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ESG Corporate Bonds Panel --Thursday, April 22, 2021

Moderator: Ulf G. Erlandsson, Ph.D., CEO of Anthropocene Fixed Income Institute (AFII)
Panelists:

- Del Anderson, CFA, FSA, Senior Vice President, Credit Research Analyst, ESG / Financials, PIMCO
- Andrew Lin, CFA, Managing Director, Infrastructure, Power and Utilities, DBRS Morningstar
- Joshua Linder, CFA, Senior Credit Analyst, APG-USA
- Bonnie Wongtrakool, CFA, Global Head of ESG Investment and Portfolio Manager, Western Asset

Introductions

- Need a market-based approach to fixed income – the P&L should drive the outcomes.
- ESG is a risk mitigator.
- Bond holder-issuer engagement is key in the analysis of fixed income issuers.

How does ESG affect the cost of capital?

- ESG is a risk mitigator; investments must avoid the down-side, particularly event risk.
- Event risks are large short-term risks.
- Identifying mispriced assets takes analyst due diligence.
- Outcomes also depend on choices at the company in question.

How far was ESG already incorporated in fixed income methods?

- ESG concerns have been to some extent in the credit assessment criteria.
- There are more disclosure requirements now.

Regulatory concerns

- The pressure of regulation is generating new investment opportunities.
- The availability of these opportunities and adjustments depends on the pace of transition to green technologies.
- In some cases, particularly in energy, regulatory concerns can delay the transition to low carbon technologies, since the incentive is to buy the least expensive power.
- Changes in government have not impeded the progress towards decarbonization or progress in green technology.

Are fixed income instruments valuing ESG differently from equity?

- Equity markets can be affected more by sentiment.

- Fixed income markets affected more by transition plans. Their valuation is over smaller and well defined time periods. Equity is valued over a longer horizon and is affected by the terminal value.
- Bond premia have responded to the changes in risks; some issuers have dropped out of the markets.

Bond holder-issuer engagement

- Engagement is key to generating information to value bonds appropriately, particularly on governance issues.
- It also gives the opportunity to influence the issuer's choices.

Investment Constraints – Cases

- If there are subsidiaries with large carbon revenues, the holding company may still be investable if the overall concentration in carbon is low.
- If the company is making a transition, it may be investable.
- If the results of a financial stress test are favorable, the company may be investable.
- Bank portfolios need to be assessed overall, and not in individual cases. Also, their investments may be in subsidiaries with holdco-level ESG performance that is acceptable.

Measurement of the quality of Governance

- New governance data sets are available.
- However, there is a need to go beyond available data – analysts need to generate more information on the policies and performance of the issuers.

Greenwashing

- Banks need to incorporate ESG concerns to a greater extent.
- Banks need to be more transparent on ESG concerns in lending.
- Bank lending in energy is not very large – ranges from 1% to 4% of their portfolios.
- These concerns should be part of Banks' compliance process.