ESG ENGAGEMENT FOR FIXED INCOME INVESTORS

MANAGING RISKS, ENHANCING RETURNS

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.

ACKNOWLEDGEMENTS

The PRI would like to thank the following individuals for their guidance on the content of this publication.

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- Susan Burns, Founder and Board Member, Director, Finance for Change, Global Footprint Network (GFN)
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- Marayka Ward, Senior Credit Manager, QIC
- Janne Paul Werning – SRI Analyst, Union Investment

OTHER ACKNOWLEDGMENTS

- Jonathan Bailey, Head of ESG Investing, Neuberger Berman
- Brooke Barton, Senior Director, Water & Food Programs, Ceres
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PIMCO FOREWORD

We are delighted to support this important initiative by the PRI regarding bondholder engagement for fixed income investors. At PIMCO, we are fully committed to the integration of environmental, social and governance (ESG) issues in our investment process, which we believe is consistent with the goal of delivering attractive risk-adjusted returns for clients.

We also believe that engagement is a crucial part of ESG-focused investing and that this shouldn't be the domain of equity investors alone. Default and spread widening are dominant risks in corporate debt investing, and seeking to avoid potential losers while identifying winners is one of the most important factors in portfolio management. ESG engagement with corporate issuers enhances this analysis. It allows us to evaluate a company's direction and aspirations, and how it will address future risks.

However, this isn't the only goal of engagement. As significant lenders of capital, we believe bondholders can also influence business practices. For example, raising awareness of environmental issues may lead issuers to adopt more climate-friendly policies. Done right, successful engagement can reduce credit risk, unlock value and influence positive impact.

Although engagement has been a longstanding part of fixed income investment processes, tracking that engagement with reference to specific sustainable investment goals is a more recent development. With that in mind, we welcome the openness with which all participants have shared their thoughts on how bondholders can best engage. We can all learn from our peers, and we congratulate the PRI for putting together such a strong group of thought leaders on this topic.

Drawing on the ideas of this group, this report offers practical guidance on defining objectives and measuring the effectiveness of engagement, timing of engagement throughout the issuance lifecycle, and tips for implementing a programme and overcoming common hurdles.

By working together, we hope to highlight how fixed income investors can support the broader responsible investing agenda and, ultimately, help move us towards the common goal of unlocking the multi-trillion-dollar universe of core fixed income capital to influence positive change.

Scott Mather
CIO, Core Strategies, PIMCO

PRI FOREWORD

The number of asset owners that regularly engage with investee companies on ESG issues has grown five-fold over the past ten years.[1] Worldwide, policy makers are introducing new stewardship codes at a rapid pace – encouraging investors to take responsibility and be active stewards of the companies they invest in.[2] The ways in which engagement creates financial value for both companies and investors are well documented.[3] Meanwhile, successful engagement practices are contributing to the "broader objectives of society" mentioned in the preamble to the Principles.

Despite the obvious benefits and increasing investor commitment to engagement among equity investors, ESG engagement remains less common among fixed income investors for a number of reasons. Bondholders typically feel their influence over a company's obligations is limited. Their interaction with issuers has traditionally been restricted to attending bond roadshows, and influencing and enforcing terms of bond covenants. Investors have historically focused their engagement efforts on matters that directly influence returns such as business strategy, cash-flow generation and financial leverage – as opposed to hidden or less direct risks such as corruption, employee welfare or climate change.[4]

The fact is that ESG issues can and do impact fixed income investment returns. ESG risks need to be managed and addressed via integrated research and engagement programmes. As vital sources of capital, fixed income investors can exert significant influence over issuer disclosure and risk management practices that directly relate to the accuracy of their analysis, and impact risk-adjusted returns.

This document includes insights and guidance gained from PRI signatories and other industry stakeholders. Whether you consider your organisation to be just starting out or a leader in this aspect of responsible investment, we hope you find it useful as a resource to further develop your investor stewardship with regards to your fixed income investments.

Kris Douma
Director of Investment Practice & Engagements, PRI

1 Based on asset owner PRI signatories engaging either directly or indirectly via their asset managers. PRI (2017). A Blueprint for Responsible Investment.

2 Finance sector regulators and investment associations in 18 countries have introduced stewardship codes, with a growing number referring to ESG issues. For an overview, see PRI. (2018). A Practical Guide to Active Ownership in Listed Equity.

3 Gond, Jean-Pascal. (2017). RI Quarterly - How ESG engagement creates value: bringing the corporate perspective to the fore; O'Sullivan, N., Gond, J.P. (2016). Engagement: unlocking the black box of value creation.

4 SSGA. (2017). SSGA's Fixed Income Stewardship Program.

EXECUTIVE SUMMARY

Principle 2 of the six Principles encourages investors to be active stewards of their investments and incorporate ESG factors into their ownership policies and practices across different asset classes. Fostering a community of active owners is also one of PRI's nine strategic areas of impact for the next 10 years, as set out in the PRI Blueprint for Responsible Investment. In the last decade, many equity investors have implemented engagement strategies to conduct fruitful conversations with companies, either individually or collaboratively. Investor attention is now shifting to other asset classes – with corporate fixed income a primary focus due to the scale and importance of the world's debt markets.[5]

As part of PRI's commitment to provide further asset class-specific guidance on responsible investment practices, this publication explains how to engage with bond issuers on ESG factors in order to identify and manage ESG-related risks, and increasingly also to maximise positive ESG outcomes. It focuses on ESG engagement with companies – including financial institutions – as opposed to government and government-related issuers.

This publication draws upon interviews with 17 investors and a law firm, guidance from an expert working group, data from the PRI Reporting Framework, and extensive desk research. It is published in conjunction with the ESG Engagement for Fixed Income Investors case study series, which showcase a variety of engagement processes, followed by examples of bondholder engagement in practice.

WHY ENGAGE AS A FIXED INCOME INVESTOR?

Investors typically engage with companies and other types of issuer to identify, monitor and manage risks to their investment returns. PRI signatories acknowledge that ESG factors can have a material impact on those returns. While the materiality of ESG risks is less familiar to bond than equity investors, ESG factors can affect the investment performance of bonds, both negatively and positively, at the issuer, sector, geographic and system levels.

There is a growing body of practical and academic evidence of the benefits to investors of engagement. They include: better understanding of companies by investors, and of investors' expectations by company management; improved ESG disclosure; management and mitigation of financial risks; and the maximising of positive sustainability outcomes, including those related to the UN Sustainable Development Goals.

PRACTICAL GUIDANCE ON ESG ENGAGEMENTS

A growing number of PRI signatories engage in relation to at least some of their total fixed income holdings, with 66% of those investing directly in fixed income markets engaging with at least one type of issuer. A much smaller number of signatories engage systematically across a large proportion of their fixed income portfolios. Among European investors, for example, 23% engage on more than one quarter of their non-financial corporate bond holdings.

This report offers guidance on how fixed income investors might structure their engagement strategies as an integral part of their approach to responsible investment. It focuses on elements of engagement that are specific to investors in corporate fixed income. Wider insights and recommendations on developing an active ownership policy, assessing external managers and service providers, and disclosure on engagement activities are set out in a recent PRI publication – A Practical Guide to Active Ownership in Listed Equity. These can equally applied to other asset classes, including corporate fixed income.

This report, meanwhile, offers guidance on the following elements:

- **Embedding engagement in the investment process:** Engagement by fixed income investors should be an integral part of a responsible investment approach, and either conducted by credit analysts and portfolio managers, by a dedicated engagement team, or integrated with ESG specialists and fixed income specialists working alongside.
- **Prioritising engagement activities:** Investors are advised to prioritise engagement activity based on size and duration of holdings, credit quality, degree of transparency, materiality of ESG risks and opportunities, and priority themes and issues, among other things.
- **Timing engagement:** Timing the engagement is a strategic decision because the bondholder's influence with issuers varies throughout the issuance lifecycle, and depends upon legal and regulatory rights and obligations.
- **Defining objectives and measuring the effectiveness of engagement:** Objectives should be developed by ESG teams in collaboration with investment teams to ensure they are robust and send consistent messages to companies.

5 More than 400 investors manage almost US$30 trillion out of the total US$71 trillion of assets managed by PRI signatories.

- **Factors determining the effectiveness of engagement:** These include the size of the investor, the credit quality of the issuer, whether the debt is publicly issued or privately placed, whether the issuer expects to imminently return to the market, general market conditions, and issuer awareness of ESG issues.
- **Collaborative engagement:** Collaboration can be an effective way to gain corporate managers' attention, as well as pool knowledge, information and engagement costs, although the practice is not without its challenges.
- **Overcoming common hurdles to engagement:** These include misperceptions about bondholders' rights, about their position in the capital structure, their influence over and access to companies, and the implications of the growth of passive investing.

The report concludes with tips for effective bondholder engagement, including on how to: develop an engagement strategy; prioritise engagement; initiate dialogue with an issuer; conduct engagement discussions; follow up on engagement; and measure and monitor engagement. The appendices include suggestions for further reading, and a commentary from law firm Reed Smith on the scope and limitations of bondholder engagement.

WHY ENGAGE AS A FIXED INCOME INVESTOR?

Engagement refers to: interactions between the investor and current or potential investees on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosure.

Source: PRI Reporting Framework

Investors typically engage with companies and other types of issuers to identify, monitor and manage risks to their investment returns.[6] In signing up to the PRI, investors affirm that ESG factors can have a material impact on those returns. In this chapter, we tackle the question of the materiality to investment returns of ESG risks, which can be less apparent to fixed income investors than they are to equity investors. We review the added value of engagement for investors and for corporations. We then explore the different motives fixed income investors typically give for engaging issuers, including:

- to gain better issuer disclosure relating to ESG factors;
- to influence how an issuer addresses specific ESG risks or value creation opportunities; and
- to maximise the positive ESG outcomes from their investments.

THE MATERIALITY OF ESG FACTORS FOR BOND INVESTORS

Bond investors are increasingly aware of the links between ESG performance and investment returns.[7] Carbon-intensive business models, labour disputes and fraud can translate into credit risk for bondholders via a business's cash flows, capital costs, regulatory oversight and reputation. While a default is usually a worst-case scenario, there are intervening risks to investors, including credit rating downgrades and associated spread widening, which have the potential to impact investor returns over the short term.

Broadly speaking, ESG factors can affect the performance of a company's bonds at different levels:

- **Issuer/company specific risk:** ESG factors affect a specific bond issue or issuer and not the market as a whole. Examples include regulatory compliance, social license to operate, and brand reputation. For example, the yield on the corporate debt of German car manufacturer Volkswagen rose and stayed high for a prolonged period of time in the aftermath of the 2015 emissions scandal.
- **Sector/geographic risk:** These stem from wider-ranging ESG factors affecting an entire industry or region, including regulatory and technological changes associated with the business activity the company is involved in, and/or to the markets it sources or sells to.
- **Multi-sector/systemic risk:** Some key emerging risks do not apply to a single sector alone but are the result of systematic interaction between sectors in response to poorly understood risks which may be mispriced. For example, data privacy and cyber security in the medical device industry (which collects patient data) create risks that are less well understood than in the managed care industry (which is where this data is often held). Taking a multi-sector view of data privacy and cyber security helps to understand where unpriced risk sits. Another example is stranded asset risk in the oil and gas sector. While it is most commonly discussed in terms of oil and gas issuers, it is present, but far less understood, for refiners, pipeline providers, service providers, engineering and service firms.
- **Indirect exposure:** Some ESG factors can affect investment returns indirectly. Resource scarcity, for instance, might add to inflationary pressures, prompting a tightening of monetary policy and a rise in the cost of capital which, coupled with adverse market conditions and poor liquidity, could prompt investment losses.

Analysis of ESG factors can therefore help investors form a more holistic view of a bond's value, identify improving credit stories, or differentiate bonds with similar financial profiles.[8] Some investors integrate ESG factors into their credit risk evaluation, but research teams do not label them as such. In other cases, investors have only recently started to incorporate ESG data into their research processes or view most ESG factors as immaterial.

6 Majoch, A., Gifford, E.J. & Hoepner, A.G.F., (2014). Active Ownership and ESG Performance; O'Rourke, A., (2003). A new politics of engagement: shareholder activism for corporate social responsibility. Business Strategy and the Environment, 12(4), pp.227–239.

7 Reznick, M. and Viehs, M. (2017). Pricing ESG Risk in Credit Markets. Research paper: Hermes Credit and Hermes EOS. QIC. (2016). Is there a proven investment case for owning bonds of companies that exhibit superior environmental, social and corporate governance (ESG) practices?; Barclays, (2016). Sustainable Investing and Bond Returns. Research study into the impact of ESG on credit portfolio performance. Clark, G., Feiner, A and Viehs, M. (2015). From the Stockholder to the Stakeholder.

8 PRI. (2014). Fixed Income Investor Guide.

Despite the technical challenges involved, some major credit rating agencies have started to increase their consideration of ESG factors in their credit risk analysis.[9] For instance, Moody's Investors Service, S&P Global Ratings and Fitch Ratings have all published papers outlining their approaches to ESG in their ratings since 2015,[10] and have delivered further research and related case studies.[11]

To illustrate, Moody's Investors Service assesses the implications of carbon reductions for its automotive sector credit ratings by focusing on the effect of several material risks judged to have a varying impact on key company rating factors, including the company's market position, its overall leverage and liquidity, profitability and returns, and cash flows.[12]

Table 1 – Material industry challenges from increasing emissions-reducing regulatory targets and growth in alternative fuel vehicles. Source: Moody's Investors Service (2016).

