Principles for Responsible Investment

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

SHIFTING PERCEPTIONS:

ESG, CREDIT RISK AND RATINGS

TAKEAWAYS FROM THE EMERGING MARKET FORUMS

Inquiry: Design of a Sustainable Financial System

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1 **We will incorporate ESG issues into investment analysis and decision-making processes.**

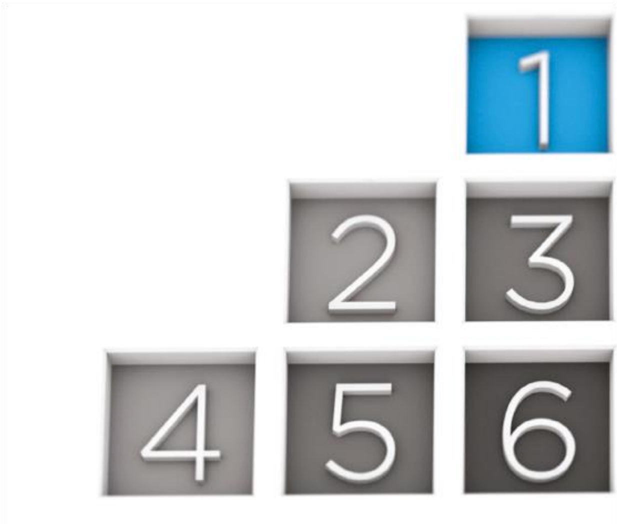
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.



PRI'S MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

PRI Principles for Responsible Investment

CONTENTS

ACKNOWLEDGEMENTS

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THE FIRST GLOBAL ESG INITIATIVE FOCUSED ON CREDIT RISK

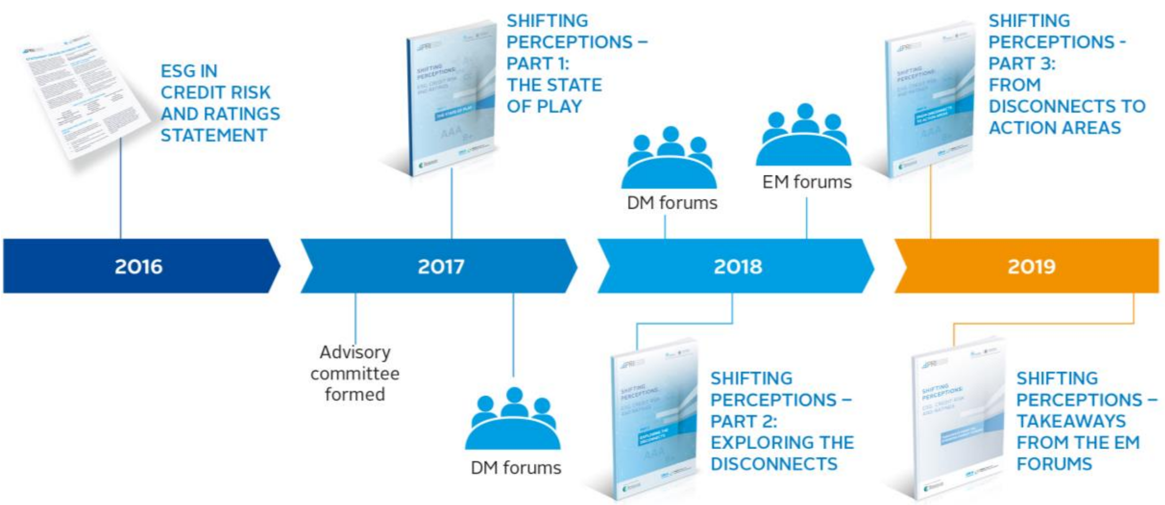
Considering environmental, social and governance (ESG) factors in credit risk analysis *transparently* and *systematically* is relatively nascent in emerging markets (EMs). However, mindsets are shifting rapidly within the investment community.

While integration practices are more advanced in developed markets (DMs), awareness of the need for augmented risk assessments – beyond traditional financial metrics – when evaluating issuers' creditworthiness is increasing in EMs.

In 2019, the PRI organised roundtables in Mainland China and Latin America, completing the global series that gathered credit practitioners from investors and credit rating agencies (CRAs) to discuss ESG topics. The series is the first of its kind because of its credit focus and scale, with 21 forums held in 15 countries (see pages six and seven).

This note is based on the latest forum discussions, adding to the results documented in the trilogy, [Shifting perceptions: ESG, credit risk and ratings] as part of the PRI's ESG in Credit Risk and Ratings Initiative (see Figure 1).

Figure 1. Milestones of the PRI's ESG in Credit Risk and Ratings Initiative



The DM roundtable discussions were covered in part 2: exploring the disconnects, and part 3: from disconnects to action areas.[1] Their main areas of focus were: 1) the materiality of ESG factors from a credit risk perspective; 2) credit-relevant time horizons; 3) organisational approaches to ESG, and 4) transparency and communication.

The DM forums revealed regional differences on three levels:[2]

- awareness and advancement of ESG consideration in a credit risk context;
- varying country sensitivities to ESG factors; and
- rising local regulatory pressures and different attitudes towards regulatory changes.[3]

These differences are also seen in EMs,[4] with some discussion points common across DMs *and* EMs. Others were specific to or more prominent in EMs. However, one clear theme emerged: the scale of ESG issues that EMs face is much higher than in DMs. This makes the case for ESG consideration in credit analysis in EMs even more compelling than in other countries – from a risk perspective and to identify investment opportunities.

Ahead are the main EM roundtable highlights.

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[1] The second and third reports of the series covered the discussions held from September 2017 to September 2018. They were all in DM countries, bar the roundtable in Cape Town (South Africa) in June 2018.
[2]For more details, see 'Regional colour from the forums' in *Shifting perceptions: ESG, credit risk and ratings: part three: from disconnects to action areas*, p. 26.
[3] In certain countries, regulatory intervention is perceived more as a threat (which may trigger pre-emptive action in the right direction). In others, notably some Asian countries, regulation is welcomed as a propeller of change.
[4] EM is a broad conventional categorisation which comprises a heterogenous group of countries. In the rest of this note, the EM abbreviation refers to the five EM countries where the PRI organised events around the ESG in Credit Risk and Ratings Initiative: Brazil, Chile, Mainland China, Mexico and South Africa.

ESG IN CREDIT RISK AND RATINGS

Initiative's mission: commitment by credit rating agencies (CRAs) and investors to consider the financial materiality of ESG factors to credit risk transparently and systematically.

