ESG integration and fixed income

A significant part of our bond exposure is through third-party funds, therefore the fund research approach of understanding the underlying manager's ESG process applies. ESG analysis for credit issuers is on a similar basis to equities. The growth of green bond issuance, and newer areas like bonds linked to the UN Sustainable Development Goals, and transition bonds, adds a new dimension which we would expect third-party managers to evaluate appropriately. Sovereign bond analysis can be limited for developed markets but could increasingly incorporate climate risk in the future

While bondholders do not have voting rights in the way that shareholders have, larger fixed income houses can influence the funding structure of issuers. They can also engage on similar matters to equity investors and reconsider their funding if no progress is made.

The direct holdings are predominantly in UK, EU and US government bonds as well as supra-national issuance. Integrating ESG factors into the selection of sovereign debt issued by developed countries is likely to increasingly incorporate issues such as climate risk over time and best approached by seeking to influence government policy where appropriate.

Within our centrally monitored universe, we have very limited exposure to corporate bonds on a direct basis and therefore are unable to influence the funding structure of issuers as larger holders are sometimes can. There are around 60 issuers (as at 30 June 2023) in which we invest, and the primary consideration is whether these issuers are senior and BBB rated[1], and whether the bonds will maintain that BBB rating over the period to maturity. We believe identifying the ESG challenges and opportunities that impact the debt issuer are an important factor in evaluating the likelihood of the bond retaining the BBB rating over its lifetime.

Most debt issuing entities we invest in are companies that are already evaluated by the equity team and therefore the fixed income research benefits from this existing work. The remaining entities are not within the equity research universe and in some cases are not listed. For these holdings, more in-depth analysis is undertaken by the fixed income team. For all the holdings within the centrally monitored corporate bond universe, the analyst has assessed the issuer's ESG credentials, and monitors these on an ongoing basis. The data sources include Sustainalytics and other ESG data providers.

1 Bonds are rated according to their credit worthiness and quality using a letter-based credit scoring scheme.

To find out more about Responsible Investment at Quilter Cheviot and how we may be able to help you, please contact us using the details below.

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