MATERIAL RISK FACTOR	HIGHLIGHTS
Policy and regulatory uncertainty	Growing policy pressure, with increasing emissions-reducing regulatory targets, is considered a likely outcome. However, there is significant uncertainty over the scope and pace of policy implementation.
Direct financial effects	Pressure on margins and cash flows will increase as original equipment manufacturers are faced with the potential need to increase R&D and capital spending to develop emissions-reducing technologies.
Demand substitution and changes in consumer preferences	Changes in consumer preference leading to increased demand for alternative fuel vehicles (AFVs) and away from traditional auto platforms such as internal combustion engine (ICE) technology are possible. However, the pace of this change is also uncertain.
Risks of disruptive technological shocks	Risks of disruptive technological shocks exist as AFV technology achieves scalable solutions that become more cost competitive with ICE technology. But the forecasts for the speed of this transition and the rate of take-up vary widely, highlighting significant uncertainties. Nevertheless, we see the emergence of new competitors such as Tesla Motors and the interest of deep-pocketed technology companies such as Google.

"We see ESG risk as being a type of investment risk – where poor ESG practices could generate additional liabilities. Analysing companies through this lens provides another filter on credit risk."

My-Linh Ngo, Head of ESG Investment Risk, BlueBay Asset Management

Analysis of ESG factors can identify opportunity as well as risk. For example, research shows that firms with strong corporate governance benefit from higher credit ratings and a lower cost of capital.[13] A review in 2017 by S&P of how environmental and climate risks have affected global corporate ratings over a two-year period identified 717 cases where such risks were relevant to the rating, and 106 cases where they resulted in a change of rating, outlook, or a "CreditWatch" action.[14] Of these 106 cases, 44% were positive and 56% negative in direction. This represents a shift from S&P's 2015 review, where only 21% of environmental and climate-driven actions were positive, and 79% negative. S&P suggests that potential contributory factors include that more companies have mitigated environmental and climate risks, or that more are benefiting from various transition opportunities or from changes in environmental policy.

9 PRI, (2017). Shifting Perceptions: ESG, Credit Risk and Ratings. Part 1: The State of Play.

10 Moody's Investors Service. (2017). Moody's Approach to Assessing ESG in Credit Analysis. S&P Global. (2017). How Does S&P Global Ratings Incorporate Environmental, Social, and Governance Risks into Its Ratings Analysis. Fitch Ratings. (2017). Fitch Outlines Approach to Capturing ESG Risk in Credit Ratings.

11 See for example Moody's Investors Service ESG implications for fixed income markets and credit ratings, S&P Global's ESG and Sustainable Energy, and Fitch Ratings' ESG Risk.

12 Moody's Investors Service, (2016). Automotive Sector Faces Rising Credit Risks from Carbon Transition.

13 Collins et al. (2006). The Effects of Corporate Governance on Firms' Credit Ratings. University of Wisconsin, University of Iowa and MIT.

14 S&P Global. (2017). How Environmental And Climate Risk and Opportunities Factor into Global Corporate Ratings – An Update. Note: CreditWatch highlights S&P Global Ratings' opinion regarding the potential direction of a short-term or long-term rating.

"We view ESG risk as a low-probability but high-impact factor. When something ESG-related does go wrong, it can severely impact the return of your bond. Particularly with long-term bonds, the probability of something going wrong over a long horizon is high if the risk is not mitigated or properly managed"

Rakhi Kumar, Senior Managing Director, Head of ESG Investments and Asset Stewardship, State Street Global Advisors

"Where others may see a typical industrial company, we see a leader in employee safety with superb staff retention and a strong credit risk profile. Where others may see unnecessary R&D expenses, we see an innovative company looking to reposition itself for the future by developing more sustainable products."

Jem Hudson, former Vice President, Director of Engagement, Breckinridge Capital Advisors

THE ADDED VALUE OF ENGAGEMENT

Engagement implies a two-way dialogue with companies, rather than a process of micro-management. On the one hand, investors have an opportunity to explain their expectations of corporate management in general and in relation to managing ESG risks and opportunities in particular, as well as to encourage actions to preserve long-term value. Engagement can also help investors become better informed to make investment decisions.

On the other hand, companies can provide clarifications on their strategy and the relationship between ESG factors, their business model and financial performance, as well as receive early warnings on emerging risks and best practices. Recent academic research shows the mechanisms through which engagement creates value for both investor and issuer (see Table 2).

Table 2 – Mechanisms of engagement value creation for investors and corporations. Source: Gond, JP. (2017); O'Sullivan, N. & Gond, JP. (2016).[15]

VALUE CREATION DYNAMICS	INVESTORS	CORPORATIONS
COMMUNICATIVE EXCHANGING INFORMATION	Signalling and defining ESG expectations	Clarifying expectations and enhancing accountability
	Seeking detailed and accurate corporate information	Managing impressions and rebalancing misrepresentations
	Enhancing investor ESG communication and accountability	Specifying the business context
LEARNING PRODUCING AND DIFFUSING KNOWLEDGE	Building new ESG knowledge	Anticipating and detecting new trends related to ESG
	Contextualising investment decisions	Gathering feedback, benchmarking and gap spotting
	Identifying and diffusing industry best practice	Developing knowledge of ESG issues
POLITICAL DERIVING POLITICAL BENEFITS	Advancing internal collaboration and ESG integration	Enrolling internal experts
	Meeting client expectations	Elevating sustainability and securing resources
	Building long-term relationships	Enhancing the loyalty of long-term investors

15 Gond, Jean-Pascal. (2017). RI Quarterly - How ESG engagement creates value: bringing the corporate perspective to the fore; O'Sullivan, Niamh & Gond, Jean-Pascal. (2016). Engagement: unlocking the black box of value creation.

ENGAGEMENT TO IMPROVE ESG DISCLOSURE

ESG data for investment decision-making can be sourced directly from the issuer: from their firm-wide corporate reporting and/or ESG risk factors included in any prospectus with regard to specific bond issuances. It can also be sourced from third parties, including data suppliers, brokers, rating agencies and industry associations.

However, corporate transparency and the third-party ESG research coverage available to fixed income investors can be poor relative to that available to public equity investors. This is especially true for smaller issuers, which are not subject to the disclosure requirements of public companies (often with non-investment grade ratings), or those issuing debt privately.[16]

> "During an engagement session with a pharmaceutical company, we noticed that a company representative, who was used to engaging with ESG investors, showed a lack of knowledge about debt investors, despite debt investors being equally relevant given their need for money to finance their R&D. We want to understand how ESG impacts their creditworthiness, not just future share earnings. In their ongoing disclosure, and at investor roadshows, they need to make sure they are inviting debt investors, and not just equity owners."
>
> My-Linh Ngo, Head of ESG Investment Risk, BlueBay Asset Management

> "We regularly compare our portfolio's own ESG ratings against those of a prominent service provider. They are often aligned, but there are times when notable deviations occur because of the additional insight we have gained through our research and analysis of the company."
>
> Won Choi, Managing Director, High Yield Team, MacKay Shields

In high yield, for example, only 20% of issuers in the Barclays Global High Yield Index reviewed and confirmed MSCI's summary of the data it uses for their ESG scores, dropping to just 3% for privately-owned companies in the index.[17] This may mean that the ratings are based on data which is not as representative as it could be, and reinforces the limited levels of ESG disclosure in this market.

Where data is available, the relevance to bondholders is often not well-articulated or understood. For example, governance issues such as executive pay and board diversity may be considered material by shareholders, but may not be sufficiently material to an issuer's credit strength to feature in an investor's credit research.[18]

> "When you're invested in a bond, it's important to understand not only what happened to the company, but its aspirations to fix the issue. An ESG scoring profile is based on historical behaviour. The information that is missing is in terms of the company's aspirations and how they will address the issue."
>
> Alex Struc, former ESG Portfolio Manager, PIMCO

16 In fact, even beyond ESG issues, bond investors report unsatisfactory communication from issuers, who are seen to disproportionally cater to equity investors, despite bond investors' growing importance as a source of financing for companies. DVFA, (2012). Standards for bond communication.

17 Neuberger Berman. (2018). Engaging in Environmental, Social and Governance (ESG). Insights | February 2018. Based on MSCI: High yield response rate as measured by MSCI using the Barclays Global High Yield Index. Privately owned high yield response rate as per MSCI for non-publicly listed constituents of the Barclays Global High Yield Index.

18 MSCI ESG Research (2017). MSCI ESG Thought Leaders Council – Corporate Governance and Fixed Income Issuers.

"If ESG factors translate into credit risk, then having an engagement relationship with the company helps you understand what direction that credit risk is likely to take. Think of ESG risks like credit risks – you wouldn't rely on credit ratings only in doing your analysis; you also talk to the companies. As for ESG factors, you don't rely solely on ESG scores and assessment services; you engage with companies as much as possible to make that assessment dynamic."

Mitch Reznick, Co-head of Credit and Head of Credit Research, Hermes Investment Management

As a result, the most common reason fixed income investors currently give for engaging is to improve their understanding of an issuer's exposure to specific ESG risks and value creation opportunities, as well as how they are planning to manage those.

ENGAGEMENT TO MANAGE AND MITIGATE FINANCIAL RISKS

Investors may prefer engagement to alternative strategies – such as divestment – which leave them with no stake and no potential to help drive responsible corporate practices. By engaging with issuers, fixed income investors encourage behaviour designed to improve credit risk metrics and drive sustainable long-term investment returns. Naturally, bond investors may use ESG analysis as an information advantage and choose to exit a position before the wider market becomes aware of a material issue.

"The asymmetric return profile of investing in fixed income compared with equities highlights the importance of understanding the downside risks that are embedded in every security. Properly assessing ESG risks and engaging management teams on the issues which may impact long-term credit quality allows fixed income investors to better meet the return objectives of our clients while not losing focus on the preservation of capital."

Jonathan Bailey, Head of ESG Investing, Neuberger Berman

"Most bonds trade at or near par. To the extent that an unresolved ESG issue is identified early on, what benefit do you get from having the company recognise this and change? On the other hand, you can sell the bonds before others do. This is a competitive advantage."

Michael Kimble, Senior Managing Director, Global Fixed Income Team, MacKay Shields

ENGAGEMENT TO MAXIMISE POSITIVE ESG OUTCOMES

Minimising risks and maximising ESG opportunities frequently represent two sides of the same coin. While one investor may choose to divest from certain carbon-intensive sectors to manage its exposure to more stringent carbon regulation, another might engage with issuers in those sectors to shift their business models to be less carbon-intensive. Viewed this way, engagement has the potential not only to protect investor returns, but also to contribute to the "broader objectives of society" mentioned in the preamble of the six Principles.

The 17 UN Sustainable Development Goals (SDGs) – which are intended to guide the global community's sustainable development priorities from now until 2030 and seek to "stimulate action [...] in areas of critical importance for humanity and the planet"[19] – are increasingly seen as a useful framework for considering these broader objectives. Some investors report that the SDGs help them define or categorise positive outcomes from their engagement activities.

Figure 1 – The United Nations Sustainable Development Goals.

For many investors, current engagement activity is focused on thematic investments such as green bonds, social bonds and, more recently, SDG bonds. By issuing such bonds – where proceeds are allocated to projects which address specific issues such as climate change or other SDGs – issuers voluntarily commit to ongoing monitoring and reporting in accordance with voluntary process guidelines for issuing green bonds, such as the Green Bond Principles.[20] If issuer reporting does not meet investor expectations, they may engage to ensure the proceeds are used for their intended purpose and clarify the sustainability credentials of those projects. With demand for green bonds increasing rapidly, many asset managers are actively engaging issuers to encourage further issuance.

For example, to ensure that the bonds in its green bond portfolio meet KfW's minimum requirements, the German development bank engages with issuers before an investment is undertaken.[21] Its process also requires an ongoing monitoring of the green bond reporting of all issuers.

> "When a green bond is issued in the primary market, all you have is [the issuer's] promise to invest in specific technologies. Impact reporting a year down the line gives you the basis for engagement. Engagement is thus about insight on reporting, asset allocation, and also impact – what positive benefits did the green bond achieve?"
>
> Felipe Gordillo, Senior SRI Analyst, BNP Paribas Asset Management

19 United Nations. (2015). Transforming our world: the 2030 Agenda for Sustainable Development.

20 See Green Bond Principles (2017).

21 KfW. (2017). KfW Green Bond Portfolio.

If the reporting does not meet its requirements, the firm will engage with the issuer. A detailed overview of how an investor engages with green bond issuers can be found in BNP Paribas Asset Management's contribution to PRI's ESG Engagement for Fixed Income Investors case study series.

A number of investors interviewed for this report noted that green bond issuers tend to be more willing to engage on ESG and provide better access to management. As a result, the PRI expects that a growing green bond market will trigger more systematic engagement practices in relation to both green and plain vanilla bonds. Better connections between the various internal functions of an issuer (for example between ESG research, environment, finance, treasury and investor relations) and more proactive consultation by issuers about investor needs or concerns will make this process a lot easier.

