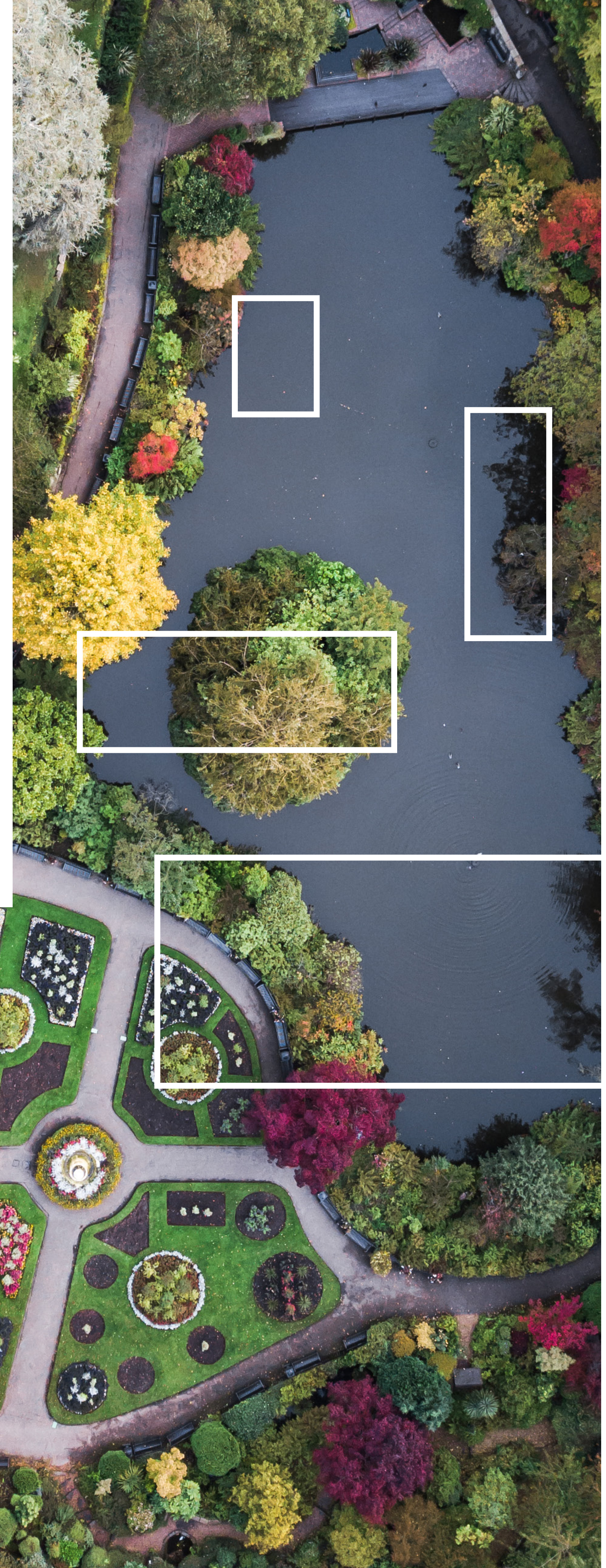
An asset owner's guide to ESG Integration for Fixed Income and Credit Portfolios

Executive summary

At Willis Towers Watson, we believe integrating environmental, social and governance (ESG) factors into the investment process will lead to better long-term outcomes, and as such, asset owners need to assess the merits of the managers they invest with. We spend a significant amount of time assessing asset managers' **integration** of ESG risks, their **engagement** with issuers and their **stewardship** capabilities; however, the ESG **integration** framework for fixed income has historically been opaque, either overly reliant on an equity model or not specific enough on what ESG metrics are relevant for bonds. This is evolving as more market participants begin to recognise the linkages between ESG and financial outcomes, as data have become more prevalent and transparency at the underlying issuer level has improved. Fixed-income asset managers have a huge role to play – whether that be accelerating the understanding and measurement of ESG risks, increasing engagement with bond issuers on stronger terms and ESG disclosures, or finding new sustainable opportunities. The diversity of the asset class – spanning corporate bonds, sovereign bonds, securitised credit and private debt – requires nuances in the approach to ESG. Here, we offer asset owners a deeper dive on ESG integration across each of these areas, best-in-class practices we have observed and a framework to begin to assess the quality of a manager's ESG integration. We have previously offered insights on fixed-income stewardship and plan to produce a follow-up piece on engagement.



