

FROM PROCESS TO OUTCOME: SUSTAINABLE INVESTING IN FIXED INCOME

RAPID EXPANSION TREND CONTINUES



RUSSELL INVESTMENTS RESEARCH

From process to outcome: Sustainable investing in fixed income

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Fixed income market practitioners are continuing to evolve their responsible investing practices and expand product offerings to meet the dynamic sustainability outcome preferences of their client base. At Russell Investments, we are witnessing a rapid expansion in the techniques used to further embed Environmental, Social, and Governance (ESG) considerations into day-to-day investment processes. In this paper, we share some key ESG integration trends we are observing amongst these practitioners. The topics covered include:

1. Active ownership in fixed income
2. Mapping the landscape
3. Data coverage availability
4. Engagement
5. Regulation
6. Reporting/Climate-risk measures
7. Product availability
8. Key portfolio characteristics
9. Surge of labeled bond issuance

1. Active ownership in fixed income

Before diving into the current landscape, it is helpful to compare how broad responsible investing in fixed income has evolved compared to equity investing. In our view, the primary difference centers around the fiduciary duty and rights associated with active ownership (proxy voting and engagement) for equity strategies as well as the instrument types associated with the fixed income market. Listed equity investing includes publicly-traded companies, whereas the fixed income market includes corporate bonds for public and private companies, and other market segments like sovereign, securitized credit and municipal bonds. Each market is unique and requires its own approach.

The role of active ownership has grown as a major part of responsible investment practices. Fixed income investors are important capital providers and are increasingly taking proactive roles in raising ESG-related agendas with bond issuers. Engagement activity has become a key source of information to assess risk and return opportunities among bond investors.

Fixed income investing is primarily focused on diversifying and moderating the risks associated with equity investing – and this is true even for riskier securities such as high yield bonds and emerging market bonds. Downside protection is key to a successful fixed income strategy. Therefore, it is not surprising that engaging on ESG issues has historically been perceived as a risk mitigation exercise within fixed income investing, rather than an exercise in the expression of sustainability criteria.

2. Mapping the landscape

The term “ESG” can be interpreted and applied in different ways and that can create confusion for many investors. We prefer the term sustainable investing and believe that it represents a continuum of products. What does sustainable investing in fixed income mean?

We think about sustainable investing as consisting of both process and outcome. This distinction helps us to classify strategies into three categories: ESG Integrated, Sustainable and Impact strategies. Process is concerned with how material ESG-related information is integrated into a strategy’s investment decision-making process. Outcomes result from intentional efforts to incorporate and express sustainable criteria in investment selection and portfolio construction, often with a measurable result. These classifications can be applied across asset classes, including fixed income. That said, it can be difficult to draw a bright line between terms and classifications.

As well, products can bridge classifications and can shift over time, so our focus is on providing a useful guide against which individual products can be compared.

Broadly

- ESG integrated strategies incorporate material ESG criteria into the investment process with the aim to better manage risks and improve the returns of an investment strategy. Material ESG issues involve a high likelihood of such information impacting the performance of the specific entity. Because the industry has increasingly recognized the materiality of environmental and social issues, many strategies today can claim to be ESG integrated.
- Sustainable strategies typically seek holistic ESG outcomes using additional processes or sustainable criteria, such as better climate risk management, engagement focus and/or allocating a portion of funds toward environmentally - and/or socially-minded investment opportunity sets. The labeled bond, i.e., green bonds, allocation is greater for sustainable strategies than traditional bond strategies. While sustainable outcomes are identified, the benchmark for this category is still most often a conventional benchmark, such as the Bloomberg Global Aggregate Index.
- Thematic/Impact strategies aim to generate specific and measurable positive sustainable outcomes for the majority, if not all, of the portfolio. The opportunity set for this category, meaning the range of investments targeted, tends to be much narrower than sustainable strategies and the benchmark can differ from a conventional benchmark.

