

# Impact investing through sterling denominated listed fixed income

## A lens on the UK

Strategy brief 2020

Triodos  Investment Management



# Impact investing through sterling denominated listed fixed income: A lens on the UK

Triodos Investment Management is a boutique impact investment firm. We operate on the conviction that capital can be used to facilitate intentional and measurable positive change, and this philosophy is embedded across our entire business. In this strategy brief, we present our approach to impact investing through listed fixed-income, with a lens on the UK bond market. It is intended to provide an overview of how we approach impacting investing through this asset class and currency.

We believe that fixed income investing, when done consciously and with purpose, can have meaningful positive impact on society and the planet. We approach this asset class with the intention to build high impact portfolios that meet the basic credit quality, liquidity, and diversification needs of our investors.

Our in-house, and often qualitative, research guides the investment process by developing opinions of each issuer's commitment to sustainability and

contribution to our sustainable transition themes through their products, services and/or operations.

Our listed fixed income strategy invests and operates in accordance with the core characteristics of impact investing laid out by the Global Impact Investing Network (GIIN) through:

- > Investing for intentional and directional positive environmental and social outcomes
- > Using evidence and impact data to drive intelligent investment design that will be useful in contributing to social and environmental benefits
- > Managing impact with clear checks and feedback loops to ensure continued progress toward intended outcomes
- > Using shared industry terms, conventions, and indicators for describing impact strategies, goals and performance, and by sharing learnings to enable others to learn from our experiences as to what actually contributes to social and environmental benefits.



## A thematic approach

Impact investing through listed bonds requires us to maintain an understanding of the chain reactions prompted by global sustainability challenges, and to establish a long-term vision as to what solutions can most effectively, and most sustainably, solve them. We take a thematic approach to impact, seeking to build fixed income portfolios of companies, issuers, and projects that actively address:



### > SUSTAINABLE FOOD AND AGRICULTURE

Companies that preserve soil, water systems, nature and biodiversity, and those that promote sustainable food and healthy diets.



### > RENEWABLE RESOURCES

Companies that provide an alternative to fossil fuel based resources, such as renewable energy and bio-based materials, and those that contribute to efficient water infrastructure.



### > CIRCULAR ECONOMY

Companies that follow the principles of circular economics, including efficient waste management and product-as-a-service business models. The circular economy model decouples economic growth from the extraction of scarce resources.



### > SUSTAINABLE MOBILITY AND INFRASTRUCTURE

Companies that offer solutions for sustainable mobility and infrastructure such as urban mobility, sustainable buildings and electric vehicles.



### > INNOVATION FOR SUSTAINABILITY

Companies that are front-runners in sustainable innovation and technology including cybersecurity, telecommunications, robotics and information technology.



### > PROSPEROUS AND HEALTHY PEOPLE

Companies that advance health solutions such as medical technology, health care and personal hygiene, as well as companies that promote active lifestyles and leisure.



### > SOCIAL INCLUSION AND EMPOWERMENT

Companies that provide education, inclusive financial services and access to media and information, as well as companies that excel as a role model in advancement of equality.

## Minimum sustainability standards

As an organisation dedicated to driving sustainable change through targeted use of capital, we believe that some of the resources and products that companies use, manufacture or sell are irreconcilable with our positive impact ambitions. We have set forth exclusionary criteria that is applicable across the entire Triodos Group. These negative screening criteria fall into three categories: Product, Process and Precautionary. You can find a comprehensive list of our Minimum Standards [here](#).

### > PRODUCT (REVENUE) <sup>1</sup>

Weapons, nuclear (0%); Tobacco, gambling (5%); Petrol, oil, gas, coal, or other extraction (5%); Unsustainable cotton (5%); Fur or leather (5%); Fishery products and beef that do not comply with international standards (5%).

### > PROCESS

Violations of conventions on labour and human rights, environment, corporate governance. Includes corporate taxation, fair wages, executive pay, and animal testing.

### > PRECAUTIONARY PRINCIPLES

For companies in sectors with increased sustainability risk, unless actively preventing controversies.

## Types of bonds used

### Corporate and sub-sovereign institutional credits

Our fixed income impact portfolios make use of a variety of debt types, including corporate bonds and sub-sovereign bonds issued by companies and institutions that possess strong positive impact driven business and operating models. We identify organisations that contribute to positive change and that meet our strict minimum criteria. If an

organisation meets these, we can invest in all its bond issues. These “vanilla” bonds of very impactful organisations are a cornerstone of our listed fixed income impact strategy.

### Designated green and social bonds





Triodos Investment Management sees designated green and social bonds as providing an important vehicle for companies to raise money for new projects with specific environmental and social benefits. By issuing these bonds, the balance sheet of the issuer becomes more sustainable. Designated green and social bonds have specific impact frameworks to which the bond proceeds must be earmarked, and, most often, are aligned with international standards such as Climate Bonds Initiative or International Capital Markets Association (ICMA) principles or guidelines. Most issuers will engage a third-party opinion provider to evaluate the bond framework for its alignment with these standards.

