Principles for Responsible Investment

ESG ENGAGEMENT FOR SOVEREIGN DEBT INVESTORS

UNEP FINANCE INITIATIVE | United Nations Global Compact

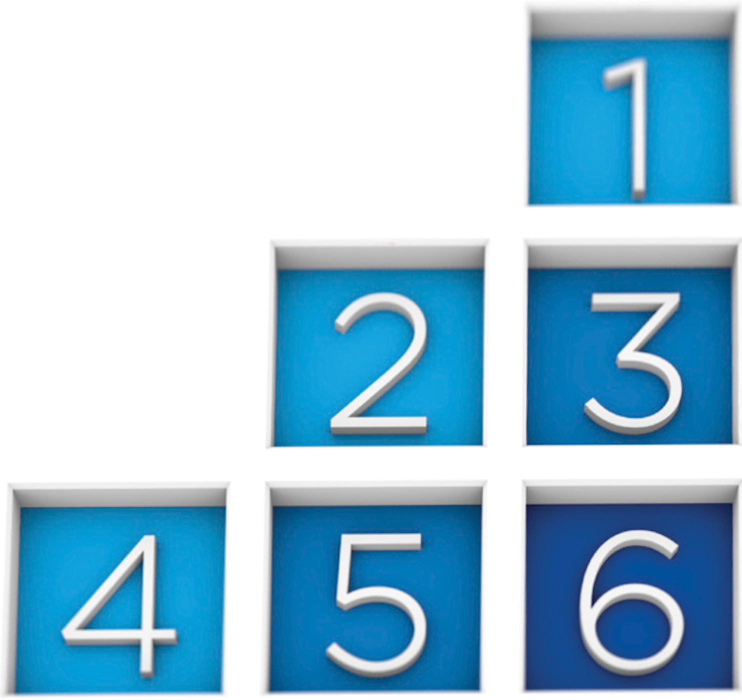
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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CONTENTS

ABOUT THIS REPORT

This report explores ESG engagement in sovereign debt investing, including current practices and challenges, and the role it can play in promoting responsible investment.

It follows the publication of the PRI technical guide – ESG engagement for fixed income investors – and is the result of recommendations by the PRI's Practical guide to ESG integration in sovereign debt, which identified the need to further explore engagement as a critical part of the sovereign ESG integration process.

Engagement in any asset class allows investors to move from merely observing an issuer's ESG performance and historical trajectory to encouraging an improvement in transparency and tangible actions in relevant areas, thus using their weight to influence and shape ESG outcomes. Both the investee entities and their investors are consequently better informed to address ESG factors that might be material to the pricing and performance of their securities. Indeed, fostering a community of active owners across asset classes is also one of nine strategic impact areas of the PRI's 10-year Blueprint for Responsible Investment.

However, the practice of engagement and the channels through which it is conducted varies by asset class. Sovereign bondholder engagement differs – not only from shareholder engagement, but also corporate bondholder engagement, as this report explores. Importantly, it provides examples of ESG topics and existing ESG frameworks to enrich investor conversations with sovereigns and other key country stakeholders to enhance disclosure and discussions that can be used to put responsible investment into practice.

FOREWORD

Sovereign engagement has been an underutilised practice and should be scaled up to improve future financial sustainability and promote responsible investing more broadly.

As funders of sovereign debt, bondholders can play an important role in driving change and shaping ESG outcomes through their investment decisions.

Some investors have engaged with sovereign issuers and non-issuer stakeholders for a long time to better assess investment risk. For example, by undertaking country research trips, investors can better understand specific sovereign policies and actions. However, conversations around environmental, social, and governance issues should happen more strategically, not only for investors to enhance risk assessments but also for sovereign issuers to understand that their debt will increasingly be valued based on ESG criteria.

Engagement should not be considered a "one-way street" – if it is done effectively it can reduce sovereign risk and funding costs. Furthermore, enhanced and clear policies can improve a country's business environment, which in turn reduces country investment risk, supports economic growth and should ensure more sustainable debt paths.

The timing of this report is particularly relevant as the COVID-19 fallout has negatively impacted the balance sheet of every country, regardless of its investment grade status or whether it is considered a developed or emerging economy. Given that the full magnitude of this impact is yet to be determined, this time should be used as an opportunity to foster engagement between investors and issuers to discuss sustainable funding solutions. Therefore, two-way discussions are encouraged around ESG topics, what impact they may have on a country's fiscal and growth path and approaches to ensure their sustainability.

This report – written with the contribution of the PRI's sovereign debt advisory committee (SDAC) whose members are experienced sovereign bond practitioners – aims to provide insights on how sovereign engagement is conducted, and where the industry can extend this custom to advance responsible investing. We hope it enhances the understanding of how sovereign engagement can be applied effectively as well as addressing misconceptions around engagement and what forms of engagement sovereign bondholders can undertake.

I would like to extend my gratitude to the members of the SDAC for their contributions and to the PRI for enabling this collaboration to promote responsible investing across asset classes, including sovereign debt. By encouraging sovereigns to commit to greater transparency, to improve policy and ESG factor oversight and to making growth models more sustainable, investors can make countries more investable and facilitate change.

Claudia Gollmeier, CFA
Chair, PRI Sovereign Debt Advisory Committee
Managing Director (Singapore), Senior Investment Officer, Colchester Global Investors

EXECUTIVE SUMMARY

Engagement is integral to responsible investment in all asset classes, and for sovereign bondholders this should not be an exception.

It comes with challenges though. In particular, the terms active ownership and stewardship – at the core of Principle 2 of the six Principles for Responsible Investment and typically associated with equity investing – are not particularly appropriate in a sovereign debt context, as investor engagement can be misinterpreted as lobbying, advocacy or an attempt to interfere in governments' policy choices.

However, bondholders engage to make more informed investment decisions. Indeed, many already regularly engage with government representatives and other country authorities to gain insight, primarily around fiscal and monetary policies, both key for pricing bonds.

Conversations specifically around ESG topics are limited though, as is tracking of how countries fare on sustainability pledges.

This can change. Investors can use the meetings they already have with sovereign officials to point out which ESG information they deem important for their analysis, to encourage ESG data transparency and disclosure and to convey expectations.

Furthermore, investors can use engagement more effectively, to go beyond risk-return considerations. As stewards of savers' money, responsible sovereign bondholders have a fiduciary duty not only to yield returns for their beneficiaries but to pursue them by promoting sustainable economic, societal and environmental outcomes.

To this end, this report highlights existing market practices and differences between corporate and sovereign bondholder engagement. Furthermore, practitioners' evidence shows how existing communication channels and opportunities can be leveraged to stimulate conversations around ESG topics through a multi-pronged process, which can be mutually beneficial for sovereigns and investors. It also describes common misconceptions which act as barriers to engagement, and how these can be overcome, including through collaborative initiatives that could increase impact.

Framing engagement around ESG disclosure and making progress towards existing policy commitments, such as the Sustainable Development Goals (SDGs) or the Paris Agreement, is a natural and non-controversial starting point for discussions with issuers. Moreover, although ESG risks may be easier to identify in emerging markets (as several examples in this report indicate), the fact that many developed sovereign bond markets are more liquid or have better credit quality should not prevent investors from adopting an "engagement mindset" and interacting with them on ESG topics too.

A sizeable amount of public debt in several large sovereign markets is held by domestic and foreign central banks, due to either quantitative easing or for reserve and liquidity management purposes. However, the COVID-19 crisis has increased countries' public financing needs, presenting institutional investors, as funding providers, with a unique opportunity to engage with sovereigns on delivering sustainable recovery plans.

This report is a stepping stone to future work: it should encourage investors to have more explicit conversations with sovereigns, so that countries' sustainability commitments do not merely remain statements of intent. Furthermore, it should help ensure that countries' progress (or lack thereof) is better reflected in bond valuations. It is useful for sovereigns to better understand the increasing ESG appetite of investors. Finally, it should promote discussions between investors, sovereign issuers and other stakeholders, including through events that the PRI intends to organise, to facilitate the funding of more sustainable growth models.

