

Signatory of:



»» ESG as a Risk Indicator for Bond Investors. Results of the PRI-Working Group “Corporates”

Frankfurt, 28. November 2013

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Bank aus Verantwortung

The logo for KfW, consisting of the letters 'KFW' in a bold, blue, sans-serif font.

»» Members of the PRI fixed income-working group “corporates”

- › **AEGON Asset Management**
- › **AllianceBernstein L.P.**
- › **Allianz Global Investors**
- › **Allianz SE**
- › **AMP Capital Investors**
- › **Amundi Asset Management**
- › **ATP - The Danish Labour Market Supplementary Pension**
- › **BlueBay Asset Management LLP**
- › **Breckinridge Capital Advisors**
- › **Caisse de dépôt et placement du Québec**
- › **Carbon Tracker**
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- › **EIRIS Ltd**
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- › **MN**
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- › **NEI Investments**
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- › **oekom research AG**
- › **Pension Protection Fund**
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- › **PIMCO**
- › **Robeco**
- › **Sustainalytics**
- › **UNEP Finance Initiative**
- › **Union Investment**
- › **Unipension Fondsmæglerselskab A/S**

»» Goals of the PRI fixed income-working group

› **1. Question**

How can ESG factors affect the creditworthiness of both, companies and countries, in the short and long run?

› **2. Question**

To what extent do academic studies support the assumption that a sustainable investment is beneficial?

»» Why a fixed-income working group?

Globally, fixed income represents **the largest portion of assets**

è up to now, only a little ESG research is available

Different focus of fixed income-investors vs equity-investors:

è Investors are rather **focused on risks** than on opportunities

è Buy-and-Hold-Strategy: Investors are **exposed to more long-term ESG risks**

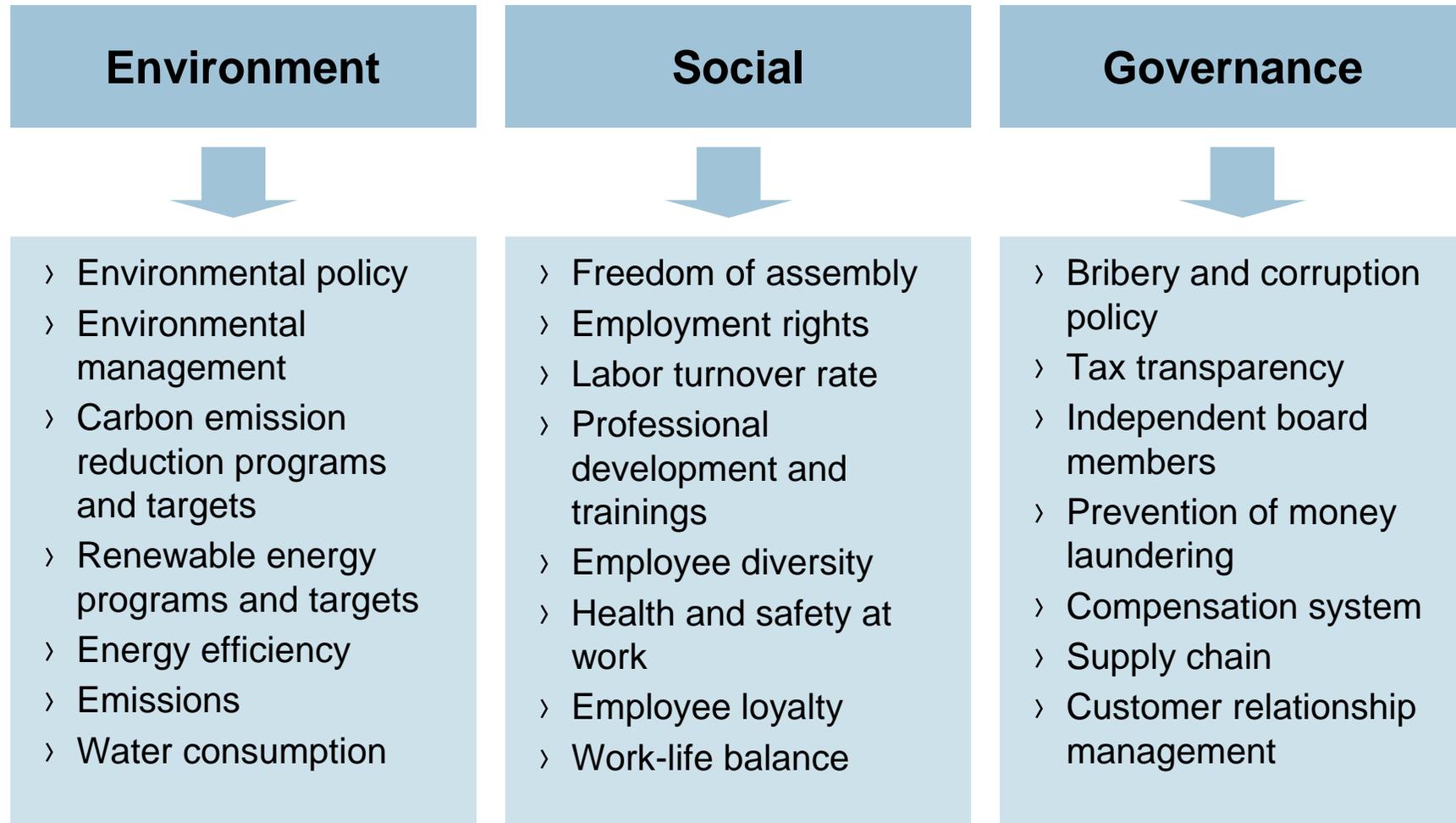
Demographic change, natural resources scarcity, climate change, “governance“-issues