PRACTICAL GUIDANCE ON ESG ENGAGEMENT

This section considers ESG engagement trends among fixed income investors before giving guidance on the practical aspects of bondholder engagement. As well as the recommendations below, suggestions on developing an active ownership policy, assessing external managers and service providers, and disclosure can be found in the PRI's Practical Guide to Active Ownership in Listed Equity.

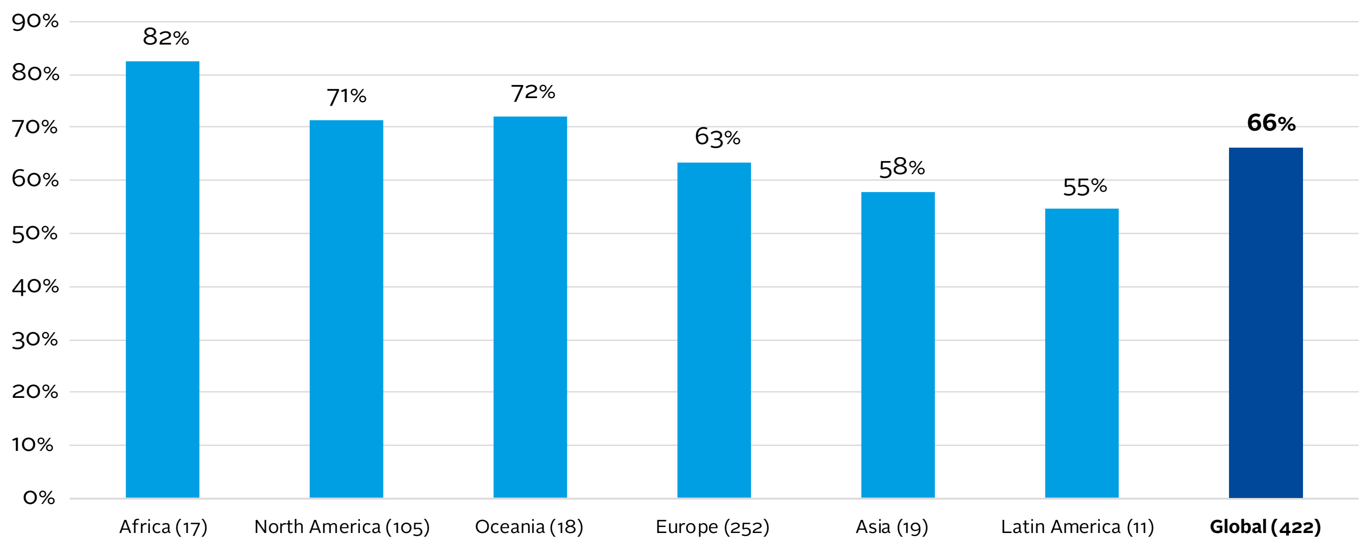
ENGAGEMENT TRENDS AMONG FIXED INCOME INVESTORS

PRI signatories are required to report annually on their responsible investment activities to ensure their accountability to the Principles as well as to the PRI initiative as a whole.[22] A review of PRI reporting data from 422 investors who reported in 2017 indicates that, while fixed income engagement is still a nascent practice, it is growing in popularity. Many signatories engage, but they typically do so in relation to a small proportion of their total fixed income holdings. A much smaller number of signatories engage systematically across a large proportion of their fixed income portfolios.

In summary:

- 66% (or 279 signatories) of those 422 investors investing directly in fixed income markets and reporting on their responsible investment activities report that they engage with at least one type of issuer in their portfolios (see Figure 2).[23]
- 71% and 63% of North American and European investors respectively report that they engage – more than any other region. Numbers for other regions are too small to draw meaningful conclusions.
- 45% of North American investors and 40% of European investors concentrate their engagement efforts on up to a quarter of their total non-financial corporate bond holdings, compared with 19% and 23% respectively for engagement on over a quarter of assets (see Figure 3).
- 52% of North American investors and 60% of European investors engage on up to a quarter of their total financial institution bond holdings, compared to 27% and 17% respectively for engagement on over a quarter of assets.

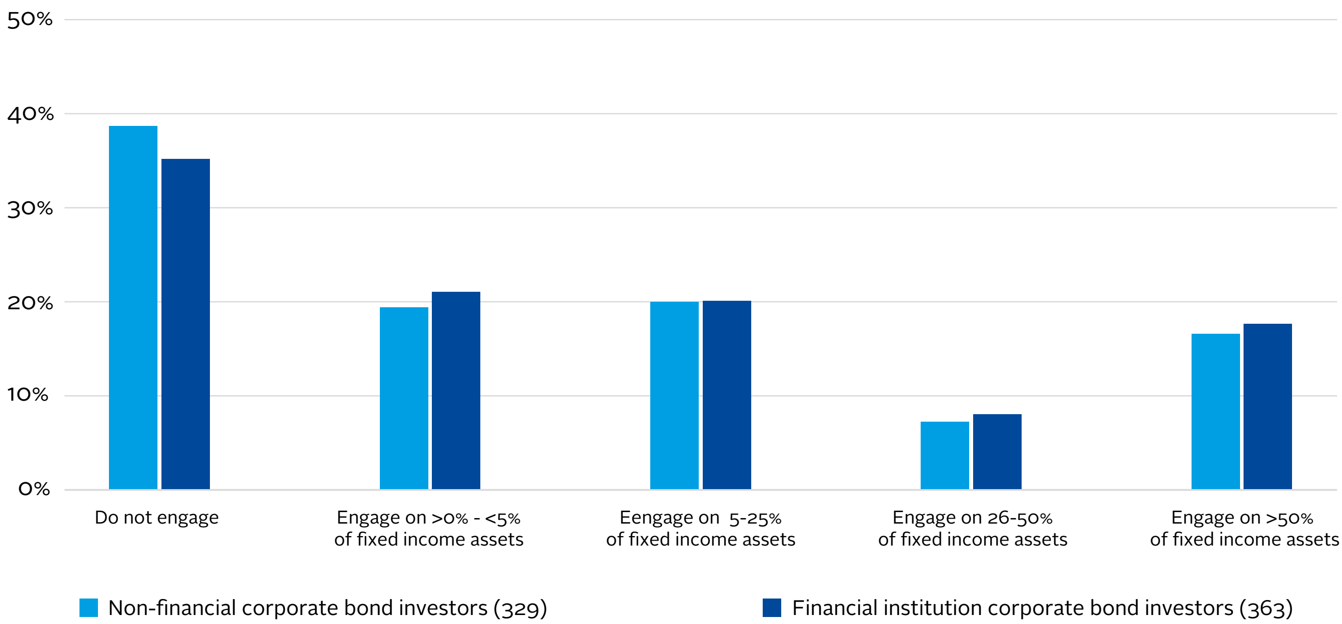
Figure 2 – Engagement trends by region. Source: PRI



22 PRI signatories report through the Reporting Framework, a standardised transparency tool. Of the 1,248 investors that reported in 2017, 560 invest in fixed income, and of those, 422 completed the 'Fixed Income Module' for funds directly invested in fixed income. The scope of the review includes responses to questions FI 18.1 to FI 20.3 of the PRI Reporting Framework, Direct – Fixed Income Module.

23 Issuer types include companies, banks, sovereigns, sub-sovereigns, supranationals, and issuers of securitised debt.

Figure 3 – Engagement activities relative to fixed income holdings.[24] Source: PRI



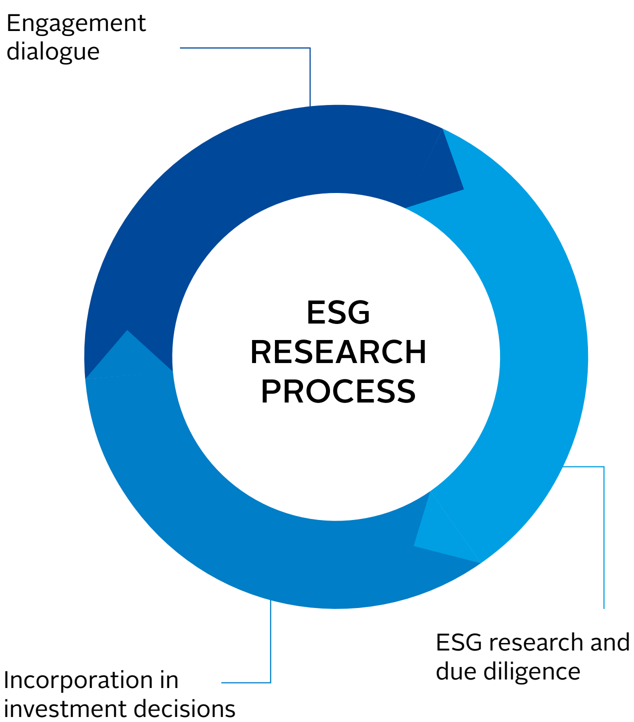
EMBEDDING ENGAGEMENT IN THE INVESTMENT PROCESS

Engagement by fixed income investors should not be seen as a standalone activity but as an integral part of a responsible investment approach – as both a source of information for investment research, and a way to directly influence the issuer's management of ESG risks and opportunities. Thus, the research used to identify cases of engagement will be continuously integrated with the insights gained during the dialogue with companies and incorporated into investment decisions (see Figure 4).

From an operational perspective, there are a range of different approaches investors can take to engagement (see Table 3). Engagement can be:

- embedded in the investment process and conducted by credit analysts and portfolio managers;
- conducted by a dedicated engagement team specialised in ESG themes; or
- integrated, whereby ESG specialists help flag engagement topics and conduct engagement alongside fixed income practitioners.

Figure 4 – The circular process of ESG research



24 The same respondent may engage with different types of issuer. Some investors report that it is difficult to quantify precisely 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.

Table 3 – Examples of approaches to engagement

INVESTOR	HIGHLIGHTS
Hermes Investment Management, Investment Manager, UK[25]	In addition to analysing and pricing operating and financial risks, the Hermes Credit team also considers ESG factors when making investment decisions. To inform its discussions with issuers, Hermes Credit relies on several inputs: ▪ First, from a more general perspective, along with the rest of Hermes, the credit team relies on the responsibility team for firm policies, approach, and investment tools. ▪ When focusing on a company-specific level, the team reviews Hermes's proprietary measures of ESG risk – their QESG scores – which represent a good snapshot of the company's overall ESG performance. ▪ This score is supported by the company information provided by Hermes's engagement team, Hermes EOS, because the dialogue with the company provides the context of the QESG score. For example, is the company on the right trajectory, or is it more on a negative path?
MN, Investment Manager, Netherlands[26]	▪ MN's credit analysts regularly review public reporting and/or cross-check and verify third-party research. ▪ Credit analysts discuss their findings with other members of the credit team, responsible investment and governance team, and equity analysts. They consider whether the issue has already been identified and if there has been any engagement, and, if so, what the outcomes were. ▪ Credit analysts lead on engagements as they know the companies best, and keep relevant parties (credit team members, responsible investment and governance team, equities) updated on the engagement progress.

For more engagement processes and examples of bondholder engagement in practice, see PRI's ESG Engagement for Fixed Income Investors case study series.

Regardless of who ultimately leads an engagement, it is considered best practice to keep relevant internal functions (risk, credit, responsible investment, corporate governance, equities teams etc.) updated on the progress and outcomes of the engagement, to ensure findings are incorporated into investment decisions (see Table 4). Leading investors have developed practices to ensure that information and insights collected through engagement can feed into the investment decision-making process such as:[27]

- ensuring regular cross-team meetings and presentations;
- sharing engagement data across platforms that is accessible to ESG and investment teams;
- encouraging ESG and investment teams to join engagement meetings and roadshows;
- delegating some engagement dialogue to portfolio managers;
- involving portfolio managers when defining an engagement programme and developing engagement decisions;
- establishing mechanisms to rebalance portfolio holdings based on levels of interaction and outcomes of engagements; and
- considering active ownership as a mechanism to assess potential future investments.

"We try not to think about engagement in a silo – we don't believe it should be the responsibility of a separate team or credit analysts working alone. Instead, we find that by bringing together analysts from across the credit spectrum, as well as getting input from our listed equity and private markets colleagues, we have a much richer understanding of emerging risks. By grounding engagement in the proprietary ESG assessments that our analysts conduct, it becomes a core part of their ongoing responsibilities."

Jonathan Bailey, Head of ESG Investing, Neuberger Berman

25 Hermes Investment Management. (2017). Engaging with a state-owned enterprise issuer.
26 MN. (2017). Engaging with a security services issuer.
27 O'Sullivan, Niamh & Gond, Jean-Pascal. (2016). Engagement: unlocking the black box of value creation.

