NatWest Markets

ON POINT

INTELLIGENTLY DIFFERENT THINKING FROM NATWEST MARKETS

Issue Your Greens

"The green heart of UK debt investors"

Sustainability is becoming increasingly core to the operations of top tier UK debt investors. This is the key takeaway from meetings we have held over the past weeks with the investment community.

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Even the most conservative funds have started looking beyond financial metrics of success, acknowledging the importance of environmental, social and governance (ESG) factors as a "hygiene check" when scrutinising and selecting investments. Following the trajectory of continental European peers, "responsible investing has entered the mainstream" as one investor put it in our discussions.

Green positives…

The motivation behind this new approach is threefold: making a positive difference, better financial performances of ESG-oriented companies and risk mitigation are equally often cited by investors.

For many funds, focusing on ESG issues serves a moral or ethical purpose.

In a recent study, 86% of the so-called Millennials said they are interested in sustainable investing, tied to their belief that they can make a positive difference with their money. This generation has now taken over roles in the investment industry, equally convinced that an ESG investment focus will positively influence corporate behaviour and culture.

While the new thinking seems to imply that a 'financial results only' attitude is a thing of the past, the UK investors we talked to pointed out that their ESG focus also makes economic sense: companies with improving ESG credentials have on average outperformed by 14.4% in emerging markets and 5.2% in developed markets over five years, an MSCI report from November 2018 showed.

Finally, a large group of investors, in particular pension funds, consider ESG-focused investing a sensible strategy in order to mitigate risk. Incorporating a greater number of risk factors, such as environmental, social and governance issues, into investment decisions not only helps seeking out more sustainable long-term returns, but to also avoid making investments into companies, which might run into problems with regulators or other authorities due to their lack of ESG compliance.

…and green frustrations

However, concerns around “ESG miss-selling” and “green washing” of new issuances are still holding back some UK investors to fully embrace a ESG investment focus.
The most frequently asked questions we heard: “What should I scrutinise in new green bond offerings?”

Of particular concern is, that investors do not feel they can turn to ESG rating agencies for support in making the right decisions, pointing out that the top four agencies use very different methodologies, metrics, weighting, and even define ESG in different ways.

However, in this context, UK investors cite self-regulation initiatives such as the Green Bond Principles that specify how issuers identify and evaluate green projects, how they account for what is done with the proceeds, and how they report on the project allocations and their impact, as a key driver behind growing investors’ confidence into the market.

The practicalities of identifying the right ESG investment opportunities

The ESG focus has led to investors significantly extending their due diligence check list for new investment opportunities. While issuers are expected to deliver facts, figures and proofs in response to these ESG relevant questions, investors also welcome a broader company storyline and strategic narrative around sustainability. They appreciate the long-term nature of making company operations sustainable and hence value a strong vision, while at the same time acknowledging that such a change in corporate strategy requires time and that therefore short-term returns on investments cannot necessarily be expected.

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