è **The importance of ESG factors will increase** in the risk analysis of both, companies and countries

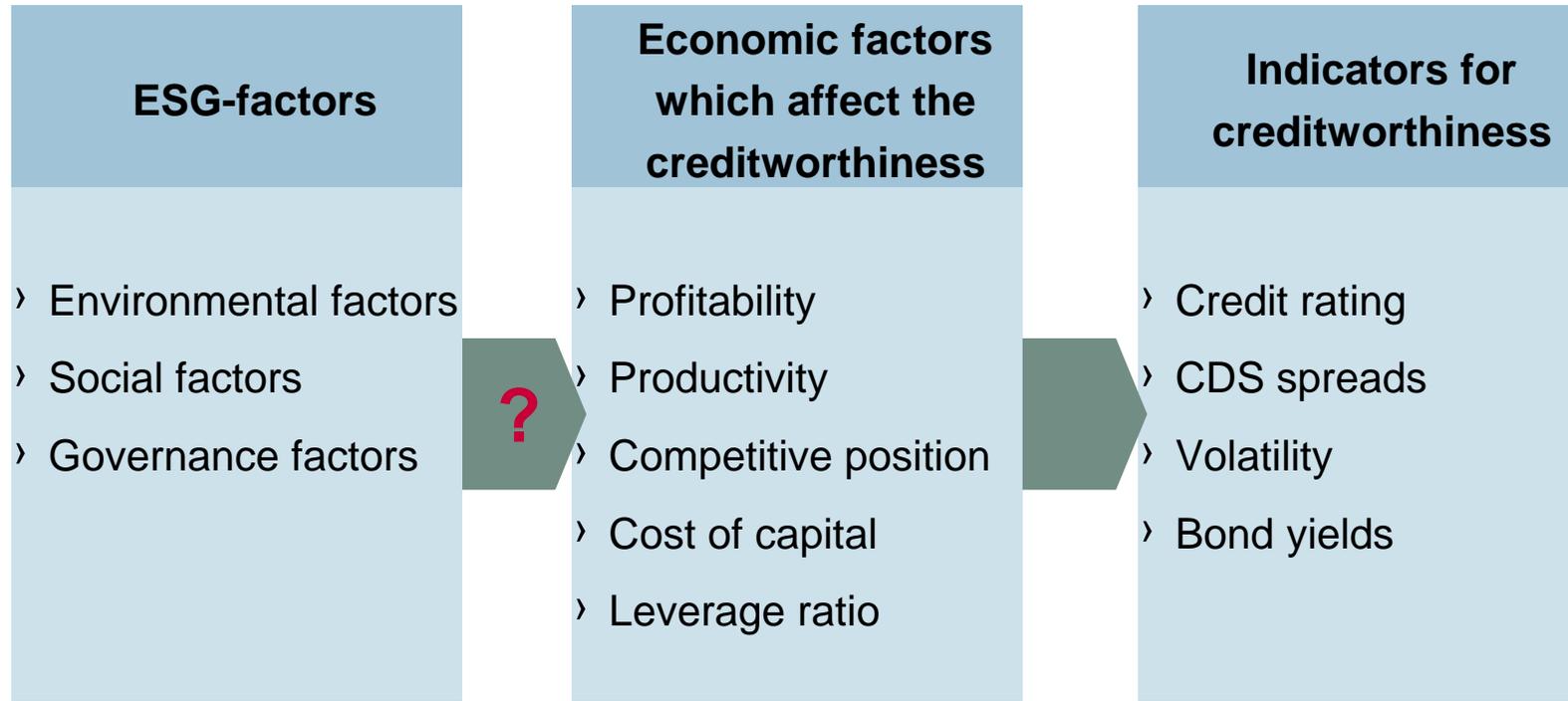
è Nowadays, both investors and asset managers pay higher attention to **reputational risk**