When investing in these types of bonds, we take our assessment several levels deeper by also evaluating the issuer at corporate level and by determining impact additionalities of the projects. We apply our product, process, and precautionary minimum standards to the issuing organisation to ensure that green investments made in one part of the organisation are not offset by ‘brown’ activities in other parts of the organisation.

### Government bonds / gilts

We also invest in bonds issued by the UK national and city governments. In their “vanilla” form, we do not believe these bonds enable direct positive impact since these instruments fund overall government treasuries, and we cannot track the use or impact of the proceeds. However, the credit and liquidity characteristics of these bonds are an important part of our portfolio management, as they enable the high impact portfolios to meet investor expectations for daily liquidity and for investment grade quality. We encourage national and municipal governments to issue green and social bonds to enable more direct positive impact through our portfolios. The British government

<sup>1</sup> The percentages reflect the maximum revenue allowed for investment eligibility.

		Issuer type			
		Sovereign and government bonds		Corporate bonds	
Bond type	Standard issuance	No impact		Impact of issuer	
	Designated green or social	Impact of the proceeds		Impact of the issuer and/or proceeds	

is yet to issue designated green or social gilts; however, we would be eager for them to explore this area of the capital markets.

### Social impact Bonds (SiBs) and Environmental impact Bonds (EiBs)

Additionally, we are exploring the potential to include **Social impact Bonds (SiBs)** and environmental impact bonds (EiBs) into our listed fixed income portfolios. These are innovative financing tools that use a ‘pay for success’ approach to raise up-front capital from private investors for social and environmental projects. These bonds are typically used to pilot new highly impactful projects or to scale up recently tested projects. In their most basic form, investors pay the upfront costs of an environmental or social project and receive re-payments based on the impacts achieved. If the project’s impacts are higher than expected, an investor can receive more than its initially agreed re-payment, however, if the project yields less than its expected impact, the investor will likely receive a lower re-payment.

SiBs and EiBs are not traded on public stock exchanges and are not listed per se. They are generally illiquid and do not obtain credit ratings, which makes these types of debt relatively difficult to invest in while maintaining the credit quality and liquidity expectations of investors. However, depending on the projects associated, these bonds can enable extremely high positive impact, so we are actively exploring ways to incorporate them. Up until this point, we have yet to find a viable way to include these into the portfolio, but will keep a

close watch on their development. They are eligible instruments, up to a maximum allocation, according to UCITS regulation.

### Engagement and stewardship

What many asset managers leave only for the equity team, we carry over into our listed fixed income strategies. Active ownership, engagement, and stewardship are important components of our bond investment process – and we use several entry points to communicate our desire for sustainable outcomes with bond issuers.

We take advantage of opportunities to influence companies and institutions on their sustainability strategies. For example, we engage with bond issuers for information regarding our minimum standards. This engagement helps us to make more well-informed investment decisions and signals to them our need for more robust disclosure of sustainability related information. For new green and social bonds issues, we give direct feedback to organisations on their impact frameworks. This is most often done as part of their capital raising road show with investment bankers. We communicate our expectations for high impact and additionality through these bonds.

### A look at the UK green bond market

The UK is the first developed economy to commit to net-zero carbon emissions by 2050. Companies are stepping up through initiatives like the Net-Zero

Carbon Taskforce launched by the Business in the Community (BITC) group, which is a collaborative platform to develop an open-source net-zero toolkit, detailing the actions businesses can take to reach net-zero in their own operations before 2050, and to encourage other actors in their sectors' value chains to follow suit.

The general public is also ready for more action on sustainability. A **study** conducted by Pure Planet found that one-in-nine (89%) of Brits place carbon neutrality as a top priority. This is up 25% from 2017. It also found that 40% of UK adults want to see greater investment in renewable energy generation and 33% want the government to reduce the amount of fossil fuels it uses to generate power.

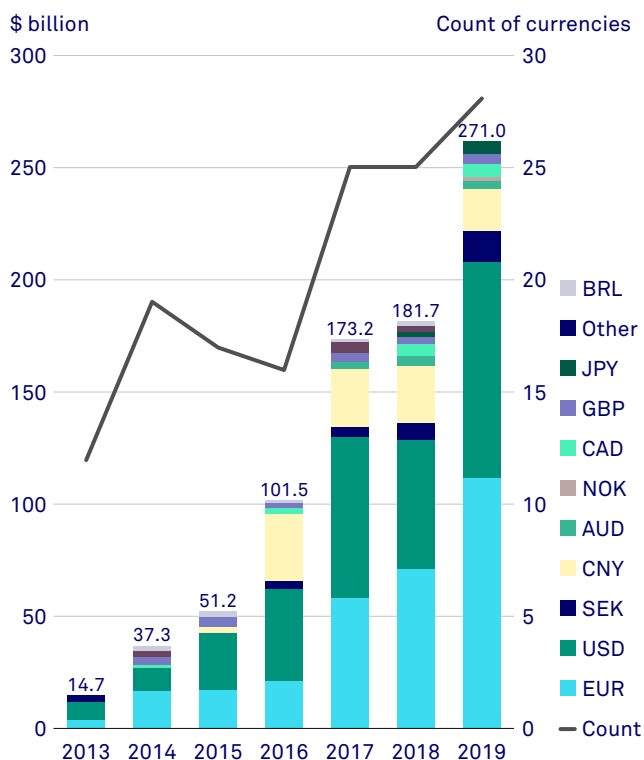
However, the UK government has yet to issue any designated green or social bonds. The UK Debt Management Office has stated a reluctance to raise this type of financing as they view it as too financially burdensome on taxpayers (due to the necessary structured monitoring of the use of the proceeds, the impact reporting, and required

