

# Sustainability In A Post-COVID World: From Sideline To Spotlight



Is this crisis the ESG wakeup call that markets needed? Policy responses and new bond issuance may set the trajectory of ESG markets for years to come and determine the sustainability of markets, governments, and societies.

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## **Featured speakers:**



**Scott A. Mather**  
**Managing Director, Chief Investment Officer**

Mr. Mather is CIO U.S. Core Strategies and a managing director in the Newport Beach office. Mr. Mather also oversees ESG portfolio integration in the U.S. and was named Investment Leader of the Year in 2019 by Environmental Finance\* for advancing sustainable investing in bond markets.



**Olivia A. Albrecht**  
**Executive Vice President, Head of PIMCO's ESG Business Strategy**

Ms. Albrecht is an executive vice president in Newport Beach and head of PIMCO's ESG (environmental, social, and governance) business strategy.



**Jelle Brons**  
**Executive Vice President, ESG Portfolio Management Team**

Mr. Brons is an executive vice president in the Newport Beach office, specializing in global investment grade credit. He is a member of the ESG portfolio management team and lead PM on the Climate Bond Strategy and Global Investment Grade Credit ESG Strategy.

\* The Environmental Finance's Sustainable Investment Awards seek to recognize and highlight the work of asset managers and key players incorporating ESG across all asset classes and winners are selected by an advisory panel consisting of industry experts chosen for their knowledge, objectivity and credibility along with the Environmental Finance editorial team, whom will review the submitted entry material. Judges score each entry individually and any conflict of interest will be removed, the judge's score will be confidential.

## Sustainability in 2020

**Albrecht:** This pandemic is arguably the first sustainability crisis of the 21st century, and it's clear to all of us that action and awareness from investors on long term sustainability risk may only accelerate post-COVID-19. For many of us, 2020 has been a wakeup call as investors realize just how interconnected, interdependent, and vulnerable the world is to the potential challenges that climate change will bring.

So far this year we have seen oil supply shocks, a global pandemic, and now protests and demonstrations across the globe regarding social justice. Firstly, all of our hearts go out to you, our clients and colleagues around the world who have been impacted by these events. COVID-19 is first and foremost a humanitarian crisis that is disproportionately affecting the world's poorest and most vulnerable. But it's also turned into an economic and sustainability crisis.

## Accelerating sustainability this year

**Mather:** Focusing on sustainability could be the only way to maximize growth over the medium and long term and do it in an inclusive way.

We expect this current crisis could serve as a sort of springboard, causing more investors to potentially look for more sustainable investment choices. This may lead to new financial instruments and innovation. We have certainly seen growing issuance in COVID-19 bonds from different issuers as well as SDG (Sustainable Development Goals) bonds and social bonds on top of a growing green bond market.

PIMCO is actively involved in industry groups and policymaking circles that are looking to innovate and develop new financial instruments. Due to our size, we are in a position to be able to advise on shaping market standards and view this advocacy as absolutely critical for us in seeking to give our clients the best investment advice going forward.

## How ESG engagement in fixed income is different

**Mather:** As an active manager, PIMCO has always believed in engaging with issuers as part of our proprietary research. Face to face engagement is a key part of our understanding of management's quality and of how they think about stress testing their business. We have numerous meetings per year with those issuers that we invest with, and naturally, they want to know what their large investors think.

Fixed income investors also have another way of engaging issuers to provide even more direct influence: bond issuance. Bond issuers need to come back to market consistently, they constantly need to engage with those that are rating them, and those like PIMCO that are buying the bonds. ESG (Environmental, Social and Governance) factors are increasingly more important to our clients and ratings agencies alike, which is directly impacting issuers' cost of raising capital. So in a lot of ways, we believe bond investors can have more influence than equity investors – they certainly may have more opportunities to engage per year.

## Social at the center of ESG

**Albrecht:** Given recent events, including the COVID-19 pandemic, but also protests around the world about inequality and injustice, we're only going to see increasing focus and data on social factors. Key social issues are data security, product quality, and human capital management, but inequality is especially top of mind.

COVID-19 can have a harder impact on the physical and economic wellbeing of people with children, women, people of racial or ethnic diversity, and service level workers. At the same time, we have also large scale protests in the U