è The demand for sustainable fixed income-products is increasing

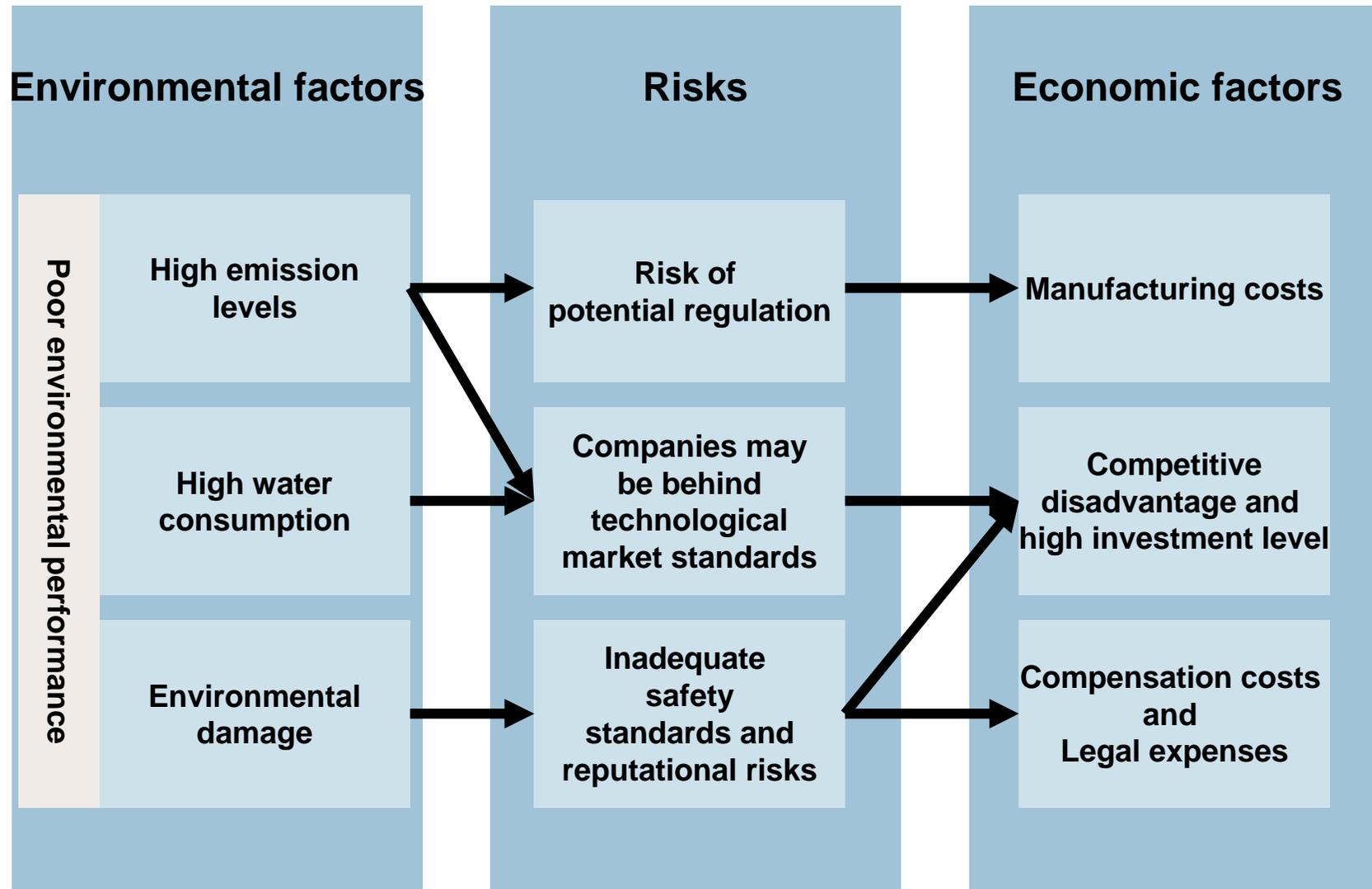
