Core Matters

Impact of ESG Ratings on Credit Corporate Spread

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Our Core Matters series provides thematic research on macro, investment, and insurance topics

- By creating a transparent and systematic methodology, our ESG Credit Index establishes a robust benchmark for sustainable credit investing in European investment-grade corporate bonds. Issuers are ranked based on a hierarchical ESG scoring framework that accounts for four dimensions: the issuer's overall ESG rating, the recent evolution of its ESG score, its ESG performance relative to industry peers, and its market value contribution within the sector. This process ensures sectoral balance and monthly rebalancing, supporting consistent and objective ESG integration across the credit market.
- Correlation analysis confirms that ESG ratings and traditional credit ratings behave largely independently. Neither the absolute level of ESG scores nor their monthly transitions show any systematic relationship with credit-quality metrics. These findings indicate that ESG assessments capture distinct, non-overlapping dimensions of issuer risk rather than mirroring conventional credit-rating dynamics.
- Analysis of spread dynamics reveals that bonds issued by ESG friendly issuers consistently exhibit tighter credit spreads compared to the broader market. This trend is especially pronounced in sectors such as Energy and Utilities, where ESG factors are highly valued by investors. The tighter spreads reflect both stronger demand and a perception of lower long-term risk for issuers with strong ESG ratings.
- The influence of ESG ratings on credit spreads is not uniform across all sectors. Sectors such as Real Estate and Health Care display less spread compression between ESG and non-ESG indices, suggesting that sector-specific risk profiles, regulatory pressures, and investor priorities play a significant role in determining the impact of ESG integration.
- During periods of market stress, such as those experienced in 2020 and 2022, investors tend to favour companies with higher ESG scores. ESG Leaders maintain notably tighter spreads than "Laggards", indicating a flight to quality within the ESG universe. However, the premium for top ESG issuers has diminished in recent years. The gap between ESG leaders and laggards has narrowed as market conditions stabilised.
- While ESG scores are correlated with spread performance at the sector and market level, the relationship is less clear at the individual issuer level. Changes in ESG cluster do not consistently lead to spread movements for single companies, highlighting the importance of broader market and sector trends over isolated issuer events. This suggests that investors should focus on aggregated ESG metrics and sector-level analysis when assessing the impact of ESG on credit spreads.

CONTENT

1. Do ESG Ratings Reflect Credit Quality?

Before any analysis on ESG ratings, we need to verify that **ESG dynamics are not simply a reflection of traditional credit quality.** Two correlations need to be analysed:

1. Are ESG and Credit rating correlated?
2. Are changes in ESG and Credit ratings correlated?

An effective way to examine the correlation between ESG ratings and credit ratings is to stratify issuers according to their ESG score levels and compute the corresponding average credit rating within each ESG cluster. Further details on these clusters are provided in the next section.

This methodology generates historical average credit ratings across five portfolios of issuers, ranging from Cluster 5 (the best ESG-rated issuers) to Cluster 1 (the poorest ESG-rated issuers). By benchmarking the time series of these cluster-level credit ratings against the broad market average credit rating, we derive the correlations presented below:

	ESG Score	ESG Cluster 1	ESG Cluster 2	ESG Cluster 3	ESG Cluster 4	ESG Cluster 5
Credit Rating	0,38	-0,02	0,04	0,15	0,21	0,55
CR Cluster 1	-0,02	-0,45				
CR Cluster 2	0,28		0,11			
CR Cluster 3	-0,49			0,02		
CR Cluster 4	-0,07				-0,12	
CR Cluster 5	0,32					0,30

ESG Rating and Credit Rating are not correlated

The correlation table shows that no stable or meaningful pattern can be extracted, as ESG scores and credit ratings do not move together in any systematic way. The overall correlation is not significant (0.38), unstable and not robust across sub-samples The signs flip depending on rating buckets.

To investigate whether ESG and credit rating transitions exhibit any meaningful co-movement, we first constructed monthly transition probabilities for four time series: credit rating upgrades, credit downgrades, ESG upgrades, and ESG downgrades. The resulting time series show markedly different behavior. Credit rating changes are relatively infrequent and tend to occur in more discrete, episodic bursts, whereas ESG rating adjustments appear more continuous and frequent.

Cross-correlation analysis of the monthly upgrade and downgrade shares confirms very low synchronization: upgrades (and downgrades) in the ESG domain show almost no co-movement with their credit-rating counterparts. This suggests that the two rating systems capture distinct dimensions of issuer risk and respond to different information sets.