WHY BONDHOLDERS ENGAGE WITH SOVEREIGNS

KEY TAKEAWAYS

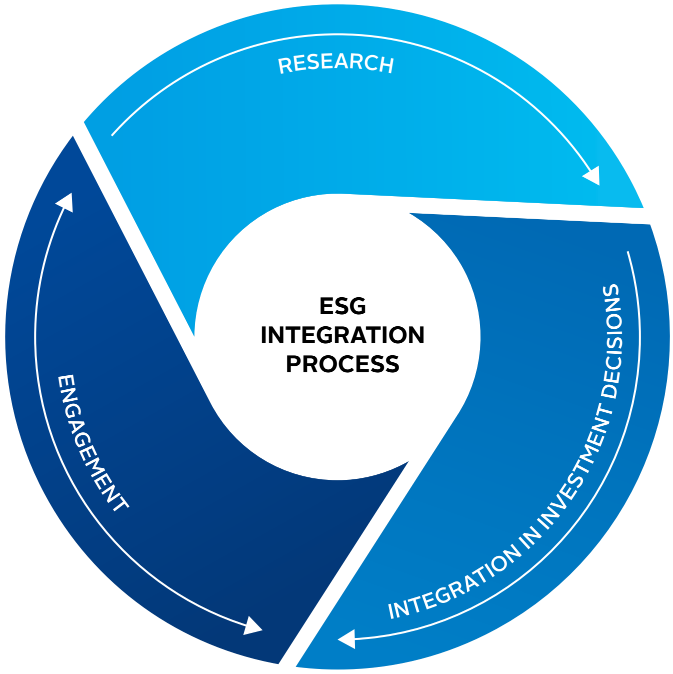
- There are important differences when engaging with sovereign issuers compared to other types of security issuers.
- Direct engagement between sovereign bondholders and government officials should not be confused with advocacy or lobbying.
- Sovereign engagement is a multi-pronged, 360-degree process: interactions extend beyond national institutions or ruling parties and include multiple stakeholders.

Engagement is integral to responsible investment in all asset classes, and it is a key component of systematically integrating ESG factors into the investment process (*see Figure 1*).

It is more established among equity investors, who can use annual general meetings, quarterly analyst calls and voting rights to engage, support or challenge corporate management and strategies, either individually or collaboratively, as explored in PRI's A practical guide to active ownership in listed equity.

Engagement practices and channels differ across asset classes, given that not all purchasers of financial instruments are shareholders, and within debt capital markets, they depend on the issuer type.

Figure 1. The circular process of ESG integration



> "Sovereign engagement is a win-win for issuers and investors. It enables creditors to flag key credit risks which may not have imminent effects but are important for the longer-term health of a country. Engagement also allows issuers to address ESG risk factors and communicate what they are doing to ameliorate those."
>
> Lupin Rahman, Global Head of EM Sovereign Credit, PIMCO

CORPORATE VERSUS SOVEREIGN BONDHOLDER ENGAGEMENT

Bondholders have always engaged with companies and sovereigns to better understand risks and opportunities and form a view on credit risk, balance sheet and economic fundamentals. In the case of sovereigns, these fundamentals include aspects such as the long-term growth outlook and fiscal debt trajectory. Historically, the focus has been primarily on governance issues, particularly relating to the "character" of issuers.[1]

However, even within fixed income, the practice and the channels of engagement vary depending on whether the issuer is a corporate or a sovereign.[2] In practice, these differences relate to their access, legal standing and issuers' obligations (*see Table 1*). Moreover, buying sovereign debt instruments only because they are more liquid than other bonds, or because of regulatory requirements, is less conducive to an "engagement mindset".

Table 1. Corporate versus sovereign bondholders - key characteristics

CORPORATE BONDHOLDERS	SOVEREIGN BONDHOLDERS
LEGAL STANDING	
▪ Lend capital under a set of legally binding rules, objectives, and protective clauses (covenants). ▪ No directorship appointments but bondholder expectations provide important signal for management and can sway business strategies.	▪ Fewer, less detailed covenants, default clauses.[3] ▪ Varied political institutions, governance structures. Bondholders can communicate views and expectations on fiscal plans, economic targets, structural reforms, although sovereign authorities retain power to set policies.
ISSUER OBLIGATIONS	
▪ Bondholder seniority (over shareholders) is usually clearly defined where a company fails to meet its contractual financial obligations, due to an inability or unwillingness to repay its debt. Defaults could restrict future market access.	▪ In case of unwillingness or inability to repay debts – including for reasons that derive from societal or political considerations – resolution processes vary.[4] Debt repayment history is not always an impediment to market access.[5]
ACCESS TO ISSUERS	
▪ Well defined but differing corporate hierarchies (public vs private companies). ▪ Access to dedicated sustainability specialists, investor relations, C-suite representatives. ▪ Average US C-suite tenure decreasing, current average (22 years) provides continuity[6] but does not prevent excessive short-term results focus.	▪ Initial point of contact varies – could be country's debt management office (DMO) / Treasury / Ministry of Finance / Central Bank. ▪ Access to ESG-relevant government officials could be difficult, but access to multiple other stakeholders can provide well-rounded view.[7] ▪ Election calendars vary depending on type (presidential, parliamentary, local etc.) – average democratic electoral cycle is four to six years, a tenure that can hamper long-term ESG decisions.

1 According to the CFA Institute portfolio managers and analysts consider four or five "Cs" in credit analysis – capacity, collateral, covenants, character (and capital). For example, the characteristics of a high-quality sovereign credit would entail the absence of corruption and/or challenges to political framework and the presence of governmental checks and balances; respect for rule of law and property rights; among others.

2 Readers interested in guidance aimed at corporate bondholder engagement should refer to the PRI's 2018 technical guide, ESG engagement for fixed income investors.

3 Bruno, E. (2013) Sovereign Debt Restructuring: Covenant and Default Clauses in Sovereign and Corporate Bonds and How the Difference Among Them Impacts the NML Case Against the Republic of Argentina in New York

4 Depending on whether bonds have been issued under local or foreign law. Legal procedures for sovereign debt restructurings, akin to a bankruptcy court for corporate issuers, do not exist. Nonetheless, significant progress has been made in aligning sovereign bond documentation and capital markets norms, to facilitate a more rapid and orderly restructuring of sovereign debt. For more detail, see Gulati and Buchheit (2020) The Argentine Collective Action Clause Controversy and OMFIF (2020) Argentina and creditors enter new round.

5 Financial Times (2020) Greece draws strong support for new 15-year bond

6 In 1964, the average tenure of a company on the S&P 500 was 33 years; today, it is 22 years and headed to 12 years by 2027. For more detail, see EY (2019) Has your C-suite changed to reflect the changing times?

7 See Sovereign engagement: a 360-degree process section.

There are different options for investors to consider once they have engaged a sovereign[8], including:

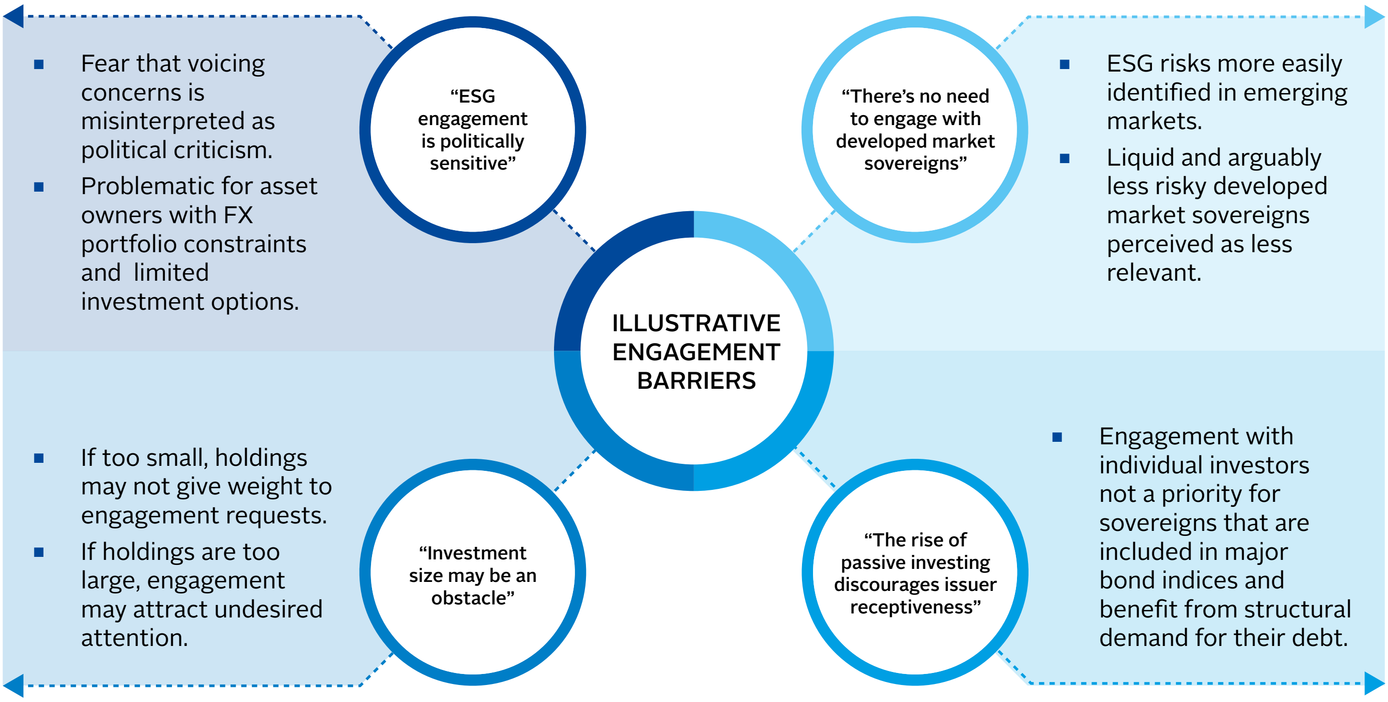
- maintaining or increasing exposure to a sovereign debt market because of attractive valuations;
- reducing exposure (either relative to a benchmark or to other sovereign debt markets), divesting or avoiding new debt issuance because of unattractive valuations.

