

Conscious wealth portfolio

Impact investing in bonds

wire group



Home of Conscious Wealth

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Triodos Investment Management

About Wire Group

Wire Group works towards a Conscious Economy - a value(s) driven economy that has wellbeing for all of life as its foundation. We are a holistic wealth partner, and have been a specialist in impact investing and conscious wealth allocation since 2010. As a collective of individuals, families and strategic partners, we research and develop ways to manage wealth in a way that generates multiple returns: social, ecological, financial and personal. We have a full spectrum service offering: from facilitating conscious wealth journeys, including the aspects of personal growth and family dynamics, to developing impact strategies, and supporting our relations in deploying their wealth more consciously. In each partnership we have the ambition to realise tangible results that contribute to a better world.

We approach a business-like mentality from a personal angle and our leading principles are transparency, co-creation and mutual pleasure.

We would like to thank Triodos Investment Management for their input and their review of this paper. www.wire-group.org

About Triodos Investment Management

Triodos Investment Management brings investors who want to use their money to create permanent positive change together with innovative entrepreneurs and sustainable companies who are doing exactly that. By doing this we act as a catalyst in those sectors that play a crucial role in the transition to a fairer, more sustainable and more human world.

During the more than 30 years we have been active as impact investors, we have gained a huge amount of expertise about sectors such as Energy & Climate, Financial Services in emerging countries and Sustainable Food & Agriculture. We also invest in listed companies that actively contribute to our sustainable transition themes. As at the end of 2020 the assets under management at Triodos Investment Management totalled EUR 5.4 billion.

Triodos Investment Management is a globally active impact investor and a wholly owned subsidiary of Triodos Bank.

DISCLAIMER: The advice included in this document concerns the impact that may be achieved with the investment proposition described in this document. The advice included in this document does not qualify as investment advice in the sense of the Dutch Financial supervision act (Wet op het financieel toezicht) and should not be interpreted as such by the reader. If you wish to obtain advice about the suitability of a (potential) investment in a specific investment product given your investment objectives, risk appetite and financial position, please contact an investment adviser or asset manager. Wire Group can refer you to an adviser or asset manager.

We also note that the investment products that are discussed in this paper are only included for illustration purposes. These products have not been screened by Wire Group. Any discussion of a specific product in this paper must therefore not be regarded as a recommendation to invest in such a product.

Introduction

When constructing an investment portfolio, investors often allocate a relatively large part of their portfolio to various types of bonds, including government and corporate bonds. Depending on their chosen objective and preferences, that allocation can account for as much as half of the total portfolio, making this a very important asset class. Objectives and preferences are usually determined based on factors such as expected return and risk and a desire to spread the assets over several investment categories.

So if bonds are an important part of your investment portfolio, you may well ask yourself whether those investments are actually a good fit with your values? Do you feel comfortable with the investments that you see in your investment portfolio under the heading of bonds? Can you also achieve impact with this asset class? And if so, how do you go about that and what options are available to you? These questions, and of course the answers to these questions, will be discussed in this paper.

Wire Group wants to contribute to and be part of a 'responsible economy' in which social and financial values co-exist and complement each other. Opting for one type of value does not need to rule out the other. Indeed, more and more companies consider both values important and integrate both in their operations. The range of possibilities for incorporating both values in your investment portfolio is growing and for the bond part of your investment portfolio opportunities are expanding rapidly too. In this paper we will introduce you to the various bond categories and discuss the possibilities for investing with impact.

In our previous paper we described the choices that you can make with regard to impact investing in listed equities.¹ Before that, we published a paper in which we introduced you to green bonds and described how this particular bond category can be included in your investment portfolio.²

In this paper we will focus on the other types of bond investments. As we will show you, this is a very broad asset category that comprises many different investment opportunities. We will discuss how bond investors, like equity investors, can exert influence on the companies in which they have invested. This type of influencing is often referred to as engagement, a very important means of achieving impact. We will also show which choices are important if you want to invest with impact through bonds. Finally, we will use several different bond products to

demonstrate how the choices that you make can be translated into bond investments with impact.

By means of this paper, Wire Group aims to familiarise investors with the possibilities for investing in bonds with impact and help them make the necessary choices. Furthermore, we want this paper to raise awareness about impact investing, especially for the broad investment category that bonds constitute.

In order to facilitate the readability of our papers across the various asset categories, we have chosen to structure this paper in the same way as the earlier paper on listed equities.

We hope that you will enjoy reading this paper and that it broadens and deepens your insight into impact investing. We look forward to receiving your feedback and will be more than happy to answer any questions that you may have after reading this paper.

¹ See "Impact investeren in beursgenoteerde aandelen" – Martha van Dijk & Michiel Lenstra – Wire Group - October 2018 (downloadable via: <https://www.wire-group.org/wp-content/uploads/2020/06/200325-Wire-Group-paper-Impact-investeren-in-beursgenoteerde-aandelen-publicatieversie.pdf>)

² See "Thema focus: Green Bonds" – Martha van Dijk – Wire Group – May 2017 (downloadable via: <https://www.wire-group.org/wp-content/uploads/2020/06/200325-Wire-Group-Green-Bonds-Reader-publicatieversie.pdf>)

1

Scope



It is important that we start by defining the scope of the range of bonds that we will discuss in this paper. We focus on investment opportunities in bonds that are liquid, meaning that it must be possible to buy and sell the bond product within a reasonably short period and at limited costs.

As a rule of thumb, we will only discuss investment products that can be traded at least once a month (buying as well as selling) and for which the entry or exit costs do not exceed 0.5%.

This means that we will not cover crowdlending platforms (such as Lendahand or PlumSeeds) or private debt (the bond version of private equity). This does not mean that we do not consider these types of bond investments attractive; it is just that they do not fit within the scope that we have defined here. As you will see, this scope still provides for a very rich universe of investment opportunities.

We will also briefly discuss (investment funds focusing on) microcredit, even though formally microcredit loans are not really bonds. We do this because investing in microcredit is a form of impact investing in interest-bearing assets that has been available for some time now and is quite well known. There are several relatively liquid investment funds available for investors looking to build a position in microcredit.

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Why consider bonds?

There are various reasons for taking a closer look at bonds as an investment category. We will look at where bonds fit into the total investment portfolio, at bond investments as a means of exerting influence on companies and at the risk and return features of bonds.

Bonds as part of the total investment portfolio

In the introduction we already noted that bonds tend to have a prominent place in most investment portfolios, partly because this is a broad investment category that can take many different forms.

Of course, the objective for the portfolio and therefore its exact composition varies per investor. Bond investments are added to the portfolio for various reasons. One reason is that investors wish to spread risks over various asset categories. Because equity and bond returns - considered over a longer period of time - react differently to macro-economic developments, this will result in a more stable return pattern for the investment portfolio. On top of that, the risk profile of equity investments is of course higher than that of bond investments. Depending on their risk preferences, investors with a lower tolerance for large fluctuations in the returns of the investment portfolio will therefore tend to invest a larger proportion of their assets in bonds.

Furthermore, for organisations such as pension funds and insurance companies the requirements of supervisory authorities also partly determine the allocation to bonds in their investment portfolios. In diversified investment portfolios, both for professional, institutional and smaller investors, bonds often represent up to 40 or 50% of the total asset mix.³

As shown above, bonds are important constituents of investment portfolios. It is therefore important to also look at the impact that you can achieve with these bond investments. Investors increasingly aspire to align their entire investment portfolio with their values. In our paper on impact investing in

equities we discussed the Toniic T100 project and the approach used by the RS Group as examples of initiatives aiming for a total impact portfolio approach.⁴ From a 'Conscious Wealth' perspective, the essence is that as an investor you feel a connection with your assets, that you understand how your investments work - in a negative or positive sense - and that you make conscious choices with regard to the impact of your investments.

Worldwide, this approach is rapidly gaining in popularity. Research by BlackRock, one of the biggest asset managers in the world, shows that the market for investment products with a focus on impact is growing sharply. As the assets invested in such products have grown almost 50% between 2013 and 2017, BlackRock believes this market is rapidly maturing.⁵ Recent research by Morningstar shows that this trend has even accelerated, with strong inflows into and a higher number of new product launches of sustainable investment funds.⁶

³ This percentage is based on the asset mixes of several large Dutch pension funds and insurance companies and the asset allocations of a number of popular mix fund products offered by asset managers

⁴ See Wire Group: "Impact investeren in beursgenoteerde aandelen"- page 4

⁵ See BlackRock: Global Insights - "Sustainable investing: a 'why not' moment", 2018

⁶ See Morningstar Manager Research: "Global Sustainable Fund Flows: Q3 2020 in Review. ESG fund assets reach USD 1.2 trillion, boosted by product development", October 2020

Exerting influence on companies

Investors in (listed) equities can exert influence on companies. Companies have a positive and negative impact in areas such as the environment and social conditions, for instance through their emission of greenhouse gases during production and by providing employment. Shareholders are traditionally the obvious parties to exert influence on companies, as they can, for instance, vote at general meetings and put forward agenda items for such meetings. This allows them to directly influence the policy pursued by the company.