Given the increased focus from investors and other market participants, we note that fixed income practitioners across the board are increasingly aware of sustainability concerns. Regulators, especially in Europe, are stepping in to try standardizing the “sustainability” frameworks, and for truly

sustainable strategies to stand out and be differentiated in this space, they need to go even further – in general, we think that is a positive for investors.



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3. Data coverage availability

- ESG data availability varies depending on the segment of the fixed income market.
- The corporate credit market has been the first to broadly adopt sustainability integration. This is understandable given that corporate bonds are the most similar to equities. Therefore, equity coverage has been more easily transferred over to the corporate credit market.
- Within the corporate credit universe, investment-graded corporate bonds tend to have more comprehensive ESG data coverage than below-investment grade, or high yield bonds. The reason for this is that there are more privately held companies that are rated below investment-grade, and therefore have disclosure requirements that are less than those that are publicly traded. That is even more true in the leveraged loan market where privately-held companies account for greater market share. Many leveraged loan managers utilize their own ESG questionnaire to underlying loan issuers since the third-party ESG data providers’ coverage in this space is limited.
- Mapping ESG-related information to a specific entity is challenging in the fixed income market when compared to equities. This is because any entities in fixed income can issue debt at a holding, operational, and subsidiary level, with different seniorities, whereas stock is often issued at a parent level. Therefore, ESG data coverage and cleaning is trickier since each entity level can have different data coverage and business models.
- ESG data coverage continues to expand within government (sovereign) bonds, followed by municipal and securitized markets, over the past few years. ESG considerations in government (sovereign) bonds are also inherently more complex. Assessing key material ESG related information can be subjective, but the corporate bond market has a well-established framework under the SASB Materiality Mapping. In contrast, the sovereign and other fixed income market segments lack such market standards. Therefore, the outputs of ESG assessments for sovereign bonds remain wide depending on ESG data providers. Most fundamental-

based asset managers form their own ESG insights to assess materiality of ESG related information across all of the fixed income segments.

- The securitized market offers a wide range of investment opportunities, including mortgage-based securities (MBS), asset-backed securities, and commercial mortgaged-backed securities, but this market segment lacks industry standard best practices for ESG-related analysis of the underlying securities. Some progress has been made. For example, Fannie Mae launched new social scores for its single-family MBS in late 2022, and many asset managers are coming up with their own methodologies in this segment. That said, the lack of adequate ESG data at the security level remains the key challenge and a work in progress for this part of the fixed income market.

In summary, each fixed income market segment has its own challenges relating to data availability. Third-party ESG data providers have ramped up in their efforts to extend their overall coverage, but in doing so, we have noted significant use of assumptions and proxies to extend coverage to those bond issuers who have not disclosed ESG-related information. Therefore, while the overall market coverage might have increased year-on-year, the underlying security level analysis and quality of data requires careful scrutiny.

An explanation of government (sovereign) bond data challenges

Fixed income market practitioners continue to expand data coverage and methodologies for ESG and climate-related metrics. However, emissions data for sovereign bonds face multiple challenges, including:

- Data availability and quality (i.e., some countries lack accurate emission calculations), data gaps (i.e., incomplete data), time lags (i.e., lacks timely data) and methodological differences (i.e., different methodologies and assumptions used) among various countries.
- When compared to corporate credit, government (sovereign) debt has a slower rate of change at the country level, given its decision-making process; therefore, investors need to be mindful of the timeline associated with this. For instance, engagements with sovereign bond issuers require a longer investment horizon than corporate bonds.
- Government (sovereign) bond carbon calculation methodologies also remain inconsistent among asset managers. While many bond managers use production-based emissions metrics, some practitioners have argued that frameworks must look at consumption-based methodologies.
- Sovereign-level climate data includes climate data of corporations, which results in double counting.
- Another challenge faced is how to normalize greenhouse gas emissions (GHG) data. For instance, this could include deciding whether to apply nominal GDP or GDP

per capita; both options can make a material difference in the calculated output.

- Many governments set and enforce climate policies and regulations which offer forward looking indications, but government regimes can change and there are often huge time lags between making pledges and their implementation.