However, in some instances there are challenges to engaging with sovereigns, some of which can be overcome better than others (*see Figure 2*).

“One of the main purposes for engagements is understanding what is happening on the ground today – due to the staleness of sovereign data we need more of real-time updates.”

Frederick Isleib, CFA, Director of ESG Research and Integration, Manulife Asset Management

Figure 2. Illustrative engagement barriers



8 Reviewed in detail in PRI’s [Practical guide to ESG integration in sovereign debt](#).

Partly for these reasons, engagement with sovereigns is less common than with corporates, as illustrated by the reported practices of PRI signatories (*see Table 2*).

Table 2. PRI signatories' engagement activities relative to fixed income holdings[9]

	CORPORATE (NON-FINANCIAL)		CORPORATE (FINANCIAL)		SOVEREIGN, SUPRANATIONAL AND AGENCY	
	2017	**2020**	**2017**	**2020**	**2017**	**2020**
Do not engage	34%	16%	38%	15%	58%	34%
Engage on <5% of fixed income assets	22%	23%	19%	18%	16%	26%
Engage on 5-25% of fixed income assets	20%	22%	20%	23%	10%	13%
Engage on 26-50% of fixed income assets	8%	11%	7%	12%	7%	8%
Engage on >50% of fixed income assets	16%	28%	17%	32%	9%	18%
Nr. of reporting PRI signatories	361	645	328	528	278	495

ESG SOVEREIGN BONDHOLDER ENGAGEMENT

When engaging directly with government institutions, bondholders do not approach sovereigns for lobbying or advocacy but to assess bond valuations and risks. The focus of conventional engagement is traditionally on monetary and fiscal policies, with the goal of determining the investment attractiveness of a country's debt.

Specific engagement on ESG topics is less common. While some ESG factors can be assessed objectively without engagement, others require investors to do so to get more information about the delivery of existing policy commitments, encourage more forceful action to progress the ESG agenda or discuss funding needs for ESG-related reforms.

Investors can use different engagement routes. Some have started writing letters to G7 and G20 countries, pressing for policy changes on climate – such as the one coordinated in 2017 by the PRI, urging nations to stand by their commitments to the Paris Agreement and to implement policy measures to achieve their nationally determined contributions (NDCs), including developing focused and targeted long-term climate plans. The Global Investor Statement to Governments on Climate Change in 2019 offers a more recent example.

A few others have begun to use meetings with sovereign officials to seek enhanced disclosure of credit-relevant ESG information. However, ESG conversations remain limited and should be scaled up. If anything, beyond risk assessment, the ESG issues that bondholders are typically concerned about are – in most cases – aligned with potential benefits for domestic stakeholders (e.g. reduced corruption or combatting tax evasion).

This type of engagement can be *complementary* to and *supportive* of other initiatives which undertake activities to influence policy, regulation and other forms of government intervention in support of a stated goal.[10] They can even amplify their outcomes.

9 The same respondent may engage with different types of issuer. Some investors report that it is difficult to precisely quantify the proportion of their assets that are subject to engagement, as the meetings are not dedicated to ESG issues and ESG is not clearly defined by investors.

10 For more detail on the PRI's policy work, see https://www.unpri.org/policy/our-policy-approach.

ENGAGEMENT BENEFITS INVESTORS AND SOVEREIGNS

Engagement between investors and sovereigns is a mutually beneficial process creating value along several dimensions, as it does for corporates (*see Table 3*).

Table 3. Sovereign bondholder engagement: a mutually beneficial process[11] *

VALUE CREATED	FOR INVESTORS	FOR SOVEREIGN ENTITIES
Exchanging information	▪ Clarify sovereign performance on credit-relevant ESG issues ▪ Evaluate government ESG strategy, clarify public policy ▪ Emphasise stakeholders' partnership role	▪ Understand growing investor ESG appetite, peer best practice ▪ Appreciate how ESG integration in bond valuations may affect demand, borrowing costs ▪ Address investor misconceptions
Improving transparency	▪ Encourage better ESG-relevant data disclosure ▪ Enhance risk assessment ▪ Contribute to more efficient, accessible capital markets	▪ Demonstrate good governance through openness to dialogue, potentially improving investability ▪ Develop regular information process to underpin bond issuances
Creating opportunities	▪ Build long-term issuer relationships ▪ Meet client ESG demand, expectations ▪ Solicit investments that contribute to real-world outcomes e.g. funding environmental, social or SDG-related goals	▪ Strengthen long-term investor loyalty ▪ Preserve/secure long-term capital flows, market access ▪ Optimise funding costs ▪ Explore mechanisms to fund SDG-related commitments, tap new capital sources

* Possible engagement benefits for illustrative purposes and not an exhaustive list.

11 Adapted from Mechanisms of engagement value creation for corporations and investors (p.14) in PRI's 2018 Practical guide to active ownership in listed equity.

