mallow street

Sustainable Fixed Income Report 2024.

IN PARTNERSHIP WITH:

IMPAX Asset Management

FLEXIBLE SOLUTIONS FOR SUSTAINABLE INVESTORS

COP16 and COP29 outcomes have been disappointing – at a time when the world is dangerously close to breaching the 1.5 degree carbon budget set by the Paris Accord. Despite a growing market for sustainable bonds, much of fixed income portfolios remains outside of climate transition considerations. To understand the preferences of institutional investors, **mallowstreet**, in partnership with Impax Asset Management, surveyed 13 insurance firms with UK offices and 7 defined contribution (DC) schemes, representing £770bn in assets.

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The results are telling. Sustainable fixed income investments are at the forefront of change in the UK pensions and insurance industry. With growing urgency to address the climate transition and broader ESG goals, institutional investors are increasingly leveraging fixed income as a tool for impact.

However, key differences emerge. DC schemes are avid sustainability adopters, prioritising measurable impact, innovative solutions, and emerging market opportunities. They have a higher risk tolerance but require daily liquidity. Insurers, on the other hand, while supportive of ESG integration, focus on structured products and bespoke strategies, which often reflect their capital reserving needs and international scope of operations. Both groups are highly interested in green and sustainability bonds, yet remain cautious about investing in them as a standalone solution.

This report provides insights into these two sectors' shared priorities, critical differences, and the challenges of integrating ESG goals into diverse investment frameworks. It presents our in-depth findings and key industry recommendations. We hope you find it insightful.

KEY STATISTICS

13
insurance firms with UK offices

7
UK DC schemes

50%
under £5bn in assets

50%
over £5bn in assets

£770bn
of total assets represented

10
questions

600+
primary data points

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EXECUTIVE SUMMARY

DC SCHEMES LEAD IN SUSTAINABLE INNOVATION: DC pension schemes demonstrate greater enthusiasm for ESG integration, prioritising measurable outcomes and innovative approaches. 71% are ready to adopt new sustainable funds, with a strong focus on investment grade corporate bonds, private placement debt and emerging market (EM) bonds. They have a preference for daily liquidity and flexible vehicles like open-ended investment companies (OEICs), Société d'Investissement à Capital Variable funds (SICAVs), and unit trusts. DC schemes also leverage sustainability as a key tool for member engagement.

INSURERS PRIORITISE STRUCTURED FLEXIBILITY: insurance firms favour structured products like collateralised loan obligations (CLOs) and mortgage-backed securities (MBSs), reflecting their operational and regulatory constraints. They prefer bespoke strategies, with 50% considering new solutions only if tailored, and almost as many opting for segregated accounts as their investment vehicle of choice. Insurers' lower demand for daily liquidity, compared to DC schemes, highlights their flexibility in aligning investments with long-term goals while navigating international ESG standards.

AN INTEREST IN IMPACT BUT NOT AS A STANDALONE SOLUTION: three-quarters of DC schemes and insurers rank green and sustainability bonds as interesting. However, the lack of specific plans to invest in use-of-proceeds bonds signals hesitancy about them, especially as a dedicated solution. Managers must align offerings with investor needs, balancing innovation with risk management and clear reporting to enable meaningful ESG integration across the industry.

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KEY STATISTICS

88%
consider investment grade the best place for sustainability opportunities.

69%
say the same about private placement debt, and 79% plan to invest more.

62%
of all UK insurers and DC schemes expect fixed income managers to report against SBTi targets.

43%
of DC schemes see EM bonds as a sustainable asset.

71%
of DC schemes are ready to adopt new sustainable funds, typically in OEIC, SICAV or unit trust vehicles.

50%
of insurers would consider investing in a new strategy if it is a bespoke solution.

[*] Throughout this report, figures may add up to 99% or 101% due to rounding of percentages. Additionally, some questions required multiple answers, so figures in some bar charts will add up to significantly more than 100%. In such charts, dark blue highlights may be used to emphasise key statistics and help the reader follow the analysis.

INDUSTRY RECOMMENDATIONS

FOR DC SCHEMES:

- Prioritise measurable impact in sustainable strategies – work with managers to incorporate impact reporting frameworks.
- Explore investment grade and emerging market bonds, as well as private placement debt, for return and alignment with climate goals.
- Adopt flexible vehicles like OEICs, SICAVs and unit trusts – these align with the need for daily liquidity.
- Support innovation in sustainable fixed income funds – including funds with less than a 3-year track record.
- Use sustainable fixed income and outcome reporting to communicate progress toward sustainability goals and engage members.