Introduction: The evolution of ESG in fixed income

ESG investing gained significant momentum in 2020 as the global pandemic, shift in policy, and social unrest led to an increased focus from corporations, institutional investors and end savers. One-third of all U.S. assets under professional management now utilise sustainable investing in their strategies,[1] and the number of fixed-income ESG funds continues to rise.[2] The focus from asset owners is also on the rise, with 80% now integrating sustainability.[3] We believe the market is poised to continue its growth trajectory in 2021 as more companies and countries increase their focus on ESG.

At Willis Towers Watson, we continue to evolve our ESG framework and believe sourcing innovative sustainable strategies as well as engaging with managers on their approach will lead to better outcomes over time. Robust integration of ESG will become a defining "edge" for fixed-income managers over the coming years. However, the universe is complex, with different borrower types (corporate, country, consumer); instrument types (bonds, loans); quality (investment grade, high yield); maturity (short versus longer duration); and place in the capital structure (senior versus junior).

This complexity leads asset owners to question: What exactly is a "good" approach to sustainability within fixed income? Is it the same across all types of credit?

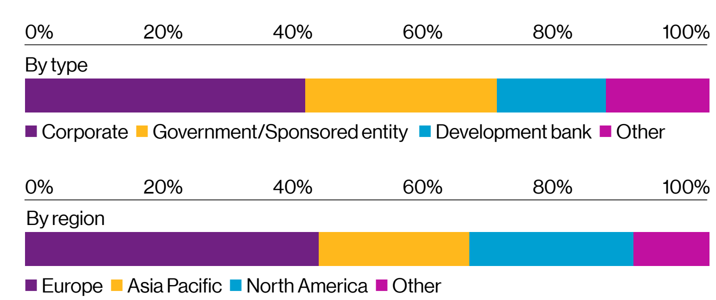
In this report, we will:

- Break down the material risks and opportunities across fixed income from an asset owner's view, focusing on the four main subsectors of fixed income: corporate, sovereign, securitised and private debt.
- Share best practices observed from asset managers and provide questions asset owners can ask of their own managers to promote further ESG integration.
- Highlight Willis Towers Watson framework of assessing the sustainability practices of managers, engagement, and sourcing.

We believe fixed-income managers can play a significant role in furthering the pace of progress by fully integrating ESG into their strategy, improving transparency, and measuring progress and outcomes to further strengthen the financial linkages between ESG and bond performance.

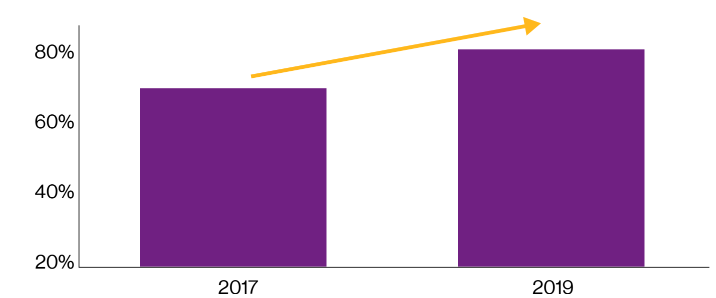
The fixed-income ESG market continues to grow globally...

$1 trillion in cumulative green bond issuance (Q1 2021)[4]



...and asset owners are increasing exposure

% asset owners integrating sustainability[5]



1. Corporate credit

Corporate credit strategies are furthest along in their integration of ESG relative to other parts of fixed income. This is driven by 1) the similarity in issuers and risk factors relative to equities, as many equity issuers also issue debt; 2) greater transparency, if debt is issued by public companies; and 3) more supporting evidence showing a positive link between ESG and corporate bond performance.[6] This became even more prevalent in Q1 2020 when, for example, energy bonds experienced negative performance due to both COVID-19 and oil price drops, but bonds from ESG leaders outperformed.[7]

Corporate credit universe: Investment-grade, sub-investment-grade (high-yield bonds and bank loans) and collateralised loan obligations (CLOs, securitisations on pools of bank loans).

ESG investment approaches: Corporate credit		
Exclusions/ Screening	**Active/ Integration**	**Impact/ Thematic**
More common in passive strategies or for clients with specific goals; however, it may lead to higher tracking error and downplay ESG risks in other sectors	Best-in-class managers integrating ESG risks into decisions	Less common in public corporate strategies given time horizon needed to invest and linkage with risk-adjusted returns

What is best-in-class? Many asset managers have adopted a security- and sector-based approach. One example is the Sustainability Accounting Standards Board (SASB) framework,[8] which has identified more than 25 sustainability-related risk factors.

Best-in-class managers have gone further to develop their own internal ESG ratings, given that gaps often exist in external ESG ratings providers. Managers should not only be able to provide financially material ESG information for each sector but also be able to identify which corporates are expected to manage these risks better on a forward-looking basis and are thus poised to outperform peers. While this is just one factor in portfolio buy/sell decisions, we believe the difference in performance between ESG leaders and laggards is slowly becoming more identifiable, and we expect best-in-class managers to weight ESG appropriately to each name to capture this return.

