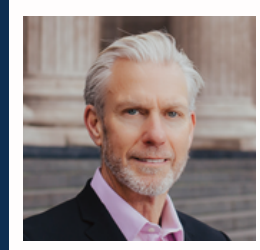
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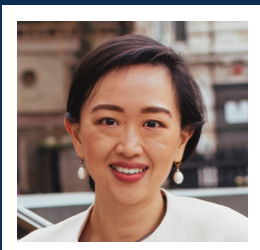
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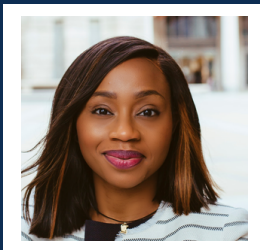
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