

# ESG Engagement Policy Statement for Sovereigns

## INTRODUCTION TO THE SOVEREIGN ENGAGEMENT STATEMENT

Along with all other investment teams at Brandywine Global, the Global Fixed Income team follows the guidelines set forth in our Environmental, Social and Governance (ESG) Integration and Engagement Policy. Please click [here](#) to access it. We use a universal integration and engagement framework to serve the diverse ESG needs of our worldwide client and consultant base. While we set our ESG initiatives at a firm level, execution—including engagements—occurs at the investment team level. Our firmwide ESG engagement policy is also universally applied to our sovereign bond investment process, and this Sovereign Engagement Policy provides clients and consultants with additional transparency into our country-level engagement process. We believe our sovereign engagement process is made most effective by tracking material ESG issues, monitoring those factors for any changes, and influencing change at the country level. However, given the monolithic qualities of many sovereign institutions, it can be difficult for a lone manager to effect change. Therefore, we believe in the power of collective action within the investment management industry; by acting in concert with other managers, our engagements in aggregate are more influential at a sovereign level.

## GLOBAL FIXED INCOME TEAM ENGAGEMENTS

Our engagement program is designed to enhance our country information risk assessments and advocate for change. Since ESG analysis is inherent to our investment process, every member of the Global Fixed Income team accounts for these factors as part of their research efforts and country assessments. We believe that sovereign engagements play a crucial role in how we evaluate information risk and therefore use these opportunities to enhance our country-level research. Our sovereign ESG framework emphasizes governance as a predominant factor, as government policymaking and effectiveness generally influences both social and environmental factors. Furthermore, governance drives long-term change within a country—including bond and currency valuations—which aligns with our longer-term investment horizon. Engaging with government officials, organizations, and key stakeholders is an integral part in forming our country positioning and outlook. In the long run, effective governance—the term we use to describe and measure this factor—translates to a positive net impact on civil society and economic activity, aspects that should promote a country's portfolio inflows. Ultimately, we believe effective governance drives improvement in social and environmental policies—we also engage directly with sovereigns on those factors and monitor them for changes.

## OVERVIEW OF THE SOVEREIGN ENGAGEMENT PROCESS

### THE PURPOSE OF OUR ENGAGEMENTS

While engagements are meant to complement our price and information risk analyses, these discussions also serve as an opportunity to highlight where countries can improve along our

## PROMOTING DEEPER INSIGHTS

At Brandywine Global, we believe the inclusion of factors related to sustainable and responsible investing are necessary for a complete understanding of both risk and opportunity.

- **Environmental** – Unsustainable or controversial environmental policies may lead to greater physical climate risks, higher borrowing costs, deteriorating multilateral relationships, competitive disadvantage, and negative implications for growth.
- **Social** – Poor labor conditions or human rights violations may put countries at risk of unrest or upheaval, impairing economic progress.
- **Governance** – Insufficient governance may promote conditions that ignore investor rights and interests while enabling fraud or corruption, limiting investment returns and exacerbating risks.



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ESG scoring. Ultimately, we believe that countries are incentivized to improve their practices and resultant ESG scores as a way to upgrade their sovereign debt ratings and lower government bond yields, thereby lowering their cost of capital—an important way to reallocate resources away from debt service and toward other important budget needs.

By participating in engagements, we learn about important initiatives, current business conditions, and upcoming policy changes from various actors from the public and private sectors. We also use these discussions as a forum to share our proprietary ESG research and scoring with these entities, and encourage efforts to improve government policymaking.

## THE ENGAGEMENT AGENDA

### IDENTIFYING MATERIAL ESG ISSUES

When determining which sovereigns to engage with, we consider aspects like initiatives within the investment management industry, macro-economic conditions, and portfolio exposures and positions sizes. Most importantly, issues of materiality largely inform our engagement topics. Materiality is primarily defined as endemic or external matters that must be addressed by a sovereign, as they are likely to impact asset prices. In addition to issues of materiality, a country's overall ESG score—or a certain factor or subset—drives our overall engagement agenda by identifying areas of improvement.