Another means of exerting influence is for shareholders to enter into a dialogue with the company's management about issues such as the company's environmental and social practices. This is referred to as 'engagement'.

Because bond holders do not have voting rights, you might think that engagement makes less sense for them. Why would a company's management bother to talk to them? And why would those bond investors want that?

As we are also witnessing for equity investors, a large and growing number of bond investors integrates environmental, social and governance factors in their investment process.⁷ As providers of debt capital to companies, they want to be able to properly assess the risks attached to their investment. By actively engaging with companies about the positive and negative impact that they have on these ESG factors, they gain a better insight into the risks that an investment in those companies entails. This is one of the main reasons why more and more bond investors are also actively engaging with corporate managements.

According to a report by the Principles for Responsible Investment (PRI), the leading organisation set up to promote responsible investments, more and more bond investors use this approach to exert influence on companies.⁸ For this report, PRI held a survey among its members about engagement based on bond portfolios. The results of the survey show that 66% of the respondents have engaged with the underlying bond issuers.

⁷ These factors are often collectively referred to as ESG. E stands for Environment, S for Social and G for Governance. Also see Wire Group – "Impact investeren in beursgenoteerde aandelen", 2018, page 9

⁸ See PRI: "ESG engagement for fixed income investors", 2018

Example of engagement by bond investors

Active engagement with companies is one of the cornerstones of the impact strategy for bond and equity investments at Triodos Investment Management (hereafter: Triodos IM). Through dialogue, Triodos IM aims to create awareness about sustainability and encourages companies to take action to achieve positive change. This engagement starts during the selection process and continues after companies have been selected. Companies are actively monitored and re-assessed every 12 months.

Triodos IM's analysts discussed Toyota's electrification and battery strategy with the company. Toyota is included in the portfolio of Triodos Euro Bond Impact Fund⁹ and has been approved for investment because of its leading efforts to reduce CO2 emissions by cars. The company is a market leader in electric vehicles (EV): one in two electric vehicles sold worldwide is a Toyota. An important discussion point was the company's handling of sustainability risks related to battery production. The company aims to have a battery-powered version of each of its standard vehicle models by 2025. The company has deliberately skipped the current generation of lithium-ion batteries and has chosen to focus exclusively on the next generation of 'solid state' batteries. These batteries offer a considerably better performance than lithium-ion batteries and their production requires far less rare earth metals and chemicals. These batteries will be introduced in 2020. Toyota is already working on developing the next generation of batteries, so-called metal-air batteries, which are due to be introduced by around

2030. Triodos IM monitors the progress of the company's sustainability efforts.

Another example of engagement concerns the Belgian internet and telephone provider Proximus. Triodos IM engaged with this company about its systems for parental supervision. The availability of such a free service is an important determining factor for the sustainability assessment of a company. Triodos IM believes that customers have a right to be able to protect under-age children from being exposed to material that is aimed at adults. Proximus currently offers such services for its TV platform but this service is not yet available free-of-charge for its internet browsers. The company confirmed that it is currently working on implementing a system for parental supervision as well as an app for monitoring screen time for its internet services.

Companies take engagement by bond holders very seriously. They issue bonds much more frequently than (additional) shares. By being transparent and actively engaging with bond holders about ESG-related issues, they safeguard their access to this important source of funding.

⁹ The position in Toyota may be subject to change. You will find a current overview of the portfolio of Triodos Euro Bond Impact Fund on <https://www.triodos.nl/binaries/content/assets/shared/fund-assets/tebif/portfolio-triodos-euro-bond-impact-fund.pdf>

Return and risk considerations

What we said earlier about exerting influence on companies already made clear that bond investors are interested in the ESG aspects of the companies that they invest in because of risk considerations. This is certainly clear on a company level, as the example of Volkswagen will show. When the emissions scandal emerged in 2015, the coupon rate that Volkswagen had to pay on the bond market shot up. Culpable behaviour, poor internal management and the risk of claims from car owners and governments immediately translated into a higher risk profile and consequently higher borrowing costs for the car manufacturer on the bond market.

The opposite can also occur. If companies can properly explain to investors what steps they are taking to address any ESG concerns or improve their sustainability scores, it is quite possible that they will be able to attract funding on more favourable terms and at lower (interest) costs than if they don't.¹⁰

PIMCO, one of the biggest bond investors in the world, indicates that it believes that the bond market is uniquely suited to both benefit from and provide finance for ESG-related corporate projects. PIMCO states that this "... has the potential to deliver attractive long-term returns while also having a positive impact ...".¹¹

Example of an ESG-linked loan

We increasingly see companies coming to the market to issue bonds that are linked to specific targets - environmental targets, for instance. If these bonds can be traded on the bond market, they are often referred to as ESG-linked bonds, sustainability-linked bonds or SDG-linked bonds.¹²

What makes this bond category special, is that the loan conditions, usually the coupon rate that must be paid, depend partly on one or more specific targets. If the company fails to reach (one or more) specific targets, it must pay investors a coupon step-up on top of the already agreed coupon.

In October 2019 Italian utility company Enel successfully issued the world's first ever 'general-purpose SDG linked bond'. What is special about this bond is that it is not linked to a specific project, as green bonds issued by companies usually are. Enel may use the proceeds from the bond issue as it sees fit, but there are conditions attached to the bond, as Enel has committed itself to targets that are linked to two specific SDGs:

1. by the end of 2021 the renewable installed capacity must represent at least 55% of the total installed capacity of Enel (SDG 7, affordable and clean energy)
2. by the end of 2030 Enel's greenhouse gas emissions must have been reduced to below a specific minimum level

If the company does not meet these conditions, the coupon rate that it must pay to investors will increase by 0.25% for each goal that it has failed to reach. A maximum penalty rate of 0.5% does not seem high as such. However, compared with the interest rate that is currently being paid (around 0% for the euro-denominated bond) this is a substantial step-up. This constitutes a solid incentive for Enel to reach the agreed goals.

A growing body of research shows that there is a strong correlation between ESG factors and investment risks for bondholders. The more a company incorporates ESG factors in its business practices, the lower the risk. The World Bank, in conjunction with the largest pension fund in Japan, GPIF, acknowledges this relationship based on a comparison of various studies. It is interesting to note that these studies also show that embedding ESG factors in the selection process for bond investments does not result in a lower expected return for these bond investments.¹³

BlackRock reaches a similar conclusion based on its own research. This research indicates that the investment portfolios of bond investors who give a significant weight to ESG factors during the selection process ('ESG-friendly portfolios') generate similar returns to portfolios that do not factor in ESG considerations.¹⁴ This conclusion was reconfirmed by a more recent study by this asset manager.¹⁵ If a bond investor combines the exclusion of certain companies with the selection of bonds of companies with relatively high ESG scores, the return and risk characteristics of that portfolio remain similar to those of a portfolio without exclusions or a focus on ESG.

Given the outcome of these studies, it is sensible for bond investors to take the impact of the companies in which they invest into account.

¹⁰ On page 5 of the paper on equity investing we mentioned bonds issued by Danone and Olam as examples of bonds for which the coupon will be reduced if the issuing company manages to obtain a higher sustainability score during the term of the bond

¹¹ See "ESG Investing and Fixed Income: The Next New Normal?", PIMCO – June 2018 Viewpoint

¹² For a more detailed description and explanation, please see for instance <https://www.hermes-investment.com/nl/insight/fixed-income/enel-steps-up-worlds-first-sdg-bond/>

¹³ See The World Bank Group (Inderst & Stewart): "Incorporating environmental, social and governance (ESG) factors into fixed income investment", 2018

¹⁴ See BlackRock: Global Insights – "Sustainable investing: a 'why not' moment", 2018

¹⁵ See BlackRock Investment Institute: "Sustainability: the bond that endures", 2019



3

Bonds: a very diverse asset class

Unlike in the case of (listed) equities, we must first look at the various types of bonds that are available to investors. Listed equities basically all fall in the same category, but bonds can be divided into several subcategories. For easy reference, we will distinguish the following three categories in this paper:

1. Government bonds (and government-related bonds)

These are bonds that have been issued by national, regional or local governments or for which coupon payments and repayments are guaranteed by such governments. This also includes bonds issued by supranational organisations, such as the European Investment Bank (EIB).