FOR INSURANCE FIRMS:

- Utilise segregated accounts and structured solutions to meet operational needs, return expectations and support sustainability.
- Discuss structured credit solutions with your asset managers – CLOs and asset/mortgage-backed securities are not always ESG-ready.
- Adopt Article 8 and 9 funds, which are internationally applicable and investing in a flexible and broad enough universe.
- Balance liquidity needs with long-term sustainability – this will enable access to higher-yield illiquid assets.
- Consider green and sustainability bonds, even if not via dedicated funds – this may require a broader look at the fixed income book.

FOR SUSTAINABLE FIXED INCOME MANAGERS:

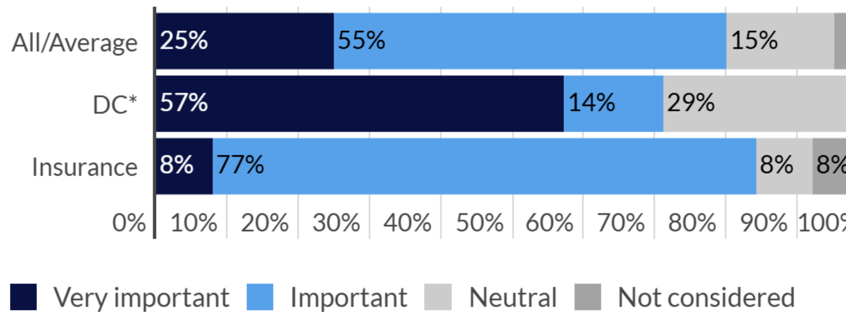
- Comply with SFDR Article 8, integrate ESG in risk management and conduct ethical screening – these steps are basic hygiene factors.
- Report progress towards sustainability goals verified and validated by the Science-Based Targets Initiative.
- Consider dedicated engagement efforts and Sustainable Development Goals (SDGs) within fixed income.
- Highlight Article 9 funds when talking to insurers, they are a better fit for their current ESG integration approach and risk-return needs.
- For DC schemes, develop solutions with the Sustainability Disclosure Requirements (SDR) Improvers, Impact, and Focus labels.
- Address insurers' appetite for bespoke, structured credit solutions, which assist with their risk budgeting and reserving needs
- Focus on investment grade corporates, emerging markets and high-yield bonds, as well as private placement debt.
- Offer scalable vehicles like OEICs and SICAVs for DC schemes. while tailoring segregated accounts and direct bonds for insurers.
- Educate investors on transition, blue, and sustainability-linked bonds as part of a diversified approach to driving ESG goals.

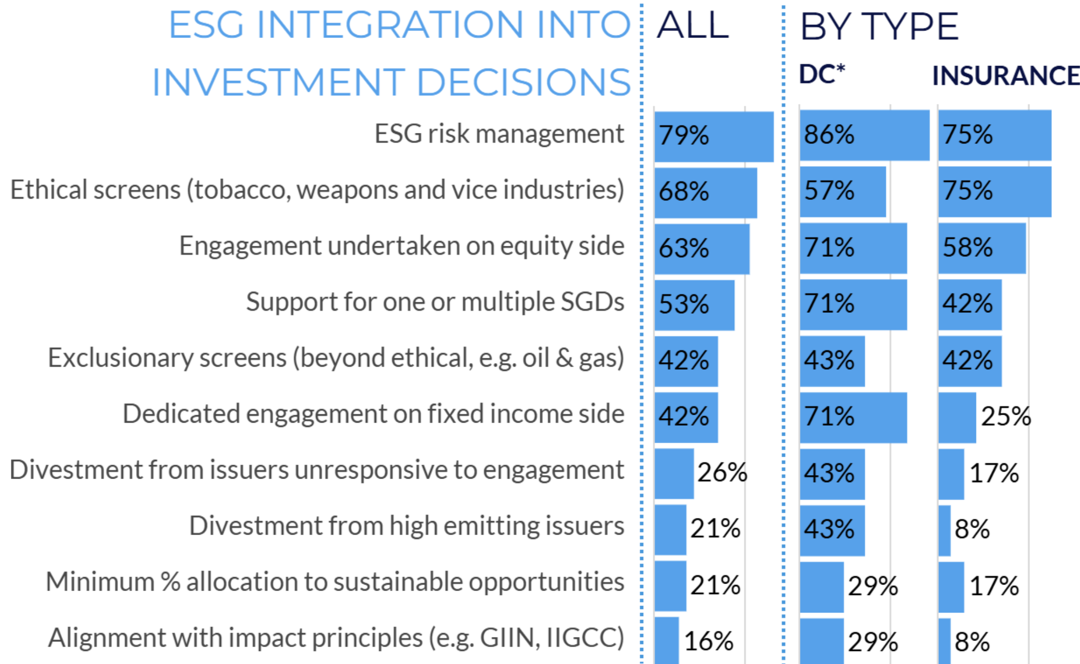
DC SCHEMES OVERTAKE INSURERS IN LOW CARBON FOCUS

DC schemes are more discerning when it comes to fixed income sustainability requirements, while insurers have less developed policies.

