INVESTOR INSIGHTS SERIES

The California Green Rush

Four key insights on Golden State residents and green bonds

Green bonds[1] are growing: Between 2015 and 2016 worldwide issuances of green bonds nearly doubled from $41 billion to $80 billion.[2] The growth trajectory continued in 2017, as issuances for the year passed the $100 billion mark.[3] Momentum is likely to continue as a growing number of states, counties, and municipalities in the US look for solutions to finance projects in sustainable energy, transportation, clean water, forestry, and other areas.

78% of California residents believe it is important to make the world a better place while growing their personal assets.

While green bonds make up only a fraction of a municipal bond market that issued $423 billion in securities in 2016 alone,[4] public finance experts are looking closely at how they leverage this investment structure to fund a growing number of sustainable projects. In evaluating their best entry into the market they will need to consider the interests and concerns of large institutional investors and individual investors alike.

In California, where the State Treasurer's Office is charting a path to launching the state's own green bond market, it is likely that the initiative will be welcomed by the 78% of California residents who believe it is important to make the world a better place while growing their personal assets.[5] But successful adoption of the state's green bonds among individuals will not just depend upon investors' good intentions. It will require a deeper understanding of the motivations, perceptions, and knowledge gaps among investors that could affect their participation in the state's green bond market.

1 A green bond is a tax-exempt bond issued by federally qualified organizations or by municipalities for the development of brownfield sites.
2 Whiley, Andrew. Global green bonds overtake 2016 total: $83bn on 28th Sept: Now in sight of our $130bn by December 31st forecast. Climate Bonds Initiative; September 29, 2017.
3 Whiley, Andrew. Breaking: 2017 Green Bond Record! $100bn in global issuance reached during COP23. Climate Bonds Initiative, November 15, 2017
4 Respaut, Robin. U.S. municipal market sales reach 6-year high in 2016. Thomson Reuters, December 2016.
5 Natixis Investment Managers, Green Bond Survey conducted by CoreData Research in August 2017. Survey included 500 investors in California. See page 7 for more information.

A joint survey of 500 California residents conducted by Natixis Investment Managers and the California State Treasurer's Office offers insight into the challenges and opportunities of engaging individual investors in the state's burgeoning green bond market. Encompassing a broad demographic cross-section of the state's population, the survey posed direct questions to Californians about their investment preferences and expectations; their commitment toward environmental, social, and governance (ESG)[6] investment principles; and their predisposition to act on their green intentions.

INSIGHT 1:

Californians want their assets to make a difference

Individual investors surveyed have a strong personal connection to their assets. To some, monetary worth may be a symbol of success for lifelong work and discipline. To others, assets may represent aspirational goals of higher education and homeownership. Others still may see their wealth as their legacy to family and the society. No matter how grand or personal the statement may be, investors in California, like others around the world and across the US, consistently connect personal assets with personal values.

In California, 77% of individuals want their investments to reflect their personal values, 76% want to know that their assets are doing social good, and 67% say they want their investments to have a positive impact in the community. Sentiments run high across all demographic sectors, but strongest are Millennials (73%). This trend is consistent with what Natixis Investment Managers has observed in surveys of defined contribution plan participants in the US and individual investors across the globe.

This broad view on "doing good" with their investments is more clearly defined in the strong affinity Californians demonstrate for ESG and sustainable investing. When asked to more specifically define their interests in ESG, 78% report they want to invest in companies with good environmental records. Another 77% say they want to invest in companies that have a positive social impact. And 82% say they want to invest in companies that are ethically run.

While aggregate numbers are promising, there is one small outlier among our sample group of 500 – members of the so-called Silent Generation or the World War II Generation. While their sentiments toward these factors are positive, it runs 10%–20% lower than others represented in the survey population. While this is the smallest group within the sample population (32 individuals), it is worth noting that their views are of immediate interest since municipal bonds can play a large role in the financial plans of individuals within this age group.