Generally, these bonds are considered to be less risky, particularly if they have been issued by governments of developed countries. Within this subcategory bonds issued by developing countries (so-called emerging market debt), are considered riskier, especially if they have been issued in a different currency than the currency of the issuer.

2. Corporate bonds

As the name suggests, these are bonds that have been issued by companies. Within this category a distinction is often made based on the credit rating of the issuer. The credit rating indicates the likelihood of the company not being able to meet its interest or repayment obligations. A company with a higher credit rating generally pays a lower coupon and will find it easier to borrow money by issuing bonds.

3. Bonds for funding specific (impact) objectives (impact bonds)

This category includes all bonds that are issued in order to fund the realisation of a specific (impact) goal. This includes, for instance, the green bonds described in one of our earlier papers. The proceeds from these green bonds are used specifically to fund activities that are aimed at creating positive environmental impact. The issuer also reports separately on these green activities.

Another, relatively new, type of bond in this category is the SDG bond. These are bonds that are used to

fund projects that are linked directly to one of 17 Sustainable Development Goals (SDGs) that have been defined by the United Nations. These SDGs were defined in order to end poverty, protect the planet and help ensure peace and security.¹⁶ The United Nations estimates that reaching these goals will cost between USD 3 trillion and USD 5 trillion per year. This requires funding from governments, but also from the private sector. The SDG bonds may cover part of this funding requirement. Mr. Guterres, the United Nations Secretary-General, reiterated in November 2020 that these bonds are important in reaching these goals since “If we fail to meet these goals, the disruption to economies, societies and people caused by COVID-19 will pale in comparison to what the climate crisis holds in store”.¹⁷

We should also take a brief look at so-called social impact bonds here. Especially in the United States, these bonds are frequently used to fund specific - often local - initiatives with a social objective. In the Netherlands we have seen a few social impact bond issues, but they are still quite rare here. Social impact bonds are of course clear examples of impact bonds, where the coupon and repayment are directly linked to the realisation of impact. However, because of their structure and limited tradability, they fall outside the scope of this paper as defined earlier.¹⁸

¹⁶ See: <https://www.undp.org/content/undp/en/home/sustainable-development-goals.html>

¹⁷ See: <https://news.un.org/en/story/2020/11/1077542>

¹⁸ For a good overview of social impact bonds in the Netherlands we refer to: “Social Finance NL. 5 Jaar Social Impact Bonds in Nederland”, under “publicaties” on www.socfin.nl

In addition to social impact bonds, social bonds are also issued. In the Netherlands, Nederlandse Waterschapsbank NV (NWB Bank, the Dutch bank for the public water sector) is a leading issuer of social bonds. In December 2020 the bank issued its first USD denominated SDG Housing Bond. Since it started issuing social bonds NWB Bank has issued EUR 16 billion in Affordable Housing Bonds and SDG Housing Bonds. These bonds make it possible for NWB to provide funding to the Dutch housing corporations on attractive terms for further expansion and sustainability enhancement of their housing stock.¹⁹

Other fixed-income investments with a specific purpose: microcredit

In addition to the different bond categories discussed above, we should also take a brief look at microcredit within the context of impact investing and investing in interest-bearing products. Based on its underlying objective (providing loans to small companies and individuals, often in emerging economies, that do not have access to the established financial institutions, such as banks), this type of credit could fall under the latter two bond categories that we described, were it not for the fact that this does not constitute an investment in a specific bond.

We should note that the term microfinance is more and more often being used instead of microcredit, because increasingly this type of lending involves offering a broad range of financial services and products to individuals and businesses that generally do not have access to such product and services via the 'regular' channels, such as banks, which often do not have branches in remote areas. In addition to loans, this can also include providing savings products, insurance policies, banking services and property loans.

We briefly mention this form of credit here because there are attractive opportunities for investing in this category via specialised investment funds. These funds make it possible for investors to establish a properly diversified investment in this type of credit.

One of the investment funds that provides funding for specific impact goals through unlisted loans (private debt) is Triodos Microfinance Fund. This fund provides loans and equity to microfinance institutions and thus contributes to building a robust, transparent and inclusive financial sector in emerging countries.²⁰

A study by Ortec Finance commissioned by Triodos Investment Management, shows that adding a fund such as Triodos Microfinance Fund has a favourable impact on the risk/return profile of a diversified investment portfolio.²¹ This is due to the fact that this fund generally has a relatively low correlation with the most common risk-determining factors.

¹⁹ See <https://nwbbank.com> for detailed information and publications about NWBs Affordable Housing and SDG Housing Bond programme

²⁰ For further information about Triodos Microfinance Fund, see: <https://www.triodos-im.com/funds/triodos-microfinance-fund>

²¹ You will find this study on <https://www.triodos-im.com/what-the-heart-already-knew/whitepaper>

4

What assessments should impact investors in bonds make?

Just like impact investors in listed equities, impact investors in bonds must also make several choices and assessments. We will discuss these choices below and present them as an overview of the questions that you could ask yourself when investing with impact in bonds. As we will demonstrate, some of the choices and assessments are interrelated.

Which bond category do I want to invest in?

Following on directly from what we just mentioned, opting for impact investing in bonds also means that you must first decide which bond category you want to invest in. As we will explain below in answer to the question about impact classes, each category offers different ways of realising impact.

The degree of impact that you can achieve by investing in government bonds is different from what can be achieved with corporate bonds. Because often the same underlying companies are involved, the impact considerations for corporate bonds are similar to those for (listed) equity investments. As the name suggests, for impact bonds the relationship is even more direct, as these bonds tend to be issued for a particular (impact) purpose.

Differences between the various categories are reflected, among other things, in differences in terms of expected return, the underlying risks and the tradability. Furthermore, within the various categories, many options are available in terms of, for instance, maturities and the currencies in which bonds are denominated. If an investor chooses to also include bonds that have not been issued in euros, the number of possibilities increases even further, especially in the impact bonds category.

Do-it-yourself or rely on an asset manager?

Like investors in listed equities, investors who want to achieve impact by investing in bonds can choose to build and manage their own portfolio. Given the diversity of this category, as we briefly noted above, that will involve making quite a number of investment decisions.

Alternatively, similar to when you invest in equities, you can choose to not invest in individual bonds but make a selection from the range of investment funds that focus on bonds. Increasingly, this offering also includes funds from providers who integrate ESG factors in their investment process or providers who actively engage with the issuer about their impact. Finally, you can outsource the selection of your investments to an asset manager and leave them to make all the decisions regarding impact investing in bonds on your behalf. Subject to a certain minimum initial investment, these asset managers can build and manage a bond portfolio for you, specifically geared to your requirements.

Earlier in this paper, we have noted that the range of investment products for impact investing in bonds is growing rapidly. We have recently seen the introduction of a large number of new products. Of course, there are differences in approach, in terms of the bond category that the provider focuses on as well as the degree of integration of ESG factors in the investment process and/or the realisation of positive impact and avoidance of negative impact.