Corporate credit: Key ESG factors

- Energy transition risk, particularly for oil and gas issuers
- Climate risk, carbon regulation

- Worker safety
- Supply chain practices
- Social trends/consumer sentiment
- Culture/diversity/litigation

- Fraud
- Regulatory scrutiny on banks or specific industries
- Solvency management

Challenges: A significant portion of companies that issue debt are private and/or small; therefore, transparency can be limited. The complexity of corporate debt (varying by maturity, ratings/quality) has made the linkage of ESG to bond performance difficult to detach, with a lack of long-term data. For example, a bond very short-term in nature (less than one year left in maturity) may have less of a direct correlation to a company's longer-term ESG trends.

CLOs: These challenges are further exacerbated in CLOs, which are securitisations backed by pools of 100 to over 200 private bank loans. This diversity does limit the impact of any individual security; however, it does not excuse ignoring it. Issuers of CLOs should be cognizant of each issuer's ESG risks and managing these in the portfolio across time. Managers investing in CLOs (i.e., secondary managers) have tended to stay more high level, examining sector exposures and limiting exposure to riskier sectors. Best-in-class secondary managers, however, are seeking greater data transparency on underlying loans across all CLOs they invest with. We find this approach to be more effective versus relying on exclusions that may only represent a small proportion of the loan universe.

Willis Towers Watson approach: We have created our own materiality map for U.S. high yield (with applicability across other corporate segments), identifying the factors that are more relevant. We now use this as a guide to engage with managers to understand their approach to managing these risks. We seek to understand not only the manager's framework to integrating ESG but also how the manager measures and tracks outcomes.

The following table offers questions that may be helpful for asset owners to pose to corporate managers, in addition to examining their approach to managing risk across sectors with higher materiality.[9, 10]

Materiality of SASB risk factors to corporate sectors

Dimension	SASB general issue category	WTW view on materiality to U.S. high yield
Environment	GHG Emissions	High
	Air Quality	Medium
	Energy Management	High
	Water & Wastewater Management	High
	Waste & Hazardous Materials Management	Medium
	Ecological Impacts	Medium
Social capital	Human Rights & Community Relations	Medium
	Customer Privacy	Medium
	Data Security	High
	Access & Affordability	Medium
	Product Quality & Safety	Medium
	Customer Welfare	Low
	Selling Practices & Product Labelling	Medium
Human capital	Labor Practices	Medium
	Employee Health & Safety	High
	Employee Engagement, Diversity & Inclusion	Medium
Business model and innovation	Product Design & Lifecycle Management	High
	Business Model Resilience	Low
	Supply Chain Management	Medium
	Materials Sourcing & Efficiency	Medium
	Physical Impacts of Climate Change	Low
Leadership and governance	Business Ethics	High
	Competitive Behavior	Medium
	Management of Legal & Regulatory Environment	Low
	Critical Incident Risk Management	Medium
	Systemic Risk Management	Medium

Asset owner guide: Assessing ESG integration of corporate bonds managers

- ☑ Does the manager have a framework to assess ESG risks? (SASB framework is a sensible starting point)?
- ☑ How does the manager integrate ESG to add alpha (as exclusionary approaches could be limiting)?
- ☑ Similarly, does the manager create its own ESG ratings, or utilise an external provider (which may be less robust)?
- ☑ Does the manager seek to benefit from lack of detailed ESG coverage on specific issues/issuers (acknowledging this may be short-lived as more managers expand capabilities)? Has this "ESG alpha" been isolated and are there any examples to support this?
- ☑ Are there dedicated fixed-income corporate ESG resources? If not, what overlap exists with equity ESG analysts and how are the gaps filled?
- ☑ Has sufficient training on ESG occurred for all relevant fixed-income analysts and portfolio managers?

Green bonds: Driving change or a risky path?

Companies (or countries) can issue green bonds, which are securities where proceeds raised are directed toward sustainable purposes. The market has grown significantly, with a 60% average annual growth in issuance from 2015 to 2020.[7] This growth is driven by new, sustainable issuers entering the market (e.g., Tesla) and existing issuers targeting renewable initiatives (e.g., Fannie Mae, the largest green bond issuer, which used proceeds to finance mortgages backed by multifamily properties awarded green certifications). Social bond issuance also saw a rise in 2020 as issuers looked to support employees or health care systems amid the global pandemic.[6] While the framework and transparency around green bonds continues to strengthen, we would note a few key risks:

- Currently, green bond labels are non-binding from a legal and regulatory perspective. In a worst-case scenario, this could result in misallocation of funds if not properly monitored. Positively, independent industry bodies are now producing standards for issuers and investors.
- Green bonds have been offering less compensation than their non-green counterparts, demonstrating that the risk reduction from sustainability initiatives may be priced in already, or that the overwhelming demand for green bonds has made the pricing too expensive.
- There is high sector concentration in green bond issuers in government/related, financials, utilities and transport firms, which could increase volatility in asset owner portfolios.