INSIGHT 2:

Despite positive ESG perceptions, green bonds are not yet top of mind

Even though issuances across the globe have surpassed the $100 billion mark in 2017, green bonds are a relatively new investment concept for institutions and individuals alike. This is especially true compared to municipal bonds, which have long been a staple in US portfolios. As a result, Californians show low levels of recognition for, and even lower levels of investment in, these securities.

What may be lacking is a higher level of specificity in the discussion of sustainable investments. Overall, Californians are conscious of ESG investments, with 53% of those surveyed reporting that they are familiar with investments that have a positive social and environmental impact. When asked a more specific question about green bonds, only 29% claimed to know what green bonds are and 13% said they currently invest in green bonds. Compounding the general lack of awareness may

As California goes, so goes the nation	CA	US*
Want their investments to reflect their personal values	77%	75%
Want to know that their assets are doing social good	76%	69%
Want to invest in companies with good environmental records	78%	73%
Want to invest in companies that have a positive social impact	77%	68%
Want to invest in companies that are ethically run	82%	84%

* Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, February-March 2017. Survey included 8,300 investors from 26 countries, 750 of whom are US investors.

6 ESG investing focuses on investments in companies that demonstrate adherence to environmental, social and governance practices, therefore the universe of investments may be reduced. A security may be sold when it could be disadvantageous to do so and opportunities could be missed in certain companies, industries, sectors, or countries. This could have a negative impact on performance depending on whether such investments are in or out of favor.

be the misconceptions these individuals have about socially responsible investments.

Many individuals perceive investment limitations for these investments, with 46% believing they will have to give up return potential to invest in green bonds and 55% believing that costs will be higher without delivering commensurate returns. Neither assumption is founded. In general, green bonds are not limited in their return potential; their potential is the same as a comparable investment that is not classified as green. Nor do green bonds generally come at a higher cost. The real issue for investors to understand is that their cost concerns are influenced by the quality and reliability of the bond itself, which is a result of the issuer's financial stability. Over time, it is conceivable that green bonds could become more "reliable" than traditional municipal bonds because they have taken the costs of climate change into account.

Misconceptions also run to non-financial factors, perhaps reflecting trends that show lower levels of trust in public institutions.[7] More than seven in ten (72%) of those surveyed in California express concerns that green investments may not produce the environmental benefits promised. Three-quarters also believe there is a lack of standardized guidelines on what constitutes a green investment.

These performance concerns and lack of standardized reporting could present barriers to investing. When asked to choose up to three issues that would keep them from investing in green bonds, Californians are first concerned with investment performance, with 32% saying that bonds are not paying enough. This is followed by the lack of a standardized definition of what constitutes a green bond (28%) and that the verification of the social and environmental benefits is lacking (26%).

Among all the factors that could prevent individuals from investing, the most telling may be the 24% who said they simply don't understand green bonds. What's clear is that engaging individuals in California's green bond market will require an investment in public outreach and education to dispel these types of misconceptions and help educate individuals on the workings, potential advantages, and potential risks of investing in these securities.

Can access to sustainable investments drive positive financial behaviors?

Results from our survey of Californians demonstrate a strong correlation to those from a study of US defined contribution plan participants conducted by Natixis Investment Managers. Among the 951 respondents to the plan participant survey:

- 82% said they would like their investments to reflect their personal values
- 78% believe it is important to make the world a better place while growing their personal assets
- 64% are concerned with the social and ethical records of the companies they invest in
- 73% said companies that provide clean water can present significant growth opportunities

As a study of attitudes related to retirement savings, the Natixis defined contribution plan survey examined attitudes one step further, examining whether fulfilling this inherent interest in ESG investing could incentivize individuals to save more for retirement. Findings show that sustainable investing may encourage positive savings behaviors, with 62% of participants saying they would either begin to contribute to a plan or increase their contributions to their defined contribution plan if they knew their investments were doing social good.

