

ESG Bond ETFs: Passive aggressive investing?

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Russian thermal coal miner SUEK bonds have been included in at least one “ESG” bond ETF with explicit thermal coal exclusion criteria, exposing investors to both economic loss and thermal coal mining funding.

On the back of this, investors in certain emerging market ESG bond-ETFs, including those highlighted in Figure 1, may have reason to engage with the fund manager on the back of potential breaches of the investment strategy criteria.

- According to filings, the ETF(s) trading in Figure 1 holds the SUEK 3.375 09/2026 bond (ISINs XS2384174228/US78486MAA80, REGS/ 144a).¹
- The issuer of the bond, JSC SUEK, is Russia’s largest thermal coal exporter.² AFII designated the SUEK 3.375s as 2021’s [most notable fossil funding deal](#). The bond is guaranteed, among other entities, by the [Tugnuisky Opencast Mine JSC](#).
- The ETF investment criteria contains an explicit exclusions of thermal coal.³
- The ETF ISINs for which it is relevant are stated as Article 8 under the European Union’s SFDR regulation.
- The referred ETF(s) is designed to track the J.P. Morgan ESG CEMBI Broad Diversified Custom Maturity Index (Ticker: JPEIBDCM). The AUM of the underlying fund is ca. USD1bn.
- The bond recently was removed from the index due to index exclusions following Russia’s invasion of Ukraine in February, but it was included prior to that; the thermal coal connections alone did not exclude the bond.

Figure 1. ISINs and top tickers (multiple tickers are available) for the ETF in question. Full list, copyable, overleaf. Source: Bloomberg.

ISIN	Top ticker	Class
IE00BLRPRF81	EMUS LN	USD distributing
IE00BLCGR455	EMAU LN	USD accumulating
IE000ZO4CUT7	EMMH SE	EUR accumulating
IE000YPT5PG3	EMDH LN	USD straight
IE0007EH5UK6	EMHC SW	CHF accumulating

Our concerns on behalf of ETF investors are the following:

- › **Some ESG metrics provided by the ESG scoring agency used by the index are misleading:** The issuer is not assigned an ESG score by the agency that is being used for index construction. However, the issuing entity (SUEK Securities DAC) is being assigned a

¹ Source Bloomberg and the manager’s holdings tables as posted on their web-page. Data as of 9 May 2022.

² “No.1 in Russia and No.6 globally by coal output — 101.2 Mt in 2020; No.4 globally by international coal sales — 53.8 Mt in 2020; No.5 globally by coal reserves — 7.5 Bt” as per the company’s [web-page](#).

³ Links to the relevant marketing material and documentation of the product available upon request.

“Consumer Finance” sector by the agency, in contrast to Bloomberg’s classification of it as “Metals and mining”. Under the “Product involvement” data point, which reasonably would flag coal product involvement, the agency says “No Evidence of Involvement.”⁴

- › **Index construction should capture coal even when not flagged by ESG data providers:** The index construction methodology⁵ explicitly states that the index should exclude thermal coal, and those statements appear to imply that the index should incorporate public information also beyond that what is provided by third party ESG data providers. In this case, it is trivial to obtain such information.
- › **ETF managers should capture coal exposure even when the index includes it:** The ETF manager explicitly states that the fund should exclude thermal coal, and has relative freedom to not buy bonds included in the index. It thus seems reasonable that the manager should exclude coal bonds based on its independent analysis, even if coal bonds are included in the index. Indeed, such independent analysis would be trivial.

Thus, we opine that methodology is failing across ESG data provisioning, index construction and ETF construction and as a result, investors may have been misled to believe that they will not be exposed to funding thermal coal when investing in the product.

The bonds currently trade at roughly 12.5c on the dollar (bid-side, mid-levels in Figure 2), meaning that the investor has suffered an economic loss of 87.5% of the fund’s invested notional in the bond. This is in dirty price terms: the bonds have not yet paid their inaugural coupon that was due on March 15.⁶ The poor performance is likely driven by Russia's invasion of Ukraine and following sanctions, but is a real economic loss to bond holders, when they should not have been exposed.

We acknowledge that the actual economic loss may be small for the investor as the original position of the ETF was small. It should however be clear that investors have been exposed to funding thermal coal through this. It is our view that it is important that passive index vehicles are aligning with their stated ESG intentionality and as standards are being set on various ESG frameworks, it should be important to supervisory authorities to signal what is acceptable and not before similar events but in more sizable volumes happen.

Figure 2. Cash price SUEK 3.875 2026. Source: Bloomberg,



Figure 3. Unique ISINs referring to the underlying EM ESG ETF, based on public data and available knowledge at the time of publication. Source: Bloomberg, AFII.

ISIN	ISIN
IE00BLRPRF81	IE0007EH5UK6
IE00BLCGR455	DE000SL0DWH7
IE000ZO4CUT7	DE000SL0DQC0
IE000YPT5PG3	DE000SL0B0B0
IE000DBHED39	

⁴ Notably, another ESG rating provider, but not the one used for index construction of aforementioned index did rate the issuer, see “[SUEK Scored 44 on ESG Evaluation](#)”, S&P Global Ratings, 1 Feb 2022.

⁵ See “[J.P. Morgan ESG CEMBI Broad Diversified Custom Maturity Index](#)”, company web, access 16 May 2022.

⁶ The company is making claims that the payments are on track, please refer to this statement. One key issue with the company is the difficulty to establish beneficial ownership after the former main owner was sanctioned by European authorities: “[ESG Evaluation on SUEK Suspended](#)”, S&P Global Ratings, 22 Mar 2022.

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