STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

Practical Implementation of Responsible Investment in Credit Strategies

SBai Toolbox

1. Introduction

Credit is a broad asset class and there are many instruments used within credit strategies. Issuers may be corporate, private, or sovereign; and debt may be publicly traded, accessed directly, or accessed via syndicated or structured products. As with all alternative investment strategies, each instrument has a unique set of characteristics that influences whether there is available Responsible Investment (RI) data, and how straightforward it is to integrate RI related risks or to run dedicated RI products.

Discussion on RI within alternative investment strategies has historically been centred on traditional long only equity portfolios. However, with RI rising in both importance and prominence across all asset classes and strategies, credit portfolios are now also in focus. RI in this space has many nuances in terms of the instruments traded, the individual jurisdictions issuing the instruments, and access to underlying data. These nuances may be encountered either when determining "good" or "bad" RI investments or when using engagement to try to drive RI related change.

As discussed in our Toolbox Memo on a Responsible Investment Policy Framework (SBAI Policy Framework) we have defined the spectrum of approaches to RI as follows[1]:

- **Responsible Integration:** Including financially material RI related risks in the investment process but not pre-defining an investment universe using RI criteria.
- **Responsible Asset Selection:** Dedicated RI approaches including exclusions, inclusions, and impact strategies.
- **Responsible Asset Ownership:** Voting, engagement, and activism.
- **Responsible Corporate and Market Citizenship:** Organisational initiatives, market behaviour, and carbon offsetting. These practices are strategy agnostic and therefore not covered within this memo[2].

This memo will assess each of these approaches as they apply to credit strategies and the instruments traded.

> This memo forms part of a series of SBAI Toolbox memos helping institutional investors and asset managers increase their understanding of how RI can be applied to different alternative investment strategies, including equity long/short, macro, credit, systematic, and insurance linked strategies.
>
> The memos are designed to be used in conjunction with the SBAI Policy Framework.
>
> Please see our SBAI Responsible Investment Toolbox for further information.

[1] Fuller explanations of these categories can be found in Appendix A

[2] See the SBAI Toolbox Memo on an RI Policy Framework within the SBAI Responsible Investment Toolbox for further information.

2. Executive Summary - Responsible Investment in Credit Strategies

Assets traded within credit strategies are varied including not only liquid and illiquid assets, but also syndicated and structured credit assets. Each of these have different features and therefore different considerations when approaching RI. The broad asset classes and themes that are discussed in this memo are shown in the summary table below:

Investment Grade Bonds and Listed Credit	**Data:** Vendor data is typically available but linked to the availability of corporate disclosures in different jurisdictions. **RI:** Integration and exclusions/inclusions are practical given data availability. Engagement may be more meaningful only with large holdings of debt.
High Yield Bonds	**Data:** Some ratings available but data is typically limited and internal research is likely to be required. **RI:** Data availability may present some challenges to integration and exclusions/inclusions. Smaller issuers means engagement can be effective.
Distressed Credit	**Data:** Theoretically high levels of interaction with the issuer present more opportunities to collect data; however, depending on the reason for distress there may be other priorities. **RI:** RI integration and dedicated approaches are practical with these assets. There are also scenarios, such as consensual restructuring, where engagement will be effective.
Private Credit	**Data:** Vendor data is more limited (although a growing area) but data can be requested directly from the issuer. **RI:** RI integration and dedicated approaches can be effective here. Engagement can also be meaningful here with direct engagement and the ability to embed RI related covenants or restrictions
Structured Credit	**Data:** Currently there is limited data available and low confidence in the data that is available. Look-throughs are possible but resource intensive. **RI:** RI approaches are more practical where the asset manager is the originator and become more challenging in the secondary market. Engagement may not be an effective strategy with this asset class.
Syndicated Loans	**Data:** Banks do not generally capture this data and therefore significant resources are required to collect this internally. **RI:** Potential is limited by collation of data but integration and exclusions/inclusions would be practical once this is sourced. Engagement can also be effective.

Strategy Considerations

In all alternative investment products, there may be additional complexities to implementing RI depending on the characteristics of the strategy. Asset managers running dedicated RI products should consider some of the following things to ensure the product meets any specified RI objectives:

Long vs Short Positions

Whether a position is held long or short could have an impact on whether the investment satisfies any RI objectives. For example, managers may want to consider whether exclusion lists would apply to both the long and short book of the portfolio.

Time Horizon

Positions held for a longer period of time may increase opportunities for meaningful engagement with issuers on RI related issues. However, strategies with a shorter time horizon could consider engagement at a sector or industry level rather than an individual security level.