There are some developments underway to address these challenges, particularly under the Partnership for Carbon Accounting Financials (PCAF), which was launched in December 2022 to address reporting standard of financed emissions for sovereign bonds with methodology options. The Assessing Sovereign Climate-related Opportunities and Risk (ASCOR) project was launched at the end of 2023 with the aim to aid assessing countries efforts towards climate change. However, it will take some time for the industry as a whole to reach a consensus.



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4. Engagement

For equity investors, active ownership is the use of shareholder rights to implement or advocate for corporate best practices to improve the long-term value of a company. Active ownership often utilizes engagement to seek its desired outcomes -- engagement being direct dialogue between an investor and the company in which they are invested. As a result, the term 'engagement' has been a mainstream investment concept in equity investing for some time. Over recent years, we have observed that fixed income practitioners are also embracing engagement practices. There has been growing appreciation that bondholder engagement activities provide more information about how bond issuers are addressing material ESG-related information, which can positively impact risk and return opportunities.

While bondholders do not have voting rights per se, as capital providers to corporations, they do have a direct line of access and communication to company management. The global bond market consists of over \$70 trillion of issuance, making bond investors substantial capital providers. Furthermore, many bond issuers are repeat issuers, meaning they come back to the capital market regularly – an incentive for companies to engage with bond investors.

In our [Annual Manager ESG Survey](#), we ask market practitioners to state how often they engage with underlying companies in relation to ESG issues. Our findings show a steady increase in ESG-related engagement across all asset classes, including market practitioners who invest in bond offerings. In 2023, 95% of participants reported that they often or always discuss ESG topics when they interface with companies in which they are invested; an increase from 91% in 2021. Moreover, in 2023, direct company engagement became managers' primary ESG info source. The heightened market interest in ESG considerations has led to many underlying companies to becoming more amenable to proactively discussing ESG related topics. Therefore, while the explicit limitation exists for bondholders who are without proxy voting, the influential power of bondholders appears to be expanding.

Successful bondholder engagement case studies include increasing labeled bond issuance, greater transparency and disclosure (especially among privately held companies), pressuring board membership composition for privately held companies, and encouraging board adoption of net zero initiatives. Via our Survey, we have observed a steady yearly increase in the number of firms reporting that they document and monitor ESG-related engagement outcomes; 78% reported doing so in 2023. To demonstrate effective bondholder engagement practices, it is important for any strategy to establish a framework on how to prioritize the objectives of specific engagement activities and identify tools for monitoring and reporting on the outcomes.

We have observed that some strategies may leverage their equity counterparts to increase influence when engaging with the underlying companies. Other strategies which have limited or no equity offerings may seek to partner with other parties to increase influence through collaborative engagement. As the importance of active ownership grows, so will the consensus among investors to implement active management methods across all asset types.

Market practitioners have a pivotal role to play in the quality and success of stewardship actions – ensuring value-additive conversations are happening between investment practitioners and the companies in which they are invested. As we move forward, standout approaches will be able to demonstrate clear methodologies, articulate a best practice and demonstrate effective engagement practices through their reporting.



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5. Regulation

Regulators around the globe are playing a vital role in how the investment industry is incorporating ESG practices. European regulators have introduced the Sustainable Finance Disclosure Regulation (SFDR) in an attempt to increase the transparency and accountability of investments that claim to have ESG or sustainability objectives. The SFDR requires asset managers in Europe to disclose how sustainability risks are incorporated into their investment decision-making process. Additionally, the European regulator has established a classification framework - EU Taxonomy - to determine whether an economic activity is an environmentally sustainable activity. To help facilitate uptake of this new classification framework the regulators, especially in Europe, are expanding the disclosure requirements. At the same time, there is some push back around sustainability regulations, especially in USA. The regulatory dispersions are creating challenges for market participants around how best to navigate in this dynamic landscape.

