How Issuer Engagements Inform Portfolio Positioning

Credit Research Case Study

The Importance of Engagement in Fixed Income

ESG continues to be top of mind for many investors – individuals and institutions alike. For many years, equity managers and activist shareholders have owned a larger share of voice regarding how they consider environment, social, and governance factors and engage with companies to enact change. Unlike equity investors, corporate bondholders do not have voting rights, but we do have the potential ability to influence issuer practices as an active manager.

As a fixed income investor, we occupy an important position among capital providers to many corporations. At RPIA, our belief is that engaging with issuers is a valuable part of our role as stewards of capital. The sheer size and importance of debt markets place bondholders in an influential position to engage with corporate issuers and hold their feet to the fire when it comes to ESG disclosures and targets.

There are unique opportunities for engagement within fixed income as outstanding debt is typically a larger portion of company balance sheets than equity, and private companies also issue debt in global capital markets. This allows fixed income asset managers to engage with prominent, impactful companies that are not available to public equity investors.

Our Approach to Issuer Engagement

As described in our ESG policy, we apply our ESG integration process across all our strategies and aim to integrate the consideration of ESG risks and opportunities into the investment process to support and augment our fundamental financial and credit analysis. We score issuers using quantitative metrics, conduct in-depth subjective credit research on holdings, and practice active issuer engagement, where we discuss and challenge issuers on ESG-related disclosures and business strategy. We then use these assessments to inform how we price risk across the portfolios. Over time, we have found that ESG-related analysis supplements our fundamental analysis and informs us of how ESG and fundamental risks may be intertwined. Our Investment team (both research and execution) is responsible for integrating ESG analysis into their process, whether through in-depth research or portfolio structuring.

Our channels of communication include individual updates from senior management teams to discuss business results and outlooks, catalyst-driven conversations with management teams as part of a transaction, and contributing to industry-driven comment letters and discussions where appropriate. In addition, we are in regular discussions with companies and syndicate desks of the underwriting banks regarding new issue transactions. We believe active engagement is a valuable component of our responsible investment approach.

In the discussions we have with issuers, we gain insights that are not always available through a review of data or other reporting. Here, management teams share their future visions for managing risks and opportunities, and we have the opportunity to discuss where companies can improve on both fundamental risks and ESG-related risks.

By integrating ESG factors into our analysis, we can better identify and assess potential risks and opportunities, ultimately leading to more informed decisions and better risk-adjusted returns for investors. This is especially true for our ESG-focused thematic strategies which have specific ESG-related investment objectives.

ESG information, including details related to material risks and opportunities is part of the total mix of information RPIA considers as part of its investment decision making, and is not itself investment determinative.

The impact and weight of ESG consideration, including our issuer engagement efforts, can differ between our portfolios based on individual portfolio objectives, strategies and suitability of investments. We encourage investors to review the offering documents of the respective RPIA managed funds for additional information.

Engagement with a U.S. Telecommunication Company

Every month, our Credit Research Portfolio Managers engage with select issuers to gain a better understanding of their risks and opportunities in the context of the objectives and positioning of RPIA strategies. In this particular engagement, we engaged with a U.S. Telecommunications Company on all three pillars - E, S, and G - but with a specific concern regarding one of their environmental metrics. We had positions in this company in several of our strategies, including our ESG-focused portfolios.

Engagement Background and Rationale

We have maintained an overweight position in the telecommunications sector for some time due to its compelling valuation: the industry benefits from a secular demand for data and has large barriers to entry. As our position in the telecommunications sector grew in the mandates, its contribution and relative Weighted Average Carbon Intensity ("WACI") became more noticeable. Recently, we have sought to reduce our exposure to the sector by capitalizing on its strong performance.

Upon receiving updated WACI data for our ESG-focused strategies, our research team swiftly identified this U.S. Telecommunications Company as having a significantly high WACI relative to its industry counterparts. This finding was further confirmed by a comparative analysis using the RP Barometer, our proprietary tool which helps us build a better, contextualized, and more standardized understanding of the ESG risks of an issuer.

Since this issuer held a notable position in many of our portfolios, particularly within ESG-focused index-relative strategies, it was important for us to understand the driving force behind their high emission intensity not only as it relates to their environmental goals, but also the company's overall management.

