Bloomberg Environmental Social Goverance - Module 4

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ESG Integration - Fixed Income

ESG and Fixed Income Investments

ESG investments offer a clear value proposition, but evaluating them within fixed income requires precise risk assessment. Unlike equities, bonds have capped upside limited to par value, so it's essential to weigh potential gains against downside risk. The ESG investment team at Worthing Capital Management emphasizes the relevance of ESG factors to a corporation's financial performance, especially how these factors influence future creditworthiness and debt repayment capacity. This includes internal dynamics such as governance, accountability, risk management, health and safety standards, as well as external pressures like environmental regulations, resource scarcity, and commodity price volatility. For instance, an airline with fuel-efficient aircraft is less vulnerable to gas price spikes, making it a stronger long-term investment. ESG materiality also varies by bond maturity and sector; climate regulations affect long-term bonds more than short-term ones, and water management may be irrelevant to financial firms but critical for materials companies. Thus, understanding ESG materiality across industries and maturities can provide a competitive edge in credit markets.

Integrating ESG into the Fixed Income Workflow

The integration of ESG into fixed income differs from equities because debt instruments like bonds and loans do not carry ESG scores, which are assigned at the issuer level. Instead, bonds are labeled to indicate how their proceeds will be used—for instance, funding renewable energy, clean transportation, or green buildings. There are several types of sustainable debt: green bonds, sustainability bonds, sustainability-linked bonds, social bonds, and transition bonds. Green bonds have gained significant popularity, with global sales reaching $513 billion in 2021, and are issued by well-known companies such as Google, Netflix, Salesforce, and Coca-Cola. These bonds, whether from corporations, governments, or development banks, are aimed at financing environmentally beneficial projects. Even companies in high-emission industries can issue sustainable debt if the use of proceeds satisfies certain criteria. However, Worthing Capital Management does not accept green-labeled bonds at face value; the eligibility of a bond to be considered "green" is determined by the underlying project's alignment with sustainability goals, not by the issuer's overall profile.

How Bonds Become Green

The integration of ESG into fixed income workflows differs from equities because debt instruments like bonds and loans do not carry ESG scores, which are assigned at the issuer level. Instead, bonds use specific labels that indicate how proceeds will be used—for example, funding renewable energy, clean transportation, or green buildings. Current classifications of sustainable debt include green bonds, sustainability bonds, sustainability-linked bonds, social bonds, and transition bonds. Driven by investor demand for positive impact, green bonds have grown in popularity, reaching $513 billion in global sales in 2021, with issuers such as Google, Netflix, Salesforce, and Coca-Cola participating. These bonds, whether issued by corporations, governments, or development banks, aim to fund environmentally beneficial projects. Even companies in traditionally high-emission industries can issue sustainable debt if the use of proceeds meets eligibility criteria. Worthing Capital Management does not automatically accept green-labeled bonds; instead, it evaluates eligibility based on the underlying project's sustainability—not merely the issuer's label—before investing.

Bond Types and Use of Proceeds

Social and sustainable bonds are used to finance projects with wide-ranging positive impacts aligned with sustainable development goals (SDGs) and climate-related objectives. The classification of these bonds depends on the designated use of proceeds. For example, the Climate Awareness Bonds issued by the European Investment Bank (EIB) in 2007 were the world's first green bonds. Sustainability bonds fund both green and social initiatives, while social bonds are focused exclusively on outcomes such as pandemic relief, affordable infrastructure and housing, food security, socioeconomic advancement, gender equity, and education. Green bonds and loans are debt instruments designed to finance projects with environmental and climate benefits, including energy-efficient buildings and renewable energy implementation. The globally recognized framework guiding green bond issuances is the Green Bond Principles (GBP), developed and monitored by the International Capital Market Association (ICMA), and structured around four key components.

Screening for Green Debt

Andrew, a portfolio manager at Worthing Capital Management, wants to ensure that his fund supports truly green investments through rigorous due diligence. He opens Bloomberg's Fixed Income Search tool by typing `SRCH` and filters for corporate bonds by deselecting government bonds in the asset classes section. To avoid duplication in his universe, he selects "Consolidate Duplicate Bonds" to merge bond series like REGS and 144A issued in different markets. He adds the Green Instrument Indicator criterion to target bonds whose net proceeds support green projects such as climate change mitigation or other environmental sustainability efforts. To enhance transparency, Andrew includes Green Bond Principles (GBP) alignment fields in his screen—specifically "ESG Project Selection Process," "ESG Management of Proceeds," and "ESG Reporting"—using Bloomberg's ICMA-targeted fields to combat greenwashing. He also adds ESG Assurance Providers to ensure credible tracking of proceeds and impact alignment. To standardize analysis, he sets currency to U.S. dollars and filters for bonds with an amount outstanding of at least $300 million for liquidity. Lastly, he excludes defaulted bonds by setting "is defaulted" to "no." After applying all these filters, the bond universe is narrowed to 276 securities for further evaluation.

Exploring Relative Value

Andrew performs relative analysis on his green bond universe using Bloomberg's Fixed Income Worksheet (FIW). He groups the bonds by sector and switches the yield display to assess average yields by maturity. In the utility sector, he observes that 5–7 year green bonds yield 6.47%, while 30+ year bonds yield 7.76%. Recognizing higher yield as a potential opportunity but aware of default risks, Andrew analyzes option-adjusted spread (OAS) to normalize comparisons between callable and non-callable bonds. He visualizes OAS versus duration across sectors, filtering for U.S.-only BBB+ to BBB- bonds to eliminate rating and currency-related risk. He then inspects spreads by sector, identifies pricing dislocations, and considers a trade: buying tech bonds and selling healthcare bonds. He uses a regression curve set to Linear-Log to evaluate bond spreads within and across sectors, noticing that the KRC bond in the financials sector appears cheap compared to FITB, with spreads of 233 and 125 BPS respectively. Further year-to-date OAS analysis reveals KRC widened by 116 BPS versus 45 BPS for FITB. With both bonds meeting green screening criteria, Andrew considers a potential relative value trade. He compares their historical spreads using Bloomberg's HS tool, finding that the current OAS difference of 108 BPS is 2.21 standard deviations above the average of 55 BPS, at the 96.8 percentile of the historical range. Concluding that the KRC bond is undervalued, Andrew considers selling FITB (163 OAS) to buy KRC (249 OAS), adding significant spread to his portfolio.

Checking for Greenium

Green bonds have historically shown a "greenium," or green premium, meaning they tend to yield less than comparable non-green bonds due to higher demand and perceived value. Andrew investigates this phenomenon within the utilities sector by creating a new SRCH in Bloomberg's Fixed Income Search tool, filtering for utility bonds, and analyzing them in the Fixed Income Worksheet. His goal is to compare the yields of green versus non-green utility bonds across different maturities. He observes that green bonds consistently yield less than their non-green counterparts, indicating they are issued at higher prices because of

their scarcity and strong investor demand. Although Andrew is cautious about paying a premium—preferring bonds that can appreciate in value post-purchase—he acknowledges that the rapid growth of the green bond market offers a meaningful opportunity to help finance the global energy transition.