There is ever-growing global support to tackle climate risk, and while Europe has led the way in regulations to address ESG measures, there are signs that other regions, like the U.S. with the recent SEC climate disclosure rule in March 2024, are following a similar path to developing taxonomies and standards. Increased regulations which focus on transparency, disclosure and use of common language in sustainable investing, assist in the global standardization of the ever-evolving ESG practices. At the same time, reportable data gaps exist in the fixed income market around ESG considerations. Bond investors are trying to comply with regulations despite the data not being readily available for certain fixed income segments.

6. Reporting/Climate risk measures

The increased regulation on ESG disclosure obligations is accelerating the demand for portfolio transparency and reporting for sustainable outcomes. Both regulators and asset owners are demanding greater transparency around ESG considerations in portfolios through reporting. The forms of ESG reporting continue to evolve and still vary by asset manager. Furthermore, each asset owner can have varying preferences in the reporting of ESG content, adding further complexity. Today, there is no standardization in ESG reporting in the fixed income market, and many asset managers are still building the infrastructure required to offer customized reporting.

With the global economy facing significant climate-related challenges, there is growing interest to measure and report on how a portfolio is facilitating the transition to a net zero carbon economy. Third-party data providers continue to expand their reporting capabilities and coverage around the measurement of GHG emissions. Climate risk can be segregated into physical risk – referring to climate-related hazards that can impact asset prices - and transition risk – referring to those arising from the shift toward a low-carbon economy. The Task Force on Climate-Related Financial Disclosures (TCFD) guidelines detail how to disaggregate

transition and physical risks, yet some of these risks are challenging to quantify. The Partnership for Carbon Accounting Financials (PCAF) has developed a methodology to report emissions associated with financial activities.

At Russell Investments, we have committed to the Net Zero Asset Managers Initiative (NZAMI) to support the goal of net zero greenhouse gas emissions by 2050. The NZAMI, along with affiliated entities under the Glasgow Financial Alliance for Net Zero (GFANZ), encourages all financial market participants to evaluate the current status of their existing portfolio offerings, their engagement activities toward net zero, and forward-looking climate transition plans. Many asset owners are increasingly interested in the transparency of how the portfolios they invest in are aligned with the Paris Agreement to address climate risk. Climate risk measures continue to expand and are key to the evolution in sustainable investing.

Climate risk measurement methodologies in the fixed income market vary from corporate bonds to sovereign bonds to green bonds. For corporate bond allocations, many market practitioners report carbon intensity normalized by sales – known as Weighted Average Carbon Intensity (WACI). Some of them have started to include financed emissions with the Enterprise Value Including Cash (EVIC), which incorporates an underlying company's total enterprise value, including market capitalization and total debt. The TCFD recommends WACI while the PCAF recommends using EVIC. We recognize each methodology provides valuable insights with unique challenges. For sovereign bond climate metrics, many market practitioners report sovereign emissions per GDP and per capita. For the green bond market, the focus of climate risk measurement is on the use of proceeds rather than the carbon emissions of the issuers who can be high carbon emitters including utility companies. Estimating how much carbon emissions are avoided with green projects is another popular reporting approach for green bond portfolios.

Options for broader sustainability reporting criteria continue to expand, and on prominent categorization is the United Nations Sustainable Development Goals (SDGs). The SDGs encompass a set of 17 goals designed to create a peaceful, sustainable, and prosperous planet for all people, and the aim is to direct capital towards investments that make positive real-world progress towards achieving the SDGs. While the SDGs provide a common framework in defining the critical positive outcomes, it leaves much subjectivity in measuring and mapping underlying investments to certain SDGs. For example, one methodology looks for revenue or activities to map to SDGs while other methodologies try to estimate a positive minus negative impact by converting all activities into asset values. Therefore, investors should be mindful of how different methodologies can lead to different impact outcomes.



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7. Product availability

Our research on sustainability-focused fixed income strategies started over a decade ago when these offerings were mostly limited to strategies investing into green bonds, outside of exclusionary-oriented mandates. Today, asset managers are trying to offer customized solutions to meet the range of client interests. In recent years, sustainable outcome-focused fixed income strategies have expanded to broader segments of the fixed income market. As mentioned earlier, we segment these strategies into two types: Sustainable and Impact.

