RBC BlueBay Asset Management

An art, not a science: how to invest for impact

For professional investors only | Marketing communication

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"The Global Impact Investing Network estimates that the size of the worldwide impact investing market passed one trillion dollars in 2022, reaching USD 1.164trn[1]."

From data challenges to attractive issuers, Harrison Hill runs down the how and the why of impact investing in public debt markets.

Impact investment is growing in popularity all the time. The Global Impact Investing Network estimates that the size of the worldwide impact investing market passed one trillion dollars in 2022, reaching USD 1.164trn[1].

Fixed income's growing role in impact

Within this ever-expanding market, fixed income is playing an increasingly important role. This is happening for two main reasons.

Firstly, as the public debt market is bigger than the public equity market , there's a huge amount of scope for investors to have an impact through this asset class. Investing via debt markets provides access to issuers and instruments that don't exist in the equity world, enhancing the toolkit available to impact investors.

Secondly, debt is an important part of the capital structure for issuing companies as the cost of debt is generally less than the cost of equity. It allows them to engineer their balance sheets to achieve tax efficiencies and reduces funding costs for the impactful projects they're working on. That means there's plenty of motivation for issuers to launch new bonds in the primary market. It also means that investors are valuable and can exert their influence through engagement or helping to structure new deals.

What's the secret to doing impact well?

Issuer selection is definitely an art rather than a science. The need for an 'artistic' approach is driven by the challenges around data. Companies may not report certain metrics, for example, their scope three emissions, and even when they do, they may calculate them in a different way than other companies. Investment grade issuers are better with disclosures than their counterparts in high yield or emerging markets, but there's still a lot of incomparable or missing data.

For us, it's not just about screening out particular types of issuers – it's about having a minimum level and then handpicking the most compelling, most impactful ones. In our impact-aligned strategy, we have a solid framework that determines an issuers' eligibility for consideration. Still, after that, we spend a huge amount of time debating them before selection.

[1] GIINsight: Sizing the Impact Investing Market 2022.

Navigating ESG reporting

There are also issues with the mainstream environmental, social and governance (ESG) data and ratings providers. Indeed, earlier this year, the UK Financial Conduct Authority (FCA) threatened them with regulatory action over the potential for widespread failings due to 'subjective' methodologies[2]. We believe these ESG ratings and metrics providers can have their uses, but there can be problems around methodological consistency and comparability of the outputs. Expanding utilisation of vendor data to impact reporting, when ESG reporting can at times be an imperfect science, has its perils and is an area where we are regularly engaging with our data providers.

In the BlueBay fixed income team, for our impact-aligned reporting, we have gone off-piste and hired a Scandinavian impact measurement firm to conduct in-depth assessments of the issuers we are looking at via net impact ratios. They can also determine the impact of funds as a whole by weighting constituent net impact ratios to provide a top-level figure. We decided this was a necessary step to align our impact-aligned reporting with how we invest, netting pros and cons of the underlying business' products and services on the planet and society while also providing a verification of sorts of our methodology.

Looking ahead

Despite these challenges, we are pleased with the progress we've made. There's no doubt in our minds that the impact investment market will continue to grow and that public debt markets offer great potential for societal and financial returns in the years ahead.

[2] FCA outlines where improvements are needed in ESG benchmarks.

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