The graphic below depicts how ESG factors and their subsectors drive our six-step engagement process.

**Figure 1** Six-Step Engagement Process



As an investment team, we identify several factors from each of the ESG segments to determine the materiality of any sovereign issues, which will then drive our engagements. The first step is therefore to identify these weaker ESG scores on a country and factor level, and then create a plan on how to address these material risks with key stakeholders. Generally, ESG rankings in the lowest-quartile countries indicates a key area for engagement. We believe raising awareness of a country's ranking is an important step in the efficacy of our engagement process.

### ADDRESSING ESG ISSUES WITH SOVEREIGNS

There are many opportunities to engage with a country within the public and private sectors. Seeking input from a diverse set of institutional actors complements our information risk analysis of a country. Though this list is not exhaustive, we typically seek to meet with:

- Government officials, particularly treasurers and central bankers
- Members of both the political majority and minority
- Cabinet members and ministers
- Non-governmental organizations

- State-owned enterprise management teams and board members
- Supranational agencies like IMF, IIF, and World Bank
- Investment bankers
- Business leaders

We leverage discussions with the private sector within a country to better understand the severity of ESG weaknesses, which may help us prepare for a meeting with government agencies to help us ask more informed questions or in preparation to advocate for change. We engage with stakeholders in a variety of ways: in-person and virtual meetings, conferences, collaborative platforms, email, letters, and phone calls.

## ADVOCATING FOR CHANGE

When given the opportunity to highlight the materiality of a country's ESG issue, we would initially like to know whether the entity is aware of the opportunity for improvement and what steps—if any—are being taken to address deficiencies, and ultimately how these actions may affect the country's debt and/or currency valuations. We believe collective action from investment managers can be crucial during this step of advocacy. We contribute to this collective action by publicly raising our ESG country analyses and opportunities for improvement—when permissible during an engagement—or through industry working groups, conferences, or our own thought leadership. Ultimately, countries should understand the areas of disagreement and points of contention that investors have with their policies. A country's reputational risk and its recognition of the risk is an important investment consideration for us.

## MONITORING FOR CHANGE

We monitor for a range of country-level outcomes resulting from our engagements:

- Improvements in relevant ESG factors and subfactors and overall scores
- Changes in policymaking (e.g. reducing carbon emissions, improving tax structure)
- Increasing resources for development of an area of weakness (e.g. education, infrastructure)
- Changes to socioeconomic data points like the GINI coefficient, the wealth gap, or unemployment
- Changes to business conditions such as ease of doing business, regulatory burdens, the rate environment

## DISCUSSING RISK-RETURN PROFILE WITH RESPECT TO ESG SCORING

The Global Fixed Income team has a shared-research policy, whereby all research analysts and portfolio managers are included in engagement opportunities and can participate. Additionally, engagement reports are circulated after any team member has conducted a meeting. The information from these reports helps inform the team's decisions on country outlooks and related portfolio positioning.

## AUDITING AND ACCOUNTABILITY SOVEREIGN ENGAGEMENTS

The ESG Council, led by its co-chairs, will review the Global Fixed Income team's sovereign engagements on a quarterly basis prior to publishing external reporting. The head of the Global Fixed Income team will also oversee all sovereign engagements.

## REPORTING ON ENGAGEMENTS

In order to promote transparency within our sovereign engagements, client and consultant reporting will be produced starting 3Q20, across all asset classes by 4Q20, and via a firm engagement report by 1H21. In the meantime, we will continue to publish our ESG research on our blog, Around the Curve, as well as industry publications and collaborative research.

This material contains the opinions of Brandywine Global Investment Management, LLC, which are subject to change without notice. Analysis and integration of ESG factors is qualitative and subjective by nature, and there is no guarantee that the ESG criteria used, or judgment exercised, by Brandywine Global will reflect the values of any particular investor. This material has been distributed for informational purposes only and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product.