The green process

Royal London Asset Management (RLAM) senior fund manager, Rachid Semaoune, chats with Duncan Ferris about the firm's new Global Sustainable Credit Fund and how in-house processes help to ensure high sustainability standards are met

What does sustainable mean at RLAM and how is it applied to global credit?
We have used the same definition of sustainability since we started managing sustainable funds 18 years ago. Companies meeting our sustainability criteria must provide a net benefit to society through the products and services that they offer or be an environmental, social and governance (ESG) leader. By 'net benefit to society' we mean helping society become cleaner, safer, healthier and more inclusive.

When it comes to applying this to global credit we have two core principles. The first one is sustainability, which I have just explained, and the second is financial soundness. We look for issuers that fit within our current sustainable themes, of which there are currently 10 *[see chart]*, and include essential infrastructure, decarbonised economy, circular economy and community funding.

Source: RLAM

Do you monitor how investments meet your criteria over time?
Definitely. This is not a static process, so we have constant reviews from both credit and sustainability perspectives. We have very strong resources that are supporting our sustainable funds. We have a team of responsible investment analysts, who are experts in looking at ESG factors, who conduct reviews on a regular basis and engage with companies, which is an important facet of our sustainable fund. We also have a large team of sterling and global credit research analysts who carry out typical credit analysis from a financial perspective.

What are the key aims of the Global Sustainable Credit Fund?
Firstly, to invest in companies that have a net benefit to society and invest in a sustainable universe according to our own definition, and to do so without compromising returns or credit quality. The financial aim of the fund, its performance target, is to outperform its benchmark by 0.75 per cent on a three-year rolling basis. The fund would typically be highly diversified by sectors, geographies and holdings. Another important aim of the fund is that it is compliant with the SFDR regulations, which came into effect in March this year. The fund meets all requirements for article nine, which calls for the highest level of sustainability integration in each investment decision.

To what extent do you make use of third-party ESG analysis?
We have our own sustainable process, so we have applied the same process across equity and fixed income sustainable funds. What is unique about our sustainable process is that it actually does not rely on third-party ESG data scoring. At the core of the process is fundamental sustainable analysis, that is done by our team of responsible investment analysts. We use some ESG data run by third parties, such as Trucost for some emissions data, but we do not use ESG data scoring as it is not a substitute for in-house analysis, while our process also does not rely on labelling.

What is really important to understand is that most of these ESG data third parties started with sustainable equity portfolios and are very equity-orientated. In the fixed income world it is very different because we invest in a lot of companies which do not have a public listing, so they are not covered by a lot of these third parties. One example is social housing in the UK, as social housing associations are registered charities and so do not have any publicly traded equities.

What are the key challenges of investment selection in the global sustainable credit market?
We launched our fund in February 2021

and some of the challenges we found were around governance standards. In order for issuers to make it in our sustainable universe they have to meet quite high governance criteria, but in general what we would find is that governance standards in Europe were higher than in the US. Some examples would be executive pay, which tends to be lower in Europe, and the disclosure around remuneration. As such, you have to look at governance standards within the same geography.

Another challenge was trying to find renewable energy companies to invest in, in the US, because there are not that many. Europe is well ahead of the US in the transition to renewables and so there are a lot of opportunities on the continent, especially in the Nordic region. We hope that, with the US joining the Paris Agreement and the new Biden Administration being more committed to tackling climate change, we will be able to find more opportunities in that renewable energy space in North America.

Will you buy green labelled bonds for the fund?

Our sustainable process does not rely on labels, so whether it is green bonds or sustainability bonds we do not rely on it. We prefer to have our own process where we are really able to separate genuinely doing some good for the environment from the ones which are just trying to advertise ESG credentials. We are not against green bonds as we want to encourage companies to grow their green projects, but we are very aware of greenwashing, where some companies give a false impression about how environmentally friendly their business actually is.

Right now, every company's roadshow includes an ESG section, but what are they actually doing and how committed are they to decarbonising their operations. We have exposure to green bonds in the fund but it is very negligible and it is for green issuers who are subject to the same in depth analysis as non-green bond issuers. The green label is not a substitute for full sustainable analysis.

Could you name three positive sustainable themes for global credit investors?

I think the one which gets the most press and is the most commonly referenced by investors is decarbonisation, which is probably the most pressing one given the threat of climate change. We have companies which are purely renewable energy companies such as Ørsted, which is the largest offshore windfarm company in Europe, and Clearway Energy in the US. We also invest in companies which are well advanced in their transition to renewable energy, with one of these being SSE plc in the UK.

Another important theme is housing, as decent quality accommodation is very important as the population grows and this needs to consider the fact that renting may be a reality for the majority of the population. In the UK social housing is very important and in Europe there are many large companies that own a great deal of residential property. We tend to invest in areas where tenants have a lot of rights and where there are rent controls, which is the case in Germany and the Nordic countries.

Another theme which is growing fast is circular economies, which is all about companies involving waste management or use of recycled materials in the manufacturing of goods. Waste less and reuse more is the concept here. Some examples are the UK packaging company DS Smith, which uses a lot of recycled materials, and Darling Ingredients over in the US, which recycles animal by-products for things like biodiesel or collagen.

How do you find the right balance between exclusion, aiming for higher ESG scores, and investing in companies with positive effects on the world?

The good thing about being global is that the size of our universe is considerably larger than the sterling universe. Even if we have a strict set of criteria we can still be truly diversified by sectors and invest in the best issuers in the best geographies. Each region of the world has different advantages. For example, in the healthcare sector there are only three companies issuing bonds in the sterling universe, but if you go global and include major US pharma companies the choice increases to over 80. This significant pickup in diversification is why we really wanted to launch a global sustainable fund on the credit side, as it allows us to take advantage of the best opportunities, including from the sustainability perspective, in different regions.

The value of investments and the income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

Find out more about the Royal London Global Sustainable Credit Fund at rlam.co.uk/GSC

Written by Duncan Ferris