IIF Green Weekly Insight
Surge in flows to ESG equities

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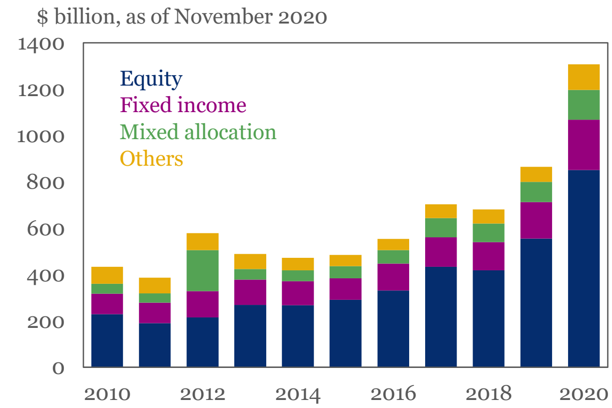
- Global ESG fund assets top $1.3 trillion in 2020—up by more than 50% from 2019 levels
- Flows into ESG-dedicated equity ETFs have surged in recent weeks, anticipating a more active climate and ESG agenda in the Biden Administration
- Voluntary carbon offset issuance reached record highs in 2020, largely driven by India, China, and the U.S.

Heyday for ESG funds: With the COVID-19 pandemic prompting a surge in interest in ESG investment across both equities and fixed-income markets, one of the key features of 2020 has been the robust growth of the ESG fund universe. While some of this expansion can be linked to strong overall market performance supported by abundant central bank liquidity, rapidly growing investor appetite for ESG-linked securities has brought assets under management of ESG-focused funds to over $1.3 trillion, a sharp spike from some $860 billion at end-2019 (Chart 1). The increase was largely driven by ESG-focused equity funds—over 65% of the ESG fund universe.

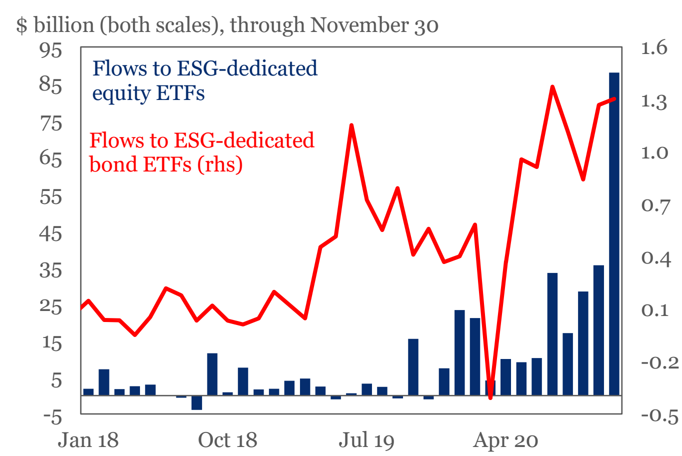
Chart 1: Dramatic increase in flows to ESG funds, bringing total assets under management to over $1.3 trillion



Source: ECB, Bloomberg, IIF

Asymmetric returns: Attractive valuations and returns have also been behind the strong growth in the ESG fund universe this year. With ESG stocks trading at a lower P/E valuation than the stock market on average, over 70% of sustainable indices in our sample of 41 sustainable equity indices have outperformed non-ESG peers year-to date (though returns for the median fund were on par with those of non-ESG counterparts). In 2020, ESG index performance has differed greatly over H1 and H2, highlighting variations in the performance of ESG equities in different market conditions. Stocks with higher ESG scores appear to have provided greater immunity to the COVID-19 shock in H1, with over 80% of sustainable equity indices outperforming non-ESG peers. In contrast, the relative performance of ESG-focused equity indices in H2 has been more muted, with fewer than 40% of sustainable equity indices in our sample outperforming their non-ESG peers since end-June 2020.

Chart 2: Record flows to ESG funds in November 2020



Source: Bloomberg, IIF

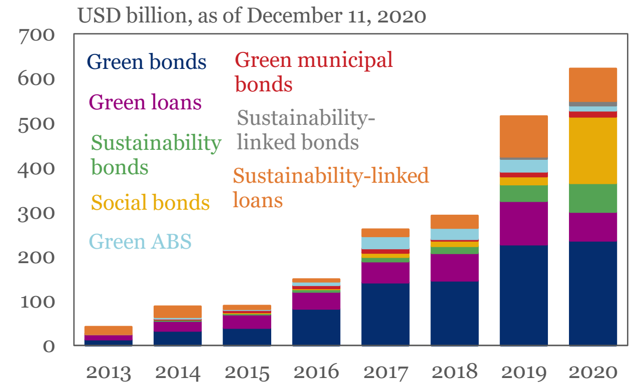
Record ESG fund flows: ESG-dedicated ETFs have attracted more than $265 billion in net inflows this year—more than five times the $45 billion seen in 2019 (Chart 2). Most of these flows have been directed towards ESG-dedicated stocks with monthly net inflows topping $90bn in November—likely fueled by expectations that the incoming Biden administration will pursue a more active ESG and climate agenda, including on renewable energy investment. Though still moderate, flows into ESG-dedicated bond ETFs have increased from $6bn in 2019 to over $8bn this year. Given the robust ESG bond issuance activity in primary markets, the pace of ESG adoption by funds will likely accelerate in 2021, in turn leading to larger ESG bond flows.