Due to greater ESG data availability in the corporate bond market, many sustainable strategies focus on investment grade credit. However, in recent years, sustainable fixed income offerings have expanded to encompass high yield bonds, emerging market debt, multi-sector/global bonds, and multi-asset credit strategies. Here we share some of the key findings for outcome-focused sustainability products thus far.

- Among preferences for sustainable outcomes, there is a clear trend towards strategies that emphasize climate-focused impact. Others have emphasized alignment with UN SDGs and broader sustainability goals.
- With the growing market opportunity set for Green, Social and Sustainability (GSS) bond issuance, more product offerings are focusing on this market to offer Impact strategies with transparency on how the use of proceeds are impacting Environmental and Social outcomes.
- With the global economy facing significant climate-related challenges and the energy transition remaining a top investment priority for many clients, there is growing interest in aligning portfolios with net zero and decarbonization goals. Net Zero targets in the fixed income market are often applied in corporate and green bond strategies.
- For Europe-based credit strategies aligned to Net Zero frameworks, some strategies are starting to utilize a Paris Aligned benchmark for a corporate bond strategy.
- Because Europe has been at the forefront of green finance and sustainable investing, it is no surprise that there are more sustainability-focused bond instruments – like green bonds – in EUR-denominated currency.
- Biodiversity outcomes, i.e., preserving and restoring ecological systems, -- in the fixed income market is limited and very early stage. Ocean biodiversity is an area within the wider biodiversity theme and addressed by a new bond category called blue bonds, which are designed to finance the conservation and sustainable management of ocean and coastal resources. The blue bond is essentially a very small subset of the green bond market. Biodiversity strategies are representative of thematic investing and that might be more accessible in private or public equities where you can construct a portfolio with a smaller number of securities. However, this theme is harder to address in fixed income portfolios which tends to adopt broader diversification to limit idiosyncratic risk.

8. Key characteristics of the sustainable landscape for fixed income

Like in the equity space, we note that more sustainable strategies are positioning themselves as mainstream offerings with similar risk and return objectives to traditional strategies. Unlike equity, fixed income contains a more diverse range of sub-asset classes, and so, where investors are seeking to switch from more traditional strategies, they will need to consider whether any key characteristics of the sustainable fixed income offerings differ.

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Risk/return

- Overall, the tracking error (deviation in returns from the traditional benchmark) for investment grade bond strategies is similar between sustainable and conventional bond strategies against the same benchmark. However, the tracking error for certain categories of sustainable strategies, such as high yield, emerging market debt and multi-asset credit strategies, can be slightly higher than that of the traditional portfolios against the same benchmark. This reflects the influence of products which seek to exploit a narrower set of sustainable characteristics. In other words, the tracking error can increase when exclusion lists expand.
- The implication of exclusion lists needs up-front understanding. For example, the global high yield bond market consists of approximately 10% in the Energy sector (~5% for equity MSCI ACWI), and many climate-focused high yield strategies will tend to avoid the sector. A meaningful weight divergence can cause a performance dispersion, especially for a short-term investment horizon.
- In contrast, the return expectations for investment grade bond strategies, such as a Global Bond strategy benchmarked against the Bloomberg Global Aggregate Index, are more similar between traditional and sustainable strategies, with idiosyncratic risk playing a less dominant role.

Sustainable outcome

- As with equity investing, sustainability outcomes in fixed income target positive environmental, social and governance impacts while generating financial returns.
- Among sustainable products which seek to incorporate certain sustainable outcomes, the outcomes may include: a reduction of carbon emissions intensity, a pre-determined level of minimum allocation in GSS bonds, greater corporate stewardship through positive engagement, exclusionary screening, and/or aligning a portfolio with UN SDGs.
- Among Impact strategies, green bond strategies aim to achieve environmental impact through financing environmental-focused projects, such as renewable energy, energy efficiency, pollution prevention, sustainable water, and green buildings. Other impact bond strategies include applying Net Zero frameworks into the corporate credit market to target carbon neutrality by 2050. Examples of such frameworks include the forward-looking target setting methodology of the Paris Aligned Investor Initiative’s Net Zero Investment Framework (PAII NZIF) and the Institutional Investors Group on Climate Change (IIGCC)’s guidance on Net Zero alignment.