Portfolio Concentration

Concentrated portfolios typically have larger positions, meaning engagement and any exclusions or inclusions could have increased impact. Asset managers with concentrated portfolios may also have more resources per position than more diversified portfolios. For more diverse portfolios thematic exclusions and industry or sector level engagement may be able to achieve any specific RI objectives.

Hedging

Asset managers have a fiduciary duty to manage the risk in the portfolio appropriately and may be required to hedge certain risks. This may mean that instruments not necessarily aligned with RI objectives may be present in the portfolio. Engagement remains possible regardless of the reason the security is being held in the portfolio.

3. Practical Implementation of RI in Credit Strategies

Data

Data is an important component for both integration of financially material RI related risks, and dedicated RI approaches. Typically, data is either purchased from a vendor or sourced by an internal research team. The SBAI Policy Framework discussed the following considerations about ESG data in general:

- Inconsistency of data and ratings across vendors,
- Data may be delayed and not reflective of recent events,
- Differences in methodologies for aggregation of E, S and G scores and weightings,
- Lack of consistency in issuer disclosures globally,
- Risk of cherry picking by selecting the vendor that produces the best portfolio scores, and
- Thorough due diligence being required to ensure that the vendors methodologies align with the portfolio's objectives.

Liquid and Listed Assets

Data coverage, both by vendors and issuer-disclosed, is highest in the corporate bond market and for listed issuers in particular. These asset classes are closest to equities and as such data provided for the equities, such as ratings or issuer disclosed data, can be used for corporate bonds. This may not be the case for all corporate bonds as, like equities, there are multiple jurisdictions that do not mandate the disclosure of this data and data is typically biased towards large caps stocks in more developed countries. As there are often multiple issues per issuer for credit assets, additional complexity is introduced when matching securities and their identifiers to the correct RI related data.

High Yield, Distressed, and Private Credit

Data, especially through vendors, can be more limited the further towards the illiquid end of the spectrum a credit asset sits. High yield bond data availability is typically closer to that of listed or investment grade and similarly depends on the mandating of corporate disclosures within different jurisdictions. Some issuers of high yield bonds may be smaller in size and as such may not be in scope for mandatory disclosures in some jurisdictions. Investors in distressed credit theoretically have higher levels of engagement and therefore increased opportunities to collect RI related data; however, depending on the reason for the distress, and bearing in mind an asset managers fiduciary duty to its investors, the issuer may need to spend potentially limited resources on resolving the issue causing the distress. Private credit historically has not been covered by data vendors, but this is beginning to change with more vendors entering the space. Private credit investments require high levels of engagement which will provide asset managers with the opportunity to source RI related data directly.

Syndicated Loans:

Syndicated loans rely on data from investment banks who do not routinely collect this data from the underlying issuers. At present there is no standardised way of collating this data and the investment banks do not have a clear picture of what key data should be captured. There are industry initiatives that are looking to improve data availability, but further work is still required. Asset managers may need to rely on sector or industry level data.

Structured Credit:

The nature of structured credit instruments can mean the sourcing of data is challenging. Data is required on a look through basis, and this may not always be available. Typically, Collateralised Loan Obligations (CLOs) are easier to obtain data for in this way due to links to corporate issuers. Sourcing data for other instruments such as Commercial-Mortgage-Backed Securities (CMBS), Residential-Mortgage-Backed Securities (RMBS) and Asset-Backed Securities (ABS) is more challenging as the number of loans in these portfolios tends to be higher.

The Principles for Responsible Investment (PRI)'s report[3] on the challenges in this area highlighted the following and some further detail on the information required versus the information available can be found in Appendix A.

- The availability of adequate ESG data is the main challenge to investors incorporating ESG factors in their securities product credit assessments.
- Other challenges include the absence of ESG reporting standards for servicers and originators, the diverse pool of underlying assets, and a lack of securitised product coverage by ESG information providers.

Sovereign Bonds

These will be more fully discussed in the SBAI's Toolbox Memo on Responsible Investment in Macro Strategies. In summary, data for sovereign assets can typically be obtained through data vendors and publicly available information such as the World Bank's Sovereign ESG Portal[4]. Credit ratings agencies are also starting to incorporate RI related factors into sovereign credit ratings. The availability of this data is in its infancy and as such does not have a long history. Data on sovereigns can remain static for some time.

Synthetic Credit Exposure:

Where the synthetic exposure is linked to a corporate issuer there will be data available - if it is available for the issuer. For other types of synthetic exposure this may be more challenging.