2016 vs 2019

	2016	2019
Number of supporting investors	91	155
Supporting investors' AUM	16 trn	30 trn
Number of supporting CRAs	6	19

Nurturing a CRA-investor dialogue on ESG topics globally

21 Regional ESG in credit risk and ratings forums (Sep 2017 to Sep 2019)

530+ Forum active participants globally

3 Reports
- Action areas for future progress
- Evidence from CRAs
- 23 investor case studies

Read the reports at **unpri.org/credit-ratings**

FORUM HOSTS AND PARTICIPANTS

Date	Location	Host	Total attendees	Participating CRAs
25 Sep 2017	Berlin (Germany)	PRI in Person	Panel session	▪ Moody's Investors Service
27 Oct 2017	The Hague (Netherlands)	Aegon AM	23	▪ Moody's Investors Service ▪ S&P Global Ratings
2 Nov 2017	Toronto (Canada)	University of Toronto AM	28	▪ DBRS* ▪ Moody's Investors Service ▪ S&P Global Ratings
3 Nov 2017	Montreal (Canada)	PSP Investments	26	▪ DBRS* ▪ Moody's Investors Service ▪ S&P Global Ratings
10 Nov 2017	New York (US)	Neuberger Berman	28	▪ Moody's Investors Service ▪ S&P Global Ratings
22 Nov 2017	London (UK)	Insight Investment, BNY Mellon	36	▪ Beyond Ratings** ▪ Fitch Ratings ▪ Moody's Investors Service ▪ Scope Ratings ▪ S&P Global Ratings
5 Dec 2017	Stockholm (Sweden)	Öhman	18	▪ Moody's Investors Service ▪ S&P Global Ratings
25 Jan 2018	Paris (France)	AXA Group	48	▪ Beyond Ratings** ▪ Moody's Investors Service ▪ Scope Ratings ▪ S&P Global Ratings
26 Jan 2018	Frankfurt (Germany)	Deutsche Börse	20	▪ Dagong Europe Cr. Rating ▪ Moody's Investors Service ▪ Rating Agentur Expert RA ▪ Scope Ratings ▪ S&P Global Ratings
29 Jan 2018	San Francisco (US)	Wells Fargo*	Panel session	▪ Moody's Investors Service ▪ S&P Global Ratings
26 Feb 2018	Sydney (Australia)	Financial Services Council	29	▪ Moody's Investors Service ▪ S&P Global Ratings
3 Jul 2018	Tokyo (Japan)	Nikko Asset Management	95	▪ Japan CRA Ltd. ▪ Moody's Investors Service ▪ Rating and Investment Info. Inc. ▪ S&P Global Ratings
5 Jul 2018	Singapore	Eastspring Investments	19	▪ Moody's Investors Service ▪ RAM Ratings ▪ S&P Global Ratings
10 Jul 2018	Hong Kong (China)	HIFKA	16	▪ Dagong Credit Rating (HK) ▪ Moody's Investors Service ▪ S&P Global Ratings
6 Sep 2018	Cape Town (South Africa)	Investec	24	▪ Moody's Investors Service ▪ S&P Global Ratings
13 Sep 2018	San Francisco (US)	PRI In Person	Panel session	▪ S&P Global Ratings
19 Mar 2019	São Paulo (Brazil)	Itaú Asset Management	19	▪ Fitch Ratings ▪ Liberum Ratings ▪ Moody's Investors Service ▪ S&P Global Ratings
22 Mar 2019	Santiago (Chile)	Moneda Asset Management	27	▪ Fitch Ratings ▪ Moody's Investors Service ▪ S&P Global Ratings
31 May 2019	Beijing (China)	Asian Infrastructure Investment Bank	31	▪ China Chengxin Credit Mang. Co. Ltd. ▪ Dagong Global Credit Rating Co.Ltd. ▪ Fitch Ratings ▪ Golden Credit Ratings Internat. Co. ▪ Moody's Investors Service ▪ S&P Global Ratings
4 Jul 2019	Mexico City (Mexico)	Compass Group	48	▪ Fitch Ratings ▪ Moody's Investors Service ▪ S&P Global Ratings
12 Sep 2019	Paris	PRI In Person	Panel session	▪ Fitch Ratings

*DBRS is not a signatory to the ESG in Credit Risk and Ratings Statement but was allowed by the PRI to participate as a gesture of goodwill. **Beyond Ratings is no longer a signatory to the statement as its rating services ceased after its acquisition by the London Stock Exchange.

EMS AND DMS: SIMILAR CHALLENGES, DIFFERENT SCALE

Similar to the DM roundtables, EM participants concurred that considering ESG factors in credit risk analysis is not new and that many of the drivers that underpin credit risk assessment can be labelled as ESG. Particularly in the context of project finance, concepts such as rights of way or labour working standards have traditionally been important in risk management.

But sensitivities to ESG factors are intensifying and more data is becoming available for investment decision making. Some participants observed that in the banking sector the concept of ESG consideration was spearheaded by The Equator Principles – a risk management framework for environmental and social risk in development projects. The Principles have also been revised since their launch in 2003; the latest iteration was published in 2013 and a new one is in the pipeline.

Another common thread between the EM and DM roundtables was the confusion between what is measured by credit ratings (issued by CRAs) and ESG ratings (computed by ESG-specialised service providers). The PRI covered discussions about this extensively in the report trilogy but the CRAs' presentations during the forums helped to reinforce it to local audiences. It highlighted that an issuer with a positive ESG profile does not necessarily have good credit quality; however, companies with a poor ESG record are more likely to have poor credit quality.

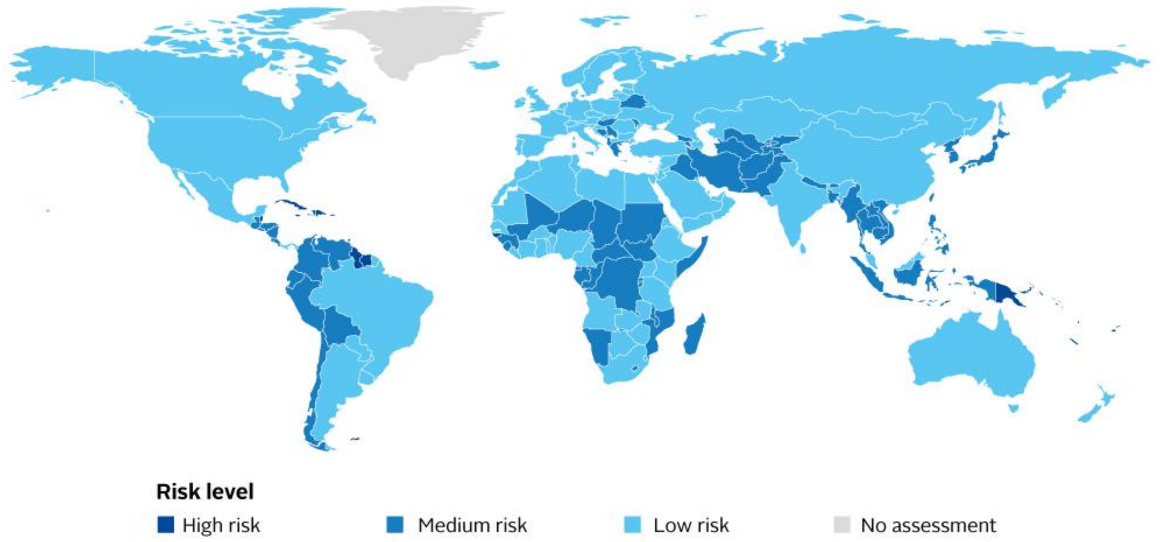
Lastly, it was widely recognised that fixed income (FI) market participants are relatively new to considering ESG factors in a more structured way, and even more so in EMs. However, several external forces are now prompting change, particularly in EMs, and encouraging analysts to better frame these considerations. These forces include:

- **rising concerns about limited natural resources and how these are managed:** all the EM countries where the roundtables were held (Mainland China, Latin America and South Africa) are commodity rich. Resource depletion, land and water contamination in the extractive process and waste are therefore top-of-mind for investors. Reputational risks are also now amplified because of better media interconnectivity.
- **increasing magnitude and frequency of climate-related incidents:** EM countries are typically more exposed to physical climate change risks than DMs, as they are often located in more vulnerable regions, have smaller and more concentrated economies, and weaker infrastructure quality. Economic losses caused by climate-related disasters and their impact on GDP is greater than in high-income countries.[5] Moreover, mitigation and adaptation measures are comparatively more expensive in EMs and market participants are not yet pricing the benefits of resilience (see Figure 2).[6]

[5] See Economic losses, poverty & disasters, 1998-2017, UN Office for Disaster Risk Reduction, 2018.
[6] See Climate change and the cost of capital in developing countries, UN Environment, Imperial College Business School, SOAS University of London, 2018.

- **mounting scrutiny by foreign investors:** as more investors in DM countries adopt ESG integration techniques, manufacturers' supply chains are more heavily scrutinised when assessing corporate issuers. Asset owners are also increasingly requesting transparency on how ESG factors are integrated in investment policies when appointing local asset managers.

Figure 2: ESG country risk atlas: natural disasters. Sources: United Nations Office for Disaster Risk Reduction and S&P Global Ratings

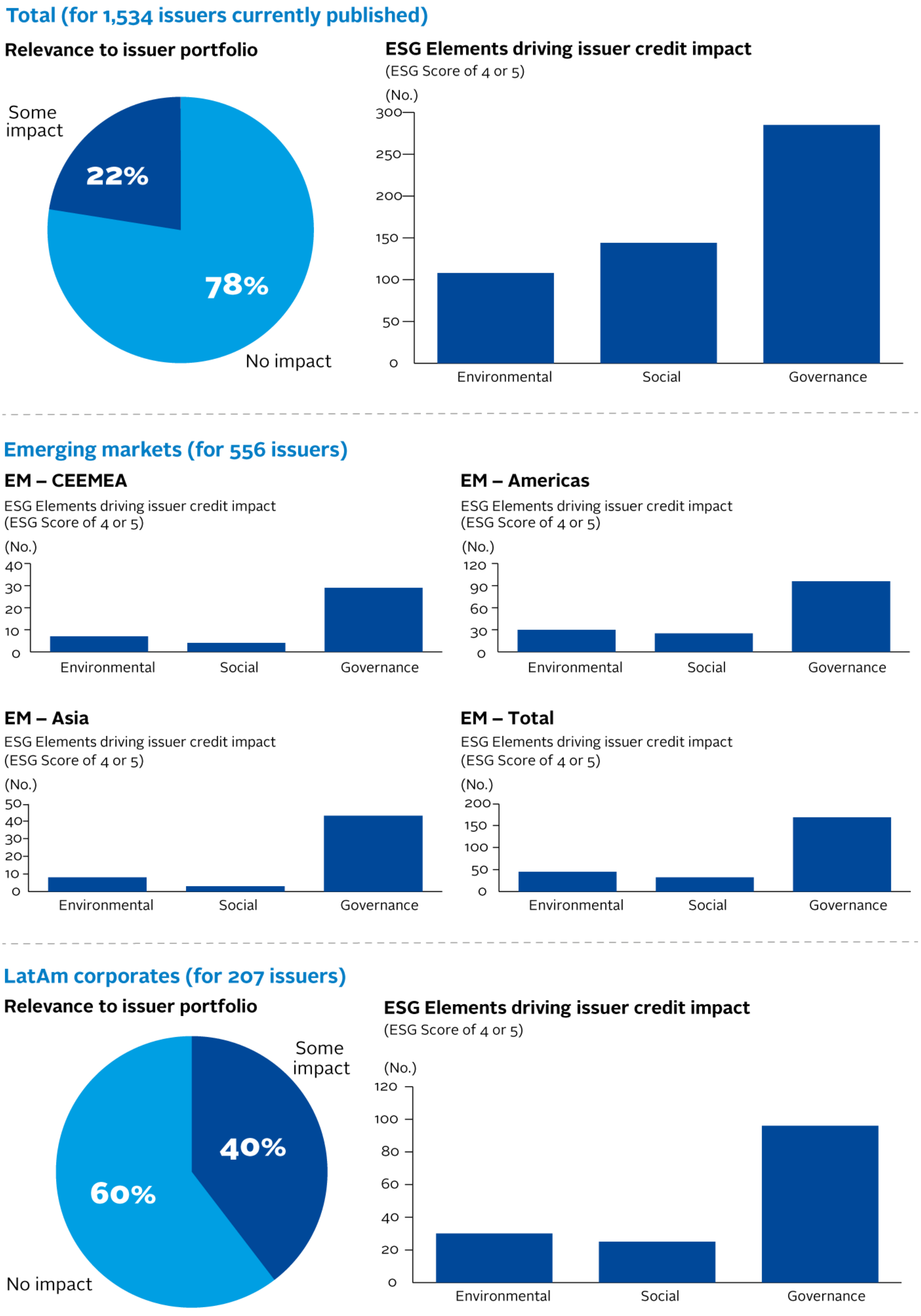


Importantly, ESG relevance in credit risk is beginning to be quantified in EMs. Because ESG issues are more pronounced in EMs, they are more likely to impact credit risk if not managed properly. But during the roundtables, participants learned about the first attempts by CRAs to *measure* this relevance.