Natixis Investment Managers, Survey of US Defined Contribution Plan Participants conducted by CoreData Research, August 2016. Survey included 951 US workers, 651 being plan participants and 300 being non-participants.

INSIGHT 3:

Personal benefits come before societal benefits

In considering how environmental and social factors play into investment decisions, Californians might best be described as prepared to act with enlightened self-interest. Individuals may have strong convictions about addressing environmental and social issues with their investments, but it is important

Awareness and education on green bonds is needed

7 2018 Edelman Trust Barometer; 2018 Edelman Trust Barometer Reveals Record-Breaking Drop in Trust in the U.S. https://www.edelman.com/news-awards/2018-edelman-trust-barometer-reveals-record-breaking-drop-trust-in-the-us

to remember that they emphasize the potential investment benefits of municipal bonds over their community impact.

Conventional wisdom may hold that individuals invest in municipal bonds for tax-free income, but California respondents believe that these securities can fulfill a wide range of investment objectives and portfolio roles. When asked for their main reasons for investing in munis, Californians focus first on direct portfolio advantages, but almost a third see the societal benefits of investing in these securities as well.

Reasons for investing in municipal bonds
(% Yes, multiple answers allowed)

- 55% Tax-free income
- 51% Low risk
- 39% Stability
- 30% Funding community projects
- 23% Ease of investing

These motivations are relatively consistent across all respondent groups with the exception of two key differences which appear in wealth band analysis. In this examination, high net worth (HNW) investors (66%) are most likely to cite tax-free income, while mass affluent investors most frequently cite lower risk. Neither answer is correct, but may reflect those objectives that are most important to individuals in each income strata. Those who have accumulated significant wealth are likely to focus on keeping more by managing tax exposures, while those with less wealth might likely emphasize the security of their assets.

Californians who see the potential for similar portfolio benefits from green bonds may not fully understand the potential tax benefits these securities could provide. When asked for their top reason for investing in these securities, only 11% said they would invest to manage their tax liability. Respondents were more likely to cite the potential for better long-term returns (26%), steady income (24%), and diversification (23%). It is important to note that those considering the tax benefits are outnumbered by the 14% who said they would not consider investing in green bonds at all.

In terms of performance, respondents do not vary what they expect for green bonds from what they expect from traditional bonds. More than six in ten (63%) of those surveyed say they have the same return expectations for green bonds as they do for traditional bonds, while nearly one-third (29%) expect lower returns.

It should be noted that only 8% of respondents expect higher returns from green bonds. These specific views on bonds are in conflict with respondents' overall view on green investments in which 50% believe environmentally sustainable investments will outperform.

Members of the World War II generation are an outlier in this area as well. Overall, they are more skeptical about return potential, with 47% saying green bond returns will be lower than traditional munis, while the same number say they will be the same. Only 6% believe they will be higher.

INSIGHT 4:

Financial and non-financial variables all factor into the decision to go green

As Californians consider investments in green bonds issued by the state, they are likely to first want to assure themselves of the quality of the underlying investments, just as they are likely to do with today's traditional municipal bond funds. For the largest group of investors, it will begin with the basic question of "What's the long-term return of the security?"

Investment professionals challenged by similar concerns

ESG is playing a greater role in institutional investment strategies. In an October 2017 survey of 500 institutional decision makers in 30 countries, 44% said they consider ESG factors to be just as important as fundamental financial factors in investment analysis. In addition, 43% say that ESG factors are also playing an important part of their organization's manager selection process.