Table 4 – Examples of investment outcomes

INVESTOR	HIGHLIGHTS
Neuberger Berman, Investment Manager, US [28]	Following its engagement with a pharmaceutical sector issuer over material ESG issues such as drug pricing and ethical practices, Neuberger Berman continued to monitor the company as a potential investment. During a follow-up engagement a year later, it discussed the reasons it had previously passed on the investment opportunity with management, who were still unable to placate Neuberger's concerns about pressures on drug prices and the growing public scrutiny of pricing practices. The company's balance sheet was low on tangible assets and its R&D spending would, in Neuberger Berman's view, not be able to sustain the company for the long term. Because of these factors, the investor once again declined the opportunity to invest. As the increased international focus on drug pricing persisted, the company's cash flows came under heightened pressure, ultimately leading the company into discussions to restructure its debt through a bankruptcy process. Neuberger Berman's focus on engaging over material ESG issues allowed it to protect value for its investors by avoiding this credit deterioration.
KfW, Asset Owner, Germany[29]	KfW influences issuers' ESG practices indirectly by informing them that their ESG profile has a direct impact on investment decisions. For its liquidity portfolio, KfW only invests in bonds of issuers whose sustainability score is among the best 80% of the respective sector. Since 2011, it has sent letters each year to issuers in its investment universe to inform them of KfW's investment approach and the issuer's current ESG score. A poor score means KfW reduces its investable limit in a single issuer. As a result, KfW has anecdotal evidence that it has driven better management and disclosure on ESG by some issuers.
QIC, Investment Manager, Australia[30]	After its engagement with an Asian automaker issuer, QIC continued to monitor the company for developments in the material areas of concern identified through the meeting: its product carbon footprinting performance, management of labour disputes, and poor governance profile. When the company issued a new bond three months later, QIC's credit analysis showed that the pricing of the new bond did not adequately compensate investors for the current ESG risks and broader credit risk. As a result, QIC declined to participate in the primary market deal, giving feedback to the syndicate and company that it had not seen sufficient progress on the matters raised in the engagement meeting to warrant further investment.

For more engagement processes and examples of bondholder engagement in practice, see PRI's ESG Engagement for Fixed Income Investors case study series.

PRIORITISING ENGAGEMENT ACTIVITIES

Engagement cases usually fall into two categories:

- **Proactive**: When investors seek dialogue with priority companies to manage more medium/long-term issues based on their analysis of potentially material ESG issues and megatrends
- **Reactive**: When investors initiate dialogue with companies in reaction to a recent downgrade, controversy or scandal which is presenting a financial and/or reputational risk

Investors with exposure to hundreds or thousands of different issuers may only be able to meaningfully and proactively engage a small proportion of those issuers.

> "Sector by sector ESG materiality is what matters most. Energy analysts will be more attuned to air pollution than a financial analyst. We try to link ESG engagement to standardisation of particular standards and refer to these initiatives during engagement. For example, we attach the SASB sector report and ask for the disclosures."
>
> Mitch Reznick, Co-head of Credit and Head of Credit Research, Hermes Investment Management

28 Neuberger Berman. (2018). Engaging with Non-Investment Grade Issuers.
29 KfW, (2017). Engagement.
30 QIC. (2017). Engaging with an Automaker Issuer.

PRI signatories typically prioritise their engagement activity based on one or more of the following criteria:

- **Size of holdings**: The largest holdings pose the greatest potential risk to portfolio performance.
- **Credit quality of the issuer:** Those issuers with less balance sheet flexibility (such as high-yield issuers) are typically less able to absorb an unexpected deterioration in their businesses due to material ESG risks.
- **Duration of holdings**: Investors should focus on debt instrument types that are most exposed to selected ESG factors over a given timeframe; for instance, emissions-reducing regulatory targets will likely not impact three- and ten-year bonds in the same way.
- **Quality of transparency on ESG**: Investors should focus on improving understanding of how an issuer is managing, or plans to manage, ESG risks and value creation opportunities in the absence of comprehensive and comparable issuer disclosure.
- **Specific markets and/or sectors**: Investors should engage over ESG issues that are most material for the specific market and/or sector. ESG sector materiality frameworks such as the Engagement Guide for Asset Owners and Asset Managers from the Sustainability Accounting Standards Board (SASB) can help focus engagement discussions on sustainability-related trends and uncertainties that are likely to affect the financial condition or operating performance of a company.
- **Specific ESG themes**: Engagement discussions should be focused on those topics representing the highest value at risk or potential impact across issuers and sectors. Investor engagements currently managed by the PRI include research and collaborative investor engagement on specific topics, such as the low-carbon transition, water risks, labour practices, cybersecurity, anti-bribery and corruption, and corporate tax transparency.[31]

Table 5 – Examples of approaches to prioritising engagement

INVESTOR	HIGHLIGHTS
Breckinridge Capital Advisors, Investment Manager, US[32]	Breckinridge aims to invest in companies and municipalities that are strategic in their approach to sustainability and clearly prioritise material ESG factors. It determines materiality based on external standards such as those provided by SASB, coupled with its internal sector-level and issuer-level materiality assessment.
MN, Investment Manager, Netherlands[33]	Preconditions for bondholder engagement include that the bondholding belongs to MN's investable universe/benchmark, lack of transparency (including ESG considerations), and poor performance (including ESG considerations). For instance, MN looks at the recurrence and gravity of financial news stories, how the company responds to and follows up on scandals, and public scrutiny of the company.
QIC, Investment Manager, Australia[34]	QIC's engagement programme aims to engage with around ten issuers per year in one of three ways: ▪ **Issuers with advanced ESG practices**: QIC prioritises companies demonstrating advanced ESG practices so it can learn from them and encourage their peers. ▪ **Issuers with weaker ESG practices**: QIC assesses the range of ESG ratings within an industry, whether there are common (negative) themes or practices across the industry, the financial and non-financial (risk) materiality of those practices, and whether it is exposed to issuers whose practices are weaker than their peers. ▪ **Thematic engagement**: QIC considers ESG issues that could impact financial returns. Generally, thematic issues will impact all issuers in an industry. We consider how advanced issuers are in their ESG practices so we can learn from the leaders and encourage the laggards.

For more engagement processes and examples of bondholder engagement in practice, see PRI's ESG Engagement for Fixed Income Investors case study series.

31 PRI. (2018). ESG Engagements.
32 Breckinridge Capital Advisors. (2017). Engaging to Deepen Insight.
33 MN. (2017). Engaging with a security services issuer.
34 QIC. (2017). Engaging with an Automaker Issuer.

- **Companies in the lowest ranks of ESG benchmarks**: Such companies tend to face the highest financial downside, including significant event risks and systemic risks which can affect issuer creditworthiness.
- **Companies in the highest ranks of ESG benchmarks**: Conversely, investors may choose to engage with industry leaders to promote and encourage best practice.
- **Specific issues considered priorities for the investor based on input from clients and beneficiaries**: Investors should focus on ethical issues or issues misaligned with their clients' purpose (such as endowment funds).

TIMING ENGAGEMENT

Successful bondholder engagement with issuers is largely dependent on whether the deal is public or private, and whether the investor engages pre- or post-issuance. Timing the engagement is a strategic decision, because the bondholder's influence with issuers varies throughout the issuance lifecycle. If the debt issuance is privately placed, the investor is more likely to have direct engagement with the prospective issuer both pre- and post-issuance. Table 6 shows the bond issuance 'lifecycle', alongside scope and limitations to bondholder engagement with issuers on a range of potential issues, including ESG.

> "The success of bondholder engagement with issuers depends largely on whether the deal is public or private, and whether engagement occurs pre- or post-issuance."
>
> James Fisher, Partner, Reed Smith

Table 6 – The legal perspective: bond issuance lifecycle and the associated scope for bondholders to engage with issuers Source: Adapted from Reed Smith (2017)[35]

	PRE-ISSUANCE	POST-ISSUANCE
Bondholder influence over issuers	▪ Prospective bondholder has the opportunity to influence the prospective issuer by requesting or requiring the inclusion of contractual obligations to provide information on ESG matters	▪ Bondholder retains some potential influence with issuer where the issuer is seeking to renegotiate contractual obligations, refinance, or where bondholders attain the required quorum to convene a bondholder meeting
Private placement	▪ Greatest opportunity to require/request inclusion of contractual obligations on the issuer ▪ Most likely to be direct dialogue	▪ Distinction between private and public is less relevant, although buyers of private debt are more likely to have contact with the issuer post-issuance ▪ Scope to engage can be limited as obligations of issuers to the bondholder have been fixed in contractual agreements (such as trust deed, indenture, transaction documentation, covenants and other transaction documentation) ▪ Bondholders may be able to convene bondholder meetings if, individually or collectively, have a specified percentage bondholding ▪ Companies frequently need to refinance – representing another point at which, post-issuance, bondholders can hold a dialogue with issuers ▪ Another opportunity to get (back) 'around the table' when an issuer seeks consent of bondholders to make amendments to contractual terms of existing bonds (for example to clarify ambiguities, to effect a restructuring etc.).
Public issuance	▪ Potentially more limited opportunity to influence specific contractual obligations, as engagement could take place quite a lot later in the issuance process (at investor roadshows, for example, when a transaction and the proposed documentation is completed or progressed) ▪ Most likely to be indirect dialogue via dealers, underwriters or other intermediaries or advisers ▪ Possibility to express views on the importance of ESG matters, and how these may influence the decision to invest and at what price ▪ This may eventually impact the prevalence of ESG risk factors in any prospectus regarding issuance	

35 The points extracted from Reed Smith's commentary and replicated in this table are subject to fuller explanations in the original text, located in Appendix.

	PRE AND POST-ISSUANCE
Overcoming challenges	▪ Whether or not bondholder requests are implemented is a matter for negotiation – potential resistance by issuers to include ESG metrics in covenant packages as breaches could lead to events of default ▪ Investors can also request that issuers prominently disclose their ESG policies in their marketing materials. By demanding this information, corporate bond funding can encourage higher standards of corporate disclosure and transparency, and promote consistent high-quality international corporate governance standards
Contractual bondholder rights and issuer obligations	Transaction documentation provides the framework for the issuer's obligations to its bondholders, which includes any obligations in respect of ESG matters: ▪ **Right to information**: The T&C and the instrument constituting the bonds (the trust deed or indenture) typically include obligations on the issuer to provide financial and other information, either to the trustee or bondholders directly, depending on the structure ▪ **Right of inspection of documents**: The majority of issuances provide an entitlement for bondholders to inspect copies of transaction documents at the issuer's registered offices ▪ **Convening bondholder meetings**: Under the terms of many bond issuances, bondholders are entitled to convene meetings provided that they hold a specified proportion of the bonds of the relevant class ▪ **Issuer-led solicitations**: when an issuer seeks the consent of bondholders to make amendments to the terms of the existing bonds
Regulatory issuer obligations	**Relevant UK/EU regulation** ▪ EU Prospectus Directive (2003/71/EC/as amended) ▪ Prospectus Regulation (809/2004) and Regulation (EU) 2017/1129 (the New Prospectus Regulation) ▪ EU Market Abuse Regulation (MAR) (596/201/EU) and/or the Disclosure and Transparency Rules (DTR) ▪ EU Markets in Financial Instruments Direction ▪ Anti-money laundering, anti-terrorism financing, anti-corruption requirements, insider dealing and market abuse regulation **Relevant US regulation** ▪ SEC mandatory disclosure rules (Regulation S-K) ▪ US Department of Labor's Interpretative Bulletin 2015-01

Table 7 – Example of engagement across the bond issuance lifecycle

INVESTOR	HIGHLIGHTS
M&G, Investment Manager, UK[36]	M&G finds that engagement can be particularly effective for private infrastructure debt because: ▪ There is often a sole lender or a small number of lenders (compared with multiple lenders in a public corporate bond issue) so lenders usually have closer relationships with borrowers and better access to engage early. ▪ Having an ability to negotiate on a purely bilateral basis allows for a closer dialogue with borrowers on ESG issues and other risks. ▪ Private lenders often have greater access to information about borrowers and have more influence on them since private debt can be an important source of funding for the borrower. The due diligence process is a good opportunity for M&G to engage on ESG issues before they've invested, which is particularly important given the illiquidity of most private debt investments. Post-issuance/investment, M&G engages with borrowers through the lifecycle of the investment to ensure problems do not arise over time. Covenants act as early warning signs to lenders: private loans tend to have strong covenants and controls attached, so a lender can engage with borrowers if things start to go off track during the life of the investment.

For more engagement processes and examples of bondholder engagement in practice, see PRI's ESG Engagement for Fixed Income Investors case study series.

DEFINING OBJECTIVES AND MEASURING THE EFFECTIVENESS OF ENGAGEMENT

Once the list of target companies has been defined, investors need to set objectives and track the outcomes of their engagement practices to ensure their effectiveness. These objectives should be developed by ESG teams in collaboration with investment teams to ensure they are robust and send consistent messages to companies. Examples of objectives for target companies include:

- developing a human rights policy;
- setting up a whistleblowing monitoring system;
- defining emissions reduction targets;
- improving skill-set balance at the board level;
- joining a multi-stakeholder initiative tackling a specific issue; and
- increasing information provided to the market on ESG matters.

> "For me, the insight that you gain is a success: I have a better understanding of issues that I have brought to consideration because I think they are relevant. With respect to encouraging continued improvement, it's more difficult to track causality."
>
> Manuel Cañas, former Senior Portfolio Manager, Colonial First State Global Asset Management (including First State Investments)

36 M&G. (2017). ESG Engagement in Private Infrastructure Debt.

Table 8 – Examples of engagement objectives

INVESTOR	HIGHLIGHTS
Neuberger Berman, Investment Manager, US[37]	Neuberger Berman prioritised its engagement efforts with non-investment grade pharmaceutical issuers based on: ▪ Assessing historical practices related to pricing of medicines; ▪ Determining management's willingness to modify historical practices and our ability to track these modifications; ▪ Assessing the degree of regulatory risk associated with pricing practices and portfolio composition; and ▪ Determining the sustainability of cash flows available for debt service if current pricing activities remained ongoing.
PIMCO, Investment Manager, US[38]	PIMCO prioritised its engagement with the European utilities sector based on: ▪ Understanding firms' planning around two degree policies; ▪ Assessment of stranded asset risk in their planning assumptions; and ▪ Plans to issue purpose bonds (green, SDG, social), given that utility companies offer scale and existing internal capabilities for green projects.
QIC, Investment Manager, Australia[39]	QIC identified the following material ESG issues as primary objectives for its engagement with an Asian automaker sector issuer: ▪ Clean tech opportunities: fleet emission reduction targets and associated clean tech product development (e.g. biofuel and hybrid vehicles); ▪ Labour relations: sensitivities in labour/management relations and strategies to improve relationships; and ▪ Governance: structures to achieve optimal balance across key stakeholders.