For example, credit analysts at Fitch Ratings presented the results of a review of 1,543 corporate rated issuers revealing that 22 percent of the time ESG factors were relevant to credit. This means that they were either not a *key* rating driver but impacted the rating in combination with other factors, or they were highly relevant, significantly impacting the rating individually.[7] This compared with an ESG relevance impact of 26 percent for all EM countries that Fitch Ratings covers. In Latin America alone, it was 40 percent, while in Brazil, Chile and Mexico it was 55 percent, 54 percent and 26 percent respectively (see Figure 3).

[7] For more information about Fitch Ratings' ESG relevance scores, see www.fitchratings.com.

Figure 3. ESG relevance scores in selected markets. Source: Fitch Ratings

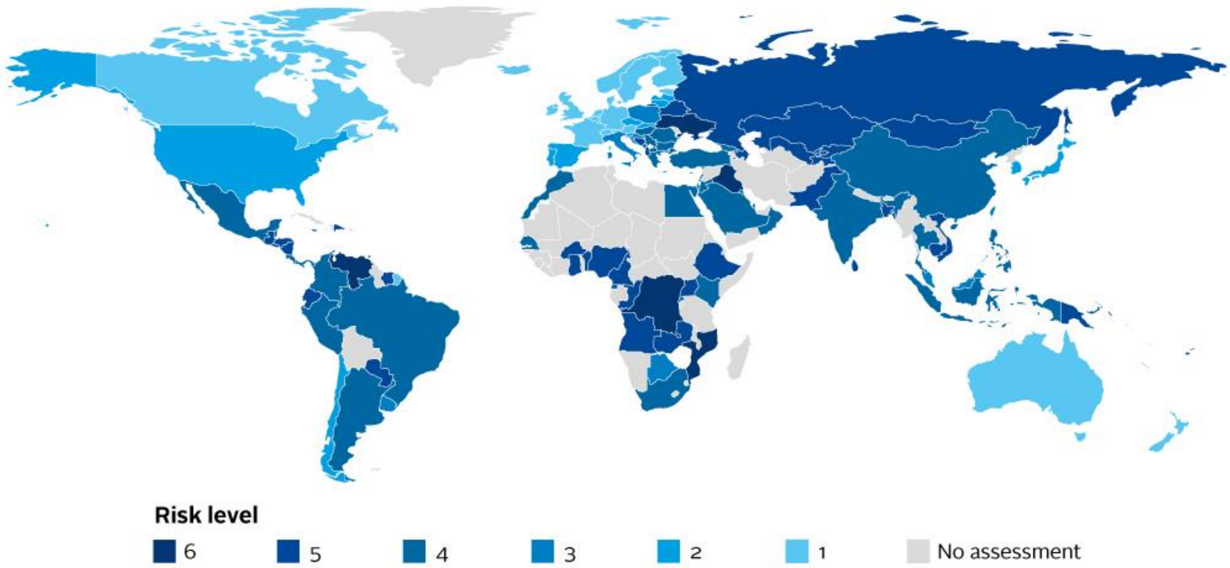


GOVERNANCE IS TOP-OF-MIND FOR INVESTORS

Governance concerns – broadly recognised as the most relevant factor for assessing credit risk during the DM roundtables – were more pronounced in EMs. This was unsurprising, as EM countries are generally associated with higher levels of political instability and corruption, as well as institutional weakness and inferior transparency. It is also the reason why investors demand a high risk premium in these markets.

However, even among EM countries, governance risk varies. This echoes observations from the recent ESG Risk Atlas by S&P Global Ratings (see Figure 4). In fact, the importance of the local jurisdiction and standards when assessing a bond issuer's credit quality were emphasised more during the EM than DM roundtables.

Figure 4. ESG country risk atlas: governance risk. Source: S&P Global Ratings



Participants also acknowledged that this could be down to there being more information to assess governance characteristics. In contrast, there are often gaps in environmental and social metrics, which are not always financially meaningful from a risk perspective.

CORPORATE STRUCTURE: AN IMPORTANT COMPONENT

A point that was stressed during the EM roundtables was that the *structure* of governance is more important in EM countries because of two unique traits:

- **Family-owned (non-traded) companies are very common.** This introduces the risk that company boards are not truly independent, with the family owner potentially influencing important decisions. Moreover, while a deep understanding of the local territory (including potentially close relationships with regulators) may bolster strength, agility and even stability, it can also contribute to weak transparency, poor discipline around capital structuring, and corruption.
- **State-owned entities (SOEs) are harder to assess.** SOEs exist in DMs but they are very common in EMs, especially in China, as highlighted during the roundtable there. The question of moral hazard regarding governance – i.e. a complacent risk assessment because of the expectation of government support – was raised during the Hong Kong discussion. However, in Beijing it was also noted that because of the gradual opening of the Chinese bond market, along with tighter regulatory standards, increasing corporate defaults and slowing economic growth, risk perceptions are being re-assessed. It is becoming apparent that the Chinese government will not tolerate excessive debt indiscriminately going forward.

GROWING RELEVANCE OF ENVIRONMENTAL AND SOCIAL FACTORS

Despite the emphasis on governance, participants expected the relative weights of environmental and social factors in a credit risk context to rise, as their impacts become better understood, easier to measure or more material.

As during previous roundtables, it was stressed that the materiality of environmental and social factors varies significantly across sectors – and even by issuing entity within the same sector, depending on its awareness of risks and ability to address them.

Many sectors in EMs have high environmental and social risk characteristics. Four of the five EMs where the roundtables were held feature among the top 10 richest for biodiversity globally and are home to various indigenous communities. Moreover, they all have active extractive industries, which present challenges such as community opposition. A recent report by Moody's Investors Service on mining companies in Latin America lists soil and water pollution, land use restrictions, water shortages, and natural and man-made disasters among the environmental risks. On the social side are health and safety, human capital and responsible production issues. Figure 5 shows the most prominent environmental and social risks for mining companies in four Latin American countries.