Credit quality

- Because many sustainable strategies will exclude certain segments of the investment opportunity set by design, this can affect the level of overall credit quality.
- For example, in a sustainable global bond strategy, certain types of bonds, such as CCC-rated bonds and emerging market debt, typically have a more limited role compared to a traditional approach. Since these excluded segments usually offer higher yields, many sustainable strategies look at other ways to bridge the ‘yield gap’, such as adopting greater allocations to BB- and B-rated bonds.
- Therefore, we note that the average credit quality of the more sustainable oriented strategies can be slightly lower than that of the flagship strategy for a similar mandate for some strategies.

Sector exposure

- The fixed income market encompasses multiple unique sub-asset classes including government bonds, investment grade corporate bonds, mortgaged-backed securities (MBS), asset-backed securities (ABS), commercial mortgaged-backed securities (CMBS), high yield bonds, leveraged loans, emerging market debt, municipal bonds, and labeled bonds.

- Sustainable strategies may seek to exploit certain sustainable themes. For instance, the sector preference might include tackling affordable homeownership in MBS, energy and climate change in ABS, multi-family affordable housing in CMBS, water and sanitation through municipal bonds, and/or renewable energy and healthcare innovation in corporate bond market.

Geographic exposure

- We note that many sustainable strategies tend to hold lower allocations to U.S. Treasuries relative to the traditional benchmark, partly due to concerns about the lack of climate change action in the U.S. relative to other geographies, i.e., Europe.
- However, for a global strategy, we would note that it is difficult to completely avoid large geographic sectors, such as the U.S., given their substantial presence in the global fixed income market. From a portfolio construction perspective, such country allocations can play a critical role in risk management and offering liquidity.
- Within certain market segments such as green bonds, the non-U.S. allocation tends to be much greater given that non-U.S. issuers dominate the green bond market.
- For emerging market debt strategies, there is a growing notion that ESG-related assessments, such as climate change, biodiversity, innovation, health, human capital and governance, play a critical role in sovereign risk analysis. ESG-focused strategies tend to have a defensive bias with higher credit quality preference.

9. A surge of labeled bond issuance

Bonds with specific environmental and/or social objectives are referred to as impact bonds or labeled bonds in the form of GSS bonds. The labeled bond market has grown in issuance over the past few years. In 2023, labeled bond issuance was flat with 2022 full year issuance volume, but this contrasts with the conventional bond issuance for 2023 which was down from the previous year in the face of higher interest rate environments. The steady labeled bond issuance speaks to higher demand for labeled use-of-proceed bonds. The labeled bond market has four primary categories: green bonds, social bonds, sustainability bonds and sustainability-linked bonds.

- Green bonds aim to support the transition toward a low carbon economy and are the largest component of the labeled bond market. Green bonds are bonds issued by countries or companies with the proceeds targeting specific environmental projects and opportunities.
- Social bonds focus on social impact, including affordable housing, access to finance, and/or supporting small businesses. Social bond issuance surged during the COVID-19 crisis to finance economic support programs and the public health response.

- Sustainability bonds target a combination of green and social goals. We have observed that such sustainability bond offerings tend to link their investment opportunities with the United Nation's SDGs.
- Sustainability-linked bonds (SLBs) have their coupons linked to the issuers reaching specific environmental or social targets or key performance indicators (KPIs). If an issuer fails to reach these targets by a given date, the coupon steps up or additional payment is due at maturity.

The key to GSS bond investing is to understand how the proceeds are used and to monitor the actual versus stated objectives.

