ESG in the Investment Industry

• The Federal Reserve Bank of San Francisco hosted a climate conference and acknowledged that climate change is a risk that they must consider in order to fulfill their mission.
• Lael Brainard, a member of the Federal Reserve’s Board of Governors, reiterated that the central bank cannot ignore the potential impact of climate change on the financial system.
• “Congress has assigned the Federal Reserve specific responsibilities in monetary policy, financial stability, financial regulation and supervision, community and consumer affairs, and payments. Climate risks may touch each of these.”
• Entering the 2020 reporting cycle, PRI signatories will complete the now-mandatory Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD)-based questions, which will help investors better understand their exposure to climate risk.

Third Party Verification Increasing for Green Bonds

• Record issuance of green bonds continues, with over 500 green bonds issued globally in 2019.
• Global green bond sales total $253 billion year-to-date, up from $182 billion in 2018.
• Third-party verification of green bond proceeds has increased significantly as investors fear “greenwashing”.

ESG at IR+M

• As ESG becomes a mainstream topic in the industry, terminology becomes increasingly important. Terms are often used interchangeably but can mean different things to different audiences. At IR+M, we are deliberate in how we use and define each term.
• We view the landscape of responsible investing as a spectrum, ranging from negative screening, most often associated with Socially Responsible Investing (SRI), to targeting a specific goal, usually referred to as Thematic or Impact Investing.
• ESG falls in the middle – each factor is considered in the analysis but wholesale exclusions are not necessarily enacted unless explicitly directed by the investor.
• Recent articles have criticized ESG funds with exposure to “bad” ESG companies. Most often the author will move seamlessly between terms without a complete understanding of the objectives of the portfolio. For example, conflating positively tilted ESG thematic strategies (such as low-carbon) with values-based SRI screening.
• As we see with the many ESG rating providers, there are numerous ways to score a company on ESG criteria, making results difficult to compare; lack of specific rules leads to gray areas where fundamental context is required.

ESG Headline Events

• ESG factors influence headlines and impact credit performance; Bank of America found that S&P 500 companies lost over $500 billion of value in the last 5 years related to ESG events.
  - EasyJet, a British airline, recently pledged to offset all of its carbon emissions by investing in renewable energy and planting trees; although EasyJet’s near-term GHG emissions are predicted to rise, other airlines could be pressured to follow this carbon-offset approach.
  - Following a leak at a Chevron oil facility, the State of California halted new permits for steam-flooding production, and is examining hydraulic fracturing and other well stimulation methods. While Chevron is not heavily exposed to California legislation, California Resources Corp (CRC) is impacted – CRC shares and high-yield debt fell over 20% on the news.

ESG Ratings

• Rating agencies continue to focus on ESG data. Fitch recently launched ESG relevance scoring for structured finance which attempts to answer how ESG risks are represented in their credit ratings.
• ESG risk scoring shows the relevance and materiality of ESG factors within the credit rating, and not overall ESG performance.
• This approach is an integral part of Fitch’s credit rating analysis.
• Fitch focuses on underlying collateral when looking at “E” & “S” risks while looking at originators and managers when considering “G” risks.

Sources: Bloomberg, Bloomberg Barclays, FactSet, Financial Times, Federal Reserve Bank of San Francisco, Federal Reserve Board, Fitch Ratings, MSCI, and PRI as of 12/17/2019

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