RP Barometer Output

Environmental Risk Factors — **Overall Rank: 3.3**

Metrics (Current & Trend) — **Current Rank: 3.3** / **Trend Rank: 3.2**

Factors	Metric	Unit	Current	Curr Rank	Trend	Trend Rank
GHG Emissions	Total GHG CO2 Emissions Intensity per Sales	CO2e/Rev	48.7	4	+5.1	4
Resource Management	Energy Intensity per Sales	MWh/Rev	132.5	4	+4.6	3
Resource Management	Pct Renewable Energy Consumed	%	17.5	3	+3.5	2
Ecological Impact	Water Use/Withdrawal Intensity per Sales	M^3/Rev	83.9	4	+10.8	3
Ecological Impact	Waste Generated per Sales	Mt/Rev	1.5	4	+5.4	3
Ecological Impact	Phones Recycled	#	15,000,000.0	1	-28.6	4

Metrics (vs. Peer Group)

Metric	X	A	B	C	D	E
Total GHG CO2 Emissions Intensity per Sales	48.7	28.2	36.7	28.2	16.3	9.4
Energy Intensity per Sales	132.5	82.4	97.7	80.8	50.3	83.2
Pct Renewable Energy Consumed	17.5	30.6	97.4	0.2	9.3	46.0
Water Use/Withdrawal Intensity per Sales	83.9	55.4	10.4			9.3
Waste Generated per Sales	1.5		0.5			0.9
Phones Recycled	15,000,000.0					

X = U.S. Telecommunications Company; A to D = U.S. Peers; E = Canadian Peer

Engagement Focus

Our team met with representatives from the U.S. Telecommunications Company in August 2024. Our conversation covered all three pillars of ESG with a primary focus on the issuer's GHG Emission Intensity as disclosed in their 2022 Sustainability Report. We were concerned about the company's high GHG emissions intensity because it was repeatedly identified as one of the top contributors to our Fossil Fuel Exclusion strategy's WACI, disproportionately driving up the fund's average. Consequently, we inquired about the reasoning behind their high emissions intensity and requested more information on their emission reduction efforts.

Engagement Outcomes

During the engagement, the company was unable to explain why its GHG emission intensity was significantly higher than that of its industry peers and committed to providing us with an answer to this question via email after the call. Our team promptly sent a follow-up email after the call which included sources (their 2022 Sustainability Report) and a comparative analysis table. Despite several follow-ups, we did not receive a response to this key question. Our team's view of the issuer did not improve given their lack of communication.

Shortly after our engagement, the company released its 2023 Sustainability report which showed a modest reduction in GHG emissions intensity as a result of its fleet electrification and energy efficiency efforts. Our team conducted another comparative analysis which concluded that this decline was not substantial, and the company's emissions intensity remained well above their peers. In fact, the company's GHG emissions intensity remained double than the average of its top four competitors. This, coupled with the company's unresponsiveness, continued to raise our concerns about their commitment to sustainability and emission reduction.

As a result of this engagement, we decided to reduce our positions in the company. This decision was driven by three factors:

1. Portfolio construction considerations across several of our strategies,
2. Company valuation no longer compensated for the incremental WACI, and
3. Our goal of lowering the overall emissions intensity score of our Fossil Fuel Exclusion strategy to continue maintaining a WACI level that is less than that of the benchmark.

We will continue to monitor the company's environmental progress but remain cautious due to its ongoing lack of alignment with peer benchmarks in emissions reduction.

Final Takeaways

While emission intensity is an important metric, we also acknowledge that the path to emission reduction is long and ever changing. Engagement has been paramount to understanding different issuers' unique pathways, which can inform decision-making of how we shape our portfolios. As a result, issuers must make transparency and communication in engagements a priority.
Overall, ESG engagement as a bond investor can be a powerful tool to enact change or manage risk in portfolios – both fundamental and ESG. The additional colour an issuer can (or in this case, cannot) provide during an engagement allows our team to evaluate the impact and likelihood of improvement in the short- or long-term and determine the course of action for portfolio positioning.

If you would like to learn more about our investment process, our ESG policy, or our strategies, please do not hesitate to contact a member of our Client Team.

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RPIA is a signatory of the UN Principles for Responsible Investment and as part of our commitment, we consider Environmental, Social & Governance ("ESG") factors as part of our firm-level activities, including our investment process. ESG factors are important considerations in our investment management process but is supplemental to our primary financial and credit research and analysis functions. ESG factors that may be considered as part of our investment process include matters relating to climate change, energy use, energy efficiency, emissions, waste, pollution, matters related to human rights, impact on local communities, labour practices, employee working conditions, health and safety of the employees and affiliates, employee relations and diversity, executive compensation, bribery and corruption, board independence, board composition and diversity, alignment of interest between the shareholders and the executives, shareholder rights, and companies' policies relating to ESG.

ESG integration, including components relating to issuer engagement, is a firm-wide investment approach but the weight and importance of it in our investment management process can vary across the investment funds we manage. Always refer to the relevant fund offering documents for important information on the investment objectives, strategies and associated risks of a particular fund. The consideration and implementation of ESG factors are also subject to RPIA's internal investment and risk management policies and may be revised as a result of investment suitability requirements, current portfolio positioning and external market and economic factors.

The consideration of ESG factors in the investment process for RPIA managed mutual funds, including RP Strategic Income Plus Fund, RP Target 2026 Discount Bond Fund and RP Alternative Global Bond Fund is limited and weighted less than the primary financial and credit analysis employed in the management of these funds. Please see the fund's simplified prospectus for important information about the investment objectives, strategies and risks of each fund. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. Always consult with your registered investment dealer before investing in mutual funds.