How ESG can help build resilience in Buy and Maintain credit strategies

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Responsible investment has always been about the long term. Equity investors want to know a company isn't vulnerable to global shifts around environmental or social issues and for fixed income investors, looking to more distant horizons, it might be about ensuring a business can be part of a resilient strategy for the next 20 years.

For asset managers seeking to build such strategies, it's all about culture. At AXA IM, we believe our Buy & Maintain business benefits from credit analysis that puts environmental, social and governance (ESG) factors at its heart. It's not for show – the integration of ESG decisively shapes allocations. We believe this can help deliver long-term performance enhancement for institutional investors.

The reason is simple. Companies that can't adapt to new realities have never made for great investments, and as the world embraces innovative ways of responding to climate and social change, this is only becoming more important. So how do we make sure our strategies are prepared?

Scores and more

ESG scores are a very useful part of our process, but they are the starting point, not the destination. Our proprietary system[1] uses raw data covering more than 7,200 companies and 100 countries to deliver a simple score from 0-10. This is the first hurdle, and we will not buy a bond from a company that scores below 2 on that scale, or which falls foul of our baseline exclusions on issues like controversial weapons.

An ESG score, however, is a static signal. It reveals its true value when combined with a full qualitative assessment. It is, for example, hugely important to track scores through time, to understand why trends emerge. Where we see a company heading up or down the scale, the real investment driver is knowing what lies behind the trajectory.

Companies with an ESG score above 2 still face detailed scrutiny from our credit analysts who take care to factor in ESG risks, and who work in tandem with our equity analysts. The goal is sustainability and resilience – and the results are tangible, not just aspirational.

Exclusions based on ESG quality have allowed us to avoid exposure to ratings downgrades and bankruptcy and we expect the effects of such examples will be seen in performance over time. ESG is like compound interest for long-term, active investors – the impact is magnified as downgrades and defaults emerge over the years. We want to lend to companies that will still be thriving, and delivering cashflows, 15 years from now.

Changing markets

This isn't only about protecting strategies from risk and adapting to global megatrends. It's also about staying relevant in changing fixed income markets. We believe that asset managers who take ESG seriously will have better prospects for allocations when debt comes to market.

AXA IM's scale in fixed income allows us a good overview of the market and we see more and more evidence that allocations are affected by responsible investment characteristics. Simply put, our experience is that banks will allocate more to what they see as real, active, long-term money. Our view is that more supply reaches asset managers who are "seen as green" and that a reputation as a major, innovative player in this space offers a hard-earned edge, and influence over the nature of issuance. The market is also moving towards standardisation of how ESG is reflected in issuance (most obviously in Green and Social bonds) and asset managers with strong systems have a potential advantage.

Transparent

Once we secure an allocation from a company with strong financial and ESG credentials, there is still more value to be gained from active engagement with management. In 2019, alongside intense stewardship activity in equity markets, we engaged with close to 40 debt-only issuers[2]. The goal is a nuanced understanding of a company's progress according to ESG criteria, that allows us to build a strategy that is sustainable from all angles.

Clients might see the effects of easier access to primary issuance, but it has been more difficult for investors to have visibility over the engagement process. Our pension fund and insurance clients need to understand how we are addressing ESG concerns and so we have enhanced reporting to give greater details of milestones and results.

Clients can receive a line-by-line report, complete with a timeline of engagement steps and the themes where we are seeking improvement. Our team is always on hand to give deeper insights into the process, while our twice-yearly Stewardship report gives details of every single engagement we make.

Engagement at a strategic level

One example has been to push oil companies to make 'net-zero' commitments on emissions as we seek to protect the long-term interests of clients by influencing the future of the energy industry.

AXA IM lends to one oil major on the basis of a 2050 net-zero commitment. Any deviation from that path could prompt a refusal to participate in new issuance. Among carmakers, we favour those trying to transition ahead of the regulatory imperative. One global name gained an allocation, not simply because it issued a Green Bond, but because it specifically earmarked funds for sales leasing on hybrids. This kind of verifiable, trackable data encourages us to invest.

Growing markets

New and expanding markets have amplified the role of responsible investment. We have sought a leading role in the growth of Green and Social[3] bonds – debt designed to directly address ESG issues, and which is often anchored in the UN Sustainable Development Goals (SDGs).

These targets have given issuers a useful way to pitch debt to responsible investors. But they do not remove the need for scrutiny – in fact, engagement can be more intense to make sure technical and disclosure requirements are met. The SDGs inform our frameworks for Green and Social bonds, but they don't decide them. It is crucial to avoid 'greenwashing', where companies pay lip service to targets, and as a proud active investor our focus is on tracking how money is actually used.

Again, reputation matters. AXA IM's leadership in the field of Green bonds[4] helps shape the sector. This includes membership of the Green Bonds Principles Executive Committee where we have helped provide industry guidelines to improve transparency and disclosure.

Our role in the development of Transition bonds highlights our thirst for practical innovation. In 2019, we published guidelines[5] that allowed for a €100m issue of this new type of debt, which allows carbon-intensive companies to finance decarbonisation projects. We are now leading industry efforts to ramp up this new asset class[6]. We also have more than £2bn of exposure to the social housing sector where we selectively lend to Housing Associations with clear social development strategies.

When you take ESG seriously in fixed income, opportunities can emerge. As the market adapts to the realities of climate change and other ESG challenges, we believe it pays for asset managers to embed true responsible investment techniques in their allocation process. Just as we seek out companies that stay ahead of the curve, so asset managers have a duty to be at the leading edge as the investment industry evolves.

FOOTNOTE

1 AXA IM: Our Scoring Methodology
2 AXA IM 2019 Stewardship report
3 Rise in Covid-19 bond issuance fans fears over 'social washing' Financial Times, 30 June, 2020
4 AXA IM: Our Green Bond framework
5 IPE, 12 June 2019: AXA IM calls for 'transition bonds' to help companies go green
6 ICMA Working Group on Climate Transition Finance

AXA Investment Managers