Figure 5. Most prominent environmental and social risks for mining companies operating in Brazil, Chile, Mexico and Peru. Source: Moody's Investors Service

TOP PRODUCING COUNTRIES GLOBALLY

Country	Rank	Metal
Brazil	2	Iron ore
Chile	1	Copper
	2	Molybdenum
Peru	2	Copper
	2	Silver
	2	Zinc
	3	Lead
Mexico	1	Silver

The tourism sector – on which many EM countries rely – was another example of where environmental risks are creating challenges. At the time of the roundtable in South Africa, Cape Town was recovering from the worst of a historic drought – partly triggered by extreme weather and shortfalls in water management and infrastructure. The drought affected the hospitality, restaurant, retail and agriculture sectors. The economic climate deteriorated and rising fiscal pressures contributed to a decline in credit quality of the City of Cape Town. This led to the risk of a downgrade at the end of 2017, when Moody's Investors Service placed the Baa3 rating (with a negative outlook) on long-term debt under review. The downgrade did not occur in the end and the outlook was revised to stable in March 2019, underpinned by the municipality's new water strategy which improved the resilience of water supply and infrastructure.[8]

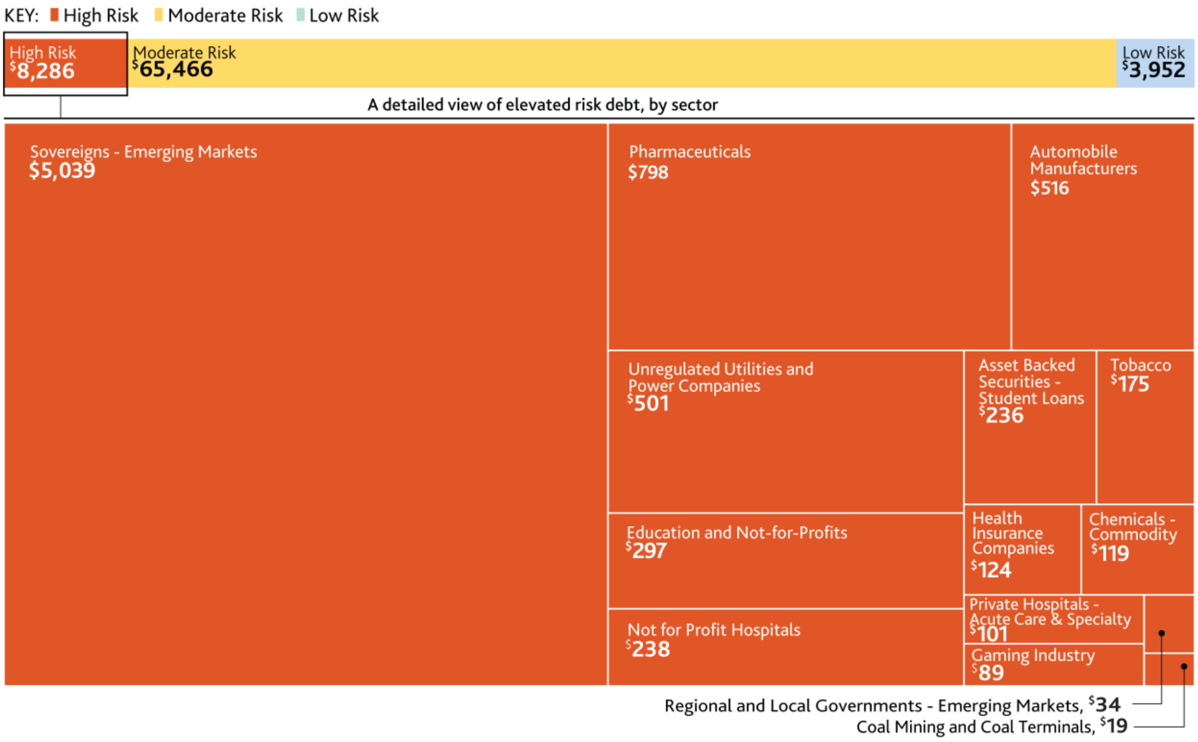
Mounting sargassum seaweed on the beaches of Mexico was another named example of an environmental issue affecting tourism. Although sargassum has ended up on the Caribbean coast for many years, its volume has increased disproportionately, partly because of deforestation in the Amazon as land is cleared for farming. Meanwhile, intensive use of fertilisers in Brazil and Congo have boosted nitrogen levels in the oceans, stimulating algae growth. Sargassum and other factors

[8] See 'Rating action: Moody's places on review for downgrade 15 South African sub-sovereigns', 28 November 2017, and 'Rating action: Moody's revises the outlook of the City of Cape Town's rating to stable and affirms its ratings', 15 March 2019.

such as oversupply and insecurity are contributing to waning tourist revenues, which in 2018 grew at their lowest rate in seven years.

In EMs, social factors also pose more risks at the country level and for sovereign credit risk assessments.[9] Another recent report by Moody's Investors Service ranked EM sovereigns, along with pharmaceuticals and automotive manufactures, as among the largest sectors with high social credit risks (see Figure 6). The reported cited access to essential services, income inequality, education levels and crime as contributing factors.

Figure 6. High-risk sectors in Moody's social risk heat map relative to value of rated debt ($ billion). Source: Moody's Investors Service



The categorisation of ESG risks was also the focus of an interesting debate. There were examples of how some factors can fall under more than one category. For instance, in China pollution was also discussed as a social issue, with rising levels causing distress to inhabitants. During the Mexican roundtable, the controversy regarding the construction of a new airport was flagged as an environmental issue as much as an example of poor management and governance.

Finally, different regulatory challenges were observed: in some countries they are getting stricter; in others, they are already abundant but enforcement is problematic. In China,

[9] The section titled 'Sovereign versus corporate credit risk' in the third report of the series *Shifting perceptions: ESG, credit risk and ratings* covered the difference between sovereign credit risk (i.e. the relative likelihood of a sovereign's ability and willingness to honour its debt) versus country risk (which is more linked to the risk of investing or lending in a country, including political risk, exchange rate risk, economic risk, ease of doing business and transfer risk).

participants noted that the focus on environmental protection is increasing via the introduction of production restrictions in certain sectors to limit carbon emissions. These restrictions can hit cash flow and profits and may increase costs as companies adjust to the stricter rules. In Latin American countries, environmental and health and safety regulations have been in place for longer but the second disaster in less than four years at a Brazilian mining company was a reminder of the costs (including human lives) and risks associated with poor compliance and lack of oversight. The current relaxation of environmental regulations in Brazil was also flagged as concern.