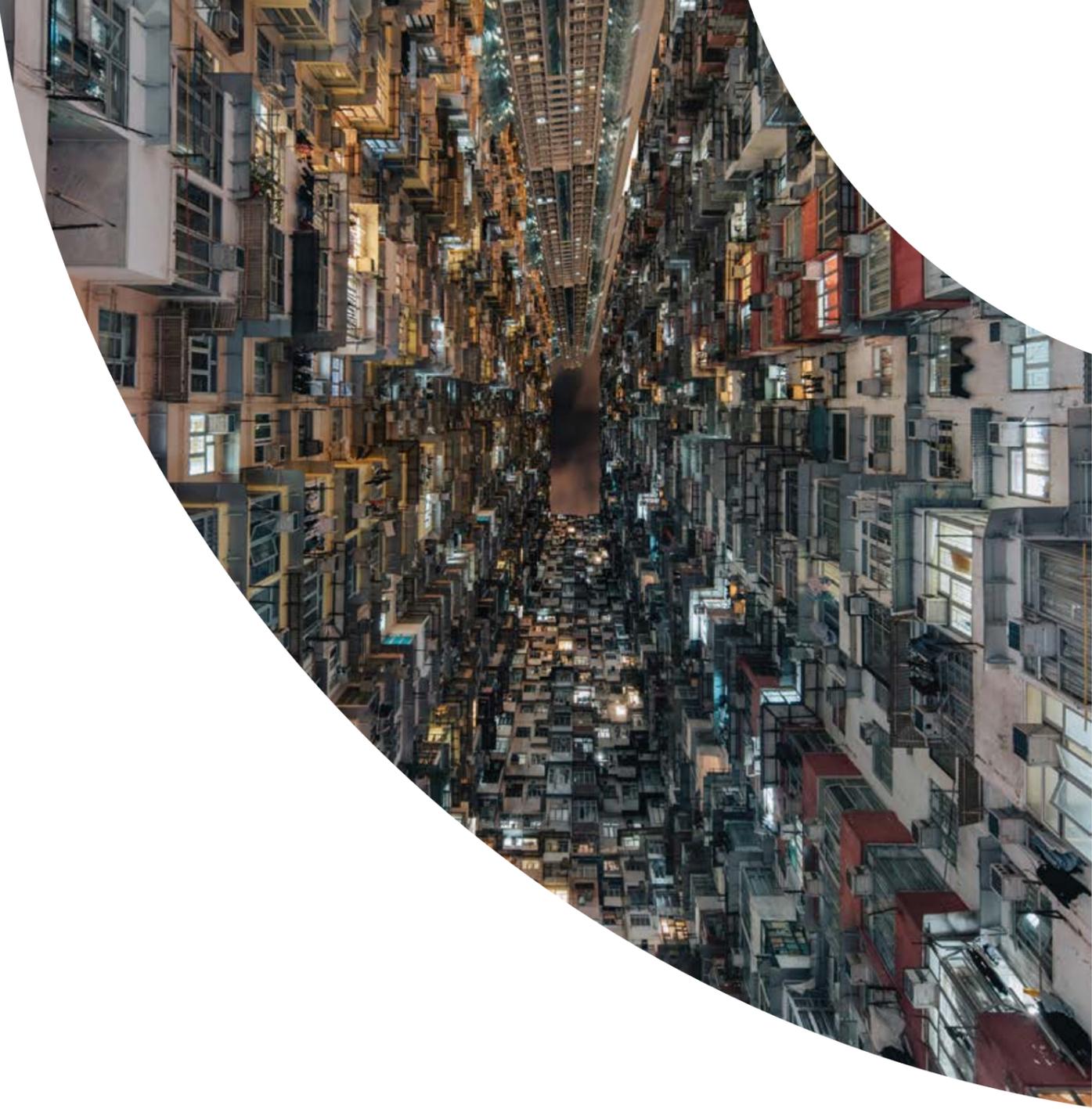
Further on in this paper we will take a closer look at a number of these products and identify the differences.

Which impact class should I choose?

For the sake of clarity, we divide the impact spectrum in which the investor can navigate into two parts: the impact class 'ESG focus' and the impact class 'investing in solutions'.²² In both cases impact is achieved, but the degree of impact will differ, as we will explain below for each bond category.

²² For the sake of the readability and the comparability of our papers, we have deliberately chosen to apply the same classification into impact classes as in our previously published paper on equity investing





ESG Focus

When you invest in this impact class, you assess the activities and/or the behaviour of the bond issuer and determine whether these aspects are aligned with your values or international standards. This may mean using an exclusion list: a list of countries, sectors and/or companies that you do not want to invest in. This is an example of negative screening, also called exclusion.

Investors in government or government-related bonds often use the EU sanctions list, for instance, or the sanctions list of the UN safety Council to ensure compliance with international standards. This is a logical approach that is often also motivated by the fact that international sanctions have been imposed on a certain country that legally prohibit investments in (bonds of) that country.

If you apply your own standards, you will probably want to go a lot further than just checking the international sanctions lists. Some investors assess the developments in a country, for instance with regard to human rights, the prevention of corruption or how the country deals with protecting the environment. The outcome of this assessment will be that countries that get a low score based on these criteria, are also excluded from investment. Below we give an example of how values may impact the investment policy of an investor in government bonds.

Values determine the investment policy: Hawksmoor Investment Management

Hawksmoor Investment Management, a UK asset manager, aims to consistently apply the principles of its ESG policy for the ESG investment funds that it manages. For Hawksmoor, consistently applying the policy pursued applies to companies as well as to countries.²³

Head of investments Jim Wood-Smith concludes that based on Hawksmoor's ESG policy, US treasury bonds must be excluded from investment. This is due to human rights as well as climate change-related concerns. By keeping open Guantanamo Bay, the United States are in violation of the Geneva Convention and the asset manager cannot reconcile this with the principles of its ESG policy on human rights. As for climate change, the withdrawal of the United States from the Paris COP21 agreements can also not be reconciled with Hawksmoor's ESG policy.²⁴

The asset manager has therefore decided to exclude the largest and most liquid government bond market in the world from the investment universe for its ESG funds.

Of course, another approach would be to identify those countries that align best with your values and thus turn the process around; this is often referred to as positive screening. In this case you actively choose to invest in bonds issued by countries that put the most effort into improving the global human rights situation or that are leaders regarding measures aimed at reducing CO2 emissions.

²³ This example is based on an article in Portfolio Advisor by John Lappin, "ESG funds ditch UK and US government debt", 6 September 2018 (see: <https://portfolio-adviser.com/esg-funds-ditch-uk-and-us-government-debt/>)

²⁴ Please note that this example dates back to 2018. Since the inauguration of Joe Biden as the new president of the United States in January 2021, he moved to reinstate the United States to the Paris climate agreement.



ESG factors and the selection of government bonds

Traditionally, macro-economic factors have largely determined the (relative) attractiveness of countries within the government bond category. This includes factors such as the state of a country's public finances, the inflation outlook for a country and its track record in meeting its debt obligations. Furthermore, investors are increasingly focusing on and researching the impact of ESG factors in order to determine the attractiveness of a country's government debt as an investment.²⁵

In order to get an idea of the state of play in a country based on these factors, you could for instance look at the relevant data collected by the World Bank.²⁶ Many of these factors tend to be quite stable: it takes years to implement a new school system or to change the energy mix for power production. That is why investors, using big data, also consider news articles and count the frequency of reports linked to these ESG factors. This helps to get an idea of the short(er)-term development of these ESG factors, alongside the more stationary picture that emerges from the World Bank's dataset.

Using these two datasets, researchers at BlackRock were able to demonstrate that ESG performance explains up to 25% of the interest rate differential between government bonds with similar maturities from emerging countries (emerging market debt). And more than that, ESG factors that were thus compiled proved to have more explanatory power with regard to these interest rate differentials than the differences in credit ratings assigned by rating agencies such as S&P and Moody's.

This highlights that applying ESG criteria can make a valuable contribution to the construction of government bond portfolios.

²⁵ This case study is based on research presented by BlackRock Investment Institute: "Sustainability: the bond that endures", 2019

²⁶ See for instance: NNIP & ECCE: "The materiality of ESG factors for equity investment decisions: academic evidence", April 2016

You can take a similar approach to investments in corporate bonds. Investors who are new to incorporating the impact dimension in their investment portfolios, often exclude certain sectors or companies. Examples are bonds issued by weapons or tobacco manufacturers. Here too you can take things a step further and seek closer alignment with your values by using positive screening to invest in bonds issued by companies that consider the impact that they have on social, environmental and government issues. For instance, you could look at whether the company that you invest in has good labour rights practices (also abroad), whether it has a policy for reducing its water and energy use and whether its management reporting is in order. The companies that you consider the strongest performers in these areas are then eligible for inclusion in the portfolio.

Alternatively, you could integrate social, environmental and governance factors in your investment process by determining which companies are making the biggest strides in these areas. This means not focusing on the companies that have already made the most progress or get the highest scores but investing in companies that are currently making the most progress. This is called ESG momentum and is also used by some asset managers during the selection process. Research shows that applying ESG momentum can be a successful investment strategy for listed equity portfolios.²⁷ Although this requires further research, it seems likely that this will also apply to corporate bond investments. Index compiler MSCI also uses the concept of ESG momentum for its ESG index series. We will take a closer look at this when we discuss the opportunities presented by passive ESG products.

When using negative or positive screening, every investor makes his own decisions, based on the

values that he or she considers important. In order to arrive at exclusions or, conversely, a list of countries, sectors and companies that you do want to invest in, you need to research the ESG factors that you believe are important.

Screening companies on ESG factors is a time-consuming process, which is why fund managers and asset managers use specialised research institutions. The bigger ones, including Sustainalytics, MSCI, Vigeo Eiris and ISS ESG, often feature in publications on ESG factors. In addition, there are all sorts of new initiatives that tend to focus exclusively on ESG research. Examples include Arabesque, Util and Screen17. Judging by the recent spate of acquisitions and takeovers of these types of specialised agencies, this market is evolving rapidly. Established players are taking over these agencies in order to benefit from the expertise that they have built up in researching ESG factors.²⁸

If you choose to have your investments managed by an asset manager instead of selecting your investments yourself, it is important to determine which impact criteria and ESG factors that asset manager uses. Do these criteria match what you find important? And also: to what extent are ESG factors embedded in the asset manager's selection process and are they decisive factors for the investments that will eventually end up in your investment portfolio?