third-party opinions). However, UK funds and investors have a large appetite for this kind of debt. According to the issuing countries, British investors were the second-largest buyers of the world's first sovereign green bond, buying 16% of the Polish issue in 2016. They were also the second-largest buyer of the Dutch sovereign green bond, and the third-largest buyer of France's green bond.

In terms of corporate issuers, the UK has a growing, yet still relatively immature, green and social bond market. Over the past few years, corporates raised about GBP 10 billion through the issuance of green and social bonds, and we expect to see this market further develop in the coming years. We think it is a good moment to enter the UK corporate green bond market and participate in its growth from the earliest days.

In a 2018 **report**, the Green Finance Taskforce, an initiative between the UK government and the City of London, said that green gilts would directly drive investment into clean growth as well as catalyse further issuance of corporate green bonds from the UK. The report states that a UK sovereign green issuance would be a game changer by:

### Green bond issuance by currency



Source: BloombergNEF, Bloomberg LP

- > Directly raising and deploying additional capital to support new key climate projects and ensuring the capital is deployed to fund areas where it will create significant additionality in terms of impact
- > Sending a powerful signal to investors and issuers that positions London as a green finance hub
- > Stimulating further development of the sterling green bond market, which lags behind the green markets in RMB, € and US\$
- > Energising wider popular participation in the green finance agenda (if a retail bond is chosen)
- > Hardwiring climate change mitigation and adaptation into the national assets and liabilities, and improving the UK long-term creditworthiness profile
- > Signalling that the UK will remain, post-Brexit, to be economy with high environmental standards

# Strategy case studies

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## Nationwide Building Society

Nationwide is a cooperative financial institution and the largest building society in the world. The company is a major provider of both mortgage loans and savings in the UK, as well as personal banking services. Nationwide is committed to building society - for the good of the communities and economies in which its cooperative members live and work across the UK. The organisation is committed to being a responsible lender, acting only in the best interests of its customers. Nationwide acts with honesty and transparency and these qualities underpin everything Nationwide does. The way the company lends money is no exception.

## United Utilities Water Ltd

United Utilities is responsible for water and wastewater services in the North West of England. Its purpose is to provide great service to customers and communities in the North West, creating long-term value for all of its stakeholders. The organisation delivers 200 million litres of clean water a day to more than 3 million homes and businesses in the North West, as well as treating all the wastewater, which disappears around the U-bend. Keeping the region flowing relies on a vast behind the scenes operation, involving hundreds of reservoirs, treatment works and pumping stations; thousands of kilometres of water pipes and sewers and a 5,000 strong workforce.



## Prologis

Prologis is a real estate company based in the US that leads the pack in terms of environmental stewardship, social responsibility, ethics and governance. The company provides industry-leading, energy-efficient buildings that meet or exceed recognized sustainable development standards and reduce customer operating costs, promote health and well-being, and enhance the local community. Prologis actively engages its employees and customers around health and wellness, and in strategies to reduce energy, water and waste usage to enhance profitability and reduce environmental footprints.

## European Investment Bank

The European Investment Bank is the lending arm of the European Union. The organisation is the biggest multilateral financial institution in the world and one of the largest providers of climate finance. The EIB helps stimulate the economy, create jobs, promote equality and improve lives for EU citizens and for people in developing countries.

Triodos Sterling Bond Impact Fund generates positive impact and stable income from a concentrated portfolio of investment-grade and non-rated, GBP-denominated bonds issued by companies, semi-public institutions and governments. The fund goes beyond ESG to apply the core principles of impact investing to listed fixed income, focusing on seven sustainable transition themes, which are the cornerstone of the (green and standard) bond selection process. The fund



holds long-term positions with broad exposure across durations, sectors and sustainable transition themes, and is daily liquid.

For more information please contact Adam Robbins, Senior Investor Relations Manager for the UK.

### **About Triodos Investment Management**

With over 25 years of experience as a globally active impact investor, and as a wholly-owned subsidiary of Triodos Bank, Triodos Investment Management has developed deep sector-specific insights across Energy & Climate, Inclusive Finance, Sustainable Food & Agriculture, and Impact Equities and Bonds. Offering impact solutions through private equity, debt, and listed equities and bonds, our assets under management amounted to EUR 4.6 billion as per 30 June 2019.

### **Investing in positive change**

For more information about the Triodos Impact Equities and Bond Funds, and other sustainable investment opportunities, please contact Adam Robbins:

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[www.triodos-im.com/impact-equities-and-bonds](http://www.triodos-im.com/impact-equities-and-bonds)