As such, while we believe the issuance of these bonds is a step in the right direction, we continue to prefer a broader mandate assessing all bonds, both green and non-green, thereby allowing managers to select the best bonds for client portfolios.

2. Sovereign debt

Historically, financially material ESG data on sovereign debt was typically related to governance. The World Bank's World Governance Indicators provide a helpful starting point to identify some of these risks; however, there is a growing body of evidence on environmental and social impacts on sovereign growth potential and debt sustainability.

Sovereign debt: Bonds issued by emerging or developed countries, either in their own (local) currency or major currencies (e.g., USD, EUR).

ESG investment approaches: Sovereign debt

Exclusions/ Screening	Active/ Integration	Impact/ Thematic
Less common given concentration of the universe, which can increase tracking error and limit opportunity set/ alpha	Best-in-class managers integrating ESG risks into decisions	Less common in public sovereign/ EMD strategies given time horizon needed to invest and linkage to risk-adjusted returns

Best-in-class practices – the low carbon transition: A key opportunity for best-in-class sovereign managers will be understanding the implications of the low-carbon transition on countries that depend on coal and other commodities for a large part of export revenue. Policies around the world are reducing demand for carbon-heavy natural resources. For example, the U.S. is targeting net zero by 2050, while China is targeting net zero by 2060 and is aiming to reach peak emissions by 2030. Countries that are unable to adapt to these global structural shifts will face significant debt sustainability challenges, increasing volatility in the balance of payments, potentially leading to sovereign credit downgrades. We would expect best-in-class managers to have a thoughtful framework assessing the risks across the various sovereigns and applying a forward projection. Further, as renewable energy becomes cheaper and more prevalent, many sovereigns will be decreasing their reliance on fossil fuels, thereby reducing debt servicing costs. This naturally creates an opportunity for best-in-class managers to pick the winners and losers in this low-carbon transition.

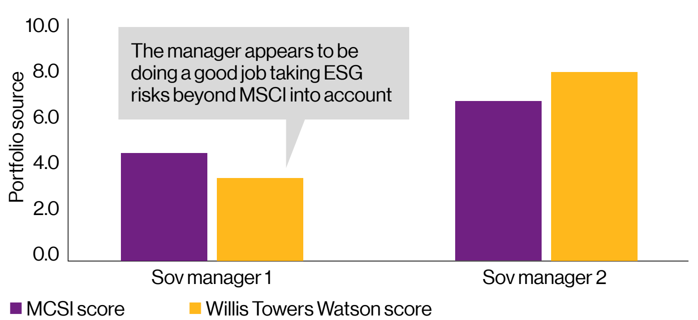
EM sovereign debt: Key ESG Risks

- Transition risk
- Physical risk
- Resource depletion

- Inequality
- Unemployment
- Demographics
- Infrastructure
- Healthcare

- Corruption
- Business climate
- Institutional strength and policy

Willis Towers Watson approach: We calculate a weighted-average-adjusted ESG score for sovereign manager portfolios, where sovereigns with higher ESG risks receive higher scores. When compared with MSCI's assessment of E, S and G risk, there are some nuances in Willis Towers Watson's approach. For example, we believe that E and S risks are underappreciated by the market given our assessment of structural emerging trends; therefore, we add greater emphasis to these factors. Conversations with managers then focus on these nuances and the management of those risks less commonly considered in traditional ratings.



We note a few questions below that may be helpful for asset owners to pose to sovereign debt managers.

Asset owner guide: Assessing the ESG approach of sovereign debt managers

- Does the manager have its own internal sovereign ratings (or provide a thoughtful overlay to existing data provider scores)?
- Does the manager's focus on factors beyond governance, integrating environmental and social risk, help enable greater "ESG alpha"?
- What is the manager's view on economies' low-carbon transition, which could prove a significant opportunity for sovereign managers?
- If exclusions are part of the approach, how punitive are these (as exclusions can increase tracking error and potentially inhibit performance)?
- Has there been any attempt and examples on sovereign engagement?