²⁷ See for instance: NNIP & ECCE: "The materiality of ESG factors for equity investment decisions: academic evidence", April 2016

²⁸ In 2020, for example, Morningstar bought Sustainalytics and Deutsche Börse acquired a majority stake in Institutional Shareholder Services (ISS)

Investing in solutions

As the name indicates, this impact class is not about exclusions or focusing on bond investments with a (relatively) high ESG score or high ESG momentum. When you invest in this impact class you focus on investments that contribute (directly) to resolving issues such as social or environmental concerns. Impact bonds are a perfect fit, because this bond category actually comprises bonds that are issued to fund a specific (impact) goal.

More and more governments - especially regional governments and supranational organisations but increasingly also national governments - issue impact bonds. This is still a small but rapidly expanding segment of the bond market.

A good example of a (regional) government that issues impact bonds is the French region of Ile de France. With a population of over 12 million, this is the most densely populated region of France. 23% of the French working population lives here and the average age of the population is relatively low: 55% is under the age of 40. As one of the wealthiest regions in France as well as Europe, Ile de France has a highly educated workforce, one of Europe's most developed transport networks (200 km of metro lines, 1820 km of railway lines, 100 kilometres of tram lines), the largest airport of continental Europe and a world-famous cultural and tourist destination - the city of Paris. Ile de France has been a frequent issuer of impact bonds since 2012. The proceeds from these bonds, which are included in the portfolio of Triodos Euro Bond Impact Fund²⁹, are used for several sustainable purposes, such as funding buildings and equipment for education and recreation, funding

public transport and sustainable mobility, promoting renewable energy and energy efficiency, funding social projects in order to help vulnerable segments of the population and improving biodiversity.

Examples of projects that have been funded with the proceeds from impact bonds include:

- The construction of the Emily Brontë secondary school in Lognes, which will have 1,015 pupil places. The school will use renewable energy and will be constructed with minimal disruption to the environment.
- Extension of the number 11 Paris metro line to Rosny-Bois-Perrier. It is estimated that 7% of car users will switch to the number 11 metro line, which implies 1.33 million fewer private car journeys per year. This will save 3,255 CO2 teq in emissions per year.
- The construction of 117 new environmentally certified houses for low-income families in Neuilly-sur-Marne. This project generated 153 full-time jobs.

Earlier in this paper we mentioned the green bonds that are issued for funding specific projects aimed at creating positive environmental impact. The emerging category of SDG bonds, aimed at funding projects related to one of the 17 SDGs, is of course a compelling example.

Finally, we refer to our earlier paragraph on microcredit, which is another means of investing in solutions.³⁰

²⁹ Please note: Holdings of this fund may be subject to change. You will find a current overview of the portfolio of Triodos Euro Bond Impact Fund on <https://www.triodos.nl/binaries/content/assets/shared/fund-assets/tebif/portfolio-triodos-euro-bond-impact-fund.pdf>

³⁰ See the section "Other fixed-income investments with a specific purpose: microcredit".pdf

How does investing in solutions work in practice at Triodos IM?

The impact equities and bond funds managed by Triodos IM invest in listed equities and bonds. They invest exclusively in companies and organisations that actively contribute to the transition to a sustainable society and that develop solutions for the main sustainability challenges. This means that they go beyond conventional exclusion based on environmental, social and governance (ESG) standards.

Companies are selected based on seven themes that will be instrumental in the transition to a sustainable economy. These transition themes have been derived from global megatrends that they believe will define the future:

1. Renewable resources
2. Circular economy
3. Sustainable food and agriculture
4. Sustainable mobility and infrastructure
5. Social inclusion and empowerment
6. Prosperous and healthy people
7. Innovation for sustainability

Every investment in Triodos IM's portfolios must materially contribute to at least one transition theme through its products, services, and/or business operating models. Triodos IM calls this positive screening. In addition, investee companies must meet the asset manager's industry-leading process, product and precautionary minimum standards. These minimum standards have been defined in order to ensure that companies will not hinder or endanger the transition to a sustainable society in other areas.

Do I want to be an active or a passive investor?

As is the case for equities, the number of passive investment opportunities for bond investors is growing. Passive investors track a selected index, which means that the composition of their bond portfolio will be almost identical to that of the index. The bond portfolio of an active investor, on the other hand, will not mirror the index as closely as possible. The investor or the asset manager that has been hired will make 'active' choices, with active meaning diverging from the index. For this reason, active investing is generally (significantly) more expensive than passive investing.

Active versus passive considered from a return perspective

Partly because active investing is generally much more expensive than passive investing, the performance of active funds is often not much better than that of passive funds.

A study by Vanguard of active bond funds confirms this: only a very small proportion of the total universe of bond funds manages to consistently outperform the index.³¹

Lower management fees and fluctuating performances of actively managed investment products are the main reasons for the growth of passively managed products such as index funds and ETFs. Data from Morningstar³² show that worldwide 40% of the total assets invested in equities, i.e. USD 7,5000 billion, is invested in passive products. For bond products this is 21% (USD 1,600 billion). Especially in the US, passive funds have gained a relatively large share of the investment fund market. In 2018 their market share reached 40% of all equity and bond investments, versus a market share of 27% five years earlier. The volatility in financial markets in the first half of 2020 has only added to the trend of increasing market share for passive products.³³

Active versus passive considered from an impact perspective

It is important to note here that when investing passively, investors still need to make one choice: the index that they wish to follow. As we will see later on, during our discussion of the actual investment opportunities, bond investors can choose from a range of indices, including indices that are composed based on an initial ESG screening.

This means that in order to make the right choice, you will still have to assess to what extent the choices that the initiator of the relevant index has made are

aligned with your values. Do the choices that are made when composing the relevant index fit with what you want to achieve in terms of impact by investing in bonds? And furthermore, what policy does the provider of the index product have with regard to actively engaging with the issuers of bonds that are included in the index (engagement strategy)?

From an impact perspective, active bond portfolio managers who integrate ESG criteria in their investment process in a way that matches your values or who focus on investing in solutions, will generally realise more impact than managers of passive products. Because they may diverge from (sustainable) bond indices, fund managers can choose to give a greater weight to bonds issuers that are expected to create the most positive impact.

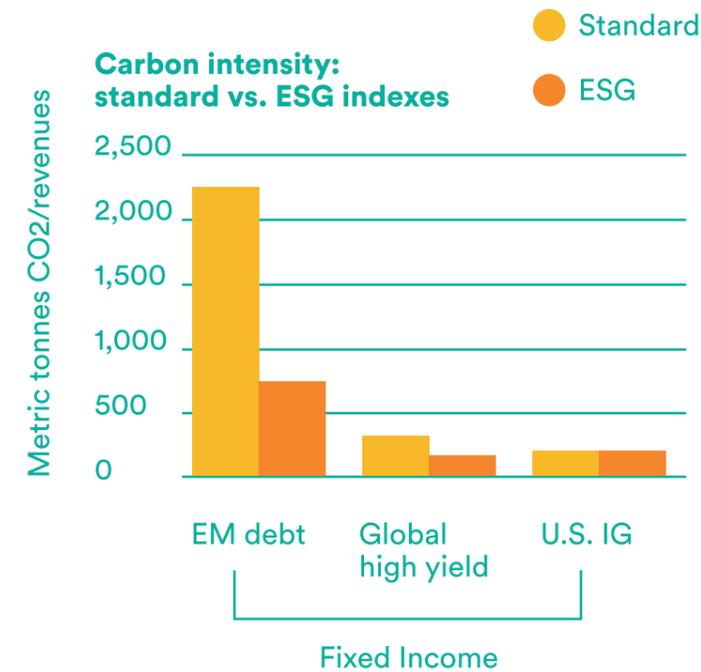
However, it is a misconception that passive ESG products are not very useful from an impact perspective. Research by BlackRock³⁴ shows that the impact itself can be considerable. In this study the asset manager compared the environmental impact of several different standard bond indices with those of their ESG counterparts. Environmental impact was measured based on the amount of CO2 emissions per million euros in revenues or national income. As the figure on the next page shows, the differences in environmental impact are particularly great for investments in government bonds from emerging countries (emerging markets debt). The difference between the standard index and the ESG index for corporate bonds with a lower credit rating (high yield bonds) is also considerable. This allows us to draw the conclusion that the use of passive products can make a significant contribution to achieving impact (in this case environmental impact) with an investment portfolio.

