July 2020

RESPONSIBLE INVESTMENT IN FIXED INCOME UPDATE: Q2 2020

HIGHLIGHTS

- Market turmoil in the wake of the COVID-19 pandemic led to a focus on how sustainable portfolios performed, with our analysis suggesting an additional focus on environmental, social and (ESG) governance issues could have helped performance for some investors
- In the US, the Department of Labor proposed restrictions on retirement plan investments, which may affect investments in sustainability-focused portfolios; this came as an influential committee called on the SEC to introduce an ESG disclosure framework
- In Europe, the European Commission published several draft delegated acts seeking input on how insurers and asset managers integrate sustainability into their investment, advisory and disclosure processes

REGULATORY AND INDUSTRY NEWS

- **Market turmoil resulting from COVID-19 sharpened the focus on how sustainable investment strategies performed**: Our research suggested that sustainability biases could have supported performance. Our paper exploring how European credit investors might have benefited over the period of volatility through March and April from having an additional focus on ESG issues is available here.
- **US Department of Labor proposes restrictions on ESG investments**: On 23 June, the Labor Department voiced an amendment to the Employee Retirement Income Security Act of 1974 (ERISA) that means economic interests must come before "non-pecuniary" goals when making 401(k) plans and pension decisions. By specifically naming ESG investing in this proposal, the proposals could undermine demand for such funds.[1]
- **Committee calls on SEC to address ESG disclosures**: After several years of contemplation, the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee has recommended that the SEC introduce an ESG disclosure framework. Among other points, the committee stated that investors need reliable ESG information on which to base investment and voting decisions, and that it would ensure flow of capital to US markets and issuers (rather than to other markets with more reliable ESG materials).[2]
- **European Commission consults on how insurers and asset managers integrate 'sustainability' into their operations**: The European Commission published six draft delegated acts for consultation, proposing material amends to the UCITS, AIFMD, MiFID, IDD and Solvency II frameworks. The pieces of legislation would require insurers and asset managers to integrate sustainability into their investment, advisory and disclosure processes. This is the latest of moves by the European Union to encourage investors to encourage sustainability.[3]

INSIGHT INVESTMENT DECISIONS REFLECTING ESG FACTORS IN Q2 2020

Sector	Asset class	ESG risk factor	Comments	Investment decision
Real estate	Investment grade (active)	Governance	Individual spearheading improvements in governance and transparency left the firm. Complex governance structure at the company so we saw this as negative.	SELL
Real estate	Investment grade (active)	Governance	We noticed a number of governance failings in Nordic property companies which started to look like a trend. We analysed our data and identified the issuer as a name which had a poor governance profile. Sold the hybrid issue as a result, which did not appear to be pricing risks adequately. Senior issues looked like better compensation for risk so held.	SELL
Automobiles	High yield	Governance	Poor financial planning and aggressive accounting in a high-growth environment. Failure to understand why it makes sense to have callable bonds by senior management.	SELL
Automobiles	High yield	Governance	Operational failures in markets resulted in significant cash deficits. Funded with debt, instead of equity or CB bond. No liquidity runway. No Brexit planning.	AVOID

This is an illustrative list of investment decisions affected primarily by ESG factors, selected to demonstrate the role of ESG analysis in our research and decision-making.

[1] https://www.bloomberg.com/news/articles/2020-06-25/trump-administration-targets-esg-funds-with-proposed-401-k-rule
[2] https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf [3] The period to provide feedback closed on 6 July 2020. Details of the draft acts, and feedback received, are available on the EC web site here.

IMPACT BOND ISSUANCE IN Q2 2020

Figure 1: Impact bond issuance by sector and year[4]

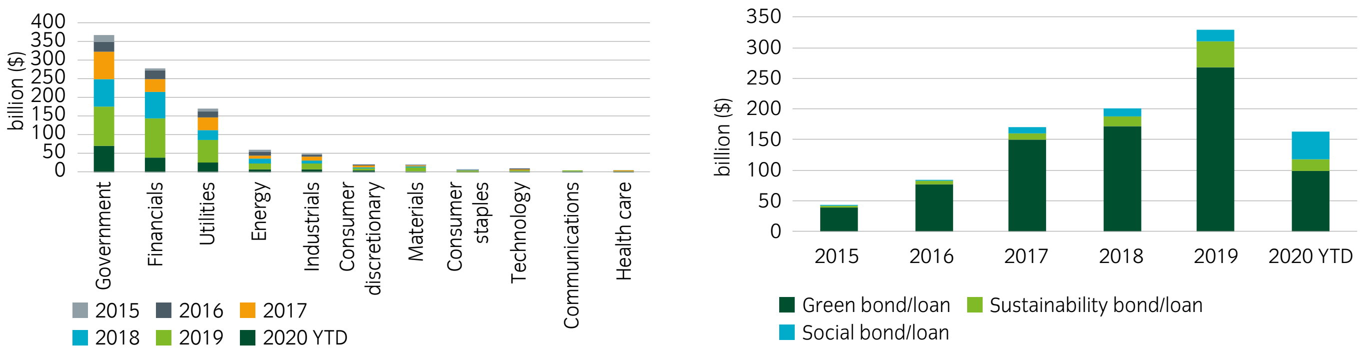


Figure 2: Largest impact bond issues in Q2 2020[5]