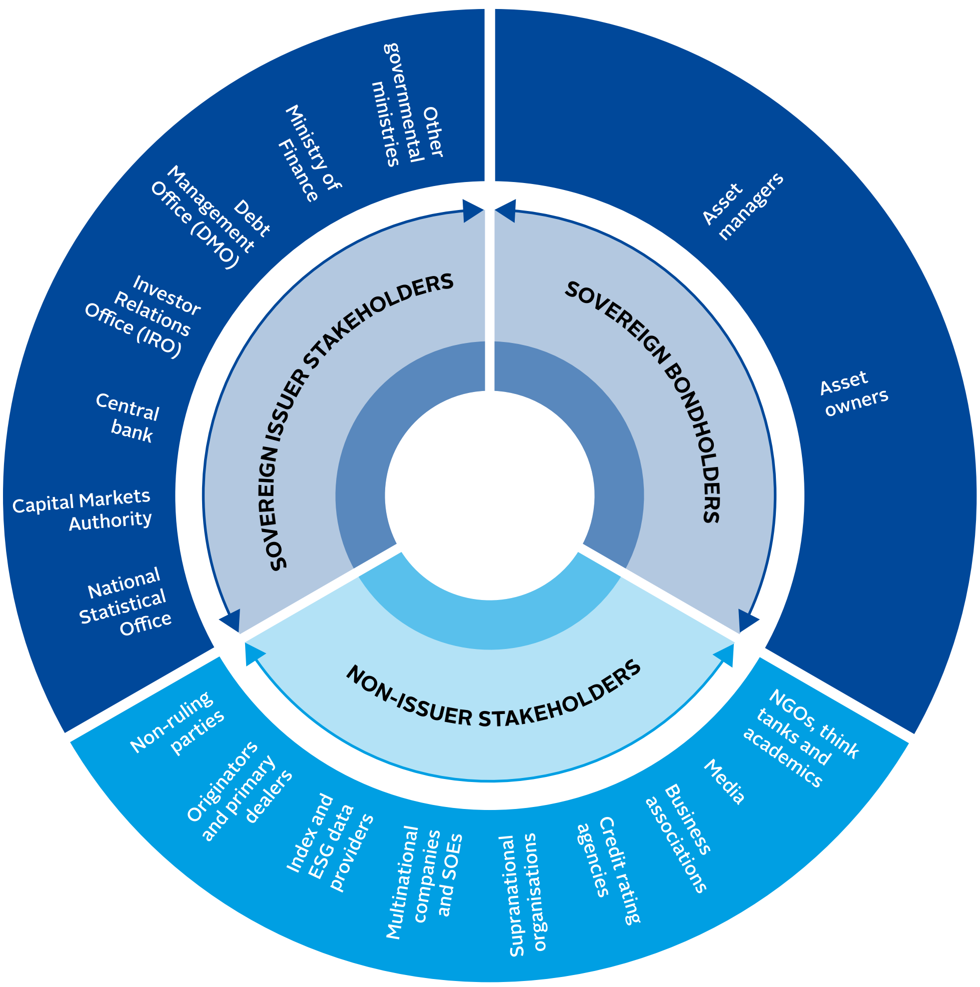
SOVEREIGN ENGAGEMENT: A 360-DEGREE PROCESS

A key feature of sovereign debt engagement is the availability of a wide array of stakeholders to engage with and provide a well-rounded view. As a result, it is not bilateral (limited only to ruling institutions) but is a multi-pronged, 360-degree process.

Beside central government officials and independent public agencies, engagement encompasses interactions with non-issuer stakeholders, including originators and primary dealers, supranational organisations, and credit rating agencies (CRAs), domestic stakeholders and private organisations (*see Figure 4 and Table 4*).

> "ESG engagement with sovereigns allows investors to raise and promote issues that they think are important in improving a country's credit trajectory and long-term growth potential, and that they determine are material to a country's sovereign fixed income performance."
>
> Kristin J. Ceva, CFA, Managing Director, Payden & Rygel

Figure 4. Sovereign engagement is a 360-degree process*



* Possible engagement stakeholders for illustrative purposes and not an exhaustive list.

Non-issuer engagement is as important for informing the investment process. It can help investors get a holistic view of developments in a country and substantiate official information.

Table 4. Non-issuer stakeholders and engagement themes

NON-ISSUER STAKEHOLDER	EXAMPLES OF ENGAGEMENT THEMES
Non-ruling parties	▪ Understanding the position of opposition parties may be valuable for anticipating potential power shifts; it could also help to identify ESG-related policies for which there could be bi- or multi-partisan support.
Originators and primary dealers	▪ Investment bank capital market desks can advise sovereigns on ESG issues that might be material to pricing and would increase the attractiveness of their bonds.
Index and ESG data providers	▪ While ESG-weighted sovereign indices are becoming more popular[12], it is important that institutional investors engage with index providers to voice their views about country selections, especially asset owners, who tend to outsource the choice of the index that asset managers must track. ▪ Discussions with ESG information providers could serve to better understand their methodologies and product offerings – which are still relatively limited compared to what is available for corporates – and to provide feedback. Some also run formal consultations with users, similar to index providers. ▪ Independent opinion providers offer useful assessments of sovereigns' thematic bonds.
Multinational companies and state-owned enterprises (SOEs)	▪ Since they operate in different jurisdictions, engaging with multinational corporates can provide valuable insight into a country's 'ease of doing business' (an important governance indicator), local practices and risk more broadly. ▪ SOEs – for example, national oil companies in commodity-exporting countries – can also be important to meet. Many of these companies impact fiscal deficits, either on the revenue side (in the case of an oil company) or on the expenditure side (e.g. if an electrical utility needs regular state support).
Supranational organisations[13]	▪ Institutions such as the World Bank, the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD) and the European Commission can be a good source of ESG data and research. ▪ For example, in response to investor demand the World Bank launched the ESG Data Portal. Furthermore, although IMF loans are already meant to help member countries tackle balance of payments problems, stabilise their economies, and restore sustainable economic growth,[14] investors can encourage the IMF to complement its traditional crisis resolution role with more explicit ESG targets. Progress towards these should also be monitored more closely, through the IMF's regular multilateral surveillance work.[15] ▪ Engaging on ESG topics with dedicated country analysts who have easier and more regular access to country officials can be very insightful, particularly in frontier markets. The influence of supranationals over sovereigns can stimulate greater transparency and more timely sovereign disclosures on material areas.

12 See for example, JP Morgan ESG index series, FTSE Climate Risk-Adjusted Government Bond Index series, and S&P's ESG Pan-Europe Developed Sovereign Bond Index.

13 Including multilateral lending institutions (MLIs)

14 See https://www.imf.org/external/about/lending.htm.

15 The IMF's country surveillance culminates in regular, comprehensive "Article IV" consultations, where a team of economists visits a member country to assess its economic and financial developments and discuss its economic and financial policies with government and central bank officials. IMF staff missions also often meet with parliamentarians and representatives of business, labour unions, and civil society. For more detail, see IMF (2019) Connecting the Dots Between Sustainable Finance and Financial Stability and https://www.imf.org/external/about/econsurv.htm.

NON-ISSUER STAKEHOLDER	EXAMPLES OF ENGAGEMENT THEMES
CRAs	▪ The focus of CRAs on ESG topics has increased in recent years, partly thanks to the PRI's ESG in Credit Risk and Ratings Initiative and closer regulatory scrutiny.[16] Many have broadened their product offering and provide ESG evaluations/assessments, in addition to credit opinions. ▪ As a result, rated issuers (including sovereigns) are beginning to receive more questions related to their ESG policies. Investors can benefit from CRAs' increased analytical and research capacity on ESG topics. They can also challenge CRAs if they think that ESG factors may not have been adequately captured by credit ratings.
Business associations	▪ Business and professional member associations, trade unions and Chambers of Commerce operate in specific sectors, with close links to companies, network events, and lobbying activities. They can provide an overview of industry developments, the business environment, social dialogue, and labour market practices.
Media	▪ Press freedom is a widely used governance indicator. In developed democracies, where views, including about government policies, can be expressed freely, a lot can be learned from engagement with journalists, political commentators, and press bodies.
NGOs, think tanks and academics	▪ Global, regional or local advocacy organisations can provide greater insight into local perspectives on ESG topics. For instance, Planet Tracker, a UK not-for-profit think tank highlighting financial risk related to ecological limits, runs a joint programme with the London School of Economics exploring the relationship between sovereign bonds, natural capital and environmental risks, and the sovereign health of a country and its key soft commodities.

16 European Securities and Markets Authority (2019) ESMA advises on credit rating sustainability issues and sets disclosure requirements

CURRENT MARKET PRACTICE

KEY TAKEAWAYS

- There are several opportunities to engage with sovereign issuers, including roadshows, investor country trips and annual conferences.
- As responsible investment practices become more embedded, growing concerns over environmental and social issues should provide a new base for discussion.

CHANNELS OF ENGAGEMENT

Some engagement opportunities are issuer initiated, others are investor led. Despite the lack of disclosure standards, examples of good practice and communication are beginning to emerge among issuers, and investors are taking notice.

The following events could be useful to initiate discussions around ESG topics:

- unveiling of fiscal plans
- roadshows
- ad-hoc events
- country research trips
- investor collaboration

UNVEILING OF FISCAL PLANS

Most governments unveil annual budgets as well as medium-term fiscal plans. In addition to providing targets, revenue and expenditure projections, these plans are often accompanied by the announcement of wide-ranging reforms, many of which encompass sustainability-related areas (education, health, labour market, pensions etc.). In democracies, the fiscal plans are submitted to the relevant legislative body for approval but, as a sign of transparency, governments often convene investors to provide clarifications and details. This enables investors to ask for better public disclosure (including ESG-related information), discuss underlying budget assumptions and enhance their assessment of fiscal sustainability. Similarly, engagement opportunities exist with some central banks, for example around inflation and financial stability report releases.