[3] https://www.unpri.org/fixed-income/esg-incorporation-in-securitised-products-the-challenges-ahead/7462.article

[4] https://datatopics.worldbank.org/esg/

Responsible Integration

The inclusion of RI-related factors into investment and risk management processes - where they have financial materiality. This involves the use of all relevant financial and non-financial information to aid asset valuation and risk assessment, but RI factors are not used to pre-define an asset universe.

In all strategies, asset managers should consider any financially material risks as part of the investment process and credit is no exception. There will, however, be differences in how financially material each of these risks are depending on both the asset class and the strategy of the fund.

As the focus on RI related risks has increased, these risks have begun to feature more prominently in the investment process of credit strategies. In the SBAI Policy Framework we highlighted the importance of a flexible and well understood process to ensure that time and resources are spent on the financially material risks to the strategy.

Importantly there is also a lack of consistency in the data and analysis required when defining and measuring the materiality of RI factors in different jurisdictions. This means it is likely resources will need to be dedicated (and trained) to understand how the different RI risks will be financially material in different countries and the interdependency of the risks.

The CFA provides guidance and case studies for ESG integration in equities and fixed income which may provide some useful information on which investment tools can be used as part of integrating ESG[5].

Short vs Long Time Horizons

Governance has traditionally been a key risk factor for the repayment of debt, but social and environmental risk factors are also important. These risks typically play out over different timescales and as such their relative financial materiality may change dependent on the holding period of the asset.

Issuer vs Instrument:

Unlike some other asset classes there can be multiple issuances per issuer. Each instrument will have different characteristics including duration, hierarchy in the capital structure, and potentially being issued by different subsidiaries of the issuer. This means when assessing the financial materiality of RI related risks, there are two layers to consider. There will be risks that may be present in the issuer; however, the financial materiality of these risks may vary for different issuances by this issuer.

Sovereign vs Corporate Issuers

Sovereign bonds typically have a longer maturity than corporate bonds and in addition have fewer enforcement mechanisms. Importantly for RI integration, the assessment of the financial materiality of the relevant RI risk cannot always be completed in the same way. Corporations typically have narrow objectives aligned with profit maximisation and other economic goals. Whilst economic goals may be part of a sovereign state's objectives there are many other factors that also need to be considered.

The PRI report on ESG integration in sovereign debt contains some further details specific to this asset class[6].

[5] Page 5 : https://www.cfainstitute.org/-/media/documents/survey/guidance-case-studies-esg-integration.ashx

[6] https://www.unpri.org/fixed-income/a-practical-guide-to-esg-integration-in-sovereign-debt/4781.article

Structured Credit

In the case of instruments such as CLOs as an example, asset managers will need to consider RI analysis at both the CLO manager or originator level, and the deal or transaction itself. In instruments such as structured credit, it may be more appropriate to make use of a sector or industry-based materiality analysis, such as the Standards Board for Sustainable Accounting (SASB) in the absence of being able to analyse the financial materiality of RI related risks at an individual issuer level.

Discussion Points for Asset Managers and Investors
Discussions should be held on how different RI related risks are factored in over the time horizon of the portfolio.

Investors may also wish to discuss with managers both the process for assessing materiality of these risks, and the experience of the investment team in the relevant jurisdictions.

Responsible Asset Selection

A dedicated approach where RI factors are used to pre-define the investment universe using tools such as exclusions, inclusions, or impact strategies.

Exclusions:

Exclusions can feature in a dedicated RI approach for one of two reasons, either to allow the manager (or investor) to express a view on RI through their investments, or to directly impact an issuer for RI related reasons.

To express an RI related view, exclusions lists can typically be applied at a firm or product level. For debt of a single issuer, the exclusions are likely most effective at an industry or sector level (or based on vendor ratings if available for the asset universe). For syndicated or structured credit, firms may be able to obtain representations from counterparties or originators that confirm certain industries or sectors are not present in the underlying loan or loan portfolio.

When looking to directly impact an issuer, exclusions theoretically increase the cost in borrowing for firms, if there are fewer market participants willing to lend money or buy bonds, then coupons or interest may need to increase accordingly to attract lenders. It is likely, however, that the impact through engagement (in strategies where this is practical) may be more effective.

<u>Issuer vs Instrument:</u>

Asset managers can apply exclusions lists in two ways, at the issuer level or at the instrument level. The issuer level would exclude any instruments from issuers that trigger the exclusions list. The instrument level would only be excluded if it financed the excluded element. As an example, the listed parent of an issuer may engage in excluded industries such as thermal coal, but the specific subsidiary issuing the debt does not or, for example, focuses on renewable energy.

