Investing for impact in fixed income

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Responsible investment has traditionally been the preserve of equity investors, but the relevance of ESG risks in fixed income markets – and the influence of fixed income investors over debt issuers – is now widely recognised.

Uniquely, fixed income investors have access to impact bonds, which explicitly use their proceeds for positive environmental or social themes. They are of growing interest to European investors as the EU green bond standard continues to be developed and the European Commission continues to consider how to support sustainable finance.

Impact bonds can provide exciting opportunities to pursue positive impact objectives, while also helping you achieve your financial goals. As with any fixed income investment, using impact bonds effectively requires sophisticated and thorough analysis – and the unique characteristics of the market mean specialist skills can help investors to make the most of the opportunities it provides.

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What is an impact bond?

Impact bonds use proceeds for positive environmental or social themes. Growth in the market has risen rapidly in recent years, but growth slowed in 2018, with US dollar issuance of all impact bonds over the year totalling $ 166.3bn – only slightly up from 2017's $ 166.1bn (see Figure 1). However, this upward trend seems to have stagnated.

In our view, there are several possible reasons for the slowdown in growth. General market weakness and cautious investor sentiment may have limited the issuance of impact bonds, as they did for conventional bonds. Uncertainty over the implications of the European Commission's green taxonomy (part of proposed regulation for creating a more sustainable financial market), which

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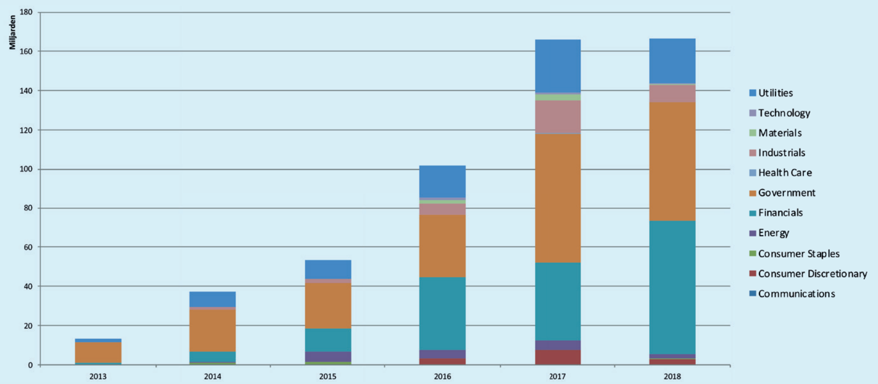
may have limited supply. And many companies with leading sustainability programmes have already issued impact bonds and are now putting the bond proceeds to work, so the pool of potential issuers has shrunk.

Are impact bond portfolios viable?

The impact bond market is sizeable – but for investors seeking to build a dedicated portfolio, it is smaller than it might at

Figure 1: Growth of the impact bond market slowed in 2018



Source: Bloomberg and Insight. As at 31 December 2018.

first appear. To be incorporated within broad fixed income benchmarks, a bond issue must be at least $ 300m (or the equivalent in other currencies) in size.

In 2018, 97 impact bonds of this size were issued, of which 89 were from issuers in the government or sovereign, financials or utilities sectors, accounting for $ 90bn of issuance. Most of these were green bonds. The relatively small amount of benchmark-size issues means that for fixed income investors, the opportunities to invest in dedicated impact strategies remain limited and are concentrated within only a few sectors.

Given the relatively small amount of impact bonds, investors seeking to construct a portfolio of impact bonds should benefit from clear parameters and skilled analysis to ensure they invest in suitable assets.

How Insight analyses impact bonds

To support our clients' expectations around impact bond investment, we have established a sustainable bond analysis framework. Along with our standard investment processes that incorporate financial metrics and ESG risk analysis, we analyse impact bonds and whether their stated targets meet our minimum requirements for sustainable issuance. Our framework gives impact bonds a green, amber or red score according to whether they meet our minimum sustainability standards.

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In 2018, we analysed 39 issuers of impact bonds: 16 received a green score, 22 received an amber score, and one received a red score. The results of our analysis proved to be surprising, given that less than half of the impact bonds issued in 2018 were found to meet our minimum sustainability requirements.

A growing opportunity

Impact bonds present fixed income investors with exciting opportunities to have a positive impact on society or the environment. We believe investors should treat them in the same way as any other fixed income instrument – analysing them according to their financial and non-financial risks, but also applying in-depth research to ensure the bonds have a robust approach to their sustainability objectives.

Despite strong growth, the investable market remains small relative to the traditional equity and bond markets. But as demand grows and frameworks are more firmly established, impact bond strategies may come to play an increasingly significant role in the wider markets. This means it will be all the more important for institutional investors, and their investment managers, to fully assess how well these instruments can help them achieve both their financial and non-financial objectives. «

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