3. Asset-backed/Securitised credit

Securitised credit is a diverse and complex market, with less liquidity and transparency versus corporate bonds given that the underlying loans are not publicly traded. Because of this information asymmetry, ESG coverage of securitisations by ratings agencies is sparser than corporate bonds, creating both opportunities and risks.

Securitised credit: Securities backed by pools of loans. Main subsectors include residential mortgage-backed securities (RMBS); commercial mortgage-backed securities (CMBS); and asset-backed securities (ABS) backed by a variety of loans, including credit card receivables, student loans and auto loans.

ESG investment approaches: Securitised credit

Exclusions/ Screening	Active/ Integration	Impact/ Thematic
Less common given secondary managers are investing in pools of loans	Best-in-class managers integrating ESG risks into decisions	Less common but growing in newer areas of the market (i.e., ABS backed by renewables)

Protecting the consumer: The 2008 global financial crisis highlighted the importance of incorporating social and governance risks into the assessment of securitised credit. Loose underwriting standards and poor governance at originators led to a proliferation in sub-prime mortgages, without regard for affordability. As these mortgages defaulted, the social impact was severe, with a record number of foreclosures that required government intervention to protect the welfare of homeowners. Since then, the mortgage market has undergone a regulatory overhaul designed to provide greater protection to both borrowers and lenders, with tighter lending standards and greater scrutiny on origination and servicing practices.

While the mortgage market has improved, we note the volume of non-mortgage consumer credit has increased, with greater variability in underwriting standards as a result. Without proper oversight, this does increase risks that similar predatory practices could re-emerge. For example, Wonga is one notable U.K. payday lender that went out of business in 2014 after the Financial Conduct Authority found it was targeting borrowers that were unlikely to repay their loans and charging high rates, which self-perpetuated their debt problem.

Key ESG risks in securitised credit

- Physical risk e.g., floods, storms
- Pollution

- Origination practices conflict with the local regulatory framework
- Weak loan servicing model
- Selling practices

- Lending practices that prey on vulnerable borrowers
- Leakage of personal data

Best-in-class practices: Best-in-class managers examine these risks carefully, choosing not to invest in deals issued by lenders with weak underwriting standards that do not focus on loan affordability. By integrating ESG into their investment process, managers can better protect the economic and reputational interests of investors. This starts with due diligence of the lender's origination platform, including the governance framework that dictates how and when it extends a loan to a consumer, which should include:

- *Fair and transparent lending practices:* Avoids discriminating against borrowers based on non-economic factors; ensures clear and appropriate financial disclosures are provided to prospective borrowers.
- *Conservative loan underwriting:* Fully considers the financial circumstances of each borrower to assess affordability, maintaining tight control over credit approval to ensure high standards are applied uniformly and in line with local regulations.
- *Strong servicing:* Delinquent or defaulted loans are managed fairly, ethically and efficiently. This includes ensuring the servicer has the resource and willingness to help delinquent borrowers find a sensible path back to resuming payments.
- *Alignment of interest:* Ensures originators, underwriters, servicers and asset managers are each incentivised to ensure the well-being of borrowers while achieving good economic outcomes for investors.

Willis Towers Watson approach: Using the SASB framework, we highlight some of the key social risks to securitised credit, which are assessed with each manager accordingly. Given the tightening in mortgage lending standards after the global financial crisis, we believe that social risks are lower here versus ABS (where climate risk may be more relevant for RMBS and CMBS to assess the property location data). The plethora of consumer lending products, online platforms and more require nuanced attention to ensure managers are only partnering with originators that are thoughtful about these risks. While engagement is not a focus of our piece today, securitised credit managers have a strong ability to engage with originators and servicers to help them improve practices, and this is something we seek in managers.

ESG materiality heat map - SASB framework

	RMBS	CMBS	ABS
Access & affordability	Medium	Low	High
Data privacy/security	Medium	Low	Medium
Product quality & safety	Low	Medium	Medium
Selling practices & product labelling	Medium	Low	High

Asset owner guide: Assessing the ESG approach of securitised managers

☑ If the manager has consumer exposure, what social and governance risks is it monitoring?

☑ Can the manager quantify how ESG risks could disrupt cash flows and portfolio returns?

☑ Is the manager capturing or attempting to capture data given the lack of standardised ESG data?

☑ Is the manager looking ahead to thematic opportunities (for example, green financing securitisations, where we believe issuance is poised to grow)?

4. Private debt

The wide range of collateral types within private debt requires a tailored ESG framework. With private debt fund lives averaging five to seven years, it is critical to consider thematic, longer-term market trends. Impact investing, or investing with an intention to generate social and environment benefits alongside a financial return, is also more common in private debt as a result.

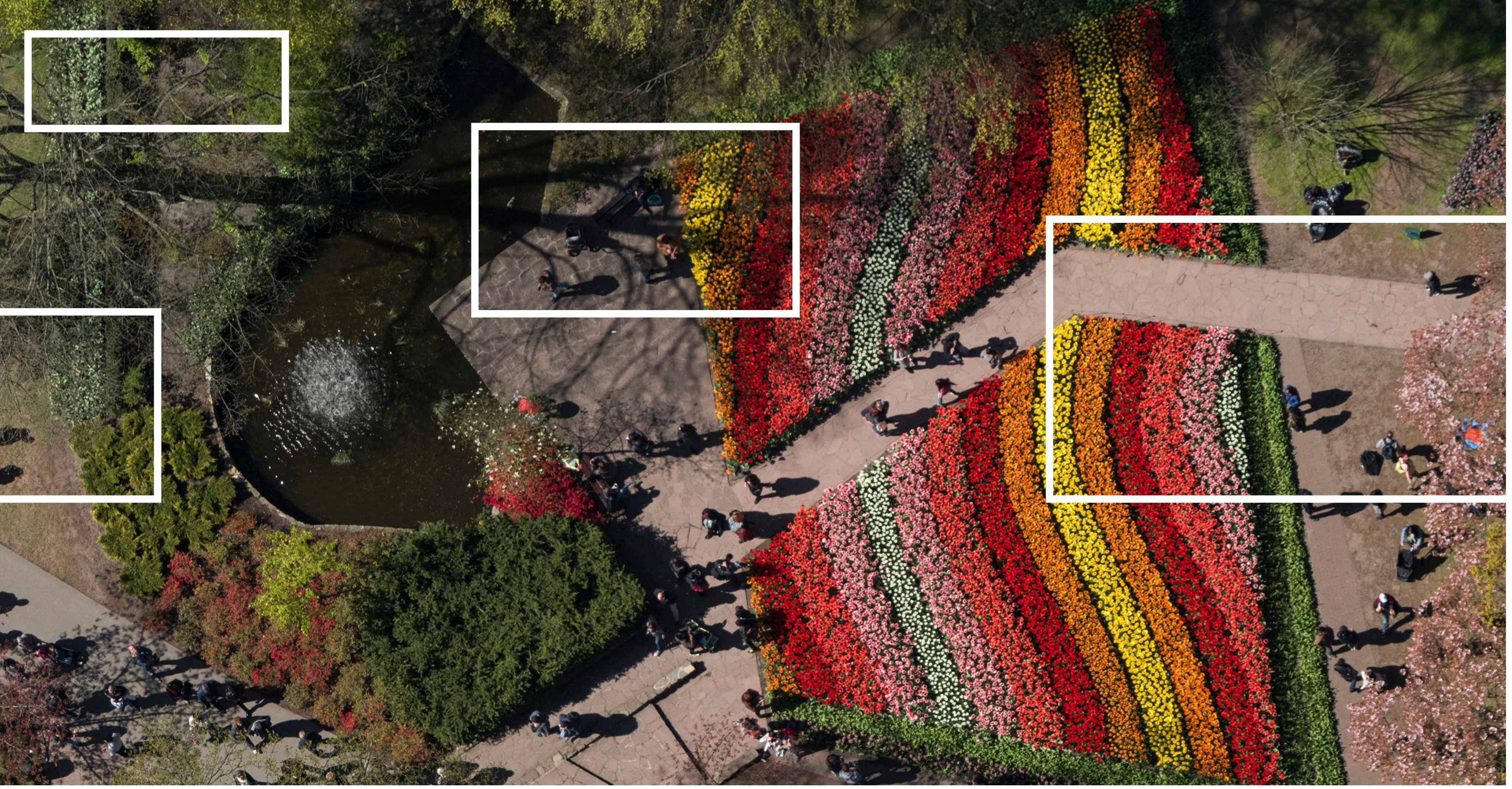
Private debt: Loans not publicly traded and typically made from a single lender to a borrower. Collateral types include corporates (e.g., direct lending), real assets (e.g., commercial real estate, infrastructure) and consumer (e.g., private loans to originators).

ESG investment approaches: Private debt

Exclusions/ Screening	Active/ Integration	Impact/ Thematic
More common given aversion to being locked-in to higher risk sectors	Best-in-class managers integrating ESG risks into decisions	More common given long-term horizon and strong economic case

What is best-in-class in private debt? We would expect a deeper understanding of material ESG issues versus public debt managers, given the bilateral nature of loans (negotiated directly between the manager and the borrower). It is unlikely that third-party research will exist on an issuer or asset. Positively, best-in-class managers have generally embraced this and consider ESG as a core part of their investment process. For direct lending managers that may be providing loans to companies owned by private equity sponsors, it is important there is awareness of the what the private equity firm is doing to further the understanding of ESG risks to that company. In doing so, this should help foster a culture across closed-end markets that see ESG as a necessary part of analysis and monitoring and an area where it is important to engage.

A newer development in private debt is recognising the financial benefits of a firm improving its approach to ESG, thereby incentivising borrowers to decrease borrowing costs on demonstrable ESG progress. We are now seeing funds raised with the sole purpose of making loans that incentivise borrowers to improve on ESG-related practices through such measures as a borrowing cost reduction upon meeting specific ESG metrics/key performance indicators (KPIs) or, conversely, seeing borrowing costs rise if these goals are not met. Examples may include percentage of inputs into the business from recycled materials, achieving a meaningful reduction in emissions or achieving a higher level of female representation in company management. Once established, these KPIs can begin to be reported and assessed by an external third party.



Willis Towers Watson approach: We have focused efforts on assessing the integration and longer-term risks that managers assess in their strategies; however, private debt is also an area where Willis Towers Watson has sourced new, innovative sustainable solutions. One such example of this is noted in our case study below. Given the underlying collateral type, questions from corporate, sovereign or securitised strategies may be relevant to consider, but a starting point for asset owners is listed below:

Asset owner guide: Assessing the ESG approach of private debt managers

☑ Does the manager have a sustainable investment policy and is it robust?

☑ How is the manager's approach different from that of related, but more liquid, strategies?

☑ What ESG metrics are tracked on each loan?

☑ Has the manager attempted to improve transparency from the borrower on ESG-related issues?

☑ What is the manager's exclusions policy?

☑ Does the manager utilise ESG covenants?

☑ If the manager focuses on distressed debt and takes control/plays a role in restructurings, what steps are taken to ensure all stakeholders are being treated fairly?

Impact case study: Sourcing sustainable strategies in private credit

Willis Towers Watson recently invested in manager lending to renewable energy and sustainable infrastructure. Renewable infrastructure is a significant part of the infrastructure market, yet the number of lenders is more limited, creating an opportunity to capture a premium by experience lenders. The manager has significant expertise, providing flexible capital to projects across wind, solar, storage and more, generating strong risk-adjusted returns while providing positive externalities to the environment and society, expecting to avoid over 600,000 tons of carbon dioxide emissions.

This is a sample representation of our work with an investment manager. Outcomes will vary and there is no guarantee that we can achieve similar results with any particular manager in any particular asset class.

Willis Towers Watson's approach

We believe integrating ESG will lead to better financial outcomes. Managers can improve outcomes and propel the industry forward by:

1. **Fully integrating ESG.** There is a significant long-term alpha potential for managers that can capitalise on ESG information asymmetry to generate alpha. Examples include:
   a. A sovereign nation with strong fiscal policy reform but a poor natural resource management record that is not currently penalised, even though the risk of drought, food shortages or social unrest has increased.
   b. Certain mortgages will be affected by a shifting climate, however the RMBS industry doesn't yet account for these risks in their models. Not anticipating negative climate risks could lead to credit losses, particularly in the lower part of the capital structure.

Minimum standards for fixed-income managers

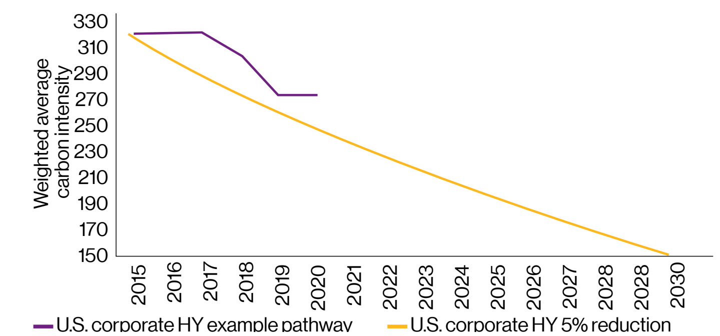
- Sustainable investment policies are in place with sufficient training
- ESG risks are formally considered within portfolio construction
- The strategy avoids issuers with significant unrewarded ESG risks
- Proprietary ESG scoring system is built on third-party data inputs
- Strategy is positioned to benefit from material sustainability trends
- Qualitative analysis is performed of climate risk in the portfolio
- The level of exposure to climate-related risks is understood
- Transition risks of companies and countries are considered as the world looks to move to a low-carbon economy

Stretch targets

- Consistently recognising, assessing and communicating potentially financially material ESG risks or opportunities (ESG "watch lists")
- Reporting ESG success as part of investment success with metrics, for example, percentage carbon dioxide emissions reduction, gallons of water saved

2. **Increasing transparency, and measuring performance and outcomes.** Managers will need to start measuring and reporting the results of their ESG decisions as part of their investment decisions. Examples of outcome metrics could include carbon emissions (for climate change mitigation), customer accounts hacked (for data privacy) and liters of water consumed per product created (for water management). Demonstrating ESG performance is the next evolution that asset owners are looking for, requiring managers to identify material ESG risks central to their strategy. Below is an example of a carbon reduction strategy, where the asset manager is reducing the WACI of the portfolio as part of its investment strategy.

US HY carbon reduction strategy



For illustrative purposes only

3. **Innovating into new areas of sustainable investing.** There are significant opportunities for managers to pave the way in new areas of sustainable investing within fixed income. One example of this is in the securitised market, where we believe green issuance is poised to grow as consumers become more focused on the climate, with renewable home improvements, solar car purchases and the like all becoming more prevalent. A recent Willis Towers Watson investment is highlighted below:

Solar ABS (securitised credit): We recently engaged with an existing manager to carve out a strategy focusing on the growing U.S. residential solar power market. The manager is identified as a leading player in the space and is targeting attractive risk-adjusted returns while also reducing carbon emissions in the markets it serves. Companies with underlying assets that lend themselves to securitisation, such as solar panels, can expand their operations and drive down the cost of capital by raising larger sums than they would otherwise be able to. This further decreases the cost of renewable energy for future generations.

Conclusion

ESG investing in fixed income is growing exponentially, requiring a closer assessment of the approach managers are taking. Simply applying an equity framework will not work given the diversity of the asset class, and as such, understanding the nuances across various borrower and security types is key. We hope this guide offers a few insights into how asset owners can probe managers about their approach to ESG, how Willis Towers Watson approaches each sector and what best-in-class practices we have observed. Asset managers have a role to play in ensuring ESG is integrated appropriately into strategies; efforts are taken to better collect, analyse and measure data; and that outcomes are tracked and shared. As more asset owners and managers focus on improving the integration of sustainability into fixed-income portfolios, we believe the industry will continue to make strides in identifying the financial linkage between ESG and bond performance. We believe differentiation among managers' approaches to sustainability will grow, and managers that don't evolve will be left behind.

Stocks vs. bonds: Why ESG approaches need to be different

	Equities (stocks)	Fixed income (bonds)
Investment	Simple: One stock (no maturity)	Complex: Multiple bond issues (with different maturities) requiring a return to the capital markets to refinance. Several debt types (loans vs. bonds, senior debt vs. junior debt, secured debt vs. unsecured debt). Differing underlying (varying subsidiaries of a parent company can each have different bonds, spanning different regional jurisdictions and so on).
Goal	Stock price appreciation	Bond coupon repayment + bond price appreciation for investors.
Environmental and social	Similar factors can affect both stock and bond prices, though nuances exist across types of debt. For example, social factors for corporate debt may be similar to equities (consumer rights, supply chain, health and safety, human rights) but different for securitised credit (product suitability and fair lending practices are key for mortgage-backed securities), or emerging markets sovereign debt (demographics, unemployment/income inequality, human rights are more relevant).	
	E and S initiatives captured in overall company view	Growth in social and green bond issuance allows companies to carve out investment options specifically tackling these issues.
Governance	Voting rights (proxy/stewardship)	No proxy voting equivalent; disclosure on ESG is more limited vs. public equities, though improving. Governance includes assessing the terms of each bond (strong contractual agreements/covenants), ensuring rights of one debt holder (e.g., senior debt) does not disadvantage another (e.g., senior junior debt) and that the firm is not favoring equity holders over debt holders. For high yield, strong governance and covenants are critical in the event of default, transfer of assets, mergers and the like.
Engagement	Active engagement with company/CEO	Interactions are usually biased toward CFO/treasurer, though this is evolving. Joint engagement across equity and fixed income is possible if firms have investments across both; however, there are legal limitations to how much lenders can engage. Lenders can exert influence in the credit approval process (and push for stronger covenants and the like); however, issues can be announced in hours, limiting engagement, thereby requiring pre-issuance influence. More engagement is possible in private debt.

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Note: This is a sample representation of our work with an investment manager. Outcomes will vary and there is no guarantee that we can achieve similar results with any particular manager in any particular asset class.

For more information, please contact your Willis Towers Watson consultant or:

Simon James, CFA
Head of Australian Credit
simon.james@willistowerswatson.com

Andrew Zurawski
Associate Director, Investments
andrew.zurawski@willistowerswatson.com

About Willis Towers Watson

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