VARYING LEVELS OF CORPORATE DISCLOSURE

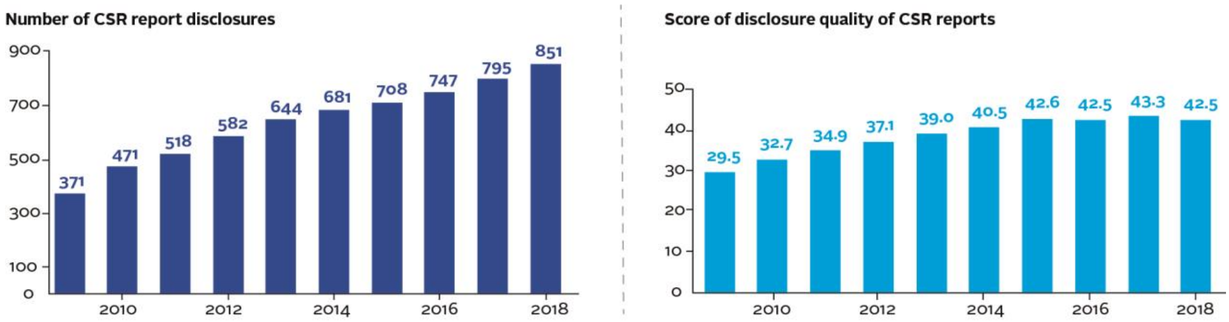
Another area of focus was issuers' level of disclosure, which varies considerably depending on the EM country as well as company size. Participants observed larger companies tend to have better disclosure, and multinationals more so, as they may have to comply with higher standards and requirements in some of the markets in which they operate. Conversely, the problem tends to be worse for private companies, many of which are family owned, as noted previously. One investor during the Chinese roundtable hoped that the gradual opening of capital markets might improve disclosure in China, as local companies invest in foreign countries where standards are higher.

The importance of bondholder engagement, which is still limited in EMs, was emphasised during discussions on disclosure. During the São Paulo roundtable, it was observed that companies perceive disclosure as a burden. Therefore, investors must be clear about what they need, in terms of relevance and materiality, to avoid under or partial reporting.

Asking for more data and clarifications can be a good starting point for engagement with an issuing entity. Participants during the Mexican roundtable recommended having a set of questions ready to ask the board, such as whether the company adheres to a particular ESG reporting standard. It was also noted that engagement should be dynamic and conducted in positive spirit – not to scare companies, as one investor remarked, but to make them understand that lack of information can lead to sub-optimal investing and higher cost of capital.

The lack of standardisation and resources to acquire and manipulate data beyond traditional financial metrics were cited as major barriers to augmented risk analysis. This echoed insights shared during some of the DM roundtables. In particular, in Beijing, it was said that while corporate social responsibility (CSR) disclosure has increased steadily over the past decade in China, the quality of ESG information disclosure needs to improve (see Figure 7).

Figure 7. Number of CSR report disclosures (left) and disclosure quality of CSR reports (right) by Chinese A-shares listed companies. Sources: Golden Credit Rating International and RKS



Note: the RKS disclosure quality score varies between 0 and 100.

DIFFERENT PERSPECTIVES ON TIME HORIZONS

Participants concurred that credit risk assessments must be more forward looking and less reactive. The ESG lens was described as an enabler to more easily identify winners and losers over the long term. However, two considerations stood in contrast to the DM discussions:

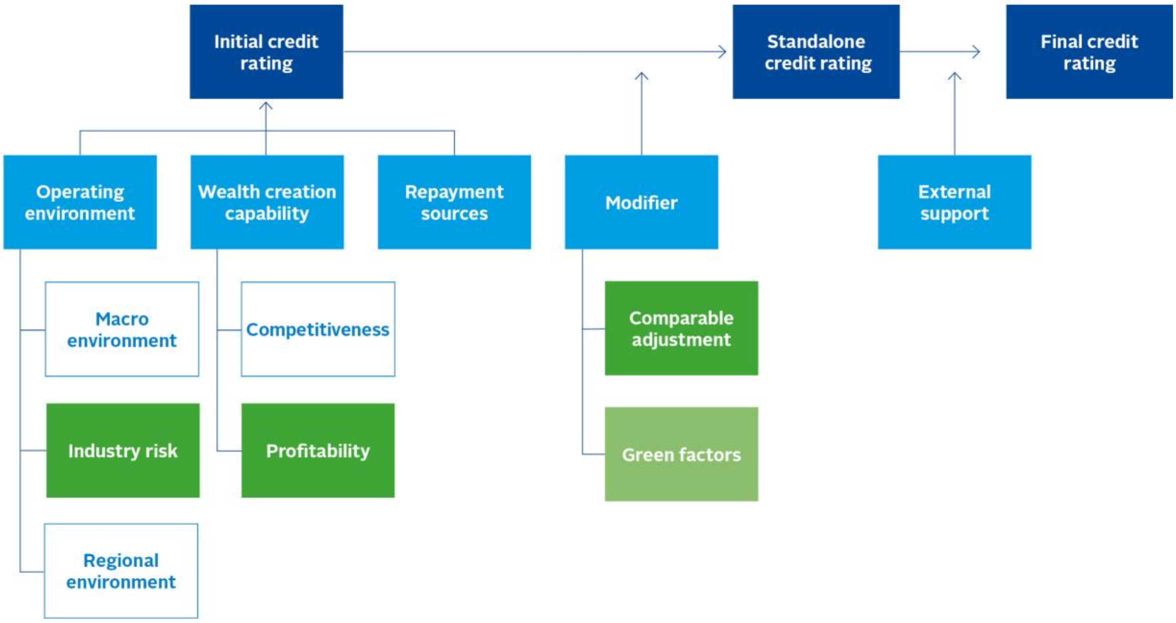
- **Assessments tend to be more frequent in EMs because risks are higher, which encourages a shorter-term focus.** One investor in China observed that the lack of a systematic ESG framework in credit risk analysis makes it difficult to make quick investment decisions.
- **However, when liquidity is poor or in markets where capital flows are constrained, investment decisions can be more binary.** In South Africa, investor participants noted that bonds are often subscribed at issuance and held until redemption. While the refinancing risk is still relevant if the bonds roll over, there are fewer concerns about periodic risk assessment during the life of the bonds.

PROGRESS IN CHINA

The Chinese forum detected rapid changes on several fronts.

ESG consideration is no longer only associated with green bonds. When the ESG in Credit Risk and Ratings Statement was launched in 2016, three local CRAs supported the initiative: China Chengxin Credit Management Co. Ltd. (CCX), Dagong Global Credit Ratings Group and Golden Credit Rating International Co. Ltd.. At that time, they were mostly focused on green bond assessments. While these are still a priority, the CRAs are increasingly integrating ESG factors when assessing the creditworthiness of mainstream bonds. They are beginning to clarify how ESG factors feature in their methodology and some are developing an internal ESG taxonomy (see Figure 8).