UK DC schemes show a stronger focus on sustainability than insurers, as reflected in their attitude towards the low-carbon transition. While 57% of DC schemes view this as 'very important' to fixed income investment decisions, only 8% of insurers place the same level of importance. Instead, three-quarters of insurers consider it merely 'important'.

This divergence persists in ESG integration practices. For instance, 71% of DC schemes rely on equity engagement, if not looking for dedicated engagement in fixed income, or support for multiple SDGs.





In contrast, just 58% of insurers focus on engagement, and even fewer are expecting fixed income teams to lead such efforts. Instead, three-quarters of them undertake ethical screening (e.g., screening out businesses dealing with tobacco, controversial weapons or vice industries). Insurers also lag in adopting more rigorous ESG policies compared with their DC counterparts, such as a minimum allocation to sustainable opportunities, or divesting from issuers with high emissions and/or low responsiveness to engagement.

This discrepancy may stem from differing priorities. DC schemes may be looking for long-term growth and impact, while insurers focus on aligning ESG with operational constraints and overall risk budgeting and capital reserving activities.*

KEY STATISTICS

57%
of DC schemes see low-carbon transition as 'very important' versus 8% of insurers.

77%
of insurers consider the low-carbon transition only 'important'.

71%
of DC schemes expect dedicated engagement efforts from the fixed income side of the manager's business.

43%
of DC schemes divest from high-emitting issuers and those unresponsive to engagement efforts.

17%
of insurers have minimum allocation targets for sustainable investments, versus 29% of DC schemes.

* The DC sample in this survey is small (7 respondents), so our findings are only indicative – however, the differences when compared to insurers are stark already.

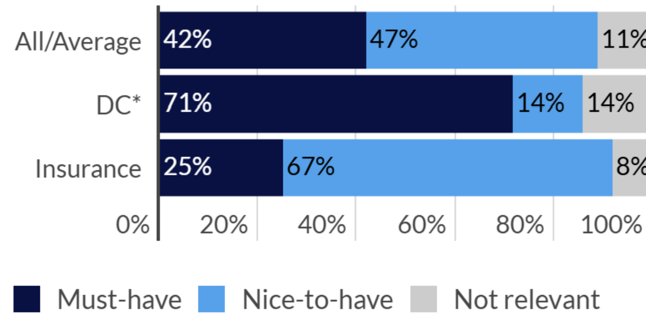
ESG APPROACHES AFFECT FIXED INCOME REQUIREMENTS

Again, DC schemes have higher expectations than insurers around measuring sustainability outcomes and impact in fixed income investments.

