

# Bonds, a green reputation helps

**An improving ESG report card supports growth in value, especially for higher risk issues which are therefore classified as less reliable by ratings agencies. And for more stable securities...**

by **Patrizia Puliafito**

What impact do sustainability criteria, ESG (environmental, social and governance) criteria have on bond performance?

It depends whether they are investment grade bonds, securities with a good reliability report card, or high yield bonds, issues that should pay higher returns because they are higher risk. This was revealed by Banor SIM and the Politecnico di Milano School of Management, which analysed the performance of 799 bonds issued between January 2014 and December 2018 and listed on European stock markets (234 with investment grade rating and 565 high yield). The securities with put, call or convertible options were removed from the sample, as well as those issued by banks, financial companies and real estate investment companies.

"We observed that when the issuer's risk of insolvency is low, such as in the case of investment grade bonds, the impact of the ESG metrics on return is not very significant", explains Angelo Meda, Head of ESG Research at **Banor** SIM. "In these cases, the issuers are stable and return is prevalently influenced by macro economic dynamics, interest rates and central bank policy.

ESG ratings, on the other hand, have a significant impact on high yield bonds, those classified as higher risk, where the issuer is less stable and has a greater risk of insolvency. In this case, the ESG rating makes a difference. An issuer that operates with respect for the environment and social issues, with good governance, is more reliable". The bonds issued by Netflix and FCA are an example of this. Both have a Standard & Poor's rating of BB, but a different ESG rating. Netflix has a good stock exchange performance but a low ESG rating, and its ten-year bond issued in 2017 was penalised. Since launch, it has underperformed the benchmark market.

On the other hand, the bond issued in 2014 by FCA, a more virtuous company with a good ESG rating, has satisfactory performance. Since launch, the security has recorded an increase of 6%.

## The mechanism

"It is worth underlining that sustainability is not a static concept, but dynamic", continues Meda. "In fact, what is sustainable today may not be so in the future. Therefore, before subscribing to a bond, it is important to evaluate the issuer's creditworthiness and its

ESG rating, not only in terms of absolute value, but we must also understand how committed the company is to improving its sustainability rating. It may be more worthwhile to buy the security of a company in a phase of improvement instead of a company that already has a high ESG rating, and it is good to choose funds built with a dynamic approach, where the manager regularly rotates the portfolio, looking at improvement and worsening of environmental, social and governance factors, which are important to safeguard the portfolio's performance and generate significant extra return", says Meda.

In particular, in the research by **Banor** SIM and PoliMi, by observing the improvement and worsening trends of ESG ratings, it emerged that, for investment grade bonds, there is a correlation with the social component, especially in managing safety and customer disputes. Meda concludes, "We hope that, once the pandemic is over, all operators will focus more on the social sphere, safety policies, the working environment and human rights".