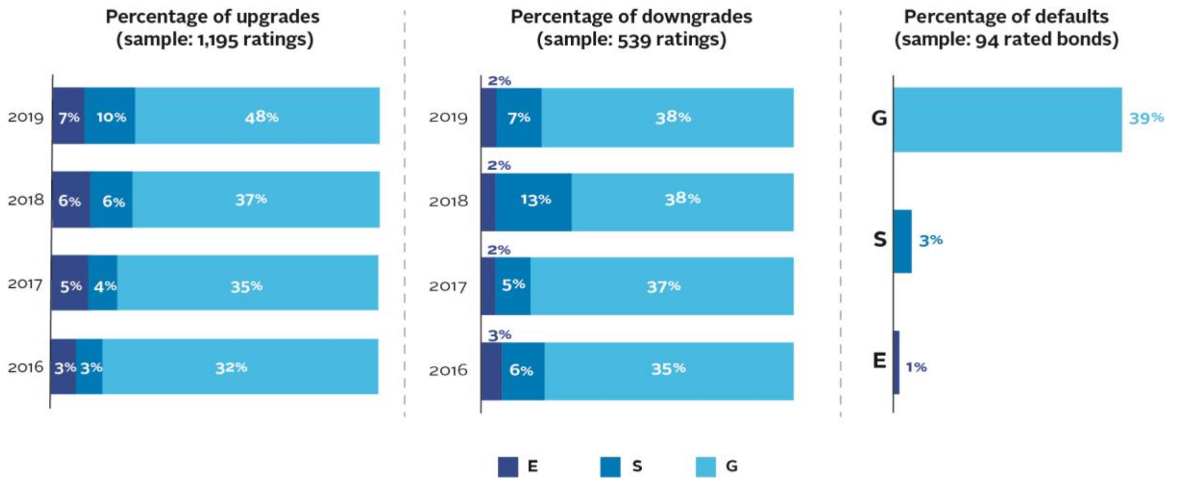
Figure 8. Example of where environmental factors feature in Dagong's credit rating methodology. Source: Dagong Global Credit Rating Co., Ltd



Note: The rectangles in green are the sections of the methodology where environmental factors feature.

Credit risk is rising. The number of corporate debt defaults is increasing. Moreover, higher costs associated with tighter environmental regulations, health and safety controls and regulatory scrutiny are negatively affecting balance sheets and cash flow. Credit analysts are taking this into account when assessing risks. For example, Dagong Global Credit Rating presented the case of a pharmaceutical company with an AA rating whose outlook was revised from stable to negative, partly on the ground that operations were stopped twice since 2017 because of excessive pollution levels. Meanwhile, Golden Credit Rating International presented a back-test highlighting how ESG factors contributed to rating action or corporate defaults (see Figure 9).

Figure 9. Environmental, social and governance factor relevance in rating action and corporate defaults. Source: Golden Credit Rating International



Note: The percentages show the share of upgrades or downgrades driven by environmental, social or governance factors, or where ESG factors contributed to a bond default during the 2016-2019 period.

The CRA landscape is also changing. the Chinese market is opening up to foreign investors as well as new CRAs. At the time of the Beijing forum, S&P Global (China) Ratings had become the first fully foreign-held CRA to receive a licence to rate domestic bonds. A few months later, it issued its first credit rating based on S&P Global Ratings' China scale, assigning an AAA to ICBC Financial Leasing Co., Ltd., with a stable outlook.[10] Foreign competitors will bring a new angle to the market and potentially challenge the (so far notoriously generous) view of creditworthiness by domestic rating agencies.

Lastly, the fact there are plans to mandate that all listed companies and bond issuers disclose ESG information is likely to enhance data consistency and transparency. This is part of policy makers' efforts to attract foreign investors to the Chinese market, including green bonds, and highlights the importance of centralised or regulatory intervention in China as a catalyst of change.

[10] See 'S&P Global China Ratings Publishes First Rating in Domestic Chinese Market', 11 July 2019.

KEY TAKEAWAYS

The global dialogue that the PRI initiated between FI investors and CRAs is the first with a distinct focus on credit risk. It has brought investors up to speed with the progress made by CRAs on ESG consideration, addressed misconceptions and served as a platform for sharing ESG integration challenges.

Although many of the discussion points were common across DMs and EMs, the EM forums were unique. They helped to highlight the following:

- **ESG consideration in credit risk analysis in EMs does not mean drafting a black list**. Using negative screening to identify issuers whose credit quality is highly compromised by ESG factors is one approach to ESG consideration and it may seem the most relevant because the scale of ESG challenges is bigger in these countries. However, excluding sectors or companies from a portfolio may also result in missed opportunities to identify issuers whose credit quality could improve, if they embrace more sustainable business practices. Thus, rather than screening, assessing the *financial materiality* of ESG factors can be a useful tool to price risks more adequately.
- **Understanding companies' ESG practices through bondholder engagement can unearth blind spots**. Transparency and accountability shortfalls are major hurdles to investing in EMs but engagement can bring additional insight to avoid losses and potentially take advantage of risk mispricing. Suppliers or downstream players may unknowingly have risk exposure, including to ESG factors. But when risks become reality, markets may belatedly recognise them and even overreact, which can create opportunities for engaged investors.
- **Scrutiny by foreign investors could reduce or improve management of credit-relevant ESG issues in EMs.** The forums highlighted the power of change that asset owners have as well as the mismatch between where funds are located (typically in wealthy countries with large pension and insurance fund industries) and where ESG challenges are more pressing (largely in developing countries). For this reason, external investor pressure can promote progress towards a more systematic and transparent consideration of ESG factors in credit risk analysis in EMs.

NEXT STEPS

Going forward, the PRI intends to work towards:

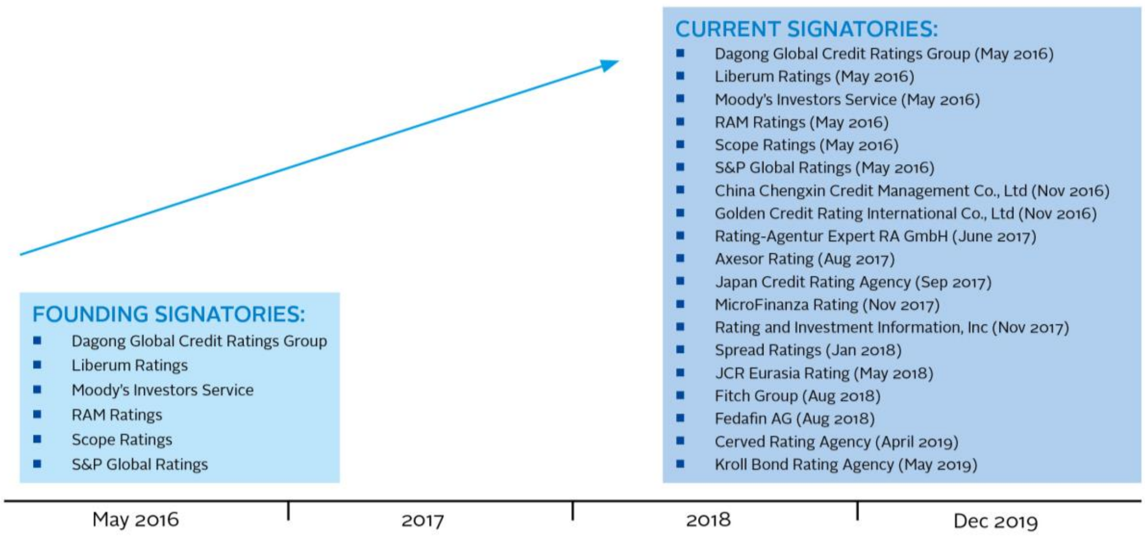
- fostering the implementation of the emerging solutions described in part 3 of the report series, with action areas to overcome some of the initial disconnects between investors and CRAs;
- identifying credit-relevant metrics on which ESG factors can have an impact; and
- extending the investor-CRA conversation to other stakeholders, particularly issuers.