Short Credit Positions

Exclusionary policies may be applied to solely to long only books or include short credit positions too. This will likely vary between asset managers and investor mandates. Whilst applying exclusions to short positions may allow an asset manager to express a view on a specific practice or issuer, it may have limited effect on the underlying issuer itself. A potential exception to this is where there is a large enough collective short position that undermines confidence in the issuer and potentially impacts credit spreads.

Syndicated Loans

Exclusion lists can be applied when trading syndicated loans. Whilst RI information is not necessarily collected and provided by the counterparties, deal documentation should allow investors to apply exclusions at a minimum on an industry or sector level. Where these loans are being purchased on the secondary market, NDAs[7] can be signed to access the original deal documentation.

Structured Credit

For asset classes such as CLO, engagement is likely to be at the manager or originator level as opposed to the issuer(s). For these instruments it should be possible to access the required information on a look through basis to operate an exclusion list. The challenge here is that it would not be possible to break up the instrument components to exclude certain elements. This means, if stringently applying an exclusion list, instruments may be excluded where the sector or industry on the exclusion list is not material overall. An alternative way to apply an exclusion list to a structured credit instrument could be to set a level of materiality i.e., if the excluded portion is more than a certain percentage of the instrument overall, then the whole instrument would be excluded.

Inclusions:

Within credit strategies there are two main ways that inclusions could be used:

1. Creating an RI tilt or overlay on the portfolio, and
2. Investing directly in more thematic credit instruments.

Tilts and Overlays:

An RI tilt or overlay can be applied in credit strategies. Even where individual assets may not be held for a long enough period to make a meaningful impact, the overall tilt of the portfolio can be towards those issuers with relatively "better" RI related practices. This could be achieved, for example, by overweighting "green" bonds or issuers with higher ESG rankings and underweighting or excluding the bonds from, for example, the bottom quintile of issuers based on their ESG scores. This approach relies heavily on data and will therefore be more challenging in instruments and asset classes that do not have wide data availability as discussed in the data section above.

Thematic Instruments:

Investing in thematic "green" or "sustainability" linked credit instruments is an alternative inclusions strategy. This may include investing in the instruments below where the use of funding is specifically defined and in line with the RI objectives of the product.

[7] Non-Disclosure Agreements

Asset managers should not rely on the naming of these instruments as an indicator of RI practices but should assess these instruments using the same criteria as for other investments. Asset managers should ensure to assess the terms of use for the capital raised by the bond and any associated KPIs. This will ensure the assets are aligned with the managers RI objectives. Of key importance to this assessment is the consequences for the issuer should the capital raised not be used for the stated objectives, i.e., are the conditions of the bond enforceable.

- *Sustainability Bonds* – These are bonds where the proceeds are exclusively to be applied to finance (or refinance) a combination of both social and green projects. These bonds tend to be aligned with either the Green Bond Principles (GBP)[8] or the Social Bond Principles (SBP)[9] both of which are voluntary principles. The primary objective of the underlying bond will be used to determine its classification but there may be green benefits to Social Bonds and vice versa.
    - *Green Bonds* – These bonds fund projects with a clearly defined benefit to the environment, for example renewable energy projects. There are now several green bond indices allowing passive tracking; however, the use of indices limits the ability of the asset manager to assess the real impact of the investment. Consideration should be given to whether it is the issuer or the specific bond that is "green" and how that impacts a manager's RI objectives.
    - *Blue Bonds* – These are bond instruments that fund projects with clear marine and ocean-based benefits, for example sustainable fishing. These bonds typically follow the same principles as the GBP but have a specific focus within this area.
    - *Social Bonds* – These bonds fund projects that provide access to essential services, infrastructure, and social programs to underserved people and communities, for example to support affordable housing or micro-financing.

- *Sustainability Linked Bonds* – These bonds are more broadly defined but aim to create a positive social or environmental impact. The proceeds from the issuance are not ringfenced for "green" or "sustainable" purposes and may be used for general corporate or other purposes. The bonds do; however, reward the borrower when they improve on pre-determined metrics such as reducing emissions or punish them with higher interest rates if they fail to achieve these. These need careful assessment as at times the KPIs linked to these bonds might be overly easy to achieve or not directly aligned with the RI objectives of the product. Another complication with bonds that increase the interest rate with "bad" practices means the investors interests are bettered if the company does not meet its objectives and are therefore not necessarily aligned with good RI practices.

- *Transition Bonds* – This is a newer asset class targeted at so-called "brown industries" with high greenhouse gas emissions. The bonds are designed to allow these companies to raise capital with the goal of reducing their contribution to global warming. While it is easy for companies with little pollution to issue green bonds, energy producers cannot meet green-bond criteria and as such this may pave the way to funding improvements such as reducing emissions.

