
Coronavirus highlights fixed income's potential for impact investing

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Investors such as pension funds are increasingly seeking investments with a positive impact, and the surge in Covid-19 bond issuance this year indicates that fixed income is the asset class well-positioned to deliver positive social outcomes.

Impact investing, where you invest to have a positive outcome on society and the environment, is a fast-growing trend, with good reason. Today's investors face huge transitional risks that are affecting their generation – from climate change to social inequality – which is why they are now increasingly open to channelling capital to financing solutions that address these issues. Fixed income plays a unique role in delivering targeted solutions for investors looking for both impact and income.

2020: the year when social issues came to the fore

In 2020, the pandemic shone a spotlight on social issues, with the result that investors are keen to invest in bonds that channel finance into areas such as affordable housing, education, healthcare and employment. Supranationals and government agencies were among the leading issuers of Covid-19 response bonds in 2020. The volume of newly issued debt based on environmental, social and governance principles reached \$510 billion for 2020, up by more than \$215 billion from 2019¹.

While green bond issuance has also grown in 2020, it's no exaggeration to say that social bond issuance has surged. In doing so, they have channelled many billions of dollars from institutional investors through to projects focused on making a positive social impact.

¹ Bloomberg, 1/1/2021.

The crisis has been a powerful catalyst, helping to establish fixed income at the core of responsible investing. It has highlighted fixed income's great potential, as the largest asset class, to move the dial. Until now, pension funds and other institutional investors have typically focussed responsible investments through equities and private market strategies. Yet to achieve the UN's sustainable development goals (SDGs), it's necessary to move far larger pools of capital.

Turning specifically to Europe's pension funds, fixed income was by far their largest allocation, at over 50% in 2019, according to Mercer's European Asset Allocation Survey²; while in the UK the proportion of DB pension scheme assets invested in bonds reached 62.8% in 2019³. By comparison, equities accounted for 25% and alternatives – the pool of capital that most impact investments currently come from – just 16%.

Why fixed income?

Fixed income enables investors to generate both income and a meaningful social and environmental impact due to two key factors: the scale of the opportunity set and the targeted nature of social and green bonds. The fixed income universe is gigantic and vastly trumps equities in scale, while issuers are more able to adapt and more quickly address the need to fix both societal and environmental issues.

Bonds are issued by a wide range of entities including governments, government agencies, supnationals, mutual organisations, charities, companies and so on. Many are the organisations best placed to deliver environmental or social outcomes, leading to a positive impact. Very few of these organisations are actually companies with publicly listed equity.

Equally importantly, bond issues can be far more targeted than equities. For instance, they can be issued by 'ring-fenced' regulated businesses or companies' subsidiaries, including housing associations and utilities, for spending, respectively, on social housing or renewable energy projects. Alternatively, they might be green, social or sustainability bonds, raised under the International Capital Markets Association principles. This framework for issuing bonds recommended practices for monitoring the use of proceeds and reporting, fostering confidence and paving the way for future growth.

Fixed income offers a broad spectrum of opportunity for responsible investing. At one end of the range, portfolios can integrate environmental, social and governance (ESG) research to minimise risk. In the middle, they exclude all investments not aligned to their values; for instance, alcohol, gambling or tobacco. At the other end, they invest in thematic green, social and sustainability bonds that tend to target a particular outcome, leading to a positive impact.

Columbia Threadneedle Investments has been a pioneer in investing in these thematic bonds, which allow investors to monitor both financial returns and social outcome. Each bond is given a score for its outcome, ranked according to a proprietary methodology. The result? Portfolio alpha is assessed in two dimensions – financial and social.

Bond issuers are part of the solution

2020's upsurge in the "sustainable" debt market is remarkable. Notably, approximately US\$90 billion worth of so-called Covid-19 bonds were issued in the first eight months of the year⁴. Whether general purpose, or "use-of-proceeds" bonds ring-fenced for a particular purpose, they are aimed at tackling the effects of the pandemic.

² European Asset Allocation Survey 2019, Mercer (page 7). <https://info.mercer.com/rs/521-DEV-513/images/ie-2019-european-asset-allocation-survey-2019.pdf>.

³ The Purple Book, Pension Protection Fund, 17.1.2020.

⁴ As at 31 August 2020. Source: Bloomberg, Columbia Threadneedle Investments.

While green bond issuance has also grown in the year, there has been a shift towards the social and sustainability bond formats used to issue the Covid-19 bonds. Green bond issuance increased a healthy 19% over the first eight months to US\$149 billion⁵, but social bond issuance surged a massive 530% to US\$63 billion⁶.

One US\$1 billion bond raised in May to support the healthcare industry through lending to not-for-profit hospitals, skilled nursing facilities and manufacturers of healthcare equipment and supplies is a good illustration of the type of bond now in demand. Issued under the Social Bond Principles framework, this bond has a high-quality reporting framework monitoring the use of proceeds and outcome.

An opportunity for pension funds

The Impacting Investing Institute, a UK organisation dedicated to accelerating the growth of impact investing, has developed five impact investing principles for pension trustees⁷. They give practical insights in the opportunities and concrete steps that can be taken. Aiming to encourage growth in the market, Columbia Threadneedle Investments has contributed to the thinking behind the principles.

A key activity for any impact investor is lobbying for change. More countries look likely to commit themselves to zero carbon emissions targets, as well as frameworks for achieving this and new regulations. A competitive tension is building as countries want to make sure they do not get left behind. Both government and the bond market will channel funds into a green recovery in 2021. Notably, the EU is raising €100 billion to aid countries hit hard by Covid-19, with much of the issuance conducted in 2021⁸.

For its part, Columbia Threadneedle Investments is looking to improve the market – in terms of the opportunities for issuance, the quality of the bonds and the rigour of reporting – and are again working with the International Capital Markets Association (ICMA) to achieve this. Both the French and German governments issued their first green bonds in 2020 and we have been making the case for green UK government gilts, notably through our membership of the Impact Investing Institute.

When UK Chancellor, Rishi Sunak, announced in November his plans to issue the UK's first green gilts in 2021⁹ it was a significant step. The Impact Investing Institute's October 2020 joint proposal for a Green+ Gilt was supported publicly by 40 asset owners and investors, representing assets under management of more than £10 trillion, showing the substantial support in the market¹⁰.

It seems that Covid-19 has hastened a shift in responsible investing. Fixed income is coming of age as an asset class for responsible investing, bringing the advantages of scale and focus. As a result, pension funds have greater opportunity to make a positive impact and a material difference in the need to deliver the UN's SDGs and create a fairer world for the future.

⁵ As at 31 August 2020. Source: Bloomberg, Columbia Threadneedle Investments.

⁶ As at 31 August 2020. Source: Bloomberg, Columbia Threadneedle Investments.

⁷ Impact Investing: Good Governance Principles for Pension Trustees. <https://www.impactinvest.org.uk/the-power-of-pensions-how-pension-funds-can-invest-with-impact/>.

⁸ EU Social Debt Among 2020's Most Coveted With \$207 Billion Bids, Bloomberg, 10/11/2021.

⁹ FTadviser.com, UK to launch first green gilt in 2021, 10 November 2020.

¹⁰ <https://www.impactinvest.org.uk/wp-content/uploads/2020/10/Green-Plus-Gilt-Proposal.pdf> October 2020.



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