The PRI will initiate another series of regional roundtables involving issuers, with more focused discussions by sector and/or asset class. This will enable corporates to better understand how financing costs could vary (up or down), depending on their exposure to risks and approach to risk management, in an environment where sensitivities to value creation or growth models are changing. It will also foster activism among credit practitioners, helping them to shape their analysis by sector or asset class.

The initiative intends to continue facilitating enhanced alignment among key stakeholders of the investment chain. In turn, it will boost information transparency, awareness of resources and ultimately the systematic consideration of ESG factors when assessing underlying credit risk.

APPENDIX I: SUPPORTERS OF THE ESG IN CREDIT RISK AND RATINGS STATEMENT

CREDIT RATING AGENCIES



Note: The dates in brackets denote when the CRAs signed the ESG in Credit Risk and Ratings Statement.

INVESTORS

ASSET OWNERS		
Allianz SE	Church of Sweden	Pegaso - Fondo pensione complementare
ASR Nederland N.V.	ERAFP - Etablissement de Retraite Additionnelle de la Fonction Publique Pension Scheme	Pension Protection Fund
AustralianSuper	First State Superannuation Scheme	Public Sector Pension Investment Board
AXA Group	Fonds de réserve pour les retraites - FRR	QBE Insurance Group Limited
Bâtirente	Geroa pentsioak E.P.S.V. de empleo	Régime de Retraite de l'Université de Montréal
British Columbia Municipal Pension Plan	HESTA Super Fund	TPT Retirement Solutions
BT Pension Scheme	KfW Bankengruppe	Treehouse Investments, LLC
Caisse de dépot et placement du Québec	KLP	University of Toronto Asset Management Corporation
California Public Employees' Retirement System CalPERS	Länsförsäkringar AB	Victorian Funds Management Corporation
CCOO, FP	Local Government Superannuation Scheme	Wespath Investment Management
CDC - Caisse des dépots et consignations	Norwegian Government Pension Fund Folketrygdfondet	Zurich Insurance Group
Challenger Limited	Ontario Teachers' Pension Plan Gramercy Funds Management	
ASSET MANAGERS		
Aberdeen Standard Investments	Erste Asset Management GmbH	Nikko Asset Management Co. Ltd.
ACTIAM	ESG Portfolio Management	NN Investment Partners
Addenda Capital Inc.	Federal Finance	Nomura Asset Management Co., Ltd.

AEGON Asset Management	Fidelity International	OFI Asset Management
Alberta Investment Management Corporation	Fiera Capital Corporation	Öhman
Alliance Bernstein	Franklin Templeton Investments	OP Wealth Management (OP Asset Management Ltd, OP Fund Management Ltd and OP Property Management Ltd)
Allianz Global Investors	Futuregrowth Asset Management	Ostrum Asset Management
AlphaFixe Capital Inc.	Galliard Capital Management, Inc.	Partners Group AG
AMP Capital Investors	Generation Investment Management LLP	Payden & Rygel
Anima Sgr	Global Evolution	PGGM Investments
APG Asset Management	Goldman Sachs Asset Management (GSAM)	PGIM Fixed Income
Ardea Investment Management	Gramercy Funds Management	PIMCO
Australian Ethical Investment Ltd.	Hermes Investment Management	PineBridge Investments
Aviva Investors	HSBC Global Asset Management	Principal Global Investors
AXA Investment Managers	IFM Investors	Prudential Portfolio Managers (South Africa)
Bank J. Safra Sarasin Ltd	Income Research & Management	Public Investment Corporation (PIC)
Barings LLC	Insight Investment	QIC
BlueBay Asset Management LLP	Investec Asset Management	RBC Global Asset Management
BMO Global Asset Management	Itaú Asset Management	RobecoSAM AG
BNP Paribas Asset Management	IVM Caring Capital	Royal London Asset Management
Brandywine Global Investment Management, LLC	Janus Henderson Investors	Sage Advisory Services Ltd. Co.
Breckinridge Capital Advisors	Jarislowsky, Fraser Limited	Sanlam Investment Management (SIM)
British Columbia Investment Management Corporation	Kempen Capital Management NV	Sarasin & Partners LLP
Brown Advisory	La Française Group	Saturna Capital
Caja Ingenieros Gestión SGIIC, SAU	Legal & General Investment Management (Holdings)	Schroders
Calvert Research and Management	Leith Wheeler Investment Counsel Ltd.	Skandinaviska Enskilda Banken (SEB) AB
Candriam Investors Group	LocalTapiola Asset Management Ltd	SKY Harbor Capital Management
Christian Brothers Inv. Services, Inc.	Lombard Odier	Sparinvest S.A.
CIBC Asset Management Inc.	Longfellow Investment Management Co., LLC	Stone Harbor Investment Partners LP
Colchester Global Investors Limited	M&G Investments	Svenska Handelsbanken AB (Publ)
Colonial First State Global Asset Management	Maitri Asset Management	T&D Asset Management Co., Ltd.
Commonfund	Maple-Brown Abbott Limited	Tareno AG
Compass Group	Mariner Investment Group, LLC.	TD Asset Management (TD Asset Management Inc.)
Conning	MFS Investment Management	Tokio Marine Asset Management Co., Ltd. Japan
Connor, Clark & Lunn Investment Management Ltd.	Mirova	Triodos Investment Management B.V.
DDJ Capital Management, LLC	MN	UBS Asset Management
Delta Alternative Management	Mondrian Investment Partners Limited	Union Asset Management Holding AG
Domini Impact Investments	Moneda Asset Management	Union Bancaire Privée, UBP SA
EGAMO	Montrusco Bolton Investments Inc. (MBII)	Vancity Investment Management
Element Investment Managers	Neuberger Berman Group LLC	Wellington Management Company LLP

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