BANOR SIM SpA

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PRESS RELEASE

Banor SIM presents a new study on ESG in the Bond Market

Rome, 15 May 2019 – Following the research that was presented last year on the relationship between stock performance and ESG criteria which analysed the European stock market, today **BANOR SIM** and the **Politecnico di Milano School of Management** presented the results of a study that examines the relationship between the European bond market and ESG ratings.

In the words of **Massimiliano Cagliero, MD and founder of Banor SIM**, "We adopted the same approach and the same methodology used by Harvard Business School Professor George Serafeim, a leading figure in the field of responsible investment, who has been analysing the phenomenon and the correlation between ESG criteria and market performance for years." He went on to say, "In 2018, we focused on analysing the stock market, which brought out the value for an investor of incorporating ESG variables into the investment process in conjunction with *value investing*. This year, we wanted to explore the other sector of the market, the bond market, where our customers have traditionally always been very active. Therefore, we felt it was our obligation to analyse the matter in depth."

Attending the convention, organised by Banor SIM in Rome, today were **Harvard Business School Prof. George Serafeim**, **the Chief Investment Officer of the European Investment Fund,** Dr. **Alessandro Tappi**, and **Politecnico di Milano School of Management Prof. Giancarlo Giudici**, coordinator of the study, to illustrate and comment on the results of the research.

Evidence shows better performance of securities that are associated with good ESG practices, above all in recent times, and in particular for *high yield* securities. Moreover, the most discriminating parameter is linked to good *governance*, while the *environment* and *social* factors seem to be perceived as less relevant for investors who are interested in reducing the risk of insolvency in the short term rather than long term sustainability and competitive advantage.

"ESG themes are in the spotlight as never before. On the one hand, investors increasingly demonstrate their desire to invest their savings, taking into account environmental sustainability, social and good governance parameters, while on the other hand, European policymakers are introducing a series of training and information requirements - **Politecnico di Milano Prof. Giancarlo Giudici** commented. It is therefore essential for asset managers to study the market and be ready for this new challenge".

There was also a confirmation of the initial theory that, over time, the market attributed a negative spread to issuers with a better ESG score, considering them less risky in the short to medium terms. This effect seems to be limited to the advantage

of adopting good practices in corporate governance which, for investors, can mean lower agency costs, lower risk of opportunistic behaviour and better monitoring.

Approach

The research conducted by Banor SIM and the Politecnico di Milano School of Management examined the relationship between the ESG score and the yield *spread* of bonds on European markets following the approach adopted by Khan *et al*. (2016) for the US market, for which the weighting of each ESG indicator varies from sector to sector to take into account the specifics of each area of business. This is the materiality principle on which the SASB (Sustainability Accounting Standards Board) built a matrix for analysis and for attributing a specific weight for each ESG dimension on the basis of the company's operational sector.

Methodology

The analysis involved 536 bonds listed on European markets and issued by 146 medium to large companies between January 2014 and December 2018, excluding convertible bonds and bonds placed by banks and real estate investment companies. Selection focused on bonds included in two State Street Global Advisors EFTs, *SPDR Bloomberg Barclays EU High Yield Bd UCITS ETF* and *SPDR Bloomberg Barclays Euro Corp Bond UCITS ETF*. For each security, the price on the exchange (source: Datastream), the issuer's financial statements (source: Worldscope) and the ESG-relevant parameters (source: Thomson Eikon ESG and manual search on information sheets and on the sustainability reports of the issuers) were gathered. Upon reaching the availability of 424 indicators, each one was associated with one of the 30 classes of variables from the SASB matrix which shows the relative importance of the ESG parameters for each sector.
The scores obtained were then standardised, and for each year a final ESG score was calculated for each single issuing company as a weighted average of E, S and G according to SASB recommendations. The issuers were then split into two groups as a function of their ESG score being higher or lower than the average. Subsequently, the Monthly Total Return Index of the bonds in the two groups was calculated, conducting separate analyses for *investment grade* and *high yield* bonds.

Highlights

This research has demonstrated that even the European bond market, especially in recent years, considers the ESG rating of an issuer as a parameter that impacts the expected yield. A comparison of a panel of listed bonds priced, among the more liquid ones, showed that the performance of bonds linked with better ESG practices was higher, above all for high yield bonds. Indeed, the determining parameter is without doubt the one that is linked to good governance, while *environment* and *social* factors seem to push in the opposite direction.

Z-spread analysis leads to a supposition that, in recent years, the market started to offer a "discount" on the cost of capital required from companies that adopt good ESG practices, thus determining a greater appreciation of their bonds.

"The results of the research are very interesting", said **Angelo Meda, the Banor SIM manager in charge of the research,** at the end of the presentation, "Our hypotheses were in part confirmed. The study has also in part shed new light and clarified some aspects. We did expect that the integration of ESG assessments in asset allocation could improve the quality of the value approach analyses that we follow, but the fact that the three E, S and G variables are not in synch was an unexpected result that we shall take into account in future."

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BANOR SIM

BANOR SIM, which has been active on the market since 1989 as a private banking vehicle for a group of banks in northern Italy, **was taken over in 2000 by a group of private investors and managers led by Massimiliano Cagliero, the current Chief Executive Officer**. The objective of Massimiliano Cagliero and his partners was to create an independent private banking hub in Italy that would put the principles of value investing into practice. With **offices in the heart of Milan and Turin**, BANOR SIM is now one of Italy's leading securities firms, specialising in capital management and consultancy services for high-value assets. The experience and independence of judgement of the managers at BANOR SIM have contributed towards building unique relationships on the international capital market over time, relationships that have made BANOR a point of reference for many foreign investors intending to invest in Italy or who simply wish to have an independent view of the Italian market. **BANOR SIM applies a model developed in-house to evaluate ESG sustainability when selecting securities**, and is exceptional for the transparency and quality of its investment process. It is one of the few management companies in Italy to have achieved **GIPS (Global Investment Performance Standards) certification**, issued by PricewaterhouseCoopers. BANOR SIM is also a **Member of the Italian Sustainable Investment Forum**, which aims to contribute to the creation of a widespread culture of sustainability. www.banor.it

POLITECNICO DI MILANO SCHOOL OF MANAGEMENT

The **Politecnico di Milano School of Management**, founded in 2003, hosts multiple activities related to research, training and high-level consulting services in the field of Economics, Management and industrial engineering that the Politecnico di Milano processes through its various internal and associated resources. In 2007, the School was granted the prestigious **EQUIS** accreditation. In 2009, it featured for the first time in the **Financial Times ranking** of the best European Business Schools, and today, it is recognised for its *Executive MBA*, *Full-Time MBA*, *Master of Science in Management Engineering*, *Customised Executive programmes for business* and for *Open Executive programmes for managers and professionals*. In March 2013, the School obtained the prestigious **AMBA** (Association of MBAs) international accreditation for its **MBA** and **Executive MBA** programs. In 2017, the School of Management was the first in Italy to be recognised for the quality of its courses delivered through digital learning in the Executive MBA courses through EOCCS (EFMD Online Course Certification System) certification. The School can rely on a teaching staff made up of more than two hundred professors, research analysts, tutors and other members of staff, and each year, more than six hundred students join the undergraduate program. The school is a member of **PRME** (Principles for Responsible Management Education), **Cladea** (*Consejo Latinoamericano de Escuela de Administración*) and **QTEM** (Quantitative Techniques for Economics & Management Masters Network). The School comprises the **Industrial Engineering Department** and the **MIP Graduate School of Business**, which focuses particularly on the training of executives and Masters programs. www.som.polimi.it