	ESG Up	ESG No Change	ESG Down
Credit Up	-0,06	0,02	0,04
Credit No Change	0,10	-0,09	0,06
Credit Down	-0,08	0,10	-0,11

These conclusions align with, and help explain, the performance results in the following section, where credit spread out- or underperformance cannot be explained by ESG rating improvements or deteriorations.

2. Building an ESG Credit Index

Our newly created ESG Index has a tighter spread compared to the overall market.

In recent years, ESG considerations have become a central theme in fixed income investing, driven by growing demand for sustainable finance and regulatory initiatives across Europe. To address this need, we have designed an ESG Credit Index that applies a transparent and systematic methodology, ensuring alignment with established ESG principles while maintaining exposure to senior investment-grade bonds in the European corporate credit market. This index serves as a benchmark for assessing ESG performance and pricing dynamics within the credit space.

Methodology in brief

Universe: Senior corporate bonds included in the Markit iBoxx indices, rated as Investment Grade (IG).

Rebalancing: Monthly rebalancing from 2019 to 2026.

Ranking Criteria: Issuer selection relies on a sector-relative, multi-dimensional ESG ranking framework. Within each sector, issuers are ranked according to the following four criteria, applied hierarchically:

1. MSCI ESG Rating:

Main ranking driver, reflecting the issuer's absolute ESG quality.

2. Trend in ESG score over the past 12 months:

Recent changes in ESG scores are incorporated to capture ESG momentum, rewarding issuers with improving sustainability profiles and penalising deteriorations.

3. Industry-adjusted ESG score:

An industry-level ESG score (at a finer granularity than sectors) is used to introduce an ESG tilt below the sector level. This ensures sector neutrality while accounting for structural ESG differences across industries.

4. Market value:

Market value is not used as a primary ESG ranking signal, but as a secondary selection constraint. It does not influence ESG ordering and is used solely to determine the number of top-ranked issuers required to reach a target coverage of approximately 50% of sector market value, thereby preserving market representativeness without diluting the ESG signal.

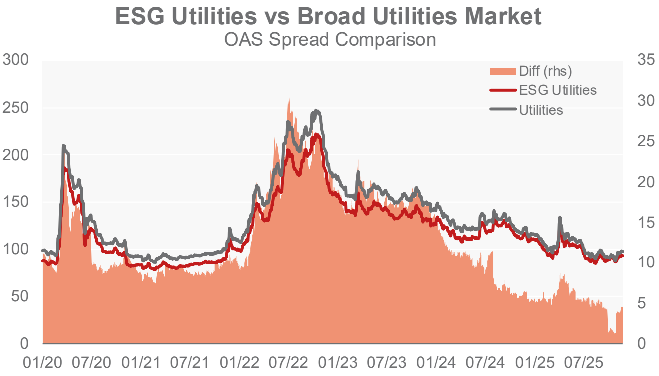
Selection Process:

Within each sector, issuers are selected sequentially from the top of the ESG ranking until the aggregate market value of selected issuers reaches approximately 50% of the total sector market value.

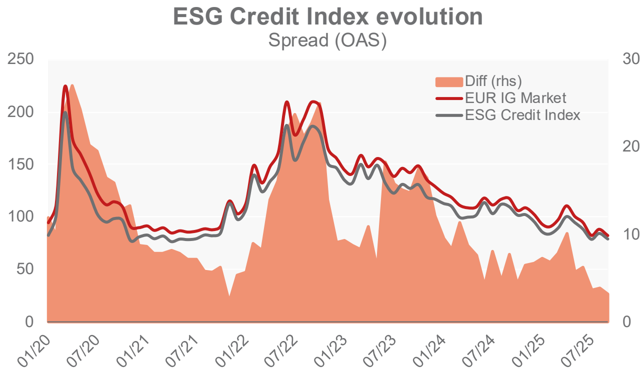
When analysing aggregated spreads, we observe that the premium between ESG and non-ESG indices varies across sectors and depends on the overall market level. This spread differential provides insights into investor behaviour: tighter spreads in ESG bonds often signal stronger demand and perceived lower risk, particularly in sectors where ESG considerations are critical, such as Industrials and Energy. This suggests that the observed spread premium reflects ESG-specific pricing effects rather than a mechanical credit-quality tilt, as ESG ratings and credit ratings show little co-movement.