Discussion Points for Asset Managers and Investors:

Investors and asset managers should discuss the intended objectives of exclusion lists to ensure that these meet any desired RI related objectives. Discussions should also take place on how exclusion lists are applied to assets such as syndicated loans and structured credit.

[8] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/

[9] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/social-bond-principles-sbp/

Where asset managers are investing in thematic instruments such as sustainable bonds, discussions should be held on the due diligence of these investments including whether proceeds are ringfenced for projects that meet the stated RI goals of the portfolio.

Impact:

It is possible to have an effective impact strategy using credit instruments; however, this will be dependent on the type of instruments traded.

In direct lending or private credit investments there are potentially increased opportunities for impact. Favourable interest rates or other loan terms could be linked to specific RI related objectives. That said, using covenants for impact objectives may be resource intensive at both the design and the ongoing monitoring stages. Asset managers will need to think clearly about performance targets that are being set to ensure they are transparent and therefore measurable.

In the case of syndicated loans this may not be possible, as an asset manager would not necessarily have control over the documentation or deal terms, particularly if investing in these assets on the secondary market. Limitations will also apply for structured credit instruments where the manager is not the originator.

Discussion Points for Asset Managers and Investors

As with any impact strategy both asset managers and investors should understand:

- The stated impact objective of the product,
- The assessment criteria of the investments chosen to be in the portfolio, and
- How these impact goals will be measured and reported.

Further detail on the governance and documentation of impact strategies in general can be found in the SBAI Policy Framework.

If an asset manager sets conditions that mean that the interest payable on the loan increases if targets are not met, then the investor's interests are aligned with the company failing to meet these targets. Investors in a dedicated impact product should discuss this potential conflict of interest with the manager to understand how this is monitored.

Responsible Asset Ownership

The use of engagement to drive improvements or changes in RI related practices using tools such as voting, engagement, and activism

Debt investors are not owners of the businesses and as such there are more limited legal mechanisms to influence issuers. In general, though, issuers engage with both equity and debt investors and these investors can use this dialogue as an opportunity for proactive engagement. Companies tend to issue more debt than equity and so there may be more opportunities for credit investors to engage with the companies. Asset managers should understand that engagement can be broader than voting.

Sovereign Debt

Investing in sovereign debt, as opposed to corporate or private issuers, has challenges when it comes to engagement. Sovereign states can be large and the size of individual holdings relative to these countries may limit the impact of engagement. Engagement may also have potential political considerations i.e., at what point does engagement become diplomacy or political intervention – sovereigns are essentially accountable to their citizens rather than their debt holders.

Engagement with sovereign states may require alternative methods, for example non-governmental organisations (NGOs), lobbyists, policy makers, media outlets or public statements, sovereign investor roadshows, or credit rating agencies. When dealing with organisations or individuals that have either access to or influence on foreign governments or policy makers, asset managers should ensure to have robust controls in place to prevent the receipt of material non-public information, or the appearance of undue influence on governmental policy for the benefit of the portfolio.

Structured Credit:

Direct engagement with issuers is more limited with this asset class, particularly where the asset manager is not the originator. Any engagement would be at the underlying issuer level which would require a look through and depending on the number of assets held this would be resource intensive.

Private Debt:

This asset class typically offers the most opportunity for direct engagement with the issuer. The terms of any loan are a bespoke agreement between the lender and borrower. The investment process already requires a significant amount of engagement with the borrower meaning that RI related considerations can be built into this process.

Other Credit Instruments:

Listed credit and investment grade bonds may offer more opportunities for engagement, but where issuers are larger, the size of investments relative to the issuance could affect the materiality of any engagement. High yield bonds tend to be from smaller issuers and therefore this issue could be negated. Distressed Credit does offer enhanced mechanisms for engagement but depending on the reason for the distress engagement may be more critical in other areas. For syndicated loans, the impact of engagement may be limited unless a majority of lenders are in agreement.

Collective and Non-Direct Engagement:

Purchasers of debt may not have access to voting rights; however, there are other meaningful opportunities for engagement. There are many opportunities for asset managers to engage outside of direct engagement, such as through investor collectives, government initiatives, and industry organisations such as the SBAI.

Discussion Points for Asset Managers and Investors:

Asset managers and investors should discuss any engagement policies that are designed to contribute towards the stated RI objectives of a dedicated product.

Discussions should include whether there are instruments held that do not provide opportunities for engagement and what use, if any, the asset manager is making of collective engagement.