Motivations for deploying ESG are changing. When asked in 2016 why they integrate ESG, the majority of institutional investors said they made the call based on mandates in their investment policy statement. A year later, they cite the top three reasons for implementing ESG as:

1. To proactively align investment strategy with organizational values
2. To minimize headline risk (Using ESG to minimize headline risk increased 21% YOY)
3. To comply with investment policy

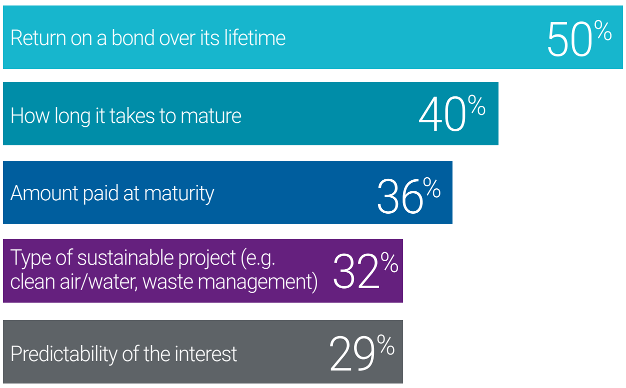
Acceptance is growing and 59% of institutions say there is alpha[8] to be found in ESG. To confirm its place in institutional money management, 60% believe that incorporating ESG will be a standard practice for all managers within five years.

Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in October and November 2016. Survey included 500 institutional investors in 31 countries. Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in September and October 2017. Survey included 500 institutional investors in 30 countries.

8 Alpha is a measure of the difference between a portfolio's actual returns and its expected performance, given its level of systematic market risk. A positive alpha indicates outperformance and negative alpha indicates underperformance relative to the portfolio's level of systematic risk.

When asked to cite up to three critical considerations in selecting a green bond investment, Californians again express a sense of enlightened self-interest: Investment performance is stressed first, social benefits second. Among those surveyed, half said they would consider the return of the bond over its lifetime, four in ten would look at how long it takes for the bond to mature, and 36% would look at the amount paid at maturity. Respondents place looking at the type of project the bond funds (32%) fourth in their priorities, followed by the predictability of the income it generates.

Key considerations when selecting a green bond investment
(% Yes, multiple answers allowed)



Investors are clearly focused on the strength of the underlying investment, but individuals also express clear concerns about the environmental impact of the bond. Three-quarters of investors say non-financial performance reporting is important to their evaluation of green investments. This factor carries significant weight with Californians.

Seeing is believing

Knowing that many worry that accurate reporting and verification may be lacking, it's no surprise that seven in ten (72%) say greater transparency and standardization of reporting would increase their desire for green bonds. Reporting is of such great importance to investors that six in ten would even be willing to pay more for their investment if it meant greater transparency.

Sources used to evaluate socially responsible investments
(% Yes, multiple answers allowed)

News and media	58%
Reports from the issuer/company	47%
A financial advisor	45%
Third-party investment ratings and awards	44%
Non-profit organizations	41%
Regulatory filings	21%

To achieve that level of transparency, investors say they are willing to accept validation on a wide range of public and personal sources. Among those sources, they trust the news and media most for this kind of information (58%). Only 47% said they would trust reports from the issuer, while only 45% would trust their financial advisors. Almost the same number (44%) say they would trust third-party investment ratings and awards, while only 21% are willing to trust regulatory filings.

Pricing and packaging matter

Access is a third factor to consider in the mix, as investors have diverse views on how they would prefer to purchase green issuances. Overall those surveyed said they would be most likely to purchase a green bond in a $1,000 denomination. Predictably, preference is driven by asset level: 32% of mass market investors may prefer a $500 face value, but 34% of high net worth investors prefer a $5,000 denomination.

While they are split in their preferences for bond denominations, Californians say they would prefer buying green bonds through a fund (59%) rather than individual securities (41%). What may be most surprising are the differences between the preferences of Millennials and those of the World War II generation. More than half of Millennials express a preference for individual securities, while seven in ten of the older generation prefer a fund. This could be the value of experience, as managing a portfolio of multiple issuances with multiple maturities can be challenging for even the most seasoned investor.