Conversely, sectors such as Real Estate and Health Care exhibit the opposite trend, highlighting that ESG influence is not uniform and may reflect sector-specific risk profiles or regulatory pressures. These findings underscore the need for investors to consider both market-wide and intra-sector dynamics when evaluating ESG strategies.

Overall, ESG indices tend to exhibit tighter spreads compared to the broader market, particularly in sectors such as Industrials and Energy. This pattern suggests that investors perceive ESG-compliant issuers in these sectors as lower risk or more resilient to long-term challenges, which translates into stronger demand and pricing advantages.



Source: iBoxx, MSCI, GenAM own calculations



Source: iBoxx, MSCI, GenAM own calculations

These differences are largely shaped by macro-level factors and sector sensitivities to social or environmental controversies. For example, the energy sector faces heightened scrutiny due to climate-related risks, making ESG ratings a critical differentiator for issuers. Historical analysis over the past five years reinforces this view: ESG indices consistently maintain tighter spreads than the overall market, signalling that investors are willing to pay a premium for portfolios that adhere to stringent ESG standards. This premium reflects not only reputational considerations but also a belief in the long-term risk mitigation benefits of ESG integration.

Since 2025, the impact of ESG ratings on credit spreads has diminished, with a noticeable compression between the ESG Index and the broader IG market. This narrowing is largely attributable to an environment characterized by exceptionally tight spreads. Historically, periods of low volatility and tight spreads have resulted in reduced differences between ESG and IG indices, as seen in 2025. In contrast, during stress periods such as 2020 or 2022, the gap between ESG and market indices tends to widen significantly. Thus, the current weakness in the spread differential is not solely a reflection of ESG factors losing influence, but also a consequence of the prevailing market conditions.

3. Positioning our ESG Credit Index Relative to EUR ESG Benchmarks

A proprietary framework enables more granular analysis.

A growing number of EUR-denominated ESG corporate bond indices are available to investors, each embedding sustainability considerations through different methodological lenses. To better understand the value added by our ESG Credit Index, it is useful to compare its construction to three widely followed benchmarks: the Bloomberg MSCI EUR Corporate Liquid Bond Screened Index, the Bloomberg MSCI Euro Corporate ESG SRI Index (tracked by iShares), and the MSCI EUR IG ESG Leaders Corporate Bond Index.

Bloomberg MSCI EUR Corporate Liquid Bond Screened Index:

A negative-screening index: it excludes issuers involved in selected controversial activities and those with severe MSCI controversy signals, while otherwise keeping market-value weights. It does not perform a positive ESG ranking; it mainly removes the most controversial / excluded names from the parent Bloomberg Euro Corporate universe (with a EUR 500m minimum size filter).

Bloomberg MSCI Euro Corporate ESG SRI Index (iShares):

A screening + quality + “sustainable exposure” approach: it combines exclusions with an ESG rating eligibility threshold and additional revenue screens (e.g., oil & gas, weapons, fossil-fuel power generation). It also targets at least 20% “Sustainable Exposure” (e.g., green bonds) and applies an issuer cap of 3%, tightening the “SRI” tilt versus standard screened indices.

MSCI EUR IG ESG Leaders Corporate Bond Index:

A best-in-class methodology: it excludes low ESG ratings and severe controversies, then ranks issuers within each sector using ESG rating, ESG trend, index membership buffer, and industry-adjusted ESG score. Constituents are selected until roughly 50% of sector’s market value is covered. It’s the closest comparator to your own sector-neutral, ranked selection design.

GenAM ESG Credit Index:

Our index differs from the MSCI ESG Leaders benchmark mainly through its underlying universe. It is built on the Markit iBoxx EUR IG Senior universe, whereas the MSCI index include both senior and subordinated debt. Its construction is explicitly sector-neutral and relies on a hierarchical ranking that prioritises MSCI ESG rating, 12-month ESG momentum, and an industry-adjusted ESG score. We do not impose manual sector exclusions, and we do not target market-value neutrality at sub industry level.

