

Promoting Dialogue between Sovereign Issuers and Investors on ESG Risks and Opportunities

On April 10, 2019, the World Bank Treasury convened a first ever roundtable on environmental, social and governance (ESG) issues to promote open and productive dialogue between institutional investors and sovereign bond issuers. Building on experience in the equity market, investors are exploring ways to strengthen and/or expand their ESG approaches across asset classes, including for investments in sovereign bonds – to enhance both risk management and returns and to achieve positive impact.

As investors develop comprehensive ESG risk assessment and portfolio selection frameworks to assess sovereign issuers and their bonds based on ESG criteria, they are interested in learning about countries' ESG policies, strategies and approaches, analyzing data on sovereign ESG performance, and assessing progress on the Sustainable Development Goals (SDGs) and Paris climate commitments.

FIRST SOVEREIGN ISSUER-INVESTOR ESG ROUNDTABLE

The World Bank Treasury, in collaboration with the Japanese Government Pension Investment Fund (GPIF) and Dutch pension fund, APG, hosted a workshop to support a dialogue between investors and sovereign issuers, focused on ESG factors. Investors had approached the World Bank Treasury's Investor Relations team to facilitate this communication, based on its experience as a development institution with a strong environmental and social framework and leadership in the sustainable bond market and impact reporting. The World Bank is also a prominent source of sovereign ESG data responsible for tracking countries progress on numerous SDGs.

WORKSHOP PARTICIPANTS AND CONTENT

The roundtable brought together 17 institutional investors, including asset owners and asset managers from the US, Asia, and Europe. Sovereign issuers included Colombia, Finland, Malaysia, and the Netherlands.

As data remains an important and evolving element in ESG investment, the World Bank kicked off the event with an update on its ESG data platforms and visualization tools, including plans for enhancing data quality and delivery. A preview of tools for scoring project resilience was also introduced. Presenters included a senior data scientist with the World Bank's Development Data Group, a lead economist with the Global Fund for Disaster Reduction and Recovery at the World Bank.

Institutional investors, represented by sustainability and bond portfolio managers, participated in a lightning round to share approaches for ESG integration for sovereign fixed income as background for the dialogue. The second half of the program provided a dedicated session for sovereign issuers, represented by heads of debt management offices and senior government officials, to highlight their funding programs and share insights on progress on climate goals and the SDGs. Participants engaged in a constructive and reciprocal dialogue on challenges and opportunities around ESG and achieving the SDGs. The session promoted peer feedback among investors on approaches, data challenges and means of engagement with sovereign issuers.

KEY TAKE-AWAY MESSAGES

1. Investors are actively including sovereign bonds in ESG integration.

Investors are increasingly looking for value from ESG analysis for sovereign bonds. Some investors stated that ESG factors have always been considered in their internal due diligence and credit analysis, but only recently have been formalized and made explicit. Investors see a strong link between an issuer's ESG performance and the consistency of financial returns for its bonds. Some investors emphasized that sovereigns can benchmark themselves against others on ESG progress.

2. Investors are engaging directly with sovereign issuers on ESG risks and opportunities. This dialogue provides needed context for ESG assessment.

The workshop provided a unique forum for asset owners and investors to learn from each other. Issuers' willingness to discuss challenges was especially appreciated by investors and the meeting format facilitated an open conversation. Guidance provided to issuers to share progress on climate commitments and the SDGs worked well. Issuers had the opportunity to hear what questions to expect as they expand their dialogue on ESG and learn how investors communicate with sovereign issuers including through letters, meetings, and calls. Participating investors said they prefer engagement with sovereigns over exclusion and do not follow prescribed checklists for assessing sovereign issuers, noting that this approach is especially relevant for emerging market sovereigns. Investors value engagement as key to building trust and understanding a country's story and ESG ambitions beyond what the data shows.

3. The initial focus for some sovereign issuers is on the 'E', e.g. green bonds.

Several sovereign issuers are adopting sustainability strategies starting with a focus on environment through green bonds. Urged by international calls to act against climate change and supported by the established frameworks of the green bond market, some sovereign issuers in Europe and in developing countries have been issuing green bonds. Issuers noted that green bonds have helped connect debt issuance teams with government agencies responsible for implementation of related programs (e.g. ministries of environment, planning). Malaysia has been building a domestic green bond market and has set aggressive climate targets promoting renewable energy and energy efficiency. The Netherlands has announced an inaugural green bond planned for May 2019. Other countries, like Finland and Colombia, presented a broader approach to ESG highlighting sustainability strategies that tackle ESG challenges in the country while noting specific progress on SDGs.

4. Investors integrate ESG using a variety of methodologies. Client preferences can affect these approaches.

All investors at the workshop integrate ESG considerations in investment decision making and have proprietary assessment processes and unique investment priorities. They noted that for third-party asset managers and external mandates, the approach is often driven by client preferences. Investors emphasized that external reviewers, specializing in ESG assessment, do not have a standard approach and assessments are not consistent across reviewers. As a result, investors tend to combine one or more external ESG valuations with internal analysis. One asset manager is developing an index ranking sovereigns based on sustainability criteria using World Bank data that will be published for use by any investor looking to index holdings to sovereigns based on sustainability criteria.

5. Data availability, timeliness, and reliability are key to ESG fixed income investing.

Investors use data available from a variety of providers (subscription and free data) and appreciate direct access to easy-to-use data. ESG data providers for corporates, multilaterals and sovereign issuers use different scoring methodologies and standards. Data lags remain a challenge and the relevance of data for ESG and bond performance is often not well understood. These issues are particularly problematic for emerging markets. A better understanding of sustainability and guidance on the relevance of indicators on performance and impact are needed. Artificial intelligence, natural language processing and big data have the potential to improve the speed and quality of the data management processes for ESG evaluation, but the application of these technologies is still in its early stage.

NEXT STEPS

Based on feedback, issuers and investors greatly valued the workshop and the unique opportunity for dialogue on ESG and peer feedback on approaches. The format was conducive to an open, constructive dialogue and the framework that issuers used for the discussion, including focusing on progress towards climate commitments and assessing progress on the SDGs, worked well. Investors have asked the World Bank Treasury, as part of its role as a champion and leader in building sustainable capital markets, to continue to facilitate dialogue and connect investors with issuers, particularly in emerging and frontier markets, and to build dialogue and advance progress with a range of market stakeholders on ESG integration. This workshop was the third investor roundtable the World Bank Treasury has hosted since April 2018 on ESG and sustainable capital markets.