Engagement in credit markets

Introduction

Shareholder activism and engagement in equity markets are well understood topics that garner a lot of attention. This has increasingly become the case as investors now have access to more information about companies' activities and their environmental, social and governance (ESG) scores, and the public have become more conscious of the impact that companies have on the world around them. However, the topic of if and how lenders engage with debtors in credit markets is less discussed, so we spoke with PineBridge, who manage a portfolio of leveraged loans for Wiltshire Pension Fund, to find out about how they're engaging with debtors on ESG issues.

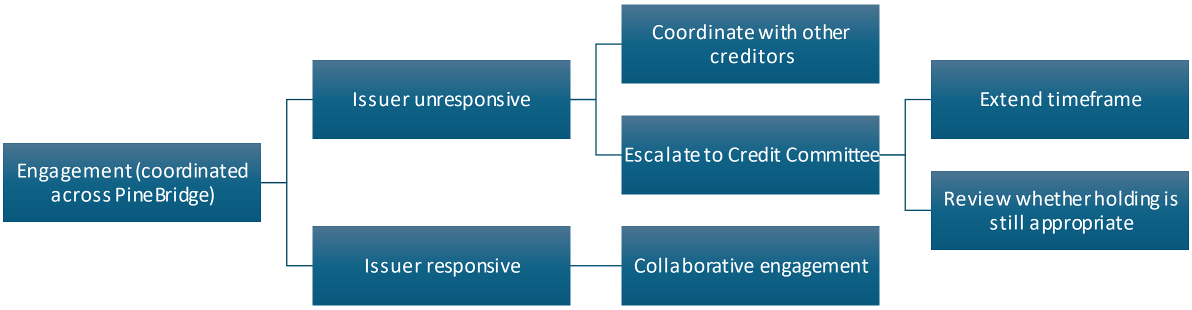
PineBridge's approach

PineBridge are focused on constructive engagement with the issuers that they invest in. This means fostering a relationship that enables an open dialogue with issuers regarding improving ESG practices, risk management and the development of sustainable business practices. PineBridge's engagement activities are generally centred around three ESG themes: limiting global warming to 1.5°C (in line with the Paris Agreement); diversity, equity and inclusion; and human rights issues. These engagement efforts are based on the understanding that ESG factors can impact the long-term financial health of an issuer. By managing ESG-related risks, PineBridge aims to preserve or enhance the long-term value of its investments.

PineBridge provided us with an example of one of their debtors, a well-known cruise line, which was receptive to their engagement efforts. The cruise line in question operates in some of the most beautiful destinations around the world. However, cruise lines in general are well known for being heavily reliant on fossil fuels and producing considerable waste from their operations. PineBridge engaged with the company on some of these concerns and found management to be receptive to their engagement, with the cruise line outlining their aspiration to be "net carbon neutral by 2050, with interim goals by 2030". The company explained that their roadmap includes fleetwide upgrades to improve fuel efficiency, investing in port/destination projects and taking delivery of Liquified Natural Gas (LNG) powered ships.

PineBridge suggest that in most instances, issuers, such as this cruise line, are receptive to engagement and willing to work constructively with creditors. But what about when issuers aren't so receptive, what levers can PineBridge pull (aside from selling the holding)? PineBridge explained that, from a legal perspective, there are limitations to the powers that lenders have in order to bring about change to an issuer's business practices, however the issuer will be subject to their escalation process where they feel that the issuer isn't meaningfully engaging with them. This means that the matter will be reviewed by PineBridge's Credit Committee, which will decide whether to continue engaging while extending the timeframe for the implementation of any suggestions or whether to review the issuer's approval status to determine if the investment remains suitable for inclusion in the portfolio. PineBridge also explained that they coordinate their engagement efforts across the firm, this gives them more leverage where they hold loans from the same issuer across more than one portfolio. Additionally, while coordinating engagement efforts with other lenders isn't part of

PineBridge's formal engagement process, they will reach out to other lenders where they feel that an issue is material and they don't feel that the issuer is meaningfully engaging.



One common issue across the leveraged finance market that PineBridge highlighted in relation to engagement and managing ESG concerns was the lack of data, most notably with regards to firms' ESG policies, management of ESG risks and greenhouse gas emissions disclosures. They went on to explain that "less than 25% of the leveraged loan market are public filers". PineBridge hope to help address this concern by encouraging issuers with poor ESG disclosures to adopt and publish a formal ESG policy, make a more concerted effort to disclose key ESG metrics, and encouraging them to complete the LSTA ESG Diligence Questionnaire, or its equivalent, on an annual basis.

Conclusion

In summary, much like in equity markets, engagement in credit markets relies on the issuer's willingness to participate. However, unlike equity holders, creditors don't have voting rights (at least not with regards to general corporate governance matters) and generally have fewer legal mechanisms to influence the issuer should they choose not to engage. Having said that, we're pleased with PineBridge's proactive approach with regards to addressing some of the challenges with engagement and ESG data in credit markets, their alignment with the values of our members, and we look forward to hearing more about how their engagement efforts are progressing.

PineBridge
INVESTMENTS

Wiltshire
Pension Fund

9 Safeguard the assets

10 Strong risk-adjusted returns

11 Responsible ownership and stewardship

12 Positive impact

13 Robust processes, controls and risk management

16 Compliance and best practice