For more engagement processes and examples of bondholder engagement in practice, see PRI's ESG Engagement for Fixed Income Investors case study series.

Investors will find it useful to define milestones and timelines at the start of engagement, although they will need to continuously review these to reflect internal and external developments during dialogue with target companies which often lasts several years. Measuring performance on specific ESG performance indicators and scores is a common way to assess success.

Tracking systems would facilitate record keeping, on a progressive basis, in the following areas:

- interactions (i.e. letters, emails, meetings and on-site visits);
- corporate representatives met;
- information and documentation received;
- commitments from management; and
- regular assessments of ESG performance.

> "If we can't get what we want from an engagement, there is often a good reason. If a company doesn't complete our in-house ESG survey, for example, that's just as relevant for an investment decision as if they did complete it."
>
> Joshua Kendall, ESG Analyst, Insight Investment

37 Neuberger Berman. (2018). Engaging with Non-Investment Grade Issuers.
38 PIMCO. (2017). Engaging with Utilities and Global Bank Issuers.
39 QIC. (2017). Engaging with an Automaker Issuer.

While this information is usually kept internal and confidential, such systems are useful for preparing reports for clients and the public on the progress and results of engagements. Engagement dialogue can be tracked through tailored, preferably cloud-based, IT systems or customer relationship management (CRM) tools, available across the organisation, from ESG analysts to portfolio managers.

While setting milestones to measure objectives is useful, this might not always be possible for each engagement dialogue and success should always be contextualised; having all milestones covered does not necessarily mean that dialogue cannot be improved. On the other hand, missing milestones might lead to perceived failure and a reluctance by investors to take on difficult issues where progress is not guaranteed or measurable. As a matter of fact, recording the details of an unsuccessful dialogue with a company can be extremely insightful from a ESG integration perspective.

FACTORS DETERMINING THE EFFECTIVENESS OF ENGAGEMENT

Fixed income investors' ability to influence issuers' senior management depends on a number of factors, many of which will appear obvious but are nonetheless important to bear in mind when developing an engagement strategy.

SIZE OF THE INVESTOR

Larger investors typically find it easier to gain access to issuers, even in cases where they don't currently hold any of the issuer's debt. Smaller investors can potentially address this challenge by seeking collaborative engagements with equity holders and/or other bondholders, and using engagement approaches that emphasise partnership, common goals, and opportunities for companies to obtain consultative feedback on their existing efforts.

> "Some of the big issuers are more difficult to engage, while smaller ones are open to communication, as they need the liquidity."
>
> Adam Shane, Head of Fixed Income Credit Research, Northern Trust Asset Management

CREDIT QUALITY OF THE ISSUER

In principle, high-yield issuers are more likely to be receptive to engagement by bondholders, and open to negotiate the terms of the issue, as they have a greater incentive to meet (potential) investors' requirements. For investment-grade issuance, investors sometimes find that there is less time to engage pre-issuance, as bond issues are announced and sold in a matter of hours. However, this does vary.

- PIMCO for example, finds that engagement in high yield can actually be more challenging than with investment-grade issuers, as the former often do not have the investor relations set-up to address investor needs and lack internal CSR teams.
- Neuberger Berman's Emerging Market Debt team, on the other hand, has found that emerging market corporate issuers are willing to engage with bondholders. Given the risk profile of these issuers, the broader points about the better pricing of risk by engaging with issuers, and the potential to mitigate risk during the hold period, are even more important for such companies. The firm prioritises its engagement efforts with high-yield credit where issuers have less balance sheet flexibility to absorb unexpected deterioration in their businesses due to material ESG risks.

PUBLIC VERSUS PRIVATE PLACEMENT

If the debt issuance is privately placed, the investor is more likely to have direct engagement with the prospective issuer both pre- and post-issuance. Moreover, investors often see engagement over ESG factors as incrementally more significant in private debt, given the illiquid nature of these markets, and the importance of assessing the private equity sponsor's commitment to ESG alongside the fundamental ESG risk of the underlying issuer.

WHETHER THE ISSUER IS LOOKING TO (RE) ISSUE DEBT IMMINENTLY

Companies that refinance regularly are likely to be more sensitive to interest rates and investor demand. They should therefore be more open to engagement by investors.[40]

STATE OF THE MARKET

Market situations of weak supply, the search for yield, and faster-moving primary markets can also lead bondholders to compromise more on covenants, particularly further down the credit curve. As interest rates rise, borrowing becomes more expensive and issuers should be more willing to engage with investors.

40 Hoepner, A., 2015. How to impact Climate Justice: Engage in Equities, Deny Debt.

RELATIVE AWARENESS OF ISSUER ESG ISSUES

While some companies dedicate a great deal of attention to ESG issues, others take them less seriously. Engagement with leaders may be easier as they develop dedicated ESG resources, while laggards may be reluctant to engage. Nevertheless, this should be seen as an opportunity to effect a positive change and a crucial part of engagement is to involve the right person within the organisation.

REGIONAL AND CULTURAL DIFFERENCES

There are historic reasons why some issuers are more receptive than others to engagement, as well as differences in legal or regulatory frameworks, policy differences, market size and corporate cultures. Anecdotally, investors in smaller markets outside North America and Europe have reported the relative ease with which they can collaborate with fellow investors to engage issuers on specific ESG issues.

> "We find that in a zero-rate environment, high-yield issuers borrow easily and then go into hiding. They have more leverage and less flexibility for extraordinary line items such as ESG. Their investor relations is also less developed than investment-grade issuers, who have developed practices and dedicated fixed income investor relations teams. It is only after default that bondholders typically get a seat at the table with high-yield issuers."
>
> Alex Struc, former ESG Portfolio Manager, PIMCO

COLLABORATIVE ENGAGEMENT

Collaborative engagement occurs when a group of institutional investors come together to engage in dialogue with companies on ESG issues.

Source: PRI

Principle 5 of the six Principles encourages collaboration by investors to enhance the effectiveness of their responsible investment approach. Many existing stewardship codes also support this concept of shared dialogue with investee companies. This typically involves multiple investors engaging the same company, or investors joining forces to engagement many companies on the same ESG issue.

When done well, collaboration can be an effective way to gain corporate managers' attention, as well as to pool knowledge, information and engagement costs. Speaking to issuers with a unified voice also typically results in a more informed and constructive dialogue. Complex market transformation is also more likely to be achieved through an alliance of investors rather than a single institution – even a large one – acting alone.

Academic analysis of major investor engagements shows that collaboration among investors has been instrumental in increasing the success rate of engagements on environmental and social issues.[41] Success rates are elevated by one third when a single investor, located in the same geographic region as the targeted firm, leads the dialogue.[42] Investor influence is also crucial; success rates are higher when there are more participating investors, as well as when they have larger assets under management, and when they own a bigger proportion of the target company. This is particularly important when investors are engaging across national boundaries.

41 Dimson, E., Karakas, O. and Li, X. (2015). Active Ownership. The Review of Financial Studies, 28(12), pp. 3225-3268.

42 RI Quarterly - Local leads, backed by global scale: the drivers of successful engagement

FOCUS ON THE PRI COLLABORATION PLATFORM

The PRI Collaboration Platform is a private forum that allows signatories to pool resources, share information and enhance their influence on ESG issues. It offers a range of engagement initiatives where investors engage listed companies, policy makers and other stakeholders. More than 600 PRI signatories have been involved in at least one collaborative initiative since the platform was launched at the end of 2006, and over 1,100 collaborative proposals have been posted on the platform.

Examples of posts on the Collaboration Platform include:

- invitations to sign joint letters to companies;
- proposals for in-depth research and investor guidance;
- opportunities to join investor-company engagements on particular ESG themes;
- invitations to foster dialogue with policy makers; and
- requests for support on upcoming shareholder resolutions.

In addition to the signatory-led engagements on the Collaboration Platform, the PRI has also directly coordinates a number of collaborative engagements across ESG topics from climate change to anti-bribery and corruption.[43] The PRI's ESG Engagements team has produced a series of outcome documents to outline the results and lessons learnt of several coordinated collaborative engagements across a range of ESG issues. The most recent publications include:

- Engaging on anti-bribery and corruption: The report, published with the UN Global Compact, draws on the findings from PRI-coordinated engagements on the topic over 2013-15, investor comments and company feedback.
- Engagement guidance on corporate tax responsibility: The guidance is primarily intended to assist investors to conduct company engagement and achieve the right balance between controlling the tax bill and mitigating related risk.
- Labour practices in agricultural supply chains: The report draws together results from the 2013-2015 PRI-coordinated engagement, and includes investor expectations and useful resources to support engagement with companies.

While collaborative engagement is a tried and tested means of engagement for shareholders, for most bondholders, bilateral engagement with an issuer is still the most common approach: 91% of corporate (financial) and 89% of corporate (non-financial) bond investors reporting on their engagement activities state they do so bilaterally.[44] To date, there are far fewer examples of collaboration by bondholders compared with shareholders. Bondholders that do collaborate are typically focused less on ESG issues and more on issues such as unfavourable bond clauses, which offer fewer protections to bondholders, or scenarios where groups of bondholders engage to bring about a debt restructuring.[45]

Fixed income investors interviewed by the PRI acknowledge that there could be scope for them to engage more collaboratively in future, particularly where it relates to systematic requests such as standardising and enhancing ESG-related disclosure, or encouraging continuous improvement in ESG policies and practices. Aside from collaborating alongside other bond and equity holders, fixed income investors may also engage regulators, policy makers, banks, credit rating agencies and other stakeholders.

Experience suggests that fixed income investors could benefit substantially from engaging collaboratively, but they need to weigh this approach as it can also present challenges.

CHALLENGES FOR COLLABORATIVE ENGAGEMENT

While collaborative engagement has a number of advantages, it is not always appropriate, and it brings its own unique set of challenges.

- **Reaching consensus**: investors involved in collective engagements will not always have the same desired outcome or interest in the target issuer(s). This can lead to a confused message to issuers. Bondholders in particular face a challenge of engaging a single company but owning debt of different tenors potentially issued by different parts of that company. They may have different objectives as the materiality of specific ESG issues will vary over different time horizons. If a compromise cannot be reached, the group may only be able to agree on the most attainable goal, which may leave those with more ambitious aims dissatisfied.
- **Coordination costs**: Costs can include time spent coordinating the group's activities, helping the group to build consensus and a common position, and making sure that each member is well informed throughout the engagement process. These costs can be borne by the investors leading the alliance, or by a third party which acts as facilitator of the collaborative initiative.

43 A list of currently active PRI-coordinated initiatives between investors and companies is available at: https://www.unpri.org/esg-issues
44 Data from responses to the 2017 PRI Reporting Framework.
45 Fidelity International. (2017). Bond covenants: beware of slipping standards late in the cycle.

- **Regulatory barriers**: Investors may encounter regulatory barriers relating to controlling bids and anti-trust. An example is acting in concert legislation in some markets, where legislators have not specified that collaborating to foster dialogue on ESG issues is not breaching the law. For further discussion on the opportunities for and challenges to collaborative engagement from a legal perspective, see the Appendix.
- **Collective action issues**: Similarly, while many investors may sign a collaborative initiative, some may not substantially contribute to the project, leaving it to a smaller group of committed investors to do all the work.
- **Bondholder identification**: One practical challenge is that can be difficult for bond investors to identify fellow bondholders, as publicly available bondholder information may only contain a subset of bondholders' identities, and is often out-of-date. There is no regulatory requirement for fixed income investors to disclose their identities or holding amounts. The trustee that represents the interests of all bondholders is not always able to provide bond issuers with a list of bondholders either. There are, however, systems which allow bondholders to communicate and work with fellow bondholders on an anonymous basis.

OVERCOMING COMMON HURDLES TO ENGAGEMENT

Despite the motivations for engagement laid out earlier in this report, there remains significant inertia among fixed income investors to engage. Below, we highlight some of the commonly heard arguments against engagement and suggest responses to overcome scepticism or reluctance to engage.

"Bondholders don't have the legal right to engage"
Bondholders do not have the same legal rights as shareholders, as they enjoy a more secure position within a company's capital structure. They do not have voting rights, neither do they have the formal communication process associated with attending AGMs. The law traditionally assigns greater corporate governance rights to shareholders, compared to creditors.

Nevertheless, as lenders of capital, fixed income investors are perfectly within their rights to engage with companies if they feel the need to manage their investment risks. They also have the right to negotiate terms of bond covenants, and a number of investors interviewed for this report do so. Unlike shareholders, whose influence over companies is ongoing, fixed income investors have most influence with regards to primary issuance, and less in secondary markets – so they stand to maximise their engagement efforts by engaging at particular points of the issuance cycle.