ROADSHOWS

Governments and DMOs organise roadshows to promote new bond issues as well as non-deal roadshow meetings – though roadshows are not always regular nor available as an engagement channel for all countries. While there are increasing examples of issuers including ESG-relevant information in investor communications, roadshows organised around thematic bond issuance[17] can be a particularly useful setting for dialogue, as issuers are better prepared to answer ESG-related questions.[18] Indeed, sovereign green bond issuers report being scrutinised thoroughly on their government's overall environmental strategy.[19]

Through such discussions, investors can help sovereigns understand that growing the bond supply in this market segment can:

- be a signal of their commitment to sustainability policies;
- provide strategic direction;
- create domestic green markets; and
- attract capital towards goals that can make their country's growth model more sustainable.[20]

Such issuance also provides investors with an opportunity to allocate capital thematically and to measure the environmental or societal outcome of their investments beyond financial returns.

17 Thematic bonds are those whose proceeds are exclusively applied to eligible environmental, social, or sustainability projects, or for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability objectives. For more detail, see https://www.icmagroup.org/green-social-and-sustainability-bonds/.

18 Since Poland pioneered the market in 2016, twelve nations have followed, and in 2019, sovereign green bonds accounted for around 10% of total issuance. See Environmental Finance (2020) The 2020s - The decade of Sustainable Bonds for more detail.

19 Climate Bonds Initiative (2020) Green Bond Treasurer Survey

20 Climate Bonds Initiative (2018) Sovereign Green Bonds Briefing

CHILE PROACTIVELY ENGAGING WITH ITS BONDHOLDERS ON ESG

The Chilean DMO organised an investor roadshow in May 2019 in various European and US cities prior to issuing its first sovereign green bond. On this occasion, the Chilean authorities also provided broader ESG information.

Chile also pro-actively reached out to engage with investors in later that year in North America on a *non-deal* roadshow. The timing was important because Chile had experienced significant social unrest a few months earlier related to living costs and inequality. SDAC investors who participated in the roadshow emphasised that Chilean officials discussed this specific situation and their concrete plans to address it (which illustrated good governance practices) and that they also took the opportunity to focus on other ESG areas where Chile was making progress.

Chile's Investor Relations Office, run by its Ministry of Finance, has also published regular investor presentations on its website since 2019 which address selected ESG topics, metrics and targets.[21]

Despite these good communication and transparency efforts, significant ESG challenges remain, many of which continue to pose risks (such as large inequality). Nevertheless, participating members of the PRI's SDAC observed that, compared to other countries, the Chilean authorities appear more willing to engage in dialogue with investors and are aware of the importance to keep communication open, a practice that other issuers should strive towards.

AD-HOC EVENTS

Safe-haven countries such as the US, some Western European countries and Japan and some large, frequent EM issuers, such as China, do not hold roadshows often; they announce a regular issuance programme with market updates instead. In this instance, ad-hoc events could be useful.

For instance, government officials feature regularly in public conferences and events where there could be opportunities for investors to ask ESG-specific questions.[22] Large development finance institution conferences, such as the Annual and Spring World Bank/IMF meetings and their side events, also provide good engagement opportunities. For example, in April 2019 during the IMF/World Bank Spring meetings, the World Bank Treasury, GPIF of Japan and APG of the Netherlands organised a roundtable to share perspectives on how to engage with sovereign issuers on ESG issues with four EM and DM sovereigns participating. A similar event was organised by the World Bank Treasury in October 2019 with six EM sovereigns, investors, rating agencies and data providers, to share their approaches to integrating ESG criteria into EM sovereign investing.

COUNTRY RESEARCH TRIPS

Country research trips have long been a regular feature of the institutional investment process. They are typically organised by individual investment houses or by commercial/investment banks for groups of clients and offer an opportunity to meet with a variety of country stakeholders. This makes country trips important for informing investment decisions as they evidence what is happening "on the ground".

> "Uruguay has been very proactive in seeking to address ESG questions from investors – giving presentations that specifically address ESG issues and, furthermore, proactively looking to engage on these topics."
>
> Yvette Babb, Fixed Income Portfolio Manager, William Blair International

21 See https://hacienda.cl/english/investor-relations-office/presentations

22 For example, the Ghanaian president spoke at a Chatham House event to discuss his government's approach to sustainable development. See https://www.chathamhouse.org/file/financing-sustainable-development-africa.

IMPROVING MEXICAN CENTRAL BANK TRANSPARENCY THROUGH TARGETED ENGAGEMENT

The Mexican central bank had lagged other monetary authorities in its communication strategy to explain monetary policy decisions. Investors, including one SDAC member, engaged with central bank officials starting from 2017, in private and public meetings, to make the case that better communication would improve the efficiency of the market in pricing the future path of monetary policy. In April 2018, the monetary authority announced that it would start to include the governing board's voting records in its statement after monetary policy meetings and to identify board members in the minutes, where appropriate, thus making the policy decision process more transparent.

> "A few countries have done a fantastic job in recent years when it comes to keeping investors informed. Some of these issuers provide comprehensive and regular written investor presentation materials, while some also hold regular in-person and virtual update roundtables."
>
> Jan Berthold, CFA, Sovereign Analyst, Fidelity International

INVESTOR COLLABORATION

Engagement can be organised on a one-to-one basis or be collaborative, albeit the latter has historically been used by equity investors and only more recently by bondholders.[23] Collaborative platforms for sovereign debt investors exist but they are limited (*see Table 5*). They offer an important channel to improve transparency and uphold ESG best practices by governments.

Table 5. Existing collaborative platforms for sovereign debt investors

COLLABORATIVE INITIATIVE	WHAT IT PROVIDES
Emerging Markets Investors Alliance (EMIA)	EMIA seeks to enable institutional EM investors to support good governance, promote sustainable development, and improve investment performance.[24] Participating investors report that it facilitates issuer access and engagement on sensitive topics.
The Investor Agenda	The Investor Agenda is a collaborative initiative that seeks to accelerate the transition to a net-zero emissions economy by 2050 or sooner. This includes elevating the profile of existing investor actions and initiatives on climate change, and amplifying investor voices calling for government implementation of the Paris Agreement.[25]

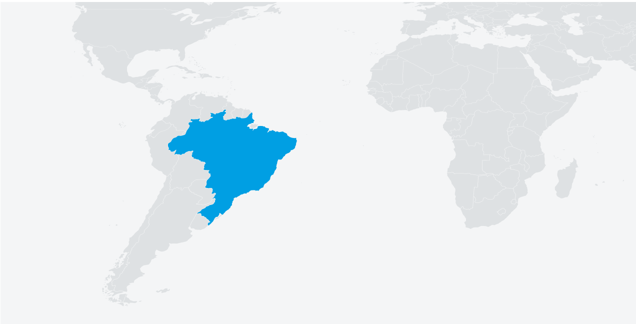
Importantly, the recent initiative by a group of global institutional investors to challenge the Brazilian government on deforestation is illustrative of increasing appetite for collaboration among sovereign bondholders and how momentum may be changing. As PRI signatories continue to grow, so could opportunities for concerted action, as Principle 5 of the six Principles for Responsible Investment encourages collaboration by investors to enhance the effectiveness of their responsible investment approach.

23 See for example, Climate Action 100+ – an investor-led climate coalition that engages with systemically important carbon emitters and includes corporate bondholders.

24 EMIA featured in the PRI webinar 'ESG integration on sovereign debt: emerging and developed markets' on 26 September 2019.

25 The Investor Agenda (2019) The Investor Agenda progress report

SOVEREIGN BONDHOLDERS USING COLLECTIVE WEIGHT AGAINST DEFORESTATION



Nordea Asset Management's public decision to suspend the purchasing of Brazilian government bonds in response to the major Amazon forest fire outbreak in 2019[26] was followed by an invitation from the Brazilian embassy in Helsinki. At the meeting, two Brazilian officials and Nordea AM's CEO, Head of EM Debt, and Head of Responsible Investment discussed the extensive deforestation situation in Brazil, the firm's concern regarding the forest fires, the environmental consequences and the possible financial impact on the Brazilian economy.[27] Politicians also had the opportunity to present their perspective, and Nordea was invited to Brazil to see how the government was dealing with the fires.

More recently, in July 2020, a group of institutional investors managing a combined US$4.6trn in assets urged the Brazilian government to halt the deforestation in the Amazon, which is happening at a record pace and enabled by rules that facilitate the privatisation of land and the invasion of indigenous territories.[28] Meetings with the government and the central bank followed an open letter sent to Brazilian embassies in ten countries a few weeks prior.[29] Quoting "widespread uncertainty about the conditions for investing in or providing financial services to Brazil" in the letter, the initiative explained that "as financial institutions, who have a fiduciary duty to act in the best long-term interests of our beneficiaries, we recognise the crucial role that tropical forests play in tackling climate change, protecting biodiversity and ensuring ecosystem services".