Issuer	Issuer type	Size of issue	Bond type
UNEDIC ASSEO	Government	€4.49bn	Social
UNEDIC ASSEO	Government	€4.36bn	Green
African Development Bank	Corporates	$3.10bn	Sustainable
Nederlandse Waterschapsbank NV	Government	€2.19bn	Green
Hungary Government International Bond	Government	€1.69bn	Sustainable

A NOTE ON RESPONSIBLE INVESTMENT AND IMPACT BONDS

Investing responsibly means taking ESG risks into account across all portfolios. Impact bonds may bear similar ESG risks to traditional bonds. Investing in them does not mean you are necessarily taking a more responsible approach, but they can be an effective way to have a positive environmental or social impact with your investments.

INSIGHT IMPACT BOND RATINGS IN Q2 2020

Our analysis of 28 impact bonds issued in Q2 2020 resulted in the following ratings:

14 bonds were rated **green**, indicating the bond meets Insight's minimum sustainability requirements

12 bonds were rated **amber**, indicating there are weaknesses in the bond with regard to sustainability

2 bonds were rated **red**, indicating the bond does not meet Insight's minimum sustainability requirements

Sample of Insight Investment's impact bond analysis in Q2 2020[6]

Name	Bond type	ESG performance met?	Bond framework criteria met?	Impact criteria met?	Traffic light score
Pearson Funding Plc	Social	Yes	Yes	Yes	

Analyst assessment: As an education bond , the bond has clear criteria for projects that could create a positive social impact and is aligned with the social bond principles. The issuer could have provided more information on exactly which category the proceeds would be used for and the extent of financing vs refinancing . However, this is an example of a best-in class issuer and there is a strong process for evaluating eligible projects, justifying the rationale for a green rating.

Name	Bond type	ESG performance met?	Bond framework criteria met?	Impact criteria met?	Traffic light score
Credit Suisse	Green	Yes	Yes	No	

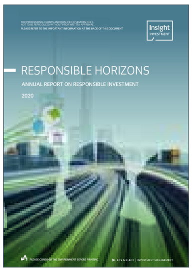
Analyst assessment: The framework notes that proceeds will mainly be used for refinancing projects, with a minimum 20% new financing to be allocated by the end of day of issue or within 12 months at the latest. A green financing committee is responsible for final selection of projects, with three steps for selection and evaluation (including financial due diligence, ESG and impact evaluation). There are limited details on how environmental risks are addressed.

Name	Bond type	ESG performance met?	Bond framework criteria met?	Impact criteria met?	Traffic light score
Bank of America Corporation	Social	Yes	No	No	

Analyst assessment: There is a lack of information on how much is going to financing vs refinancing . It seems the framework has been verified by the ICMA, but this is not completely clear. Some of the wording around impact is not very clear on how often they would provide reporting and some KPIs are noted but, again, it is not clear if/when they will provide reporting or include KPIs rather than case studies alone. Compared to other COVID-19 social bond issuances the framework itself lacks detail and the ambiguity of the impact reporting is not sufficient to measure the overall impact of the bond. On the positive side, how proceeds will be used are more specific compared to other issues, but alone this is not enough to justify a higher rating.

[4] Source: Insight. Data as at 30 June 2020. [5] Source: Bloomberg. Selected by Insight according to absolute value of local currency.
[6] The specific securities identified and described are subject to change, for information only to demonstrate our approach to ESG. No assumptions should be made that the securities identified were or will be profitable.

FURTHER READING



Responsible Horizons 2020 report

Our annual responsible investment report aims to highlight how we are investing responsibly on your behalf. We consider how best to approach responsible investment, provide evidence of the difference a responsible investment approach can make and analyse how the impact bond market can be used to achieve long-term positive outcomes for society or the environment.

Wirecard: three lessons for investors on ESG risks

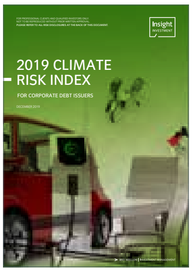
Wirecard, the German payments company, filed for insolvency on 25 June 2020. We believe there are three lessons that we can take away from this event when assessing ESG risks.

Beware impact washing as issuance tops US$1 trillion

Impact bond issuance now exceeds US$1 trillion, but lack of regulation means ‘impact washing’ is rife. We explain the growth of the market and how investors can identify suitable opportunities.

How did European sustainable bonds perform during the COVID-19 turmoil?

This paper explores how European credit investors might have benefited over the period of volatility through March and April from having an additional focus on environmental, social and governance (ESG) issues in their portfolios.



Climate Risk Index 2019 for corporate debt issuers

The Climate Risk Index provides an annual assessment of 1,846 corporate fixed income issuers and analyses how they are managing the risks and opportunities presented by climate change. In this paper we outline our methodology and results from our 2019 climate risk index.

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

ASSOCIATED INVESTMENT RISKS

Fixed income

Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.

A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.

The issuer of a debt security may not pay income or repay capital to the bondholder when due.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.

FIND OUT MORE

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