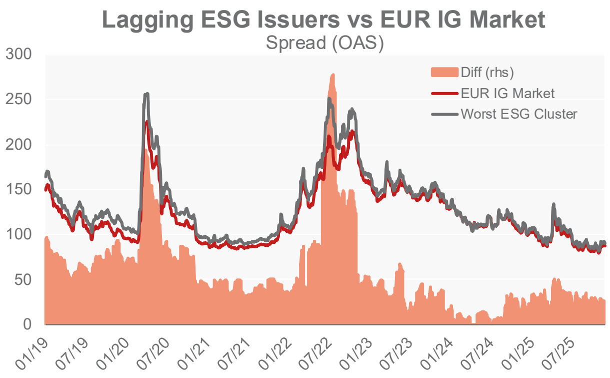
Building a proprietary index framework also allows us to create sub-indices at sector **enabling more granular analysis and targeted applications**.

4. Are ESG scores correlated to spread performance?

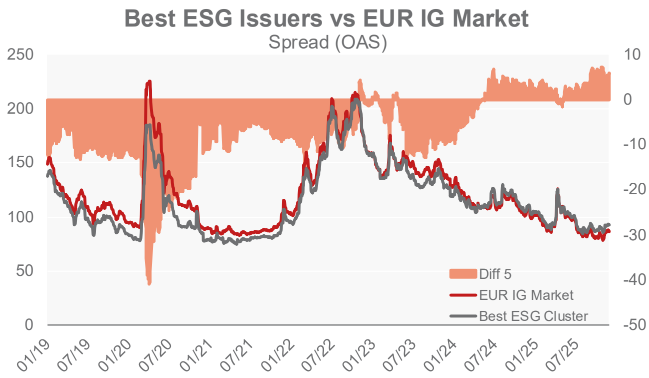
Investors tend to rely more on well-ranked ESG companies in stress periods

For this analysis, we again use Senior Investment Grade bonds from the iBoxx universe and segment the market into five clusters based on ESG score quantiles provided by MSCI. These clusters include the top performers, the ESG Leaders, and the lowest performers, labelled Laggards. With this framework, we obtain the following results:

The same characteristics observed in the ESG Index are present here: **ESG Leaders indeed have tighter spreads than Laggards**. Lagging Leaders tend to trade at a discount (spread gap always positive, and often well above zero), whereas Leaders trade at a premium. Indeed, they have been trading at a premium for the past five years, but the trend seems to be running out of steam. Additionally, while Laggards spreads widen during periods of stress, ESG Champions spreads tend to tighten versus the index.



Source: iBoxx, MSCI, GenAM own calculations

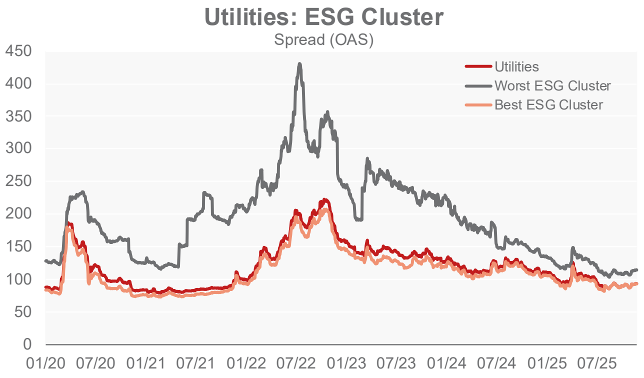


Source: iBoxx, MSCI, GenAM own calculations

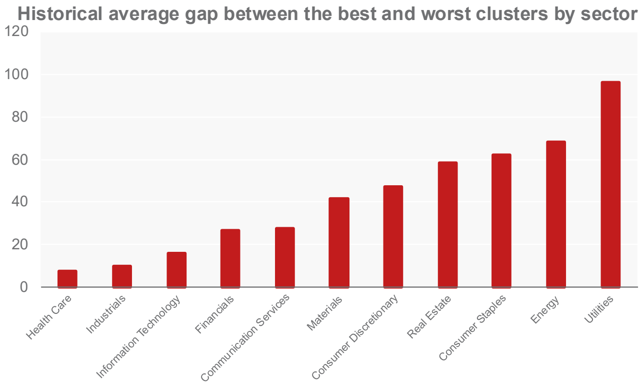
Furthermore, this is not due to a rating bias within the clusters, with an average rating by cluster remaining close to A, independently of ESG scores, for the whole period of the analysis.

Continuing this analysis at the sector level, we observe that while the impact of ESG is obvious in some sectors (such as Utilities), it is much less pronounced in others (such as Health Care).

The following comparative graph (for each sector, the average gap between ESG Leaders and Laggards has been computed over the past five years) shows that indeed, not all sectors are impacted by ESG metrics with the same importance (or significance). Nonetheless, ESG Leaders have tighter spreads within all sectors, with the largest gap being observed for the Utilities sector, in line with previous observations.