"Our attitude is that we are an important lender of capital, entrusted by clients to ensure all risks are covered, so we just ignore fact we don't have equity and pick up the phone"

Marayka Ward, Senior Credit Manager, QIC

"Bondholders shouldn't engage because of their privileged position in the capital structure"
Ultimately, despite perceived conflicts between shareholders and bondholders in the short run, shareholders and bondholder interests should be aligned over longer timelines regarding the financial sustainability of any issuer.

"We're all stakeholders in a company that has enterprise value and, to the extent that this is growing, it is a positive for both shareholders and creditors."

Mitch Reznick, Co-head of Credit and Head of Credit Research, Hermes Investment Management

"Bondholders don't have the influence to engage"
When the shareholder-primacy model of corporate governance originated in the 1930s, the equity markets far outweighed the corporate bond market. However, bonds have now become the principal source of external financing for US firms, dwarfing equity issuance.[46] Since 2006, new corporate bond issuances have exceeded new issuances of equity more than eight-fold.[47] This increase is also seen in the number of companies that use primary bond markets, rising from about 1,250 before the 2007 debt crisis to over 2,500 today.[48] Given the increased significance of the bond market today, fixed income investors have a strong argument for public companies to pay attention to their concerns. Doing so will help companies maintain a loyal base of creditors to provide cost-effective debt capital.

46 Schwarcz, S.L., (2017). Rethinking Corporate Governance for a Bondholder Financed, Systemically Risky World. William & Mary Law Review, Vol. 58, p. 1345 (2017); Duke Law School Public Law & Legal Theory Series No. 2016-22.

47 Gowland, P., (2015). Bondholder engagement is already happening. Like it or not! Sodali

48 Çelik, S., G. Demirtaş and M. Isaksson, (2015). Corporate Bonds, Bondholders and Corporate Governance, OECD Corporate Governance Working Papers, No. 16, OECD Publishing, Paris.

"There is no time to engage between an issuer announcing and closing a debt issue"
In a public placement, the opportunity to influence specific contractual obligations is limited, as engagement usually happens later in the issuance process. However, it is possible for investors to express their views on ESG issues, and how they may influence the decision to invest, and/or the price they are prepared to pay. This may eventually impact the prevalence of ESG risk factors required to be included in any prospectus with regard to the issuance. Post-issuance, bondholders retain some potential influence with issuers, especially where the issuer is seeking to renegotiate contractual obligations, refinance, or where bondholders attain the required quorum to convene a bondholder meeting. Furthermore, for carefully prioritised engagement targets, there will be other opportunities to engage with issuers at conferences, investor calls, roadshows, and in-person management meetings. When done well, collaboration with shareholders and/or other bondholders can be an effective way to gain corporate managers' attention, as well as to pool knowledge, information and engagement costs.

"We do not get access to the right people at target companies as bondholders"
Some bondholders report they have limited access to senior management, particularly in comparison to shareholders, or find that the individuals who usually participate are not necessarily best placed to discuss strategic matters. For example, BlueBay Asset Management explained that, where it has sought to raise ESG matters on an ad-hoc basis with companies, it is not unusual to be faced with management representatives who were not expecting (or able) to talk about ESG issues. For instance, whereas shareholders usually meet the CEO, CFO or Chairman and the agenda can shift between a more strategic discussion on matters such as ESG and details on the financials, debt meetings are often quite technical, and focused on debt aspects, while company representatives are more likely to be the Treasurer or CFO, who are less able to effectively discuss bigger picture matters. As such, making a clear investment case for the consideration of ESG issues in credit analysis, collaboration with other investors, understanding how the company works (i.e. who does what), and communication skills to get hold of the right person are all important determinants of successful engagement.

> "We are long-term in nature, a significant and a quasi-permanent investor – divestment is not an option, which is why we believe stewardship is so important."
>
> Rakhi Kumar, Senior Managing Director, Head of ESG Investments and Asset Stewardship, State Street Global Advisors

"With more money shifting into passive funds, engagement is on the decline anyway"
In recent years, passive management has risen in popularity as investors seek to reduce investment costs.[49] Some have expressed concerns that issuers could therefore face less scrutiny from their investors, given the rising proportion of debt held in passive funds, and the costs associated with engagement. In addition, passive investors have less incentive to engage, because there's less flexibility to adjust weightings of investment following engagement.

Many argue that passive investors' limited scope for choosing (and avoiding) specific issuers actually increases the need for active engagement. Major passive investors such as BlackRock, Vanguard and State Street Global Advisors have increased their corporate governance resources over the past three years.[50] State Street Global Advisors, for example, revised its corporate governance practices in 2013 in recognition of the increased importance of engaging with the companies in which it invests. This included expanding its stewardship team and engaging with companies more regularly. In 2017, the firm also developed a dedicated fixed income stewardship programme.

49 FT. (2016). Investment culture in Europe stunts growth in ETF market.
50 FT. (2017). Passive houses insist they do care about governance.

TIPS FOR EFFECTIVE BONDHOLDER ENGAGEMENT

In this section, we present a summary of practical tips for effective bondholder engagement. Some of these have been identified through interviews with and case studies provided by fixed income investors. Others relate to best practice engagement strategies outlined in a recent PRI listed equity publication – A Practical Guide to Active Ownership in Listed Equity – which can equally be applied to other asset classes, including corporate fixed income.

DEVELOPING A BONDHOLDER ENGAGEMENT STRATEGY

- ✓ Review peer engagement policies, whitepapers and case studies.
- ✓ Decide where engagement fits within your organisation's broader investment philosophy.
- ✓ Develop and communicate an organisation-wide engagement policy and strategy.
- ✓ Extend any existing equity engagement policy and strategy across corporate bonds.
- ✓ Draw on leverage derived from any stock ownership to conduct engagement that is fed back into fixed income research.
- ✓ Combine equity and fixed income engagement practices without ignoring the unique rights associated with the bond holdings.

PRIORITISING ENGAGEMENT

- ✓ Draw on internal and external ESG research and intelligence on target companies and their sectors to identify specific issues on which to engage.
- ✓ Decide how to prioritise engagements with issuers based on the resources available, percentage holding in the companies concerned, and the materiality of the ESG issues in question.

INITIATING DIALOGUE WITH THE ISSUER

- ✓ Invite fixed income practitioners to existing equity engagements that may already be underway.
- ✓ Make initial contact with the issuer's board, executive members or investor relations. Leverage any existing relationships.
- ✓ Time requests appropriately. Keep in mind the company's position in the business cycle and its current focus on certain issues when defining requests.
- ✓ Focus on the link between ESG and credit risk and select the right indicators on which to base engagement tracking.
- ✓ Outline why issuers would benefit, for example through investor base diversification, a higher likelihood that investors participate in future issuance, lower cost of capital as a result of lower risk perception, management of regulatory and reputational risk.
- Explain how companies themselves need to help investors by providing public ESG reporting and proactively engaging debt investors on ESG matters.
- Encourage standards of ESG disclosure in fixed income based on broader market disclosure frameworks.
- Consider collaboration as means to maximise effectiveness and efficiency of engagement.

CONDUCTING ENGAGEMENT DISCUSSIONS

- ✓ Demonstrate a holistic understanding of the company's performance and strategy to clarify how both companies and investors are focused on attaining similar goals.
- ✓ Understand the corporate culture by considering a series of red flags/indicators that could signal a shift in risk: high turnover; discussions with board members and operational people; results of employee surveys; customer satisfaction; fines and penalties; and incentives/remuneration.
- ✓ Present a consistent and integrated message from ESG analysts and portfolio managers, both of whom should join meetings with companies.
- ✓ Where possible, align requests with international standards to address companies' concerns about receiving varying and detailed questions from ESG specialists.
- ✓ Build on and foster on-going relationships, show persistence and consistency in approach, and listen and be open to what management is saying, rather than simply ask and monitor.
- ✓ Be sensitive to cultural differences; whenever possible, speaking the local language is an advantage.
- ✓ Arrive prepared and provide feedback. Enter an engagement with a clear agenda, having reviewed financial and sustainability performance data in-depth and having talked to experts beforehand. Bring ideas and expertise to how a problem can be solved to provide value for the organisation in question.
- ✓ Share best practices. Speak with leading companies to identify best practices they can refer to and share with peer companies that are lagging behind. It is easier to give examples of peers that have achieved the change being sought, rather than asking the company to be the first.
- ✓ Praise positive practice. Positive engagement is very cost-effective as it helps ensure performance is maintained.
- ✓ Collect feedback from local experts, government representatives and other stakeholders.

FOLLOWING UP ON ENGAGEMENTS

- ✓ After meetings, jointly approve a confidential summary of the discussion and commitments made. Seek feedback on the quality of the meeting and use it to improve subsequent engagements.
- ✓ Use clear evaluation methodologies to help guide dialogue with the target companies and measure progress made against set objectives.
- ✓ Ensure the efficient and effective sharing of information gained from engagements with all relevant investment team members.
- ✓ Agree time-bound goals with companies on their requests for disclosure/systems implementation.

MEASURING AND MONITORING BONDHOLDER ENGAGEMENT

- ✓ Set targets for the outcomes of your engagements.
- ✓ Continue communication with companies to provide feedback on their progress against investor expectations.
- ✓ Report on (ESG) outcomes of specific or general engagements to internal research teams' key stakeholders, including clients.

CONCLUSION

Issuer engagement on ESG factors is becoming increasingly commonplace. Investors are starting to formalise their engagement as an integral part of their approaches to responsible investment. Some examples specific to bondholders are showcased in PRI's ESG Engagement for Fixed Income Investors case study series.

Nevertheless, there are investors who are at the early stages of developing fixed income engagement processes. This is understandable in the context of the unique challenges faced by fixed income investors, such as their different legal standing point compared with equity investors, and the inherent complexity of bond markets given the variety of instrument types, maturities and issuing entities.

This publication has highlighted the influence that fixed income investors have to engage with issuers, based on the increased significance of the bond market and their specific legal and contractual rights and obligations. It has shared practical guidance on how to use this influence to engage strategically across the bond issuance lifecycle. We have concluded with a summary of practical ways to overcome common hurdles to bondholder engagement, and a collection of tips for effective engagement. The appendices include suggestions for further reading, as well as the full version of law firm Reed Smith's commentary on the scope and limitations of bondholder engagement, both one-to-one and in collaboration with other bondholders.

Further, several insights and recommendations outlined in a recent PRI publication – A Practical Guide to Active Ownership in Listed Equity – can equally be applied to other asset classes, including corporate fixed income.

The PRI will continue to support fixed income investors with guidance and support in applying responsible investment practices to their investments. We believe there is considerable untapped potential for them to do so; collaboration between bondholders and/or equity investors offers a means for them to overcome key hurdles and scale corporate engagement efforts. Opportunities exist to better articulate the perspective of fixed income investors in existing and future PRI-led collaborations. Meanwhile, there is also scope to extend engagement to government and government-related issuers, who constitute 40% of the global bond market. Such engagement will present a different set of challenges and opportunities.

Finally, while there has been strong evidence of how active ownership can help to mitigate ESG risks and enhance returns, there is a need for more research and practitioner work to be done to explore the relationship between engagement and positive impacts on society and the environment. This is an area in which the PRI plans to be active going forward, specifically in linking it to our agenda to support investors' contributions to the SDGs.

APPENDICES

THE LEGAL PERSPECTIVE ON BONDHOLDER ENGAGEMENT

To reconcile concerns over the perceived inability of fixed income investor engagement with issuers, the PRI collaborated with law firm Reed Smith LLP to produce the following commentary on the legal aspects of bondholder engagement and collaboration, focusing on the contractual and regulatory framework governing such engagement.[51]

PRE-ISSUANCE ENGAGEMENT: CONTRACTUAL RIGHTS AND LIMITATIONS

Prior to an issuance of debt securities, a prospective investor is not, legally speaking, a bondholder since the bonds have not yet come into existence. However, in its capacity as a prospective bondholder, such an investor may have dialogue with a prospective issuer of debt securities, either directly or indirectly.

If the debt issuance is to be privately placed, the investor is more likely to have direct engagement with the prospective issuer pre-issuance. If so, investors may have an opportunity to require or request the inclusion of contractual obligations on the issuer to, for example, provide further information regarding ESG practices or policies or otherwise to make changes to them either prior to issuance or at a later date and time specified by the contractual arrangements. Whether or not such requests are implemented is a matter for negotiation. If they are implemented, they become contractual obligations of the issuer and non-compliance may result in a breach of contract. If the breach is specified to be an event of default in the bond terms and conditions, there are contractually prescribed consequences typically including that the bonds are capable of being accelerated at the direction of a requisite percentage of bondholders. At this point, the bonds would become immediately due and payable. Given the severity of the consequences of a breach for an issuer, any such triggers would likely face resistance from issuers and, if they were agreed, would need to be tightly drafted and preferably objectively measurable; otherwise there are likely to be disputes as to whether or not such an event has or has not occurred.