4. Reporting

Investor reporting will be discussed in more detail in an upcoming SBAI memo but the below highlights some credit strategy specific elements that investors and asset managers should be aware of:

- Investor DDQs are typically geared towards equity strategies. This can make it challenging to provide the required information for credit strategies. Metrics based reporting may be relevant in the case of listed credit or high yield bonds; however, in other credit instruments the metrics are unlikely to be relevant and may lead to the purchasing of data solely to provide reporting that risks becoming a "tick box" exercise.
- In dedicated RI credit strategies, the use of metrics reporting may obscure efforts by asset managers to create impact in other ways, for example by investing in "green" or "sustainable" bonds or using covenants in private credit investments.
- Investors should provide credit managers with the opportunity to articulate their own approach, including why RI may not be effective within their strategy, and asset managers should be prepared to explain their analysis and conclusions on this topic.

Short Positions:

There are two ways that short positions can be reflected on RI related reporting:

- Gross – where long and short positions along with any associated scores or metrics are presented separately, or
- Net – where short positions are netted against long positions with aggregated scores or metrics presented (i.e. long metrics minus short metrics).

Discussion Points for Asset Managers and Investors:

Asset managers and investors should ensure to discuss which types of reporting make sense for the specific strategy and instruments held.

When choosing how to present (or receive) this information, asset managers and investors should consider which way might be more appropriate based on some key considerations:

- If the fund is not a dedicated RI product with stated objectives, then the purpose of the reporting may dictate its format i.e., are investors looking for an aggregated portfolio score or position level transparency to be able to fully understand their exposure.
- For a dedicated RI product, the stated RI objectives will factor into how this is reported. For example, an objective to keep the entire portfolio above an average ESG score may better suit net reporting, but an objective to hold long positions in "good" scorers and short positions in "bad" scorers may be more accurately reported showing long and short positions separately.

5. Investor Due Diligence Questions and Policy Disclosures

The SBAI Policy Framework contains a detailed list of disclosures that should be included in an RI Policy. The below list adds further credit specific disclosures that should also be considered.

Investors may also wish to use these points for discussions with asset managers on RI related practices.

Non-Dedicated RI Products
• What sources of data are being used for each instrument type traded?
• How is the data being used within the investment and risk management processes?
• What training (or relevant experience) has the investment team had to understand the local nuances to assess the financial materiality of RI related risks?
• How does the manager think about different types of ESG related risks in relation to the time horizon of the strategy?
• When holding syndicated loans or structured credit, does the manager look through to the underlying loans or rely on disclosure from counterparties or originators?
Dedicated RI Products and Engagement
• Do exclusion and inclusion lists apply to both long and short positions?
• How are short positions used (or not) to achieve any stated RI objectives?
• Are there positions in the portfolio that are not used to further stated RI objectives e.g., assets used for hedging purposes only?
• What is the objective of any exclusions or inclusions-based strategies i.e., intended to produce an impact in the relevant sector or to reflect the views of the asset manager or investor?
• How do the investment choices – including asset classes – align with these objectives?
• Is the due diligence process relating to RI any different for sustainable or green sovereign instruments versus those not labelled in this way?
• When holding syndicated loans or structured credit, how is the exclusion list applied to these assets. For structured credit are exclusions binary or is there a materiality threshold?
• What type of engagement does the manager do and through which entities? E.g., at the issuer level or through other organisations.
• When trading Sovereign debt, does the manager have robust anti-bribery and corruption policies and keep records of meetings with any person or organisation that has either access to or influence on foreign governments or policies?

6. Appendices

Appendix A – Structured Credit and Responsible Investment Further Detail

The UN PRI Report "ESG Incorporation in Securitised Products the Challenges Ahead[10]", provides the following tables which compare the RI related information that investors want from CLOs, CMBS, RMBS, and ABS and compares this to the data that is currently available.

ESG information wanted by investors

CLOS	CMBS	RMBS and ABS
▪ CLO manager corporate governance information and information on how ESG issues are managed in its business operations ▪ Stricter exclusion criteria ▪ More disclosure on CLO manager's commitments, which should be stricter ▪ More information on underlying loans and corporate borrowers ▪ Increased CLO manager ESG data disclosures in trustee portfolio reports	▪ Sponsor ESG information in deal documentation ▪ Marketing materials should include how originators address ESG issues in loan underwriting processes ▪ Deal documentation should highlight how environmental risks, including climate change, can affect underlying properties	▪ Marketing materials should include how originators address ESG issues in loan underwriting processes ▪ Deal documentation should be complete and address potential ESG concerns in how servicers operate ▪ Deal documentation should include specific ESG risks that could affect transactions ▪ Portfolio files should feature environmental information on underlying assets