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Along with preferences for bonds priced in traditional denominations, Californians also expressed an interest in buying into green bonds at smaller face values, suggesting there could be a market for a green savings bond that could further democratize public funding. While overall preferences vary little between $25 (59%), $50 (59%), and $100 (61%) denominations, there are marked differences between wealth bands. Mass market preferences run strongest for $25 (66%) and $50 (63%), while high net worth individuals had the strongest preference for $100 (65%) and $500 (62%) denominations.

Conclusions and implications

Public outreach and education

If individual investors are to be a focus market for California green bonds, public outreach and education may be a key success factor. While investors may be aligned with the principles of ESG investing in spirit, misconceptions and knowledge gaps may inhibit them from taking action. Public information and education efforts should not be limited to the green part of the equation, as data shows that many individuals may also benefit from more education on investment fundamentals, particularly around municipal bonds.

Among the survey group, only 31% of individuals and only 45% of high net worth investors are currently invested in municipal bonds. The greatest gap in the level of muni investment appears between those who work with financial advisors (40%) and those who don't (19%).

Knowing that the top reasons California investors give for investing in municipal bonds are tax-free income, low risk, and stability, education efforts will have to be clear. One key message may be as simple as stressing that while these are often positioned as a conservative investment, municipal bonds are not risk-free.

Research conducted by Natixis Investment Managers over the past eight years has consistently shown that investors in the US may not fully appreciate the risks associated with their investment goals.

In 2017, individuals in the US estimated that they needed average returns of 8.9% above inflation to meet their investment goals. Assuming a traditional inflation rate of 3%, this figure translates into real returns of upwards of 12%. Pursuing this level of return would generally mean focusing on equity investments and assuming the higher levels of risk and volatility associated with this asset class. Yet 81% of the US population said that if forced to choose, they would take safety over investment performance.[9]

Knowledge gaps presented by California investors are consistent with the global investor trends we at Natixis have observed since initiating our global survey program in 2010. Simply put, investing is a complicated proposition and individuals can likely benefit from clear information and education. The same could be said for green investing. Even though 77% of California respondents say they want their investments to reflect their personal values, only 53% say they are knowledgeable about ESG investing. This knowledge gap could be leading to confusion.

77% of Californians say they want their investments to reflect their personal values

BUT only 53% say they are knowledgeable about ESG

The good news is 66% say they would invest in green bonds because of their potential environmental impact

In keeping with their views on green bonds, 43% believe that green bonds are less risky, while 46% believe they will give up return potential with these investments. It will be important that individual investors understand that the "green" part of a green bond does not necessarily reduce risk, and that risk is determined more by the underlying investment fundamentals. By the same measure, being green does not impact the coupon rate for the security nor does it reduce the bond's return potential.

Californians demonstrate strong interest in green bonds, as evidenced by the 66% of individuals who say they would invest in green bonds because of their potential environmental impact. A key step in engaging them in these issuances will be working to ensure they understand the investment side of the equation as well as the environmental.

Product planning

Motivating the participation of individuals in the California green bond market cannot depend solely on investor education. Consideration must also be given to the development of an investment proposition. Pricing, packaging and promotion are likely to be key success factors in efforts to engage California residents.

If the goal is to have investors representing a wide range of asset levels participate, bonds will need to be issued in a range of denominations. While a $1,000 bond appears to be the most popular among survey respondents, investors in different wealth bands express different preferences.

It is likely that those with higher asset levels may want to streamline portfolio and income management by acquiring fewer individual bonds. Conversely, smaller denominations could make it easier for those with lower asset levels to access green bonds issued in the state of California. In effect, scaling down the face value of these could scale up the pool of potential investors and more residents would be able to participate in the state's green bond market.

Packaging green bonds in even smaller denominations may provide another avenue for easier access to more residents via a state-issued green savings bond. Here again, the data suggests the need for a range of denominations. Those categorized as mass market by asset level demonstrate strong preferences for $25 and $50 bonds, while high net worth prefer $100 and $500 bonds. While early indications are strong, more specific research must be conducted to determine the viability of this option. Given that the US Treasury stopped issuing paper bonds in 2012, consideration will have to be given to how this program could best be administered.