»» ESG-criteria for corporates



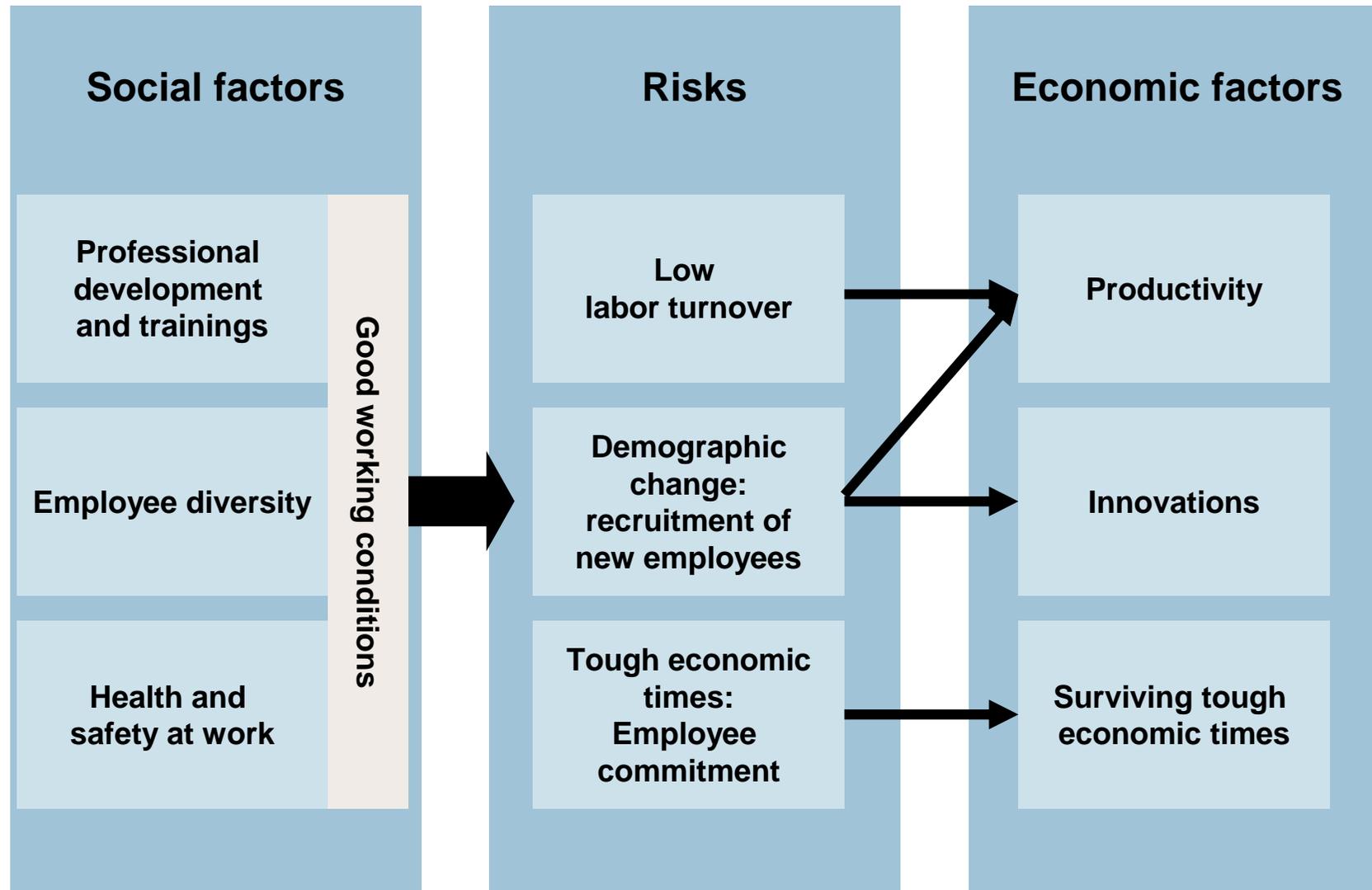
»» Connection between ESG and creditworthiness