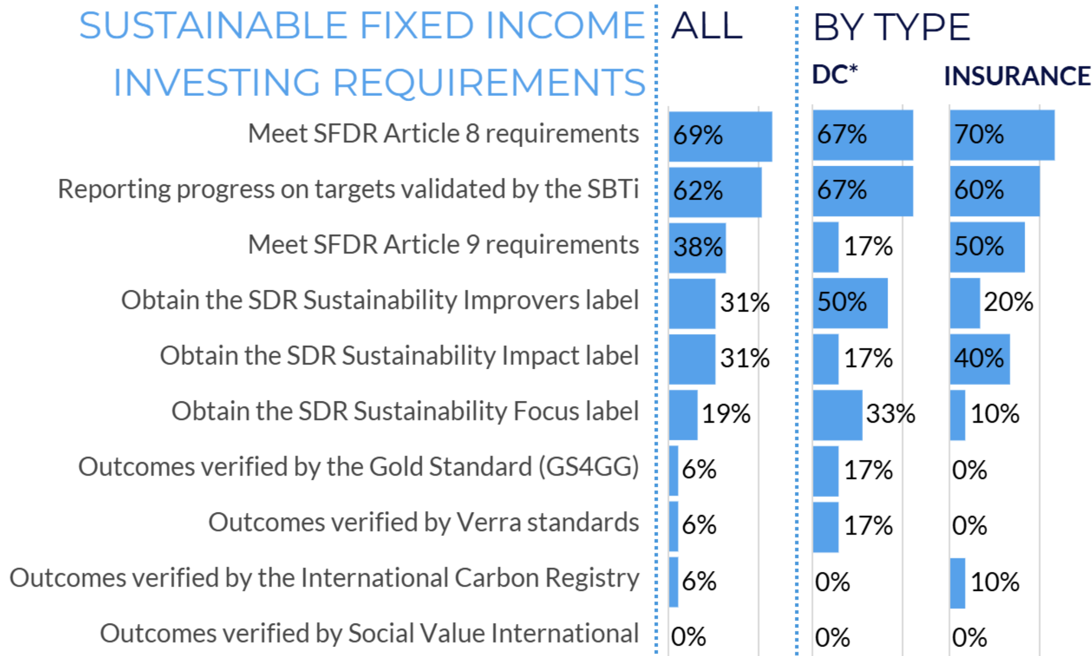
Sustainable Finance Disclosure Regulations (SFDR) Article 8 funds, which promote environmental or social characteristics, are universally popular, with 69% of all investors expecting sustainable fixed income funds to meet these requirements. Surprisingly, 62% also expect their sustainable fixed income managers to report against targets validated by the Science-Based Targets Initiative (SBTi).

Beyond these two top requirements, DC schemes are more likely to favour the UK-specific SDR labels. Half prefer Sustainability Improvers, and a third Sustainability Focus funds, compared with 20% and 10% of insurers, respectively. This aligns with DC schemes' preference for engagement-driven fixed income strategies to support the carbon transition.

MEASURING IMPACT AND ENGAGEMENT RESULTS



SUSTAINABLE FIXED INCOME INVESTING REQUIREMENTS



In contrast, insurers, perhaps due to their international footprint and operations, align more closely with European labelling standards, particularly Article 9 funds, which have environmental and/or social sustainability as their objective.

When it comes to measuring impact, 71% of DC schemes rate this as a 'must-have', far exceeding the quarter of insurers sharing this view. Some DC schemes believe that impact outcomes can improve member engagement. Despite this, very few investors expect fixed income managers to verify impact and outcomes against other independent standards, such as the Gold Standard for Global Goals (GS4GG), Verra or similar.*

KEY STATISTICS

71% of DC schemes see impact measurement as essential, versus 25% of insurers.

62% of all UK insurers and DC schemes expect fixed income managers to report against SBTi targets.

69% expect sustainable fixed income managers to at least meet SFDR Article 8 requirements.

50% of DC schemes are interested in the SDR Sustainability Improvers label, compared to 20% of insurers.

50% of insurers favour funds with Article 9 designation instead.

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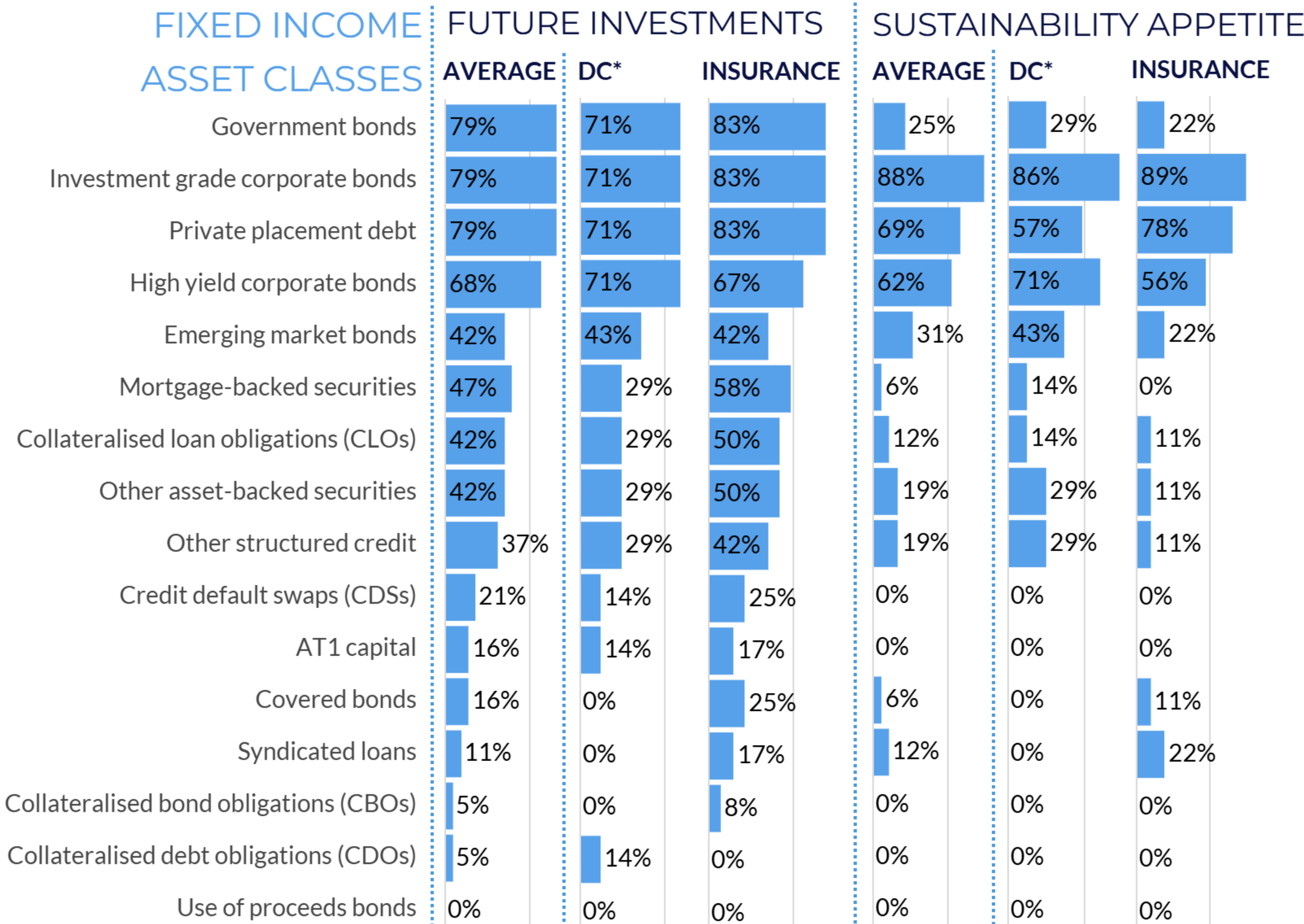
SUSTAINABLE OPPORTUNITIES DOMINATE IN INVESTMENT GRADE

Insurers favour structured credit solutions, while DC schemes explore riskier options, but not all fixed income classes offer opportunities in sustainability.

Government and investment grade corporate bonds dominate fixed income investment plans over the next 12-18 months, with 79% of investors targeting them. However, only the latter offer sustainable investment opportunities – and, in fact, are the main focus for sustainable investors. Private placement debt and high yield bonds also attract high interest and sustainability appetite.



Moreover, DC schemes show strong interest in emerging market bonds (43%), reflecting their risk appetite in growth portfolios. Insurers, by contrast, focus on structured solutions like CLOs (50%) and various asset-backed securities, which are typically less conducive to ESG integration.

Surprisingly, despite the interest in impact measurement, use-of-proceeds bonds receive no interest, suggesting a reluctance to invest in them as a dedicated standalone allocation. This echoes the lack of interest in impact verification standards (see previous page).*

KEY STATISTICS

79%
of investors plan to add to government and investment grade bonds in the next 12-18 months.

88%
consider investment grade the best place for sustainability opportunities, compared with 25% who think this about government bonds.

69%
say the same about private placement debt, and 79% plan to invest more.

43%
of DC schemes see EM bonds as a sustainable asset class.

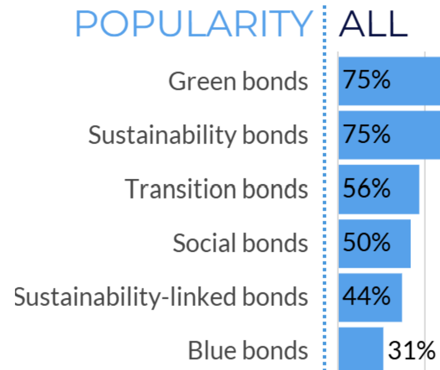
50%+
favour structured and asset-backed solutions, which are not always ESG-ready.