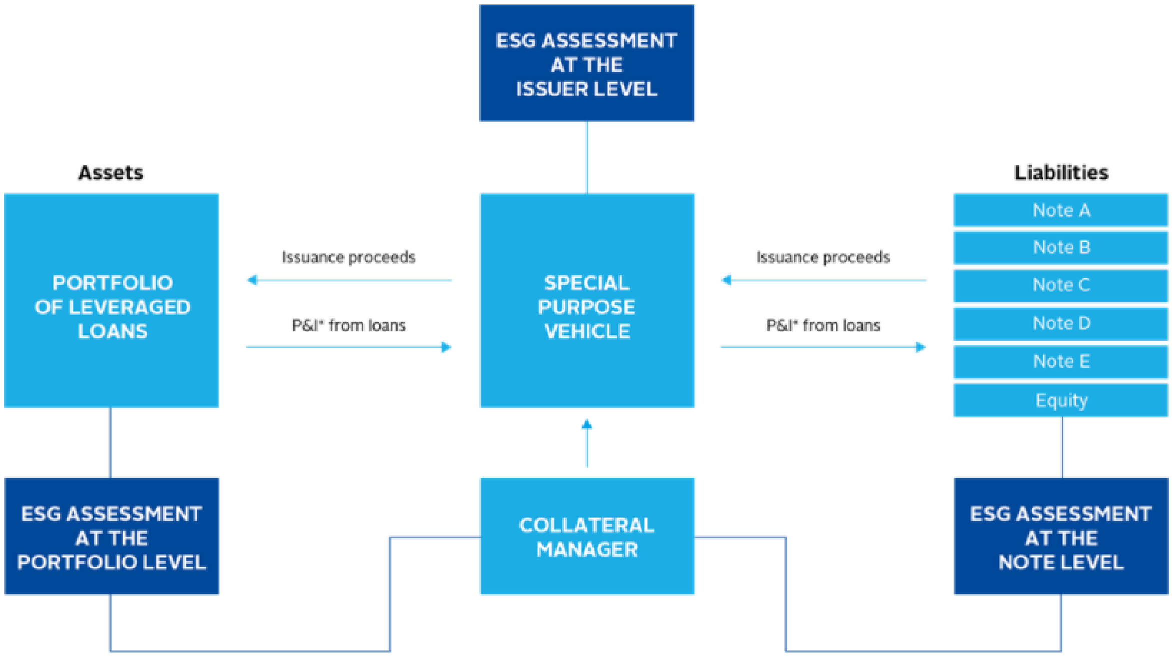
Figure 21: ESG information available to investors

CLOS	CMBS	RMBS and ABS
▪ CLO documents detail the SPV's legal and deal structure, outlining payment priority, portfolio profile tests, collateral quality tests and coverage ▪ Exclusion lists ▪ Disclosures about CLO manager's ESG commitments ▪ Underlying loan portfolios provide an overview of industry exposures and single obligor concentrations ▪ Detailed portfolio reports by CLO trustees (usually monthly)	▪ Marketing materials usually cover detailed information on the deal sponsor, including its track record ▪ Deal documentation typically outlines structure and specifies deal triggers and tests to protect investors ▪ Underlying property information, including independent third-party valuations ▪ Portfolio-level summaries, valuation reports and due diligence reports undertaken by the arranger, which may identify ESG transaction risks ▪ Underlying portfolio files typically include key collateral characteristics, sometimes include borrower credit metrics	▪ Marketing materials outline the originator's underwriting criteria – including borrower income verification and affordability testing ▪ Deal documentation may include servicer's arrears policy and collection procedures, loan portfolio restrictions, deal triggers and tests to protect investors ▪ Underlying portfolio files typically include key collateral characteristics, sometimes include borrower credit metrics

[10] https://www.unpri.org/fixed-income/esg-incorporation-in-securitised-products-the-challenges-ahead/7462.article

It also provides a diagram that demonstrates the different parts of the process where RI related risks can be assessed:

Figure 8: ESG assessment in the CLO structure



Appendix B: The Different Approaches to Responsible Investment

As laid out in the SBAI Policy Framework

Different Approaches to Responsible Investment

Responsible Integration		The Inclusion of RI-related factors into investment and risk management processes, where they have financial materiality. This involves the use of all relevant financial and non-financial information to aid asset valuation and risk assessment, but RI factors are not used to pre-define an asset universe.
Responsible Asset Selection	Exclusions	An "Exclusion List" or "Negative Screening" is used to pre-define an investment universe. Exclusions may be based on "damaging industries" such as gambling, fossil fuels, or tobacco, relatively low ESG ratings or other considerations such as faith-based investing.
	Inclusions	"Positive Screening" is used to pre-define an investment universe. Inclusions may be on a "best in class" basis, i.e., those with relatively high ESG ratings or on a "thematic" basis with investments in particular sectors or industries targeted.
	Impact	Investing with the specific goal of delivering meaningful societal and environmental outcomes, for example, reduction of carbon emissions, or more generally contributing to societal goals such as the UN's Social Development Goals (SDGs).
Responsible Ownership	Voting	A form of engagement based on participating in Annual Company Meetings and using voting rights to support RI-related initiatives or express a negative view on current practices.
	Engagement	Having a dialogue with underlying issuers or companies with a view to achieving improvements on RI-related practices. This can also be used for improvements in wider industries through collective engagement for example with regulators or investor groups.
	Activism	A more involved form of engagement where investors look to promote change through building up a significant holding within a company and potentially gaining a seat on the board. This may also be a more public form of engagement.
Responsible Corporate & Market Citizenship	Organisational Initiatives	Initiatives and policies put in within the Investment Manager's own firm to address environmental, social and governance issues for example, energy efficiency, diversity, and employee wellbeing.
	Good Market Citizen	Being a responsible market citizen by governing the firm's behaviour in the market and ensuring the maintenance of free and effective markets, for example, by having strong controls in place to prevent market abuse.
	Carbon Hedging	Offsetting carbon emissions either directly produced by the firm (for example via travel) or funded within the portfolio (for example by investing in high carbon emitters) using carbon credits or other forms of carbon hedging.

Appendix C: SBAI Responsible Investment Credit Working Group

(Alphabetically by firm)

Emir Boydag
Portfolio Manager, *400 Capital Management LLC*

Joe Meginnes
Deputy General Counsel, *Balyasny Asset Management L.P.*

Pavlos Anagnou
Managing Director, Client Relationship Group, *Balyasny Europe Asset Management LLP*

Lucy Byrne
Senior ESG Analyst, *BlueBay Asset Management LLP*

My-Linh Ngo
Head of ESG Investment, Portfolio Manager, *BlueBay Asset Management LLP*

Lauren Hardardt
Chief Operating Officer for Sustainable Investing, *Bridgewater Associates, LP*

Tina De Baere
Head of ESG and Macro Strategy, *Cairn Capital*

Wai Leng Leong
Managing Director, Head of Asia Pacific, *CDPQ Asia-Pacific Pte Ltd*

James Harris
Product Development & Sales Business Management, *CQS (UK) LLP*

Simon Tannett
Head of Research, Partner, *CQS (UK) LLP*

Kenneth Kan
Managing Partner, *Dymon Asia Capital (Singapore) Pte. Ltd*

Nicholas Maffeo
Portfolio Manager – Hedge Funds, *Employees Retirement System of Texas (ERS)*

Thibault Nantes
Senior Associate, International Business Development, *EnTrust Global*

Subhashree Dutta
Chief Executive Officer - Singapore Office, *Fiera Capital (Asia)*

Lisa Monaco
Managing Director, *HPS Investment Partners, LLC*

Haiwei Cao
Global Markets Research Analyst, *Lakefront Asset Management (HK) Co. Ltd*

Lu Lu
Analyst, Global Markets, *Lakefront Asset Management (HK) Co. Ltd*

Peiying Li
Director, Global Markets, *Lakefront Asset Management (HK) Co. Ltd*

Weber Hsu
Analyst, Global Markets, *Lakefront Asset Management (HK) Co. Ltd*

Sapna Vir
Director, External Relationships, *New Holland Capital, LLC*

Rishab Sethi
Manager, Listed Mandates and External Partnerships, *New Zealand Superannuation Fund*

Neil Messing
Head of Hedge Funds, *Office of New York City Comptroller*

Bradley Belt
Vice Chairman, *Orchard Global Asset Management*

Sophie Keatley
Investor Relations Associate, *Orchard Global Asset Management*

Jordon Snow
Product Strategy and Development, *Polar Asset Management Partners*

Les Young
Head, Business Development & Investor Relations, *Polar Asset Management Partners*

Michael Beaton
Portfolio Manager, *Polar Asset Management Partners*

Madeleine Rice
Director of Research, *Taconic Capital Advisors LP*

Robert Sachs
Head of Business Development, *Whitebox Advisors LLC*