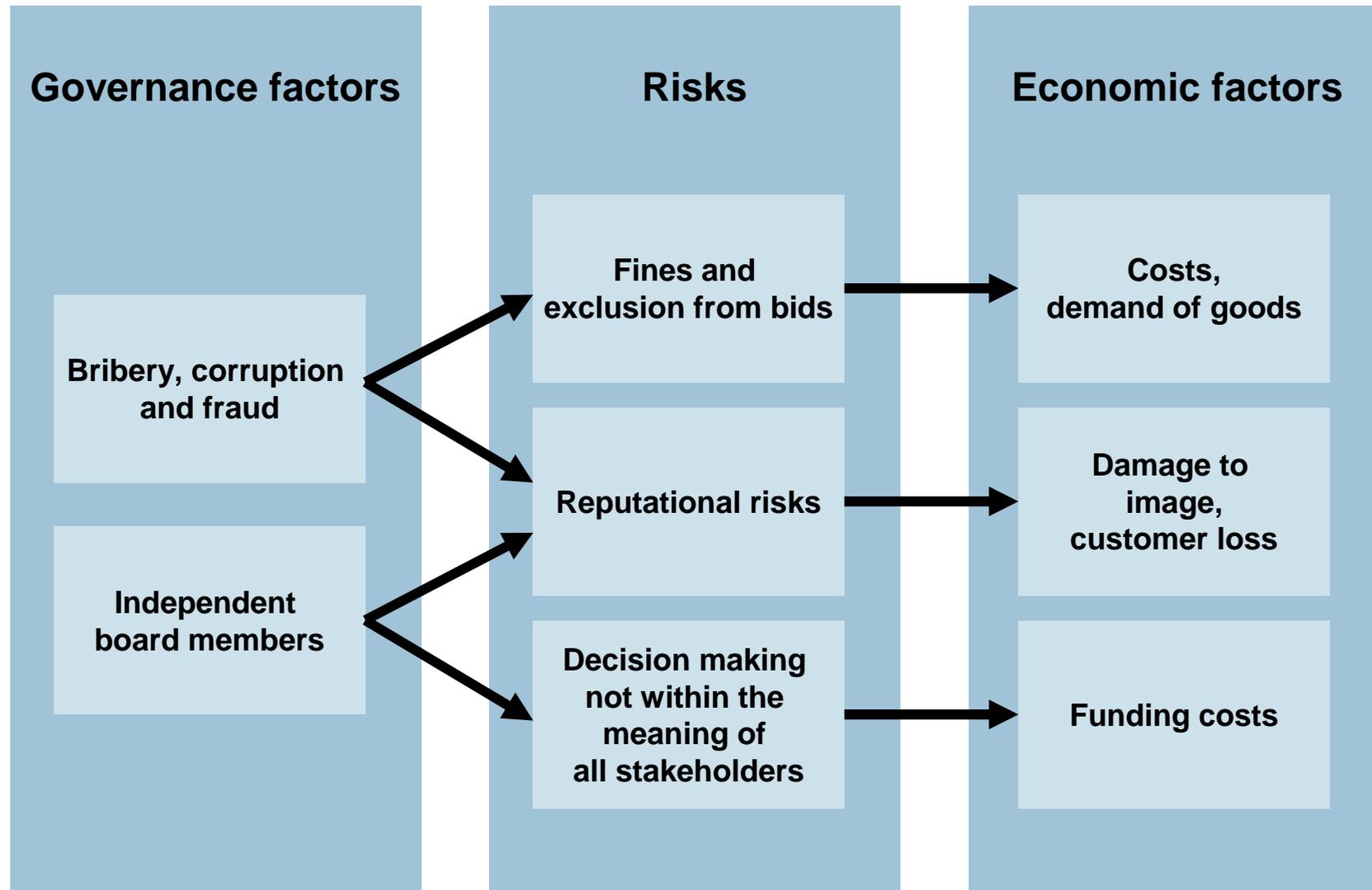
»» From environmental factors to economic factors