If the debt issuance is not to be privately placed, it is more likely that a prospective investor's pre-issuance engagement will be indirect; for example, through dealers/underwriters or other intermediaries or advisers. Some prospective investors may only have this opportunity at a later stage, when a transaction and the proposed documentation is substantially completed or progressed, for example at a roadshow. The prospective investor can at this stage express its views on the importance of ESG matters, the relevance of ESG considerations in its decision whether or not to invest, and also any impact ESG matters have on the price at which it is willing to invest. This may eventually impact the prevalence of ESG risk factors required to be included in any prospectus with regard to the issuance. This is also an opportunity to make requests for the inclusion of contractual obligations on the issuer, for example to provide further information regarding ESG practices or policies or otherwise to make changes to them either prior to issuance or at a later date specified by the contractual arrangements. Again, whether or not such requests are implemented is a matter for negotiation and indeed the size of the prospective investor's subscription will be relevant, together with the interests of other investors that may not require such changes. The issuer may also consider that additional ESG obligations specifically requested by bondholders may impact pricing, but this, again, is a matter for negotiation and is influenced by other market factors.

A typical US bond issuance would be similar. Because many ESG issues do not easily lend themselves to quantitative analysis, most corporate issuers will be reluctant to include metrics in their bond indentures that cannot be easily measured and verified objectively without a high administrative cost. However, investors can have a targeted ESG impact by requesting that issuers prominently disclose their ESG policies in their marketing materials. By virtue of the information demanded by investors, corporate bond funding can encourage higher standards of corporate disclosure and transparency, and promote consistent high-quality international corporate governance standards. In addition, investors may consider lobbying regulators (such as the U.S. Securities and Exchange Commission (SEC)) to make ESG disclosure mandatory in public filings. In contrast, social impact bonds are structured specifically to finance social goals by investors, usually by using intermediaries to access achievement, and are often guaranteed by a governmental entity.

51 Unless expressly specified to the contrary, the information, materials and opinions in this document reflect the position under English and/or EU law. The information, materials and opinions contained in this document are for general information purposes only, are not intended to constitute legal or other professional advice, and should not be relied on or treated as a substitute for specific advice relevant to particular circumstances. Neither Reed Smith LLP nor any other Reed Smith entity accepts any responsibility for any loss which may arise from reliance on information or materials contained in this document. If you wish to find out more about the information or the materials contained in this document, please contact partner James Fisher at Reed Smith.

POST-ISSUANCE ENGAGEMENT: CONTRACTUAL RIGHTS AND LIMITATIONS

After the issuance of debt securities, the obligations of the issuer to bondholders are fixed in the contractual arrangement entered into in respect of the issuance, such as the trust deed or indenture, the terms and conditions of the bonds, and other transaction documentation. This transaction documentation provides the framework for the issuer's obligations to its bondholders, which include any obligations in respect of ESG matters, if any. Bondholders that have purchased bonds on the secondary market will have been deemed to invest in the bonds subject to their terms and conditions and in the knowledge as to the extent of the issuer's covenants including in respect of ESG matters, if any. As such, they will be bound to the contractual framework in the same way as if they had initially subscribed for the bonds.

A bondholder is more likely to have direct contact with the issuer in respect of a private placement. If the issuance is not privately placed, the contact may instead be indirect via a trustee which holds, amongst other things, the benefit of the issuer's covenants on trust for the benefit of the bondholders. However, it is also possible for bondholders to have direct contact with the issuer on non-privately placed deals.

Information

The terms and conditions and the instrument constituting the bonds (the trust deed or indenture) typically include obligations on the issuer to provide financial and other information, either to the trustee or directly to the bondholders, depending on the structure. Bondholders can pay close attention to the information provided and, if desired, raise questions generally or on the information provided. When this information is not provided, bondholders have a contractual entitlement to demand that it is provided pursuant to that obligation. If the issuer does not provide the information, it risks a breach of the information covenant, which may be a default under the bonds.

Unless the bond documentation requires further information to be distributed, then the issuer may not strictly speaking be compelled to provide anything further, provided it has complied with its information covenant. This is subject to any regulatory obligations on the issuer with respect to the disclosure of information (see below, for example, in respect of the Market Abuse Regulation and the Prospectus Directive, as implemented).

In some corporate bond issuances, there may also be covenants on the issuer to provide the trustee/bondholders with all notices, statements or circulars sent to shareholders. In these circumstances, bondholders may then take the benefit of the success of any shareholder engagement on ESG matters in terms of requests for information.

ESG-specific covenants

To the extent that there are obligations in the transaction documents on the issuer to comply with certain policies or practices, then any breach of those covenants could be considered as a breach of contract and would have the consequences specified in the agreement.

Right of inspection of documents

The majority of issuances provide an entitlement for bondholders to inspect copies of transaction documents at their registered offices. These documents are typically specified in the disclosure materials (e.g. prospectus) relating to the issue in question. Bondholders have the right to inspect the documentation and information, which may form the basis of queries relating to ESG matters, or at the very least open a dialogue with the issuer in the first instance. That said, and as mentioned above, subject to regulatory obligations to disclose information, the issuer cannot be compelled to provide anything further than is specified in the transaction documentation.

Convening bondholder meetings

Under the terms of many trust deeds, bondholders are entitled to convene meetings provided that they hold a specified proportion of the bonds of the relevant class. This threshold is often, but not always, at least one tenth of the aggregate principal amount outstanding of the relevant class of bonds. If bondholders either individually or collectively hold the requisite principal, then the transaction documents may require a bondholder meeting to be convened. In many cases, these bondholder meetings are used to consider passing resolutions to permit the issuer to take certain actions (in respect of which, see above in respect of restructurings, consent solicitations and defaults). However, bondholders may seek to use this as a platform to engage with other bondholders and discuss matters relating to the issuer, including in respect of any ESG matters that may be of concern. By contrast, U.S. bond indentures do not typically contain express rights of bondholders to convene meetings in the same way that an English law trust deed may do, but this is not to say that bondholders are precluded from doing so.

Issuer-led solicitations

As described above, successful bondholder engagement with issuers depends largely on whether the deal is public or private, and whether engagement occurs pre- or post-issuance.

There are, however, instances, post-issuance, where bondholders have the opportunity to get (back) "around the table", whether their bonds were placed privately or not. This occurs when an issuer seeks the consent of bondholders to make amendments to the terms of the existing bonds. This consent may be solicited for a variety of reasons, ranging from the clarification of ambiguities through to affecting a wholesale restructuring of the economics of the bond issuance.

From a contractual perspective, the terms of the bonds themselves will prescribe the circumstances and manner in which bondholder consent can be solicited and obtained, including the required approval thresholds. In the US, in particular, these thresholds have been the subject of considerable statutory and judicial attention, focused on the protection of minority bondholders' rights. However, this focus has largely been directed towards the economic rights of bondholders and the effect upon these which any proposed amendments and restructurings may have. Nevertheless, from an engagement perspective, consent solicitations offer bondholders the opportunity to enter into dialogue with issuers and one another on the topic of ESG. Ultimately, to the extent that a bondholder or group of aligned bondholders hold a sufficient percentage of a given class of bonds, consent solicitations allow them to dictate whether or not a solicitation passes, and they grant them the ability to withhold their consent unless their concerns regarding ESG are listened to (noting however the competition/antitrust law considerations discussed below).

This should not be over-stated, however. In reality, particularly in distressed situations, the primary focus for investors and issuers is likely to be on economic recovery and the protection of the investment, and engagement over ESG issues may not be at the forefront of the parties minds, especially so where timeframes are compacted. In addition, there are often other factors at play which influence how bondholders vote in restructurings, including cross-holdings of equity in the issuer, holding put options on the bonds or even the taking of credit default swap positions.[52]

Notwithstanding the foregoing, it should be kept in mind that bondholders' rights in the documentation are typically focused on what is required to ensure repayment of the debt and, in respect of secured bond issuances, to ensure that, to the extent there is a default in payment and an acceleration, security can be enforced to recover the debt. Absent the ability to enforce share security when an issuer is in default and its debt has been accelerated, the bondholders do not have the power to replace the board of directors, who owe their duties to the company and not the creditors or bondholders. As such, the directors may not take into consideration the creditors' views with respect to ESG matters if they consider on balance that taking an alternative course of action or not complying with those requests would be most likely to promote the success of the company for the benefit of its members as a whole.

Also, as noted above, in many trust deeds, bondholders are entitled to convene meetings, provided that they hold a specified proportion of the bonds of the relevant class, meaning that a bondholder that has smaller holdings will not be able to call a meeting of bondholders without support from others. Similarly, the larger a given bondholder's holdings, the more likely it is that it will have greater influence in discussions both with other bondholders and the issuer. A bondholder may also have a blocking stake in relation to any resolution proposed by an issuer to amend the documentation.

POST-ISSUANCE ENGAGEMENT: REGULATORY RIGHTS AND LIMITATIONS

Bondholders should also consider the regulations to which an issuer is subject and how these impact engagement with issuers on ESG issues.

For example, in the EU, issuers are required to disclose certain information in public documents under the EU Prospectus Directive (Directive 2003/71/EC (as amended)). The overriding requirement is that the prospectus must contain all the information necessary for investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the issuer and of any guarantor and of the rights attaching to the securities. In certain instances, the corporate issuer's approach to ESG may be relevant, for example because of the sector in which it operates, pr because of concerns regarding reputational management or potential litigation, and so may be required to be disclosed in the prospectus. Ultimately, this is a decision for the issuer to determine. The new EU Prospectus Regulation (Regulation 2017/1129/EU) will require disclosure of material risk factors, with their materiality based on the probability of their occurrence and the expected magnitude of their negative impact. It is possible for some issuers that ESG issues will be a material risk factor. This risk factor disclosure requirement will apply from July 2019 onwards.

Equally, any ESG issues that may impact the price of an issuer's bonds that are traded on a regulated market or trading venue may need to be disclosed under, for example, the EU Market Abuse Regulation (MAR) (596/2014/EU) and/or the Disclosure and Transparency Rules (DTR).

52 See "The New Bond Workouts": University of Pennsylvania Law School Institute For Law And Economics Research Paper No. 17-9 by William W. Bratton and Adam J. Levitin.

Broadly speaking, under MAR an issuer must disclose to the public any inside information which directly concerns that issuer as soon as possible (Article 17(1)). Information will be classified as 'Inside Information' if it is:

- of a precise nature;
- has not been made public;
- relates directly or indirectly to one or more issuers or financial instruments; and
- would likely have a significant effect on the prices of those financial instruments if it were made public. (Article 7(1)(a) MAR)

Information will be deemed to be of a 'precise nature' if it indicates a set of circumstances which exists or which may reasonably be expected to come into existence, or an event which has occurred or which may reasonably be expected to occur where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances on the price of the financial instrument in question (Article 7(2)).

In addition, information will be considered to have a have a 'significant effect on the prices of financial instruments' if it is information which a reasonable investor would be likely to use as part of the basis of his or her investment decisions (Article 7(4) MAR).

Where an issuer concludes that it is in possession of inside information, it must ensure that the inside information is made public as soon as possible, in a manner which enables fast access and complete, correct and timely assessment by the public (Article 17 (1) MAR).

Issuers who are regulated by a financial services, banking, insurance and/or investment management authority are subject to various corporate governance requirements under regulatory rules (including code of conduct and market practice) and the EU Markets in Financial Instruments Directive contains certain provisions which are designed to promote diversity on the board and in senior management positions of regulated issuers[53]. Bondholders may wish to encourage and support these regulatory initiatives by emphasising their importance in discussions with regulated issuers.

More generally, issuers will also be subject to anti-money laundering, anti-terrorism financing, anti-corruption, insider dealing and market abuse regulations which should provide comfort to bondholders that investors have procedures and controls in place that are designed to prevent their business being used to further financial crime, corruption and/or disorderly markets, all of which can have negative economic and social impacts.

In seeking to engage with issuers, bondholders are advised to consider whether the non-public disclosure of certain information relating to an issuer's ESG approach amounts to inside information. If it does, and they receive any non-public information, they could risk being treated as insiders under MAR and would be prevented from trading, or would otherwise risk committing an offence of insider dealing pursuant to Article 14 of MAR. This will be committed where a person possesses inside information as a result of:

- being a member of the administrative, management or supervisory bodies of the issuer;
- having a holding in the capital of the issuer;
- having access to the information through the exercise of an employment, profession or duties;
- bring involved in criminal activities; or
- where the person who possess the inside information knows or ought to know that it the information they possess is inside information,
- and they use that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates (Article 8(1) – (4) MAR).

In the United States, most ESG reporting by companies is done voluntarily. In 2016, the SEC began to review its mandatory disclosure rules (Regulation S-K) with a view towards modernising them. Several topics addressed the disclosure of company information relating to sustainability and other ESG issues. At issue is to what extent ESG reporting by publicly-traded companies should be required by SEC regulations. It would appear that many US publicly traded companies argued against the proposals for mandatory ESG disclosures, arguing that it is difficult to assess whether such matters are "material", that the SEC would be exceeding its jurisdiction by making such disclosure mandatory, and that they would require additional costs to comply. In contrast, many investors advised the SEC that ESG matters are both quantifiable and material and that such disclosure would aid investors in identifying companies who have values aligned with theirs. They further argued that disclosure allows investors to assess a company's attention to all material sources of risk and return and that the benefits of robust disclosure outweigh the costs. To date, the SEC has not made robust ESG disclosure mandatory and is still considering the proposals.

