

Picking out “ESG-debt Lemons”: Institutional Investors and the Pricing of Sustainability-linked Bonds

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ABSTRACT

We introduce a novel framework for classifying sustainability-linked bonds (SLBs) based on their sustainability impact. We show that although SLB profiles usually enjoy a greenium at issuance relative to similar plain vanilla bonds, pricing does not significantly differ across SLBs with various degrees of sustainability impact. We find evidence consistent with investors overpaying to purchase an ESG-label of SLBs that are unlikely to yield strong impact. Demand for different SLB profiles is influenced by institutional investors' ESG credentials, portfolio allocation to green firms, investment preferences and prior experience in ESG investing. These features also help explain how investors price SLB profiles. Overall, we provide evidence of investor characteristics that predict the selection and pricing of ESG-labeled bonds with various degrees of sustainability impact.