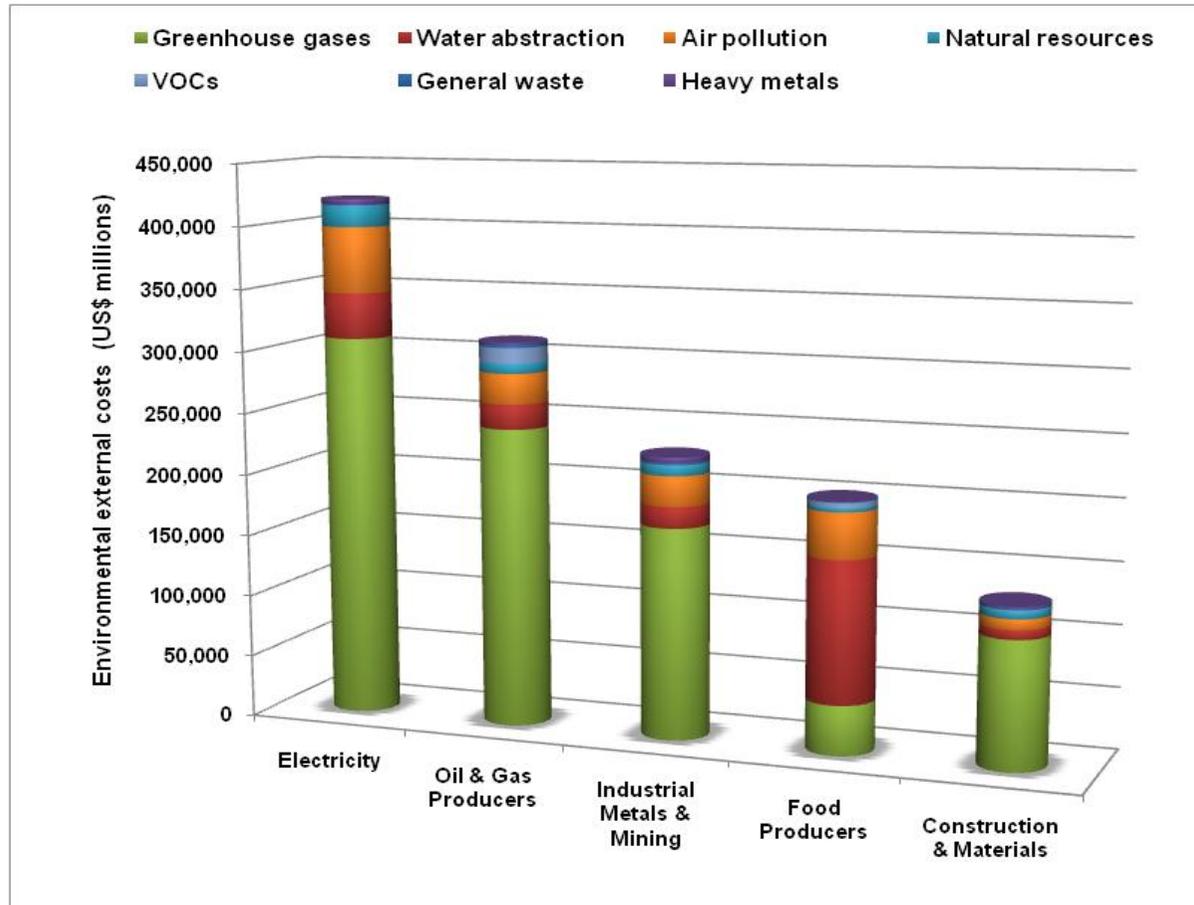
»» From social factors to economic factors