Source: iBoxx, MSCI, GenAM own calculations



Source: GenAM own calculations, iBoxx, MSCI

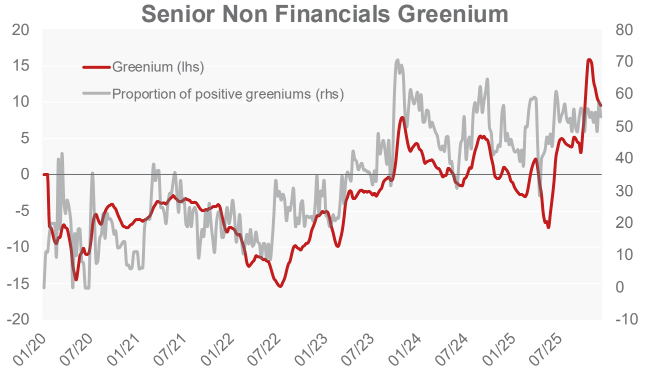
Finally, the following table reports the average spread change relative to the market one year after an issuer moves from one ESG cluster to another, with an additional 3-month lag also included. Cluster 5 corresponds to the highest ESG scores ("best-in-class"), while Cluster 1 represents the lowest ESG scores ("worst-in-class").

Cluster Change	2019	2020	2021	2022	2023	2024	All Year
1 → 2	-2	2	-5	-2	-4	3	-1
2 → 1	-8	0	-9	3	-6	1	-2
2 → 3	-2	-4	-17	0	-1	1	-4
3 → 2	-8	-2	-19	13	-8	4	-3
3 → 4	15	1	7	-1	-13	7	2
4 → 3	1	2	2	-12	-18	0	-3
4 → 5	-13	6	-5	0	-5	12	-1
5 → 4	-5	-1	-3	4	19	2	2

Overall, the results do not reveal a consistent or robust relationship between changes in ESG cluster and subsequent spread movements. Similar patterns were observed across different lags and horizons, leading us to conclude that such transitions do not exhibit a meaningful correlation with spread behaviour.

To clearly identify the impact of ESG scores, broader aggregations at the sector or market level, appear more relevant. At the issuer level, links between ESG rating changes and spread dynamics remain weak and difficult to isolate.

It is interesting to put these results into perspective with the evolution of the greenium (premium on green bonds). While the premium for bonds issued by high ESG-rated issuers has compressed, in contrast the greenium has increased in 2025. This shows a clear decoupling: the risk premium on green bonds can move differently from the risk premium linked to issuer ESG ratings. This highlights the importance of monitoring both dimensions to better understand what drives green bond valuations versus standard ESG indices.



Source: iBoxx, GenAM Calculations

5. ESG and Credit Spreads: Future Perspectives

ESG effects are clearer at the index level, while issuer-level ESG signals add little incremental value

The findings of this study carry two key implications. First, when structuring investment processes and allocating analytical bandwidth to ESG considerations, resources should be deployed where they are most likely to influence risk-adjusted returns, namely in sectors with a demonstrably higher sensitivity to ESG-related factors. Conversely, attempting to exploit marginal changes in issuer-level ESG scores offers limited payoff from a market-performance perspective. Such analysis may still support the construction and maintenance of exclusion frameworks, but its incremental contribution to alpha generation appears minimal.

This conclusion is becoming increasingly relevant against the current macro-policy backdrop. In the United States, political scrutiny of ESG-linked investment and regulatory initiatives have intensified, challenging some previously assumed structural tailwinds. In Europe, challenging fiscal conditions and shifting policy priorities similarly risk relegating ESG objectives behind more immediate economic imperatives. As a result, the influence of ESG criteria on credit pricing is likely to remain muted in the near term, with spreads continuing to be driven predominantly by conventional credit fundamentals.

ESG-tilted credit indices behave very similarly to standard indices, with nearly identical return dynamics

The second implication follows naturally: the behaviour of ESG-tilted credit indices is expected to remain closely aligned with that of their traditional counterparts. Given the relatively modest valuation dispersion attributable solely to ESG characteristics, return dynamics across the two index families are likely to exhibit a high degree of correlation for the foreseeable future. In practice, forecasting ESG index performance therefore remains largely analogous to forecasting mainstream credit indices.

IMPRINT

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