ENGAGEMENT TOPICS

Many ESG factors can affect growth and fiscal projections – they form part of the conversations sovereigns and investors have, even if they are not explicitly labelled as such.

Governance has traditionally been the most important feature of sovereign bond evaluations and pricing. Corruption levels as well as the accountability and credibility of policy makers are key indicators of a sovereign's willingness and ability to repay its debt.

Other issues traditionally considered include:

- the structure of the labour market;
- a country's competitiveness and degree of technological advancement;
- welfare spending (such as pensions and healthcare outlays); or
- sources of tax revenues.

But the emphasis is now changing: with an increasing number of investors developing more systematic approaches to ESG integration, environmental and social issues are beginning to provide a new base for more targeted engagement, amidst growing appreciation that the focus should not only be on a country's growth rate and potential but also on the *quality* of its growth.

For example, on the labour market, questions around decent work practices and addressing systemic inequality are increasing.[30] Similarly, there is more focus on how sovereigns are tackling tax avoidance. Climate change, the loss of biodiversity and the health implications of pollution are also becoming more topical, as they are rising on the political agenda, partly because of the systemic risk they involve.[31]

These issues can impact sovereign debt valuations in multiple ways. For example, speaking about managing climate risk in the insurance sector, a senior Bank of England official recently warned that understanding physical climate risks "will be important not only to insurers and regulators but also governments and societies adapting and ensuring continued climate resilience", adding that the value of sovereign debt, in extreme circumstances, could also be affected.[32]

26 Reuters (2019) Nordea Asset Management suspends Brazilian government bond purchases due to Amazon fires

27 Nordea Asset Management (2020) Da Nordea Asset Management blev inviteret til Brasilien for at tale om skovrydning

28 See AM Watch (2020) Storebrand leads investor initiative to stop the deforestation of Brazil's Amazon; Financial Times (2020) Investors warn Brazil to stop Amazon destruction.

29 Responsible Investor (2020) "This marks a start": Investors hail engagement with Brazil over Amazon fires

30 SDAC members report using a variety of existing resources to inform their ESG engagement priorities. These include the OECD Centre for Opportunity and Equality – a platform for promoting and conducting policy-oriented research on the trends, causes and consequences of inequalities – and PRI and the Investment Integration Project's Why and how investors can respond to income inequality, which examines how investors can promote policies that increase income equality in their interactions with policy makers.

31 With historic waves of protests throughout 2019, the Fridays for Future movement has increased pressure on governments, especially but not only in industrialised countries. These protests are the culmination of increased public awareness and send a strong signal of momentum for political leadership to act on the climate crisis.

32 See Bank of England (September 2020), Paving the way forward: Managing climate risks in the insurance sector, speech by Anne Sweeney, Executive Director, Insurance Supervision Division.

ENGAGEMENT AND COVID-19

The COVID-19 pandemic has created a significant increase in deficits and public debt for sovereigns.

Many countries have made substantial fiscal commitments to deal with the health and economic impacts of the pandemic. A few have been able to draw on surpluses; the majority have boosted their public deficits significantly and increased their debt levels through market funding, others have taken agency loans or resorted to emergency programmes from multilaterals. Debt market solutions have included traditional sovereign bonds as well as sustainability-focused funding, including from first-time issuers.

At the same time, the crisis has created more room for issuers and creditors to engage. Sovereign bondholders can provide technical expertise to devise innovative financial solutions that fund new debt and can allocate capital to sustainable investments. They can also encourage countries to consider ESG factors in their medium-term fiscal plans and post-COVID-19 recovery measures; or go even further by making the terms of refinancing contingent on the attainment of sustainability targets, as some investors increasingly suggest.[33] This could boost countries' sustainability pledges and help them to build greater capacity and resilience to deal with future crises.[34]

The use of video/tele-conferencing and communication via email has increased significantly during the pandemic. Going forward, this should greatly reduce travel costs related to engagement, facilitating the overall process.

> "Sovereign debt is one of the major asset classes in financial markets and our investment portfolio. Our approach to sustainable investment and our role as a 'future maker' would be incomplete if we are not able to have a dialogue on environmental and social risks with government debt issuers."
>
> Jean-Charles Sambor, Global Head of Emerging Market Debt, BNP Paribas Asset Management

33 See Financial Times (2020) Investors can use their weight to save the planet's resources; and PRI webinar (July 2020) COVID-19 crisis: a test of EM sovereign bondholders.

34 Edie (2020) Coronavirus: EU's recovery deal lacking climate spending accountability, green groups warn

INCREASING ESG ENGAGEMENT EFFECTIVENESS

KEY TAKEAWAYS

- Framing engagement around ESG disclosure and progress towards existing policy commitments is a natural and non-controversial starting point for discussions with issuers.
- Some engagement themes require coordinated action, including engagement with developed markets on practices that pose problems for emerging markets.
- Collaborative engagement opportunities could scale up engagement effectiveness and overcome challenges.

There are many ways to overcome common challenges to ESG engagements and increase their effectiveness. Some are relatively easy to implement, while others are nascent and require further work.

As not all sovereigns that issue bonds are democracies, approaches to engagement could vary depending on the political regime in place. Democracies may be relatively more receptive to discussions framed around human rights, legal processes, and journalistic expression but these issues may be more relevant (and challenging) to discuss with non-democratic regimes.

It may also seem that sovereigns benefitting from structural demand for their bonds might not be compelled to engage with investors. But ultimately, fundamental developments – including ESG issues – drive funding costs, regardless of whether a country is included in a benchmark index or is highly liquid. There are examples of sovereigns whose borrowing costs have gone up due to underlying balance sheet weakness coupled with negative ESG developments, despite index inclusion – such as Lebanon, following the mass uprising at the end of 2019. The case of Argentina is also illustrative: because of faltering fundamentals, its 2017 inclusion in a widely-followed EM local currency government bond index proved temporary, and the country was removed in 2019 following the election outcome (which added to weak governance and external balance sheet pressure).

> "We have been focused for several years on aligning our portfolio with the Paris Climate goals. We are now increasingly turning our attention to human rights and social issues as well – we believe the SDGs can provide a good basis for engagement with sovereigns. If you want to engage the authorities on climate, it can be key to also discuss wider social issues, as human rights [violations] or glaring inequalities often hinder the implementation of sustainable climate policies."
>
> Kristian Hartelius, Head of Quantitative Strategies, AP2

FRAMING ENGAGEMENT AROUND EXISTING INTERNATIONAL COMMITMENTS

The international commitments and frameworks that sovereigns have already ascribed to – such as the SDGs and the Paris Agreement[35] – can be used to facilitate engagement discussions and minimise potential pushback. Moreover, there are other less well-known country conventions or agreements which many sovereigns are party to – for example the Aichi Biodiversity Targets[36] or the San José Principles[37]. It is important that countries' progress towards such goals is tracked, to ensure that they do not remain statements of intent which are not implemented.

The SDGs articulate the world's most pressing sustainability challenges, which some sovereigns are only just starting to focus on but that many have generally already committed to.[38] They build on other global agreements, such as the Universal Declaration on Human Rights and the United Nations Framework Convention on Climate Change. This makes them a natural and non-controversial starting point for discussion with issuers. Several governments have also recognised that the SDGs can serve as a guide for responding to the COVID-19 pandemic.[39]

The SDGs set objectives on key global issues. They enable comparison across countries – investors can monitor a country's progress towards 17 overarching goals, underpinned by 169 specific targets and 232 indicators, using concrete performance metrics such as the SDG Index.

There has been progress in some areas since the SDGs were agreed – e.g. extreme poverty and child mortality have fallen, and access to energy and decent work have increased. However, there is consensus that overall, the world has failed to make enough advances. Hunger is rising, half the world's people lack basic education and essential healthcare, women face discrimination and disadvantage – with one reason for the faltering progress being a lack of financing.[40]

Thus, engaging with sovereigns on their progress towards the SDGs, related policies and reforms, not only helps bondholders to conduct a more comprehensive assessment of their credit risks, but also allows them to contribute to driving broader societal change.

On climate, the Paris Agreement – based on the findings of the Intergovernmental Panel on Climate Change – is the best example of international action. It binds the 197 countries that ratified the United Nations Framework Convention on Climate Change to a common cause – to undertake ambitious efforts to combat climate change and adapt to its effects, with enhanced support available to assist developing countries.