Robust sustainable debt issuance activity: As we noted in our Sustainable Debt Monitor, the COVID-19 pandemic has prompted more interest in social investment projects, bringing sustainable debt issuance to over $620bn in 2020—vs $515bn in 2019 (Chart 3). The expansion has been largely driven by skyrocketing social bond issuance, increasing from $18bn in 2019 to nearly $150bn. While green bonds still account for the lion's share (up 4%, to over $235bn), the rate of growth in green bond issuance has decelerated from 2019's frantic pace (up 55%, to $227bn).

Voluntary carbon offsets - another year of strong issuance: Despite concerns that COVID-19 could put the brakes on climate action given the (temporary) decline in global carbon emissions in 2020, voluntary carbon offset (VCO) issuance remained robust this year (Chart 4). Available data on VCO projects listed on major registries show that issuance volumes continued to rise for the fourth straight year in 2020, reaching close to 140 $MtCO_2e$ (million metric tonnes of carbon dioxide equivalent) up from 40 MtCO2e in 2015. The rise is in line with the growing number of commitments by businesses to reach net zero emissions. However, achieving these ambitious goals is particularly challenging for businesses in harder-to-abate sectors such as oil and gas, heavy manufacturing and transportation where low-carbon alternatives remain limited. Thus, voluntary carbon markets allow firms to buy carbon offsets that support emissions-reduction projects, thereby offering an attractive strategy for firms to reduce net carbon footprints in industries where core business practices will take longer to change.

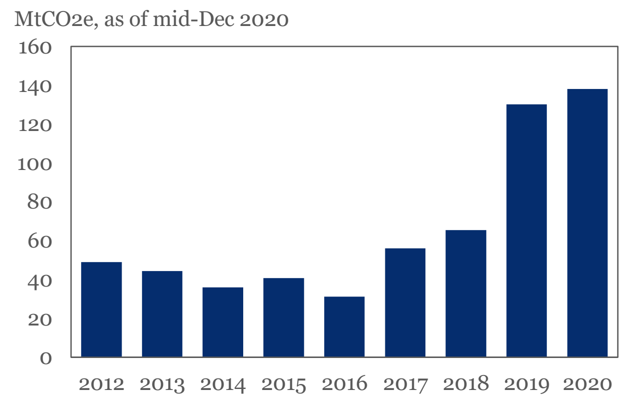
Emerging markets and low-income countries are home to the world's largest carbon offset projects, comprising 9 out of the 10 top issuers over the last two years (Chart 5). While issuance has been mostly concentrated in India and China in recent years, issuance activity in the U.S. has also been solid. Scaling voluntary carbon markets could play an especially important role in channeling international capital towards low-carbon, climate resilient projects in countries where more investment is needed to achieve the UN's Sustainable Development Goals.

Chart 3: Sustainable debt issuance surpassed $620bn in 2020



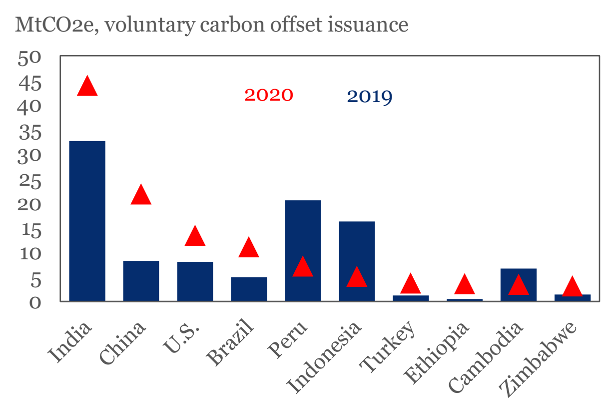
Source: Bloomberg, IIF

Chart 4: Robust growth in voluntary carbon offset markets



Source: IIF, VCS, GS, CAR, ACR; MtCO2e = million metric tonnes of carbon dioxide equivalent, excludes ARB eligible issuance

Chart 5: Voluntary carbon offset issuance, by country



Source: IIF, VCS, GS, CAR, ACR; MtCO2e = million metric tonnes of carbon dioxide equivalent, excludes ARB eligible issuance

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