Sustainability-linked bonds were newer instruments in the impact bond market and remain relatively small in volume when compared to other impact categories. Note that these bonds are not tied to specific projects and can be used for general corporate purposes. Some bond issuers favored sustainability-linked bonds due to this flexibility – they do not have to be tied to specific projects and are not rigid in how the proceeds are used, while still showing their commitment to specific environmental or social outcomes. However, investors are challenging the relevancy and self-selective nature of KPIs associated with SLBs and have shown a preference for GSS bonds over SLBs in more recent years. As such, the SLBs issuance in 2023 declined.

The valuation of labeled bonds is also worth highlighting. The surge in labeled bond issuance over recent years was driven by strong demand. In fact, the demand was so strong that the spreads between labeled and unlabeled bonds for the same company were showing a clear trend: labeled bonds were often slightly more expensive than unlabeled bonds – referred to in the market as the greenium. This was likely due to the proliferation of ESG product offerings that prefer to invest in labeled bonds, creating a supply/demand imbalance that influences price. That being said, a greenium varies depending on the regions, i.e., Euro vs. U.S., and instrument type, i.e., investment grade bonds vs. high yield bonds.



In fact, the demand was so strong that the spreads between labeled and unlabeled bonds for the same company were showing a clear trend: labeled bonds were often slightly more expensive than unlabeled bonds – referred to in the market as the greenium.

Summary and conclusions

The words ESG and Sustainable get applied in widely varying ways, and we believe it's important for all investors to understand what is meant by them in each context. When evaluating the sustainability features of strategies and products, we break down ESG or Sustainable investing evaluation into a consideration of process and outcome. Moreover, when classifying sustainable strategies, we group them into categories classified as ESG Integration, Sustainable, and Impact. ESG integrated strategies employ process expansion to incorporate material ESG criteria into the investment process with the aim to better manage risks and improve returns of an investment strategy. Sustainable or Impact strategies will go a step further, aiming for a particular outcome through integration and via portfolio construction. These outcomes can be evidenced through case studies or by asset or portfolio characteristics. The level of sustainable outcome expected for the Impact strategies is much more strenuous than for the Sustainable strategies.

ESG specific information is increasingly available in the marketplace, yet this remains scarce in some areas of fixed income markets. The access to ESG-related data and the means to digest such information into an investment process continue to evolve. Bondholder engagement has become a key information source in assessing material ESG topics. As ESG related information increases, asset managers are examining such information flows to identify material ESG issues. Regulators are stepping in to set rules with the aim to enhance disclosures, transparency and accountability of ESG or Sustainable credentials. Reporting on ESG and climate risk criteria is a major focus, and there has been considerable adaptation in the fixed income market in the recent years, which will no doubt continue.

Responsible investing product offerings continue to expand around the globe into the mainstream. Sustainable strategy options are broadening, even outside of the investment grade credit markets. There is a clear trend towards emphasizing climate-focused sustainable outcomes. Many sustainable bond strategies aim to manage the portfolio's risk and return profile in a way that is similar to traditional strategies with the same benchmark. However, portfolio performance may be impacted, especially for a shorter investment time horizon, when measured against the same benchmark; this is often in situations when the targeted sustainable outcome requires limiting the investment opportunity set. Impact bond strategies mostly focus on Green, Social, Sustainable bonds. The labeled bond market continues to grow in issuance, with Green bonds offering greater linkage to positive environmental outcomes.

To conclude, the incorporation of environmental and social factors continue to expand in the fixed income market as more strategies with sustainable outcomes are introduced into the marketplace. The role of engagement has gained ground among bondholders who want to better understand the potential risks and returns associated with ESG related information, while seeking outcomes with sustainable goals where warranted. The methods of implementation continue to vary, with best practice being dependent upon the asset type and practitioner; identifying a common reporting mechanism still has a long way to go. As we move forward, the development of standout approaches will be essential to demonstrating leading implementation methodologies, articulating a best practice, and defining informative metrics that are broadly recognized by investors as effective implementations of ESG considerations.

Russell Investments' commitment to responsible investing

As a global investment solutions provider, we believe that transparency and investing responsibly can help deliver attractive investment returns and meet client objectives in the long-term. We collaborate with organizations that establish and drive responsible investment practices.



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