As such, a starting point for engagement is to identify countries which have already developed policies to support their NDCs as part of their commitment to the Paris Agreement. Discussion topics could include how prepared a country is to address and/or mitigate physical climate change or an assessment of costs related to the transition to a low-carbon economy.

Useful tools for framing these discussions include the Climate Change Performance Index (CCPI) and the Notre Dame Global Adaptation Initiative (ND GAIN) Country Index.

35 The Paris Agreement aims to strengthen the global response to climate change by keeping a global temperature rise this century well below 2 °C pre-industrial level. For more details, see https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement.

36 For instance, none of the 20 Aichi Biodiversity Targets set in 2010, most of which should have been reached by the end of the decade, have been achieved and only six have been partially met. See UN News (2020) UN report highlights links between 'unprecedented biodiversity loss' and spread of disease.

37 The San José Principles set benchmarks for carbon markets and were agreed in December 2019 at the UN Climate Talks in Madrid. They are supported by 32 countries. See 32 leading countries set benchmark for carbon markets with San Jose Principles for more details.

38 The 2030 Agenda for Sustainable Development was adopted by the 193 United Nations Member States in 2015 – read more here. Member states are encouraged to conduct regular and inclusive reviews of progress at the national and sub-national levels, documented in the Voluntary National Reviews Database.

39 European Commission (2020) The global response: Working together to help the world get better

40 Financial Times (2019) Progress toward sustainable development is seriously off-track

There are other entry points for dialogue that can prove useful:

- The shift to a low-carbon economy must include a social dimension, to ensure a just transition. Climate change & the just transition: a guide for investors identifies priority action areas which can inform engagement discussions.
- Investors could gauge how familiar sovereigns are with the potential, significant financial implications of delaying government action to meet Paris Agreement obligations, as outlined in the PRI's Inevitable Policy Response (IPR).[41]
- The work by the central banks' and supervisors' Network For Greening the Financial System, including a set of climate scenarios for forward-looking climate risk assessment, and an inquiry into the potential impact of climate change on monetary policy, could also be a subject for discussion.[42]

Finally, while disclosure frameworks such as the Task Force on Climate-Related Financial Disclosures (TCFD) and targeted initiatives such as Climate Action 100+[43] do not exist for sovereigns, they have been called for in the media.[44] Until such frameworks or initiatives emerge, investors need to continue to engage – individually and collaboratively – to encourage transparency and accountability against existing pledges.

INVESTORS FILE CLASS-ACTION LAWSUIT AGAINST AUSTRALIA'S GOVERNMENT FOR FAILING TO DISCLOSE CLIMATE-RELATED SOVEREIGN BOND RISKS

Novel approaches to government engagement are beginning to emerge on other fronts, including from civil society. The Australian government recently faced a class-action lawsuit from a student investor who alleges it failed to disclose the material risks from climate change to its sovereign bond.[45] The action – the first of its kind – seeks a declaration from the government that it breached its disclosure duty by failing to address Australia's climate risks in the bond's information documents, as well as an injunction restraining the government from further promoting exchange-traded bonds until it complies with this duty.

> "SDGs provide a meaningful framework for engagement discussions with sovereign issuers to assess risks and opportunities across the spectrum of ESG issues."
>
> Yvette Klevan, Managing Director, Portfolio Manager and Analyst, Lazard Asset Management

41 Governments are planning to produce about 50% more fossil fuels by 2030 than would be consistent with limiting warming to 2°C and 120% more than would be consistent with limiting warming to 1.5°C. For more detail, see http://productiongap.org/2019report/.

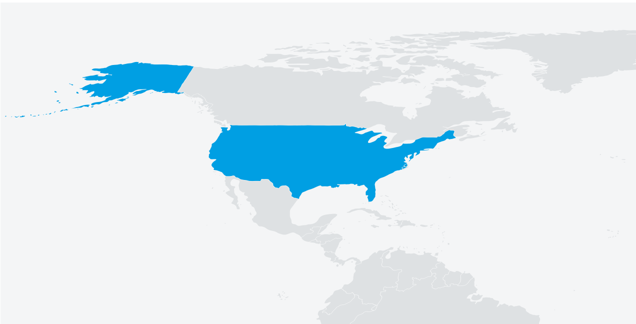
42 For more detail, see https://www.ngfs.net/node/294716.

43 So far, more than 450 investors (including corporate bondholders) representing US$41trn have signed up to encourage 160 of the world's largest corporate greenhouse gas emitters (including state-owned enterprises) to meet their 2050 net-zero targets and engage on TCFD implementation.

44 Environmental Finance (2019) Green bond comment December: It's time for a CA100+ for sovereigns

45 Financial Times (2020) Australia faces legal challenge over bonds' climate risks

INVESTORS URGE US FINANCIAL REGULATORS TO ACT ON CLIMATE CHANGE AS A SYSTEMIC FINANCIAL RISK



In July 2020, investors with nearly US$1trn in assets under management wrote to the heads of the Fed, the SEC, the FDIC, and other regulatory agencies, urging them to consider the climate impacts of their decisions, to act on climate change as a systemic financial risk, and to heed the recommendations of a recent Ceres report, Addressing Climate Change as a Systemic Risk: A Call to Action for U.S. Financial Regulators. The report:

- finds that financial regulators have a responsibility to better understand and protect financial markets from those risks;
- provides an overview of what other regulatory bodies and central banks around the world are doing to act on climate change; and
- recommends more than 50 key actions US financial regulators can adopt to address climate change as a systemic risk — actions that already fall within their existing mandate.

ENGAGING WITH DEVELOPED AND EMERGING MARKET SOVEREIGNS

The PRI's 2019 [Practical guide to ESG integration in sovereign debt] clarified that ESG factors are relevant for developed and emerging market investors. What differs across countries is the nature of financially material factors and their respective abilities to withstand related shocks. Investors seeking to better understand and encourage action on material ESG risks should not target issues in isolation. Rather, engagement should be informed by a systemic view of how individual country policies may be contributing to global problems.

To this end, some engagement themes require coordinated action at multiple levels, such as engagement on developed market practices that pose problems for emerging market countries. The fiscal and human costs of certain policies – such as Western subsidies/tariffs on agriculture and energy, or plastic or electronic waste-dumping regulations that disproportionately impact smaller low-income countries – often fuel a negative spiral between ESG issues, politics and economic growth. Emerging market ESG risks may also be amplified by developed market countries that choose not to proactively provide oversight for their own multinational corporates.[46]

Another example is carbon leakage. While many developed economies have achieved reductions in domestic emissions over the past decade, many have been outsourcing their production of carbon-intensive products to emerging economies – known as carbon leakage – and are net importers of carbon. Engagement efforts could focus on the extent to which measures have been taken to reduce the risk of carbon leakage – similar to the EU's proposed Carbon Border Adjustment Mechanism, designed to price imports so that they more accurately reflect their carbon footprint.

46 For example, the activities of oil companies Shell and Eni in Nigeria. For more detail, see Global Witness (2018) Shell and Eni on trial.