³¹ See: VANGUARD, "The case for low-cost index fund investing", August 2016, figure 3b on page 5

³² See "Top-5 Passief Wereldwijd: strategische beta stuwt groei", Jeffrey Schumacher, Morningstar, 17 September 2018

³³ See, for example, FT 25 July 2020: "Passive funds batter active products during 2020 'wild ride'", <https://www.ft.com/content/c64871d8-08cb-40cc-a87c-15b3b555a663>

³⁴ See BlackRock: BlackRock Investment Institute: "Sustainability: the bond that endures", 2019



Concluding remarks on investment choices

As we have demonstrated, a bond investor who wishes to achieve impact through his or her investments needs to consider quite a few questions. We should note that this does not require absolute or exclusive choices, but that a combination of choices is also possible.

For instance, you could choose to invest part of your portfolio in active funds and allocate the remainder to passive funds. Or you could opt for maximum positive impact by combining an investment in the impact class 'investing in solutions' with products in the 'ESG focus' category. There are also funds available that, for instance, combine different categories of bonds. We expect the range of impact bond investment products to expand further in the years ahead, giving investors more and more choice.

One tool that you could use when making investment choices and assessing the degree of impact, is the impact assessment model. In this model impact is assessed based on four criteria: additionality, intentionality, measurability and scale.³⁵ In the appendix to this paper we will explain how this works for bond investments.

³⁵ See: "Toward sustainable impact through public markets, A Framework to Align Investments with the UN Sustainable Development Goals", Veronique Menou Laura Nishikawa, April 2016

5

What bond investment products can I choose from?

Impact investors in bonds not only need to make a considerable number of choices, they also have quite a broad and rapidly expanding range of investment products within this category to choose from. Earlier, we already described a number of the drivers. In this section we will take a closer look at a few concrete investment products and opportunities.³⁵

We have classified the products based on their impact class and according to whether they invest actively or passively. The following overview shows the main possibilities. After the overview we will discuss these investment options in further detail.

		Impact classes	
		ESG Focus	Investing in solutions
Bond selection	Active	Individual bonds	
		ESG-focused bond funds	
			Bond funds focusing specifically on impact
	Passive	ESG bond index funds and ETFs	

³⁵ See: "Toward sustainable impact through public markets, A Framework to Align Investments with the UN Sustainable Development Goals", Veronique Menou Laura Nishikawa, April 2016

Selection of individual bonds

An important advantage of selecting your own bond investments is of course that you can personally determine which criteria you will use. This allows you to align your bond portfolio very closely with your values and requirements. We have explained earlier that this does mean that you need to consider various issues beforehand, which requires quite a lot of time and knowledge. What type of bonds do I want to invest in? In which region and in which currency? And which impact class is the most appropriate? But also: how do I ensure proper and timely reinvestment of coupon payments and redemptions for my bond portfolio? And what are my views on the market interest rate trend?

As is the case for listed equities, there are also ways of outsourcing the management and selection process to an asset manager. This asset manager can construct and maintain a portfolio in accordance with your requirements. It should be noted though that for this service asset managers will require a certain minimum (high) initial investment. Moreover, this service is generally only worthwhile from a cost point of view if the portfolio is large enough, because these types of personalised solutions generally entail relatively high management costs.

Active ESG-focused bond funds

As more and more asset managers are integrating ESG factors in their investment processes, investors have a large choice of funds in this category. The reason why many asset managers who offer bond funds consider ESG factors, as we have explained earlier, is that they see this as an element of the research process for assessing the issuer risks. Most funds in this category focus on corporate bonds. There are also several bond funds that focus on a combination of categories, for example government (related) bonds and corporate bonds.

When selecting bond investments, the manager will in that case look at fundamental factors of a more financial nature (for example the profitability of the company, its profitability relative to the sector, the outlook for both, etc.) and at ESG criteria. Examples of ESG criteria are: how does this company perform in terms of energy efficiency? How harmful are its products or services for the environment? How does the company treat its staff? How does the company account for its management activities? The fund manager weighs all these factors to arrive at a diversified selection for the fund's bond portfolio.

Examples of active ESG-focused bond funds:

Provider	Fund name	Fund description
Robeco	RobecoSAM Euro SDG Credits	The fund invests mainly in European corporate bonds with an investment-grade rating. The selection process is based on fundamental analysis, with an initial screening in order to assess whether the company is eligible for investment. During this screening process the manager assesses whether the company contributes to the realisation of the 17 SDGs and companies that make a negative contribution to these goals are excluded. The fund's investment policy is based on integration of ESG factors, engagement and an exclusion list.
PIMCO	Global Bond ESG Fund	This fund invests mainly in investment-grade corporate bonds. These bonds may be issued by companies anywhere in the world and any currency risk is hedged to the euro. The asset manager uses an exclusion list, actively engages with bond issuers and focuses on companies with a best-in-class approach to ESG factors, based on research carried out by the manager. In addition, the fund may invest in companies that may currently not be best in class in terms of ESG but that are making the most progress in this area.
NNIP	Euro Sustainable Credit	This fund invests mainly in euro-denominated investment-grade corporate bonds. When constructing the portfolio, NNIP takes into account the social and environmental impact of the companies that it invests in. NNIP uses an exclusion list: companies with serious and structural problems and proven controversial corporate activities are excluded.
ACTIAM	Duurzaam Euro Obligatiefonds (Sustainable Euro Bond Fund)	This fund invests around half of its assets in government bonds. The remainder is invested mainly in bonds issued by investment-grade companies. Prior to investment, the fund assesses all issuers on the basis of environmental, social and governance performance (ESG criteria). A negative score for this performance can result in the bonds of these institutions being excluded from the portfolio. In case of doubt, the manager may try and bring about an improvement through engagement.

Bond funds focusing specifically on impact

As the description of the products categorised as 'ESG Focus' indicates, this category often features bonds from issuers that perform relatively well within their sector (best-in-class). Portfolios are well-diversified across several sectors and companies and exclusion often focuses on sectors and/or companies that clearly underperform or perform downright badly in terms of ESG.

By investing your bond portfolio in these products, you achieve positive impact in comparison with a bond fund that does not explicitly consider ESG factors during portfolio construction. This therefore constitutes an important step forward.

There are also ways of further enhancing the positive impact of your bond portfolio. You can do this by selecting investment funds that focus specifically on realising positive impact. We are noticing that these products are increasingly linked directly to the SDGs that we discussed earlier.

Furthermore, we see that in this category managers of investment products try to express the degree of impact in measurable units. Examples include the number of jobs created and small and medium-sized businesses reached, and the amount of CO2 emissions avoided, and sustainable energy generated.

When designing these products, managers often focus specifically on the intention to have an impact (intentionality), as well as the degree of impact that would not have been achieved without the specific investment choices made by the manager (additionality).³⁷ This is what distinguishes these managers from their ESG-focused colleagues, who we discussed earlier.

Bond funds that invest in green bonds also fit in this category, because these are bond investments aimed especially at solutions for climate change. Examples of these types of funds are NN (L) Green Bond fund and the Global Climate Bond fund offered by Lombard Odier.³⁸

³⁷ For more detailed information about additionality and intentionality we refer to the appendix to this paper

³⁸ For more detailed information about green bonds, see our earlier paper on this subject: "Thema focus: Green Bonds" – Martha van Dijk – Wire Group – May 2017 (<https://www.wire-group.org/wp-content/uploads/2020/06/200325-Wire-Group-Green-Bonds-Reader-publicatieversie.pdf>)

Examples of bond funds focusing specifically on impact include:

Provider	Fund name	Fund description
FMO-Privium	Impact Fund	This fund mainly participates in loans granted by the Dutch development bank FMO to companies in developing countries. The investments cover four sectors: Agri-business, Renewable Energy, Financial Services and Telecom Infrastructure. Environmental and social aspects are fully integrated in the fund's investment policy and measurable impact is generated. Important aspects of the fund's policy are the prevention of climate change and job creation in developing countries.
Triodos Investment Management	Triodos Euro Bond Impact Fund	The fund invests in bonds issued by large-cap listed companies that make an active and solution-focused contribution to the transition to a sustainable society through their products and/or services or their business practices. The fund also invests in government bonds issued by democratic European governments and government institutions. Corporate and government impact bonds also constitute an important part of the fund's portfolio.
BlueOrchard	Euro Sustainable Credit	This fund invests primarily in bonds issued by financial institutions in developing countries. These may be government institutions or local financial institutions. The fund's objective is to achieve financial inclusion and provide funding to economically vulnerable areas. The fund focuses its investments specifically on realising the following SDGs: no poverty (SDG 1), affordable and clean energy (SDG 7), decent work and economic growth (SDG 8), industry, innovation and infrastructure (SDG 9) and reduced inequalities (SDG 10).

ESG bond index funds and ETFs

Investors can invest passively by using index funds or index trackers (ETFs). In both cases the asset manager does not select individual bonds but tracks a particular (sustainable) index. For bonds fewer passive investment products are available than for equities. This is partly due to the fact that passive investing first developed mainly for equity products. As noted earlier, in recent years we have seen an increase in the number of bond products, including bond products that can be classified as sustainable.

At the end of 2019, the European ETF market for the first time exceeded EUR 1,000 billion. In that year the volume outstanding increased by almost EUR 125 billion. Most of this growth - almost 50% - was accounted for by an increase in the assets invested in bond ETFs.³⁹

We expect the market for passive bond (index) funds to grow further - by analogy of the market developments that we have seen for equity investments - and that an important part of this growth will be accounted for by sustainable index products.

The market for passive sustainable bond investments is evolving and the leading index providers are working on further expanding the range of sustainable bond indices. As noted before, using a specific ESG index for bonds can create considerable impact for your portfolio.⁴⁰

Every index provider has its own methodology for determining the composition of the ESG index. As we discussed earlier, it is sensible for investors to study this methodology and to check whether it suits their requirements and values.

³⁹ See <https://www.etfstrategy.com/european-etf-assets-break-through-1trn-aum-10339/>

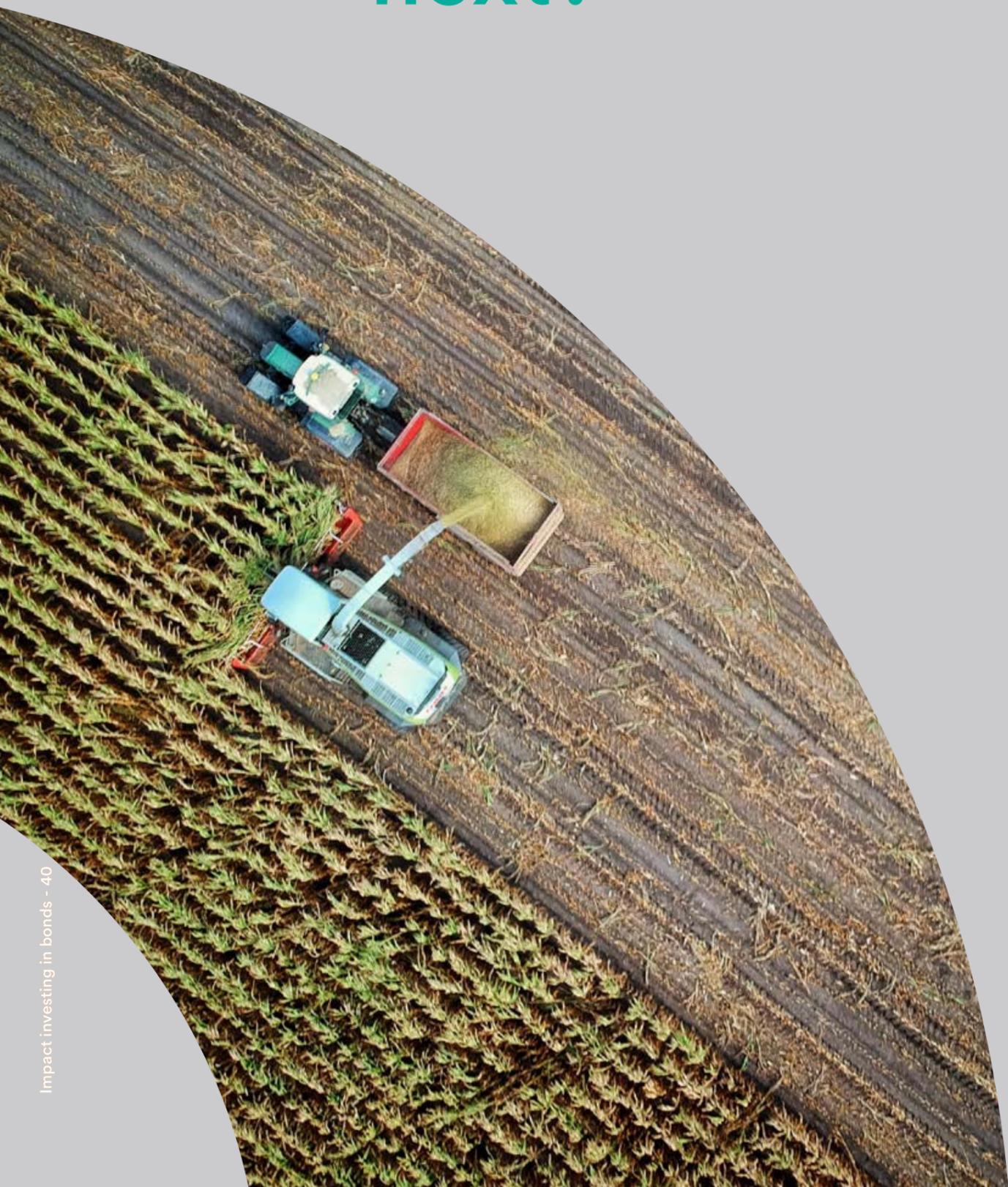
⁴⁰ See the section "Active versus passive from an impact perspective" in this paper.

Voorbeelden van indexfondsen en ETF's

Fund name	Description of the tracked index
Euro Sustainable Corporate Bond Index Fund	This index fund tracks the Markit iBoxx Euro Sustainable Corporate Bond Custom Index as closely as possible. This index focuses on bonds issued in euros by companies with a relatively high credit rating, so-called investment-grade bonds. In addition to applying more general restrictions (for instance with regard to the diversification of the index composition), the index provider uses an external party (currently: ABN Amro) to perform a six-monthly review of the issuers based on ESG criteria. This review determines whether (bonds issued by) a company can or cannot be included in the index.
UBS (LU) Sustainable Development Bank Bonds UCITS ETF	This ETF enables investors to gain exposure to bonds issued by (multilateral) development banks. These banks provide loans for funding projects with positive social and environmental impact in developing countries. These bonds have the advantage of significantly lower borrowing costs than if these countries themselves were to attract funding directly. The projects that are funded are often directly linked to one of the UN's development goals (SDG's). Solactive subsequently establishes the index based on several criteria, including minimum credit rating, the size of the bond issue and the remaining term to maturity. The ETF tracks the calculated index as closely as possible.
Lyxor Global High Yield Sustainable Exposure UCITS ETF	This ETF managed by Lyxor uses derivatives to track the Bloomberg Barclays MSCI Global Corporate High Yield SRI Sustainable Index. This index tracks the global high-yield bond market, where bonds issued by companies with a lower credit rating than investment grade are traded. In addition, the fund will only invest in companies that have a minimum ESG rating from MSCI, that do not have a red flag based on the MSCI ESG Controversy Score and that are not involved in activities such as the production of alcohol, tobacco or controversial weapons.
iShares J.P. Morgan ESG Emerging Markets Bond UCITS ETF (hedged to EUR)	By investing in this ETF, investors gain exposure to the J.P. Morgan ESG Emerging Market Bond Global Diversified Index. This index includes bonds issued by emerging market companies as well as governments. From this universe, JP Morgan selects bonds for inclusion in the index by applying a sustainability filter that is based on its own research. Furthermore, the bonds must at least have an investment-grade rating and meet a minimum size threshold (to ensure liquidity). The sustainability filter consists of three steps: 1. bonds issued by companies or countries that do not comply with the United Nations Global Compact are excluded; 2. the remaining bonds are subdivided into five groups based on their ESG scores. The bottom 20% with the lowest ESG is not included in the index; 3. finally, the weight of the green bonds that remain in the universe after the first two steps is raised.

6

What steps can I take next?



Wire Group is pleased to note that the opportunities for impact investing in bonds are expanding, as we have demonstrated in this paper. Active as well as passive investors can choose from a growing range of products and we expect this trend to continue in the near future.

By making conscious choices when constructing your investment portfolio, you can also achieve impact through bond investments. This paper shows that there are plenty of ways in which positive impact can be generated or negative impact can be reduced. By also actively engaging with issuers, you can further strengthen this impact. This applies to situations in which you invest in bonds yourself as well as when you invest via an asset manager or a fund.

Would you also like to learn more about how you can create more impact with the bond part of your investment portfolio? Wire Group is ready to help you!

Specifically, we can help you with the following:

- If you want to know what the current state of your portfolio is viewed through an impact lens, Wire Group can perform an Impact Scan of your investment portfolio.
- If you are considering transferring your portfolio to a different asset manager, Wire Group can help you select a manager who can offer a sustainable investment mandate.
- If you are interested in investing in funds, we can carry out the following impact screenings:
 - Comparative (impact) analysis of various ETFs
 - Comparative (impact) analysis of various active impact investment funds

Do you have any questions after reading this paper?

