



# PRI AUSTRALIA NETWORK: ESG AND FIXED INCOME BRIEFING

ACGA 16<sup>th</sup> Annual Conference, Tokyo, November 15, 2016

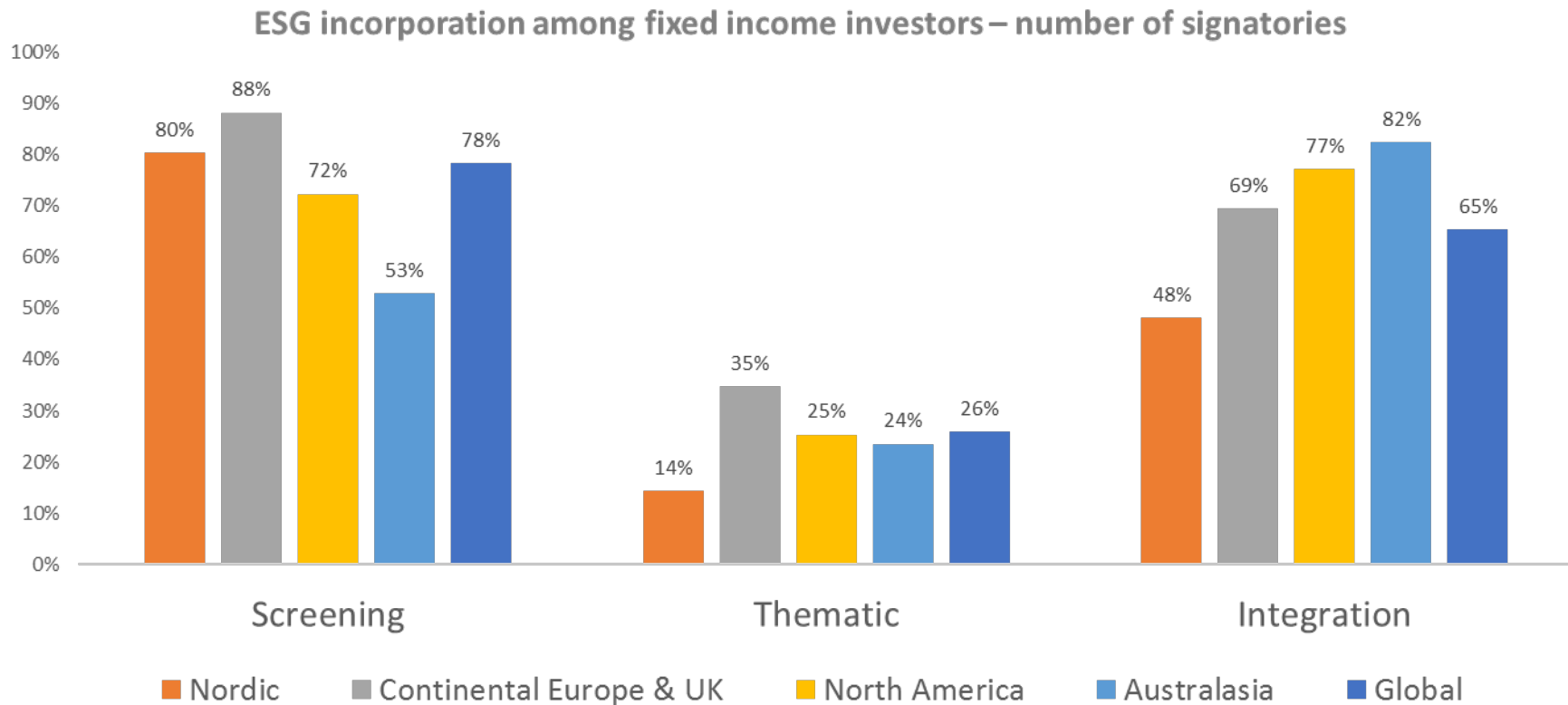


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# ESG strategies in fixed income

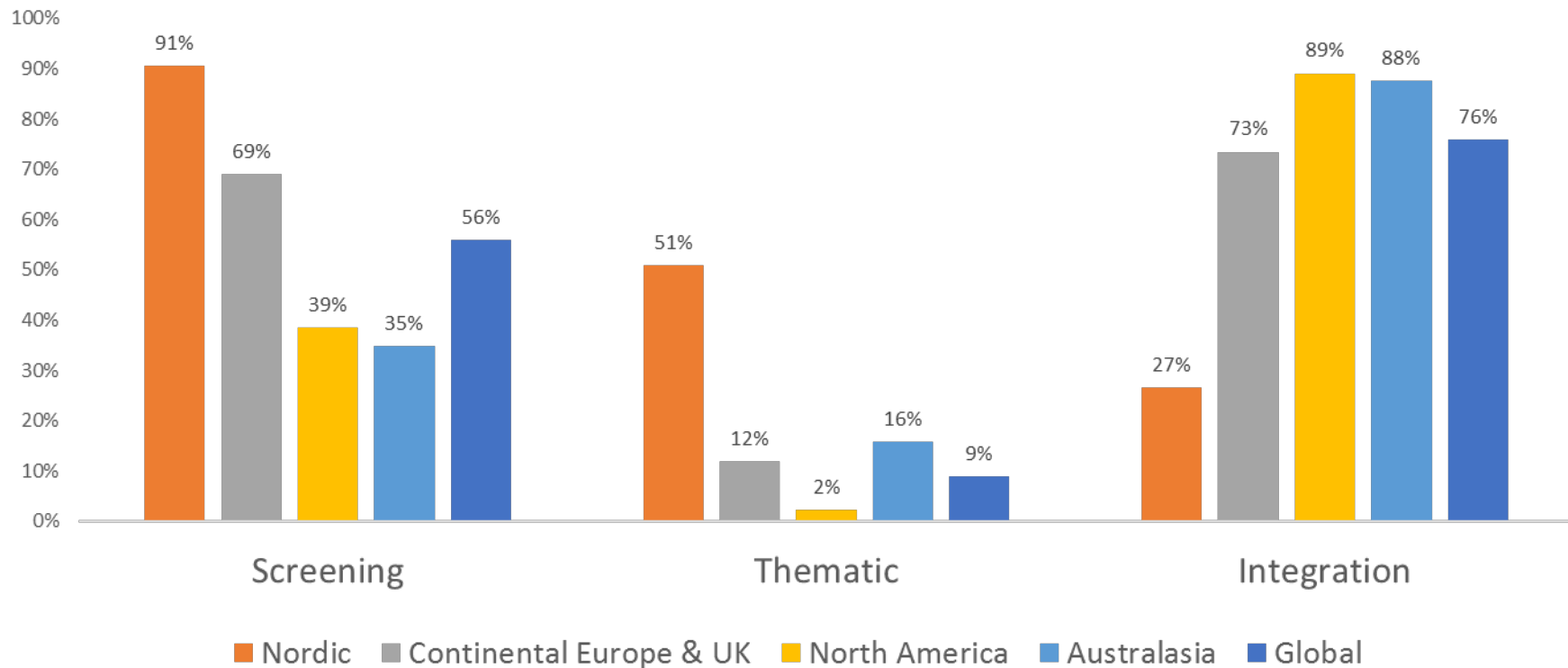
Both globally and in the Nordics, screening is the most popular ESG strategy for PRI signatories



# ESG strategies in fixed income

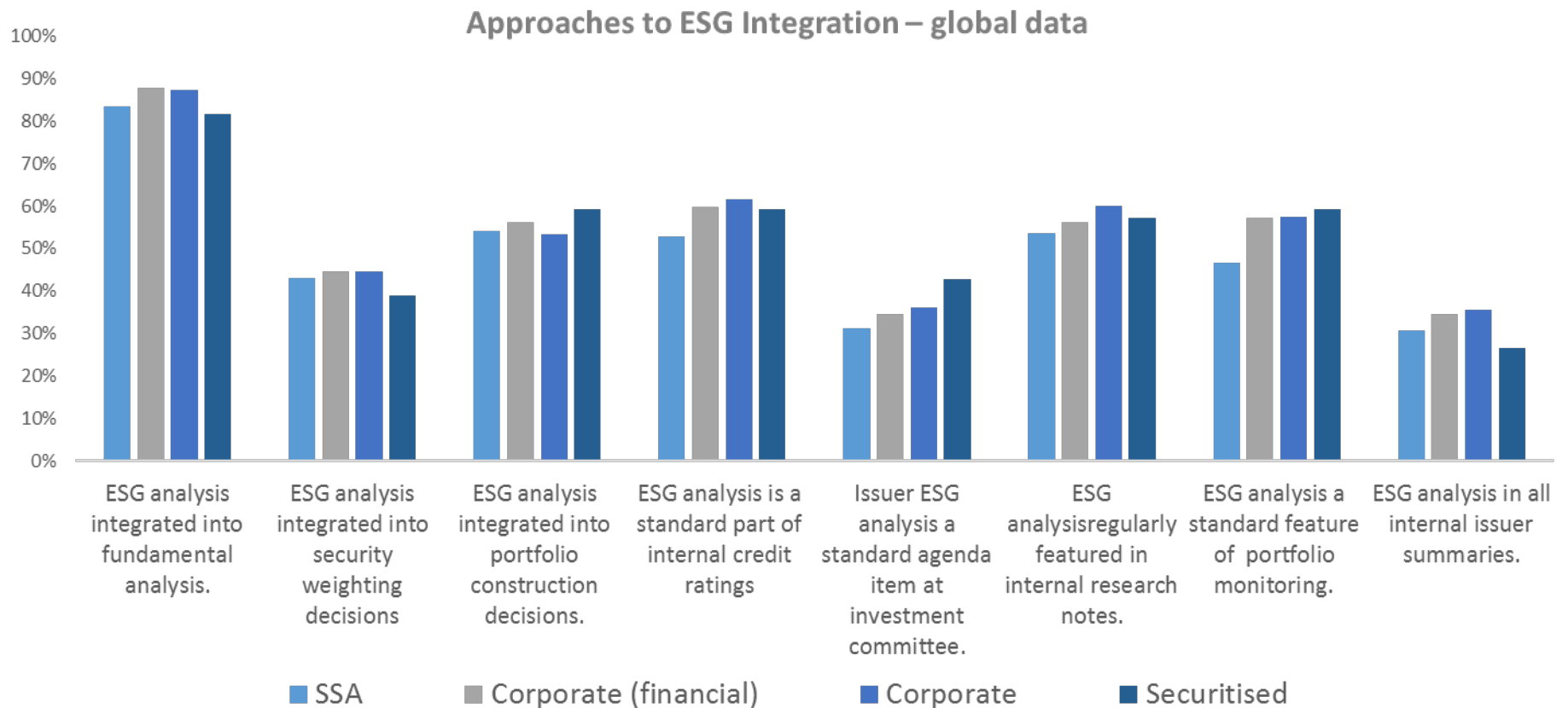
However, globally, ESG integration covers the largest share of signatory FI assets

ESG incorporation among fixed income investors - % of actively managed assets



# ESG Integration approaches in FI

ESG integrated in fundamental analysis, internal credit ratings or research



# Fixed income at the PRI

## PRI resources

- Fixed Income investor guide
- Spotlight on ESG in corporate bonds
- Spotlight on ESG in sovereign bonds



## On-going projects

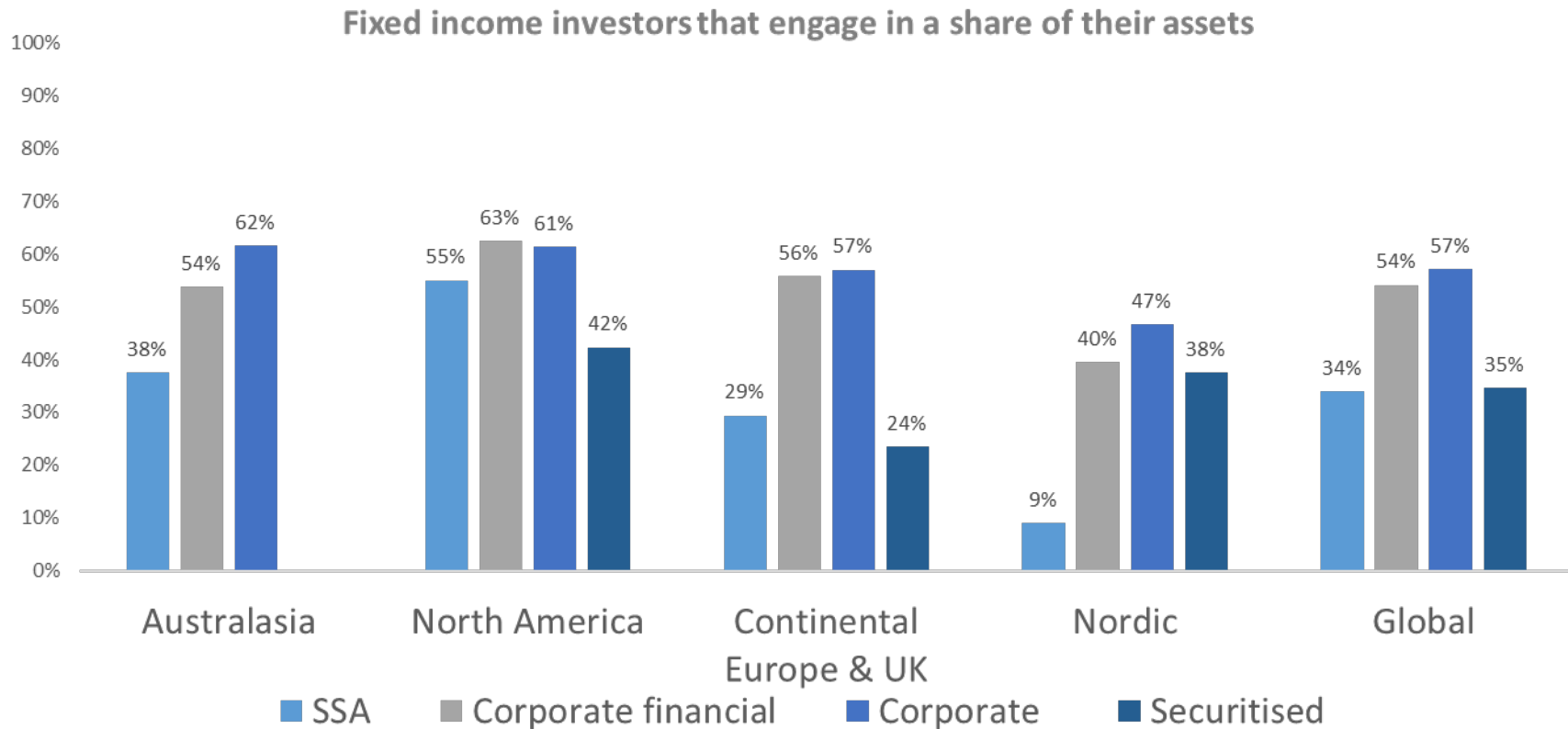
- Bondholder Engagement
- ESG in Credit Ratings

## How can you get involved?

- Provide case studies
- Speak in or attend webinars and events
- Project Working Groups & PRI Advisory Committees
- Sign Statement on ESG in Credit Ratings and engage ratings agencies

# Bondholder engagement

Emerging practice? PRI signatories report engagement either as bondholders or jointly as a bondholder and shareholder



# ESG in credit ratings

## Increasing credit rating agency focus on environmental issues

- Many credit ratings methodologies incorporate certain ESG factors, but may not be a predominant factor in the rating outcome

### Moody's

- Cross-sector heat map considers **sector exposure to environmental risks**
- 86 sectors assessed - 11 sectors with elevated credit exposure – all carbon related
- Carbon regulations and air pollution** are the most frequently identified environmental risks

MOODY'S

### S&P Global

- Research: how **environmental and climate risk is already affecting corporate ratings**
- 60 ratings actions over 2 years directly correlated with E&C risk
- Low number but increasing

S&P Global

# Statement on ESG in Credit Ratings

PRI is working with credit rating agencies and investors to encourage more systematic and transparent consideration of ESG in issuer creditworthiness

Broad involvement of CRAs and investors:

- **6 credit ratings agencies** – S&P, Moody’s, Dagong, RAM, Scope, Liberum
- **111 fixed income investors** – US\$17.5 trillion AuM

Two-year PRI project:

- **Develop understanding** of links between ESG issues and issuer creditworthiness
- **Relation between ratings horizons and ESG materiality**
- **Improve transparency** on ESG related risks

**STATEMENT ON ESG IN CREDIT RATINGS**

We, the undersigned, recognise that environmental, social and governance (ESG) factors can affect borrowers' cash flows and the likelihood that they will default on their debt obligations. ESG factors are therefore important elements in assessing the creditworthiness of borrowers. For corporates, concerns such as stranded assets linked to climate change, labour relations challenges or lack of transparency around accounting practices can cause unexpected losses, expenditure, inefficiencies, litigation, regulatory pressure and reputational impacts.

At a sovereign level, risks related to, inter alia, natural resource management, public health standards and corruption can all affect tax revenues, trade balance and foreign investment. The same is true for local governments and special purpose vehicles issuing project bonds. Such events can result in bond price volatility, and increase the risk of defaults.

In order to more fully address major market and idiosyncratic risk in debt capital markets, underwriters, credit rating agencies and investors should consider the potential financial materiality of ESG factors in a strategic and systematic way. Transparency on which ESG factors are considered, how these are integrated, and the extent to which they are deemed material in credit assessments will enable better alignment of key stakeholders.

In doing this the stakeholders should recognise that credit ratings reflect exclusively an assessment of an issuer's creditworthiness. Credit rating agencies must be allowed to maintain full independence in determining which criteria may be material to their ratings. While issuer ESG analysis may be considered an important part of a credit rating, the two assessments should not be confused or seen as interchangeable.

With this in mind, we share a common vision to enhance systematic and transparent consideration of ESG factors in the assessment of creditworthiness. The credit rating agencies listed below affirm their commitment to:

**HOW CREDIT RATING AGENCIES SUPPORT THIS VISION**

The credit rating agencies listed below recognise the needs of investors for greater clarity on how ESG factors are considered in credit analysis. In order to achieve the shared goal to enhance systematic and transparent consideration of ESG factors in the assessment of creditworthiness, the credit rating agencies listed below affirm their commitment to:

- evaluate the extent to which ESG factors are credit-relevant for different issuers;
- publish their views transparently on the ways in which ESG factors are considered in credit ratings;
- review the ways ESG factors are integrated into credit analysis as our understanding of these factors evolves;
- maintain organisational governance and resourcing to deliver quality ratings, including ESG analysis where relevant;
- participate in industry-wide efforts to develop consistent public disclosure by issuers on ESG factors that could impact their creditworthiness;
- participate in dialogue with investors to identify and understand ESG risks to creditworthiness.

**CREDIT RATING AGENCY SIGNATORIES**

Dagong Global Credit Ratings Group  
Liberum Ratings  
Moody's Corporation

RAM Ratings  
Scope Ratings  
S&P Global Ratings

**HOW INVESTORS SUPPORT THIS VISION**

The investors listed overleaf are all signatories to the six UN-supported Principles for Responsible Investment. In signing the Principles, the investors listed below affirm their commitment to:

- incorporate ESG factors into investment analysis and decision-making processes;
- seek appropriate disclosure on ESG issues by investee entities;
- report on activities and progress towards implementing responsible investment.

Specifically, as fixed income investors, and as the primary users of credit ratings, the signatories of this statement will support formal integration of ESG factors into ratings. This helps ensure ESG risks are appropriately addressed in investment decision making, which will increase investor confidence in the quality and utility of those ratings. To support these efforts, these investors seek to participate in dialogue and engage in collaborative initiatives with other investors and credit rating agencies to further efforts to integrate ESG.