THE ROAD AHEAD

KEY TAKEAWAYS

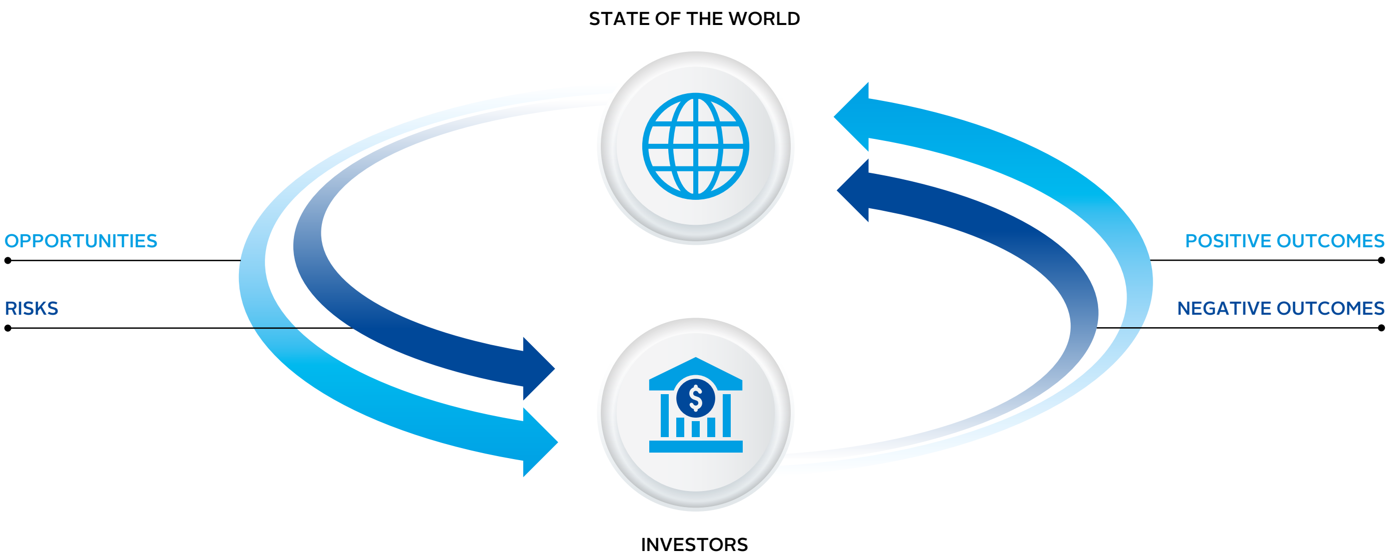
- As responsible investment expectations evolve beyond pure risk-return considerations to shaping sustainable outcomes, so will capital allocation and engagement practices.
- Through their contribution to countries' funding needs, sovereign bondholders can help accelerate progress towards sustainability goals, and cease being an underutilised resource.

Better risk assessment, increasing client demand and a rapidly changing legislative[47] and regulatory[48] landscape are driving the *integration* of material ESG factors in investment analysis and decision making – including through engagement. These practices are also gradually becoming established in sovereign debt markets.

This paper is the second[49] in an ongoing effort by the PRI to provide more clarity to sovereign bondholders about how to practically implement their commitment to the six Principles for Responsible Investment. Sovereign engagement can take many forms and can be a very effective input to sovereign debt analysis if it is done in the right spirit. Although direct engagement between investors and issuers has always existed to help better assess debt sustainability and credit risk, responsible investors need to go beyond that and broaden the conversation around sustainable growth patterns.

Issues such as climate change, income inequality and human rights are becoming more prominent in risk assessment, and can affect sovereign bond valuations, although attribution remains difficult. Moreover, expectations from clients and beneficiaries on how asset owners and asset managers are considering these issues, at least in the responsible investment community, are shifting – with more emphasis on shaping outcomes aligned with a low-carbon economy or the SDGs, for example (*see Figure 5*).

Figure 5. Continuous cycle of investors' SDG outcomes, the resulting state of the world, and ESG investment risks and opportunities.

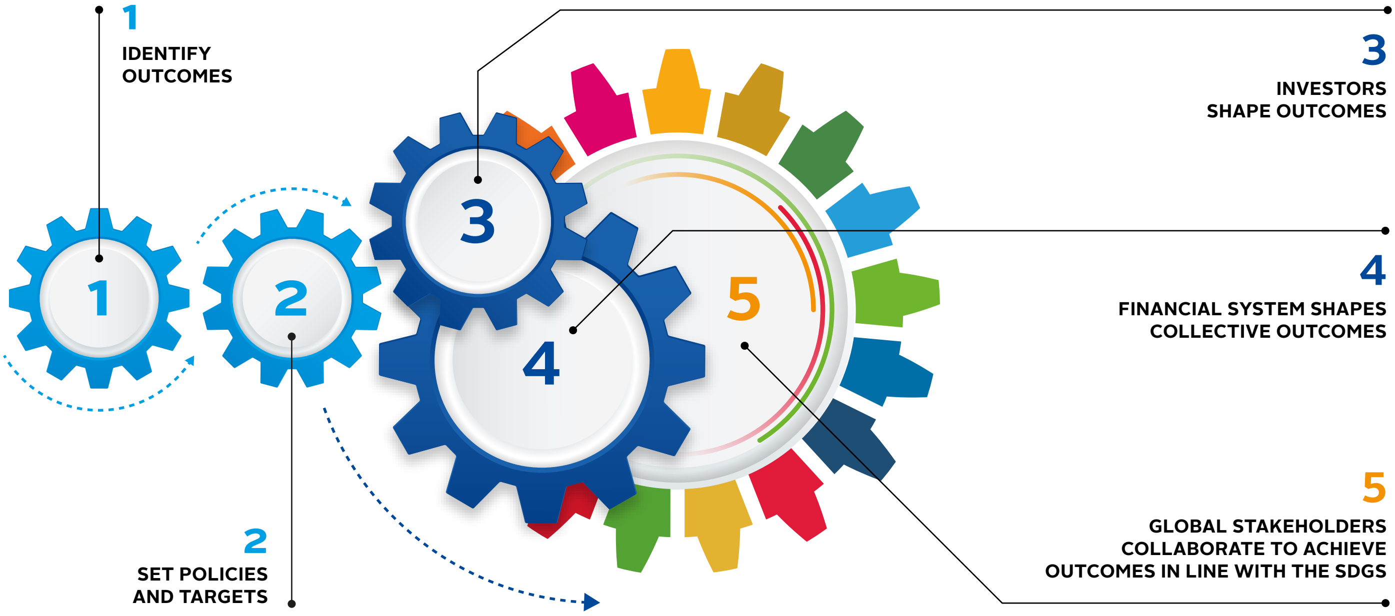


47 See https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted and https://www.legislation.gov.au/Details/C2018A00153.
48 See Esma (2020) ESAs consult on Environmental, Social and Governance disclosure rules.
49 Following the release of PRI's 2019 Practical guide to ESG integration in sovereign debt.

Therefore, investors need to understand that their decisions have negative and/or positive outcomes in the real world, and that by acting individually or collectively, they can shape these outcomes. Investor analysis needs to go beyond risk assessment to include a parallel analysis of the most important outcomes to society and the environment at a systemic level, as highlighted in the PRI's paper, [Investing with SDG outcomes] (*see Figure 6*).

To date, these types of conversations between asset owners – who play a strategic role in driving the responsible investment agenda - and investment managers are still limited and as a result have not significantly altered investment mandates. But this should change.

Figure 6. Five-part SDG outcomes framework for investors



Similarly, [Active Ownership 2.0: the Evolution Stewardship Urgently Needs] was launched in 2019 as an aspirational standard for improved stewardship, building on existing practice and expertise but explicitly prioritising the seeking of positive real-world outcomes over process and activity.

Crucially, both papers make it clear that no one set of actors will achieve the SDGs in isolation, and that enhanced collaboration – in a variety of forms – improves the ability to address collective goals and is therefore central to achieving the required evolution in stewardship practice.

Sovereign debt investors are uniquely placed to contribute towards shaping sustainable real-world outcomes – in terms of supporting policy engagements, and by using every opportunity for direct individual and collaborative engagement with sovereign issuers to broaden the conversation, using a wealth of tools and techniques highlighted in this paper.

Importantly, collaborative platforms could encourage local pension and insurance funds, banks and asset managers – who might otherwise be reticent to engage, either because they invest only in domestic sovereign bonds or for political reasons – to be more proactive.

Stepping up action is particularly relevant at a time when, exacerbated by the COVID-19 crisis, fiscal deficits are swelling in several countries, in many instances endangering the sustainability of future fiscal plans. As a result, investors have an opportunity to convey to governments their expectations that future corrective actions and debt issuance are aligned with sustainability criteria.

In addition, more governments are likely to experience debt crises, particularly in emerging and frontier markets, and will require relief measures.[50] Aligning these with responsible investment is crucial.

50 Financial Times (2020) [Debt relief: which countries are most vulnerable?]

And while it is easy to think of engagement as mainly relevant for emerging markets, where ESG issues are often most visible, many of these are rooted in developed markets. As such, engagement on developed market practices that pose problems for emerging market countries is a critical piece of the puzzle.

This paper will form the basis for future PRI interactions with investors, to gauge to what extent these findings resonate with their sovereign engagement experience. It hopes to encourage more signatories to have or increase the conversations with country stakeholders about ESG issues. Finally, we hope this report will also be useful for sovereigns to better understand why ESG appetite by investors is growing, and will increase their opportunities for outreach, including through events that the PRI intends to organise or through collaborative platforms.

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact