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ESG Fixed Income Indices Panel -- Friday, April 23, 2021:

Moderator: Henry Shilling, Director of Research, Sustainable Research and Analysis

Panelist:

- Philip Galdi, Head of Indices, ICE Data Indices, LLC
- Chris Hackel, Index Product Manager, Bloomberg LP
- Kumaran Ram, Executive Director, J.P. Morgan Global Index Research
- Elisabeth Seep, Executive Director, ESG Fixed Income Product Manager, MSCI

Introduction

- The number of indices with ESG criteria grew 40% in 2020.
- ESG indices help direct investment towards sustainable technologies.

ESG indices vs. Other Market Indices

- ESG indexes are helpful in negative screening.
- Since ESG weights differ from other indices, they influence the direction of investment.
- Their use does not only aim at higher risk-adjusted return, they aim to create social and environmental impacts.
- Similar to other indices, ESG indices must also be accessible, liquid, and replicable.
- Unlike other equity and fixed income indices, data for ESG indices is still relatively difficult to gather.
- Turnover and transaction costs are more important for fixed income indices compared to equity indices.
- Among corporate ESG indices, investment grade indices have better coverage than high yield.
- ESG Indices for munis, structured products and quasi-governments are yet to be developed.
- Mapping security data to issuers is particularly important for ESG, since the environmental impacts may be different in different parts of the corporate entity.
- Asset managers are interested in ESG indices that also help manage other fixed income risks.
- ESG scores generally take a long-term perspective.
- Unlike credit ratings, there is more dispersion in the ESG scores produced by different sources: they use different data, and measure ESG components in different ways.
- In contrast to credit ratings, blending ESG scores may not be appropriate.
- Users of ESG indices need to know their components; regulators are beginning to insist on transparency in index construction.
- Issuer transparency may itself be an indicator of risk; unrated high-yield issuers have performed poorly.
- There appears to be a convergence of ESG to traditional credit analysis; there is more demand for specialist analyses on the causes and prospects of ESG issues.

Green Bond Indices vs. Other ESG indices

- Green bonds were the original climate change offering; however, they are a small part of the fixed income universe.
- Social and sustainability bond issuance are not of sufficient scale yet for the creation of indices.
- Notable recent indices include the Paris-aligned MSCI index which is intended to help investors align to Net Zero goals.
- There are significant commitments from the EU and from many sovereign issuers to green bond issuance.
- The recent increase in green bond issuance appears to be related to European regulation. However, social bond issuance and issuance of sustainability linked bonds are also growing.
- There is more interest in variants of indices for different segments such as high yield and emerging markets.

Performance of ESG indices

- In the data of the last decade, there appears to be no “cost” to ESG investing. The performance of ESG investments is on par with non-ESG investments. However, longer time series are needed to confirm this result.
- Last year, ESG indices outperformed other indices by 40 bps on average, but during 2021 Q1, this result was reversed.
- The premia and coupons on different types of ESG fixed income instruments are different, in primary and secondary markets; they also evolve differently over time.
- Emerging markets represent a huge ESG opportunity, as they make their transition.
- There is no market ESG rating at this time, and a consensus on the right composition of such an index needs to emerge.

New Developments in ESG Indices

- There will be more emphasis on forward looking, momentum driven, and target based concerns. These will increasingly be based on dynamic rather than single period analyses.
- We expect new indices for munis, structured products, and quasi-government organizations.
- Regulatory concerns may drive the development of new indices.
- There will be an increased demand for ESG attribution analytics.
- ESG rebalancing will be important in portfolio allocations.
- Asset managers need to develop an ESG performance track record.
- Green bonds are currently the dominant instruments, but we expect sustainability linked bonds to be more important in the future.