»» From governance factors to economic factors



»» Importance of ESG factors for different sectors



Source: *Universal ownership: why environmental externalities matter to institutional investors (full report)*, Trucost/PRI, April 2011

»» Answer to 1. question

Answer of the working group to the 1. question

ESG factors affect the creditworthiness of companies.

The importance of ESG factors depend on...

- **Industry sector**
- **Business size**
- **Leverage**

However, all companies are exposed to an **increasing importance of ESG factors** because of...

- **Scarcity of resources**
- **Climate change**
- **Governance issues**
- **Increasing reputational risks**
- **Regulatory risks**

»» Academic research outcomes

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“environmental practices affect the solvency of borrowing firms, by determining their exposure to potentially costly legal, reputational, and regulatory risks.”

Rob Bauer, Daniel Hann, “Corporate Environmental Management and Credit Risk”, European Centre for Corporate Engagement, Maastricht University, 2010

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“knowledge of the state of employee relations is incrementally useful in assessing the likelihood that firms will experience the onset of financial distress”

Kane, G. D., Velury, U., Ruf, B. M., 2005. Employee relations and the likelihood of occurrence of corporate financial distress. Journal of Business Finance and Accounting 32, 1083-1105.

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“we find that firm credit ratings are:

- *negatively associated with the number of blockholders that own at least a 5% ownership in the firm;*
- *positively related to weaker shareholder rights in terms of takeover defences;*
- *positively related to the degree of financial transparency; and*
- *positively related to overall board independence, board stock ownership and board expertise and negatively related to CEO power on the board.”*

Ashbaugh, H., Collins, D. W., and LaFond, R., (2004), “The Effects of Corporate Governance on Firms’ Credit Ratings.” Journal of Accounting and Economics 42, 203-243.

»» Summary of all academic research outcomes

- › The working group assessed **15 academic research articles**.
- › The majority of studies evaluate how **ecological and governance factors** influence companies.
- › All articles compare US companies only.

› **Significant results**

- › **Strong dependence between ESG factors and credit risk**
 - no significant indication that relationship does not exist.
- › **Poor ESG performance** leads to poor credit ratings and higher funding costs.
- › Economic consequences depend on **leverage** and **industry sector**.



Answer to 2. question : academic research articles underline that sustainable investments are economically useful.

»» Discussion paper

Will be published
in December 2013



»» Working group's next steps

- › **1. “ESG risks“ - stage:**
 - › Currently, outcomes are summarized in a presentation and discussion paper.
- › **2. “ESG implementation“ - stage:**
 - › How to implement ESG factors in an investment strategy?
- › **3. “Engagement“ - stage:**
 - › How can fixed income investors engage with issuers?

- › **Expansive communication of the outcomes** to all signatories, “mainstream investors“, rating agencies, and the media.

»» Kontakt

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