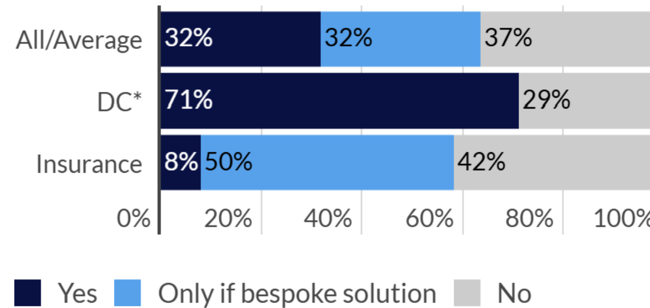
* The DC sample in this survey is small (7 respondents), so our findings are only indicative – however, the differences when compared to insurers are stark already.

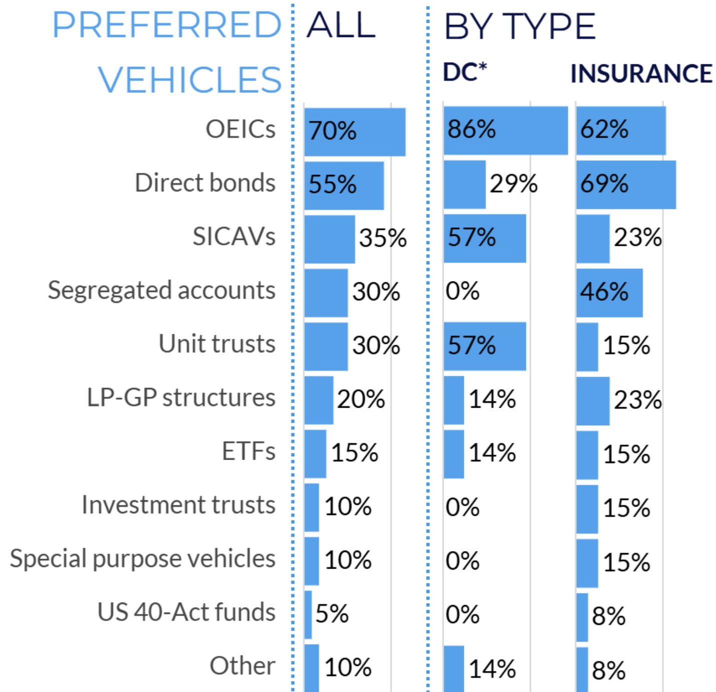
MANAGERS SHOULD OFFER A MIX OF SUSTAINABLE SOLUTIONS

DC schemes would invest in new liquid sustainable fixed income funds, while insurers prefer the flexibility of bespoke solutions albeit at lower liquidity.

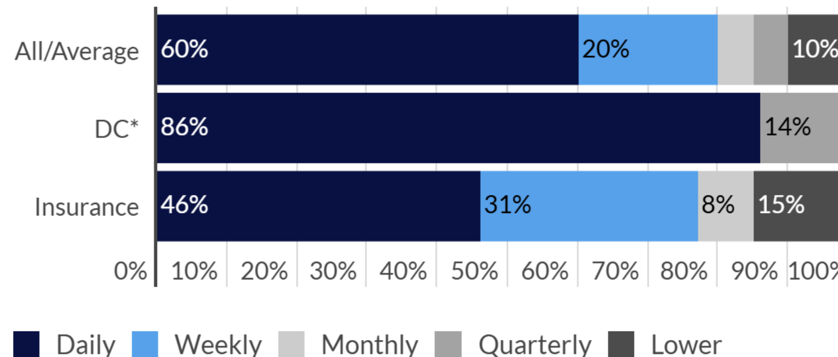
Despite the lack of immediate plans to invest in use-of-proceeds bonds, green and sustainability bonds would be the most relevant for UK investors, each attracting 75% interest. However, DC schemes demonstrate greater openness to innovation, with 71% ready to adopt new sustainable fixed income funds which do not have a long track record or too much seed capital. They favour OEICs (86%) and unit trusts (57%).







Insurers, in contrast, would only consider new strategies if they comprised a bespoke solution, and, unsurprisingly, would prefer direct bond investments (69%) and segregated accounts (46%). Insurers are more flexible with liquidity, with only 46% requiring daily access, compared to 86% of DC schemes. These distinct priorities highlight the importance for managers to maintain a varied and flexible offering.*



KEY STATISTICS

75% of investors would consider green and sustainability bonds equally.

71% of DC schemes are ready to adopt new sustainable funds, typically in OEIC, SICAV or unit trust vehicles.

86% of DC schemes require daily liquidity, against 46% of insurers.

50% of insurers would consider investing in a new sustainable fixed income strategy if it is a bespoke solution.

46% of them prefer separately managed accounts as the best vehicle.

* The DC sample in this survey is small (7 respondents), so our findings are only indicative – however, the differences when compared to insurers are stark already.

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