Market segmentation is also an important consideration. One potential market to tap is that of a "green investor." For example, investors who demonstrate environmentally sound behaviors, such as carpooling and owning an alternative fuel vehicle, or who actively support community and charitable organizations may be predisposed to investing in green bonds. Additional research and analysis could help identify traits of those who could become early adopters within the green bond market.

Public and Private Partnership

Engaging residents in the green bond market will likely require establishing touchpoints outside the usual communication channels deployed by the California State Treasurer's Office. Our initial research indicates two potential opportunities that could be deployed in support of the project: financial advisors and the media. Both carry weight with investors which can be leveraged to drive them to action.

As evidenced by survey data, individuals who work with a financial advisor are twice as likely to invest in municipal bonds (40%) as those without an advisor (19%). This split follows logic that municipal bonds are often deployed as tax management tools for the higher net worth individuals who are more likely to work with a financial advisor. This logic is corroborated by results of our 2017 investor survey in which individuals in the US say the number one service they want from a financial advisor is help with tax issues.[10]

9 Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, February-March 2017. Survey included 8,300 investors from 26 countries, 750 of whom are US investors

10 Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, February-March 2017. Survey included 8,300 investors from 26 countries, 750 of whom are US investors

It will be important to conduct targeted outreach and education with the advisor population, as many of these professionals are just starting to warm to ESG investing. Advisors are most concerned with measuring financial and non-financial performance. Making it easy for advisors to access and interpret non-financial data will likely be a primary goal in these efforts, as 45% of California residents say they would trust their advisor for this type of information. This is likely to become less of an issue for advisors as new evaluation tools introduced by Dow Jones, Standard & Poor's, MSCI, and Morningstar become integrated into advisory practices.

Along with financial advisors, the media could also play an important role in driving green bond engagement with California residents. Among those surveyed 58% said they would trust the news and media for reporting on environmental performance.

Along with financial advisors, the media could also play an important role in driving green bond engagement with California residents.

This is of particular note in that only 21% said they would trust regulatory filings for this validation. Given this level of trust, a public service campaign for financial literacy and green investing might help not only to distribute key information but also to ensure acceptance.

ABOUT THE SURVEY

Natixis Investment Managers surveyed 500 investors in California in August 2017, with the goal of understanding the perceptions, attitudes and opinions of individuals residing in California related to green bonds and ESG-focused saving and investing approaches.

Respondent breakdown

500 California residents

256 Males

244 Females

144	155	169	32
Participants	Participants	Participants	Participants
MILLENNIALS	GENERATION X	BABY BOOMERS	WWII GENERATION

133 Mass Market

140 Mass Affluent

124 Emerging HNW

103 High Net Worth

284 Advised

216 Non-Advised

PROGRAM OVERVIEW

About the Natixis Center for Investor Insight

Investing can be complicated: Event risk is greater and more frequent. Volatility is persistent despite market gains. And investment products are more complex. These factors and others weigh on the psyche of investors and shape their attitudes and perceptions, which ultimately influence their investment decisions. The Center for Investor Insight conducts research with investors around the globe to gain an understanding of their feelings about risk, their attitudes toward the markets and their perceptions of investing.

Research agenda

Our annual research program offers insights into the perceptions and motivations of individuals, institutions and financial professionals around the globe and looks at financial, economic and public policy factors that shape retirement globally with:

- Global Survey of Individual Investors – reaches out to 8,300 investors in 26 countries.
- Global Survey of Financial Professionals – reaches out to 2,550 professionals in 15 countries.
- Global Survey of Institutional Investors – reaches out to 500 institutional investors in 30 countries.
- Natixis Global Retirement Index – provides insight into the environment for retirees globally based on 18 economic, regulatory and health factors.

The end result is a comprehensive look into the minds of investors – and the challenges they face as they pursue long-term investment goals.

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