Lastly, in the area of fiduciary duty in the United States under the Employee Retirement Income Security Act (ERISA) and its interface with ESG factors, PRI signatories will be aware of the US Department of Labor's Interpretative Bulletin 2015-01[54] which sought to "acknowledge that

53 See the package of measures that consist of a recast Directive and a Regulation, collectively known as MiFID II.

54 Discussed in PRI publication dated 23 October 2015 "US Department of Labor clarifies ERISA fiduciaries' ability to consider ESG factors".

environmental, social and governance factors may have a direct relationship to the economic and financial value of an investment, and when they do these factors are proper components of the fiduciary's analysis". It also confirmed that "fiduciaries may not accept lower expected returns or take on greater risks in order to secure collateral benefits, but may take such benefits into account as "tie-breakers" when investments are otherwise equal." It remains to be seen how the change in the US administration will affect this position.

POST-ISSUANCE ENGAGEMENT: COLLABORATION

Broadly speaking, the acceptability of collaboration amongst bondholders to promote ESG practices under competition laws will depend both on the degree and nature of coordination among bondholders being considered and also the extent to which different competition law regimes will accept ESG benefits as valid countervailing factors. Bondholders choosing to collaborate with one another in their engagement of bond issuers would thus be advised to consider whether their collaboration gives rise to any competition law implications.

It is conceivable that coordination between bondholders to promote ESG standards could take place to influence the pricing or acceptability of bonds at the time of issue, and also after bonds are issued – particularly where bondholder consent is required to effect a reorganisation as described above. In the United States, a number of decided cases have considered whether coordinated action of bondholders is anticompetitive,[55] and have largely concluded that it is not, at least where the coordination takes place between bondholders (i.e. those who have already purchased their bonds), rather than between prospective bondholders who may still influence the price or rate applicable to the bond pre-issuance. The idea which seems to have been retained here is that, once the bonds are issued, there is no further competition between the bondholders in respect of those bonds. Given that the competition has already taken place, later coordination between bondholders cannot by definition restrict competition.

However, the situation may not be so clear cut where bondholders are asked to consent to the exchange of their bonds for bonds on modified terms. Coordination at this point, to the effect that modified terms would not be accepted absent some ESG improvement by the issuer, would, it seems, imply a restriction on competition between the bondholders regarding acceptance of the re-issue or exchange.

Coordination around the time of issue would clearly take place at the same time as competition between bondholders to take up bonds, and agreement between prospective bondholders not to subscribe for bonds in issuers with low ESG standards, or to downgrade such issuers, or to require better terms would appear to constitute a restriction on competition between bondholders.

In the United States, a consent defence has been used in relation to collaboration amongst bidders in auction settings . According to this idea, where the issuer knowingly consents to bondholder coordination regarding the terms on which bondholders will take up new issues, this consent constitutes a defence to any allegation that the coordination was anticompetitive and harmed the issuer.

Consent will not, however, operate as a defence in all jurisdictions, and not in Europe in particular. Also, whilst it may be easy to establish consent by an individual issuer who has invited a particular group of prospective bondholders to negotiate jointly, it would be more difficult to establish a general consent by a larger group of issuers.

This having been said, the concept of countervailing benefits means that an agreement which restricts competition will not necessarily be unlawful, and most jurisdictions have established a set of criteria upon which the parties can rely to justify an anti-competitive agreement. For example, under EU competition law, an otherwise anti-competitive agreement will be exempted if (a) the agreement contributes to improving the production or distribution of goods or promotes technical or economic progress while allowing consumers a fair share of the benefit and (b) any restrictions within the agreement are indispensable to the attainment of these objectives and cannot enable the possibility that competition would be eliminated in a substantial part of the products in question.[56]

In the United States, the "per se" and "rule of reason" tests apply, and are as applicable to manufacturers and other services companies as they are to banks and other financial institutions, consistent with the overall purpose of US antitrust legislation, namely to foster competition. "Per se" violations are those which are so inherently harmful to consumers that they are always illegal (for example price fixing) whereas the "rule of reason" test requires courts or US enforcement agencies to find a violation of the US antitrust laws only where the behaviour's anticompetitive effects outweigh its pro-competitive benefits.

55 For a review of some relevant cases, see Ali M. Stoeppelwerth, "United We stand: Antitrust Aspects of Collaboration Among Corporate Bondholders" The Business Lawyer, Volume 67, Feb. 2012.

56 See Article 101 (3) TFEU.

In summary, where restrictions on competition are claimed to be justified by benefits, in general greater benefits will need to be shown where restrictions on competition are more severe. This is either because the benefits are balanced against the detriment to competition (under US-inspired systems), or because (under European inspired systems) the restriction on competition must be no greater than in necessary to secured the claimed benefit.

One final word on regulated issuers. When dealing with regulated issuers, bondholders would also need to consider whether their 'collaboration' amounted to 'acting in concert' for the purposes of the 'controller regime', since this may require bondholders to aggregate their voting rights, resulting in them becoming controllers, if their combined voting interest exceeds certain thresholds. Broadly speaking, in the EU this would be 10%, 20%, 30% and 50%, but would depend on the activities performed by the issuer. The term 'acting in concert' is not specifically defined but may include circumstances where bondholders agree to vote together as a block in relation to, amongst other things, strategic issues relating to the issuer (for example whether to invest in certain countries, offer certain products etc.). Proposed controllers are required to be pre-approved by the regulated issuer's regulator.

FURTHER READING

PRI RESOURCES	SUMMARY
PRI (2018). ESG Engagement for Fixed Income Investors case study series.	PRI case study series showcasing engagement practices by fixed income investors around the world.
PRI (2018). A Practical Guide for Active Ownership in Listed Equity.	A global framework for active ownership based on best practices around the world. While it focuses on practices related to listed equity holdings, insights and recommendations on policy development, execution and disclosure can be equally applied to other asset classes, including corporate fixed income.
PRI (2017). ESG, Credit Risk, and Ratings.	The first in a three-part series by the PRI on its initiative to enhance the systematic and transparent consideration of ESG issues in the assessment of the creditworthiness of borrowers in fixed income markets.
PRI (2014). Fixed Income Investor Guide.	A guide for fixed income investors on implementing the six Principles for Responsible Investment.
PRI (2013). Introductory Guide to Collaborative Engagement.	A handbook to provide a practical guide on engaging collaboratively with listed companies on ESG issues.

LEGAL RESOURCES	SUMMARY
Bratton, W. and Levitin, A. (2017). The New Bond Workouts. University of Pennsylvania Law School Institute For Law And Economics Research Paper No. 17-9.	Discussion of recent case law on bondholder workouts in the US.
Official Journal No C 101 of 27.4.2004	Guidelines on the application of Article 101(3) TFEU (formerly Article 81(3) TEC).
Stoeppelwerth, A.M. (2012). United We stand: Antitrust Aspects of Collaboration Among Corporate Bondholders. The Business Lawyer, Volume 67.	Review of some relevant US cases which consider whether coordinated action of bondholders is anticompetitive.
Bloom, M. (2015). Doing Good Well. US Federal Trade Commission.	Discussion on potential conflicts between US antitrust laws and the SEC's regulation under TIA of the issuance of corporate debt and related collaborations by bondholders.

ACADEMIC PUBLICATIONS	SUMMARY
Schwarcz, S.L., (2017). Rethinking Corporate Governance for a Bondholder Financed, Systemically Risky World. William & Mary Law Review, Vol. 58, p. 1345 (2017); Duke Law School Public Law & Legal Theory Series No. 2016-22.	Schwarcz (2017) rethinks the shareholder-primacy model of corporate governance, arguing that bondholders, who are more risk averse than shareholders, should be included in the governance of systemically important firms.
Hoepner, A. G. F. and Nilsson, M. A, (2017). Expertise among SRI fixed income funds and their management companies.	The authors find that ESG engagement activities are a significant differentiating performance factor for fixed income investments.
*Dimson, E., Karakas, O., and Li, X., (2017). Local leads, backed by global scale: the drivers of successful engagement. RI Quarterly.	A detailed study providing the first detailed, global evidence of the impact of collaborative engagements. It finds that successful engagements improve profitability at target companies, and identifies the key characteristics that lead engagements to be successful.
Çelik, S., G. Demirtaş and M. Isaksson, (2015). Corporate Bonds, Bondholders and Corporate Governance. OECD Corporate Governance Working Papers, No. 16, OECD Publishing, Paris.	The authors argue that, just as shareholders, bondholders can play an important role in corporate governance through both exit and voice. They provide a comprehensive global overview of all corporate bond issues since 2000 and experiences of governance engagement by bondholders, building on issue-level data for more than 100,000 individual bond issues in 108 jurisdictions between 2000 and 2013.
*Friede, G., Busch, T and Bassen, A. (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, 5:4, 210-233, DOI: 10.1080/20430795.2015.1118917	A study on the combined findings of about 2,200 individual studies on the relation between ESG criteria and corporate financial performance (CFP). The results show that the business case for ESG investing is empirically very well-founded. Roughly 90% of studies find a non-negative ESG-CFP relation. More importantly, the large majority of studies reports positive findings. Promising results are obtained when differentiating for portfolio and non-portfolio studies, regions, and young asset classes for ESG investing such as emerging markets, corporate bonds, and green real estate.
*Dimson, E., Karakas, O. and Li, X. (2015). Active Ownership. The Review of Financial Studies, 28(12), pp. 3225-3268.	The study found that US companies targeted in corporate governance- and climate change-related engagements by an investment manager between 1999 and 2009 showed significant financial outperformance of the market in the period following engagement. The average one-year abnormal return after initial engagement was 1.8%, growing to 4.4% for successful engagements, and no market reaction for unsuccessful ones.
Oikonomou, I., Brooks, C. and Pavelin, S. (2014). The effects of corporate social performance on the cost of corporate debt and credit ratings. The Financial Review, 49:1, 49-75.	This study investigates the differential impact that various dimensions of corporate social performance have on the pricing of corporate debt as well as the assessment of the credit quality of specific bond issues. The empirical analysis, based on an extensive longitudinal data set, suggests that overall, good performance is rewarded and corporate social transgressions are penalized through lower and higher corporate bond yield spreads, respectively. Similar conclusions can be drawn when focusing on either the bond rating assigned to a specific debt issue or the probability of it being considered to be an asset of speculative grade.

*Asterisks before citations denote a general publication on investor engagement, not specifically featuring bondholder engagement

INDUSTRY GUIDES	SUMMARY
High Meadows Institute and KKS Advisors, (2017). Incorporating ESG Considerations into Engagement Practices.	This guide examines strategies to strengthen the integration of ESG factors in the active ownership and engagement practices of mainstream investment managers.
*AIGCC, CDP, Ceres, IGCC, (2017). Investor Climate Compass: Oil and Gas. Navigating Investor Engagement.	This shows how, through persistent engagement on climate change risks, institutional investors are having a major influence on the conduct and board-level decision making of key oil and gas majors.
Sustainability Accounting Standards Board (SASB), (2016). Engagement Guide for Asset Owners and Asset Managers.	SASB provides industry-by-industry guidance on how asset owners and asset managers can use the organisation's standards to inform and enhance their engagement with companies.
*Cass Business School and Sustainalytics, (2016). Engagement: Unlocking the black box of value creation.	Cass Business School and Sustainalytics research individual dialogues about environmental and social issues between institutional investors and investee companies.
BlackRock and Ceres, (2015). 21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions.	BlackRock and Ceres lay out frameworks for engagement strategies, and present a range of case studies, including a chapter on enhancing credit analysis through engagement, and suggested questions investors should ask companies based on industry.
*The Conference Board, (2014). Guidelines for investor engagement.	The Conference Board proposes guidelines to assist companies and their investors in evaluating the costs and benefits of engaging with each other on corporate governance, sustainability, and other matters.

*Asterisks before citations denote a general publication on investor engagement, not specifically featuring bondholder engagement

NEWS ARTICLES	SUMMARY
Dropkin, M. (2018). Ahead of the curve: Why bond covenants matter. Investment & Pensions Europe (IPE) 2018 at IPE.com	Dropkin highlights the role of engagement with issuers over unfavourable bond covenants.
Mann, Fiona (2017). Topical Article: Market discipline and UK bank bondholders. Bank of England Quarterly Bulletin: 2017 Q1	Fiona Mann of the Bank of England's Prudential Policy Division builds the case for harnessing discipline from holders of bank debt in support of financial stability.
Gowland, P., (2015). Bondholder engagement is already happening. Like it or not! Sodali	Gowland explains why establishing a fluent communication with fixed income investors has been progressively important and describes the challenges of communicating with such investors.
Cusworth, E. (2015). Bondholder engagement: No pain, no gain. Investment & Pensions Europe (IPE) 2015 at IPE.com	With demand far outstripping supply despite a surge in issuance, the structures of bonds are tipping increasingly in favour of issues, offering fewer protections to bondholders. In a market that sees relatively little engagement by investors, Cusworth examines whether investors are opening themselves up to greater risk and what they can do to protect themselves better.
Gull, M., (2010). Engagement for corporate bond holders – Just saying 'corporate bond holders don't vote' is ducking the issue. Financial Times.	Gull explains the need for more active stewardship from bondholders given the growth in responsible investing and pension fund allocations to fixed income.

CREDITS

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Work stream strategy and planning for this project has been supported by members of the PRI Bondholder Engagement Working Group and the PRI Fixed Income Advisory Committee.

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