Please send an email to Tera Terpstra via tera@wire-group.org. We look forward to discussing this topic with you.



Appendix

Insight into the degree of impact for each impact class of bond investments

As we discussed in the paper on equity investing, when assessing the (degree of) impact the following criteria are often considered: additionality, intentionality, measurability and scale. We can also use these criteria when looking at bond investments.

Additionality

For many impact investors this is an important measure: can I make a difference by means of conscious investing? Am I able to create impact through my investment that would not have been achieved without my investment? If so, then your investment provides additionality. For listed equities additionality is often achieved more indirectly, because companies do not issue new shares that often and shares therefore tend to be bought - via a stock exchange - from other shareholders.

This is different for bonds. Bonds have a maturity date on which the loan must be repaid. Bond issuers often have a calendar with different dates on which they want to refinance their outstanding bonds, so that they will always have sufficient debt capital and do not have to rely on one specific refinancing moment for refinancing their outstanding debt. On any of these dates, the impact investor may choose to participate in the bond issue from the perspective

of additionality. In other words, for bonds there are in fact more points in time when the issuer must engage with investors in order to attract debt funding. This means that for investors there are also many moments when they can choose whether or not they wish to provide capital to the bond issuer. This applies to the 'ESG Focus' impact class as well as to 'Investing in solutions'.

Intentionality

Intentionality involves looking at the objective of the investment: the objective is to achieve impact. This means that as a bond investor in the impact class 'ESG Focus' you must carefully assess the process that is used for selecting bonds for the portfolio. Which criteria are used? Is it mainly about excluding bond issuers that have a negative impact? Does the fund mainly invest in issuers that aim to have a positive impact through their (business) activities, for example on social conditions?

The intentionality of the impact class 'investing in solutions' is greater, because this category is actually about investing in bonds that have been issued for a specific (impact) purpose. This does not alter the fact that a high degree of intentionality can be achieved with investments that are made using an ESG selection process that is aligned with your values.

Measurability

In case of investments covered by the impact class 'investing in solutions' the capital that is raised is often used for and directly linked to realising several specific SDG's. This makes it clear to investors what positive impact is achieved by means of this investment. For most investments underlying subgoals of an overarching SDG are in fact also defined. Examples of such subgoals are:

- access to primary services, including banking services (as a subgoal of SDG 1: no poverty);
- giving more people access to affordable and safe drinking water (as a subgoal of SDG 6: clean water and sanitation);
- more jobs (as a subgoal of SDG 8: decent work and economic growth).

By focusing on specific goals and measuring and reporting the outcomes of the effect that the investment has, the intended positive impact is made clear and comparable for the investor.

We should note here that measurability is not restricted just to the impact class 'investing in solutions'. For the 'ESG Focus' class we also note more and more initiatives by asset managers aimed at making the impact of their portfolio policy transparent. An example is the quarterly report prepared by Robeco for RobecoSAM Euro SDG Credits Fund. This report shows the distribution of the fund portfolio's contribution to the SDG's compared with the benchmark of the fund. This too gives the investor insight into the choices that were made and thus in the impact that his investment decision has had.⁴¹

Impact investors who are interested in measuring the impact of their portfolio must realise that the methods for measuring impact are still very much evolving. For instance, there is still no universal method for measuring impact. As a result, impact is measured in different ways by different parties, which can make it difficult to aggregate the impact of the various elements of an investment portfolio.

Scale

The scale of the impact achieved of course refers to the scale of the impact itself as well as to the size of the market on which that impact is achieved. This implies that the total impact of your investment is the impact of each element multiplied by the size of that element.

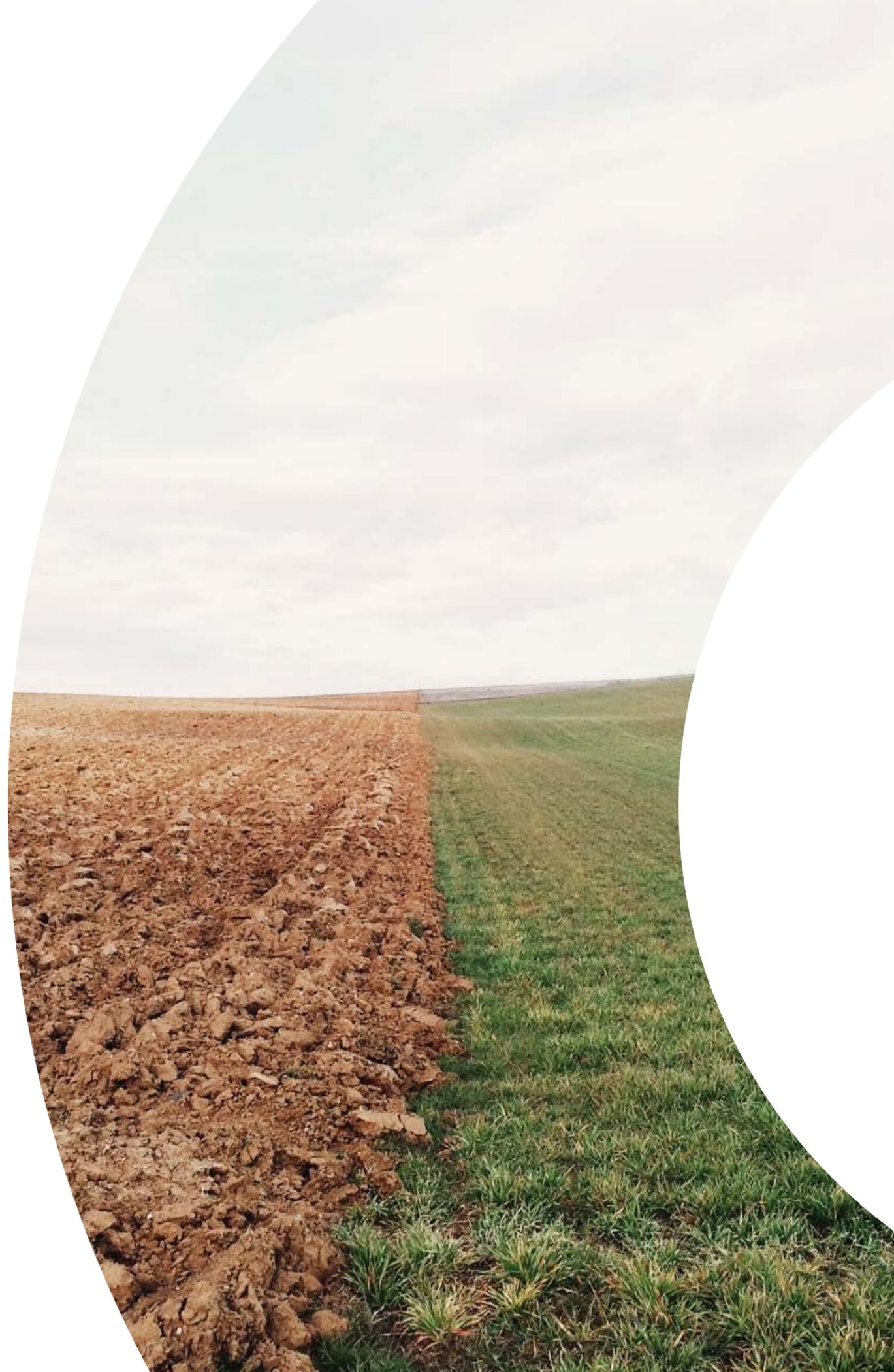
In the introduction to this paper we noted that bonds often constitute a large part of an investor's total investment portfolio. That is why it makes sense to look at and think about how you can restructure this part of your investment portfolio for it to achieve (more) impact.

Apart from the size of a specific investment category in your own investment portfolio, you can also consider the total market size for each category. The size of the global bond market is estimated at USD 100 trillion, versus around USD 65 trillion for the global equity markets. For comparison: global private equity investors have jointly invested an estimated amount of around USD 3 trillion in unlisted equity participations.

The scale of the global bond market, which is therefore estimated to be more than 30 times the size of the total private equity market, means that a substantial impact can be achieved if bond investors choose to invest their assets responsibly.

If we consider the impact classes, we note that the product range available in the 'ESG Focus' class is (for now at least) greater than that for 'investing in solutions'. The products that are available make it quite feasible to achieve impact via bond investments in either class. Given the recent evolution of the offering in both classes and taking into account the huge amount of capital that will need to be spent in order to reach the SDG's, we expect to see a strong increase in both the number of products and the scale of this segment of the market.

⁴¹ See: "Portfolio Manager's Update" via <https://www.robeco.com/en/funds/prof-glob-en-11/robecosam-euro-sdg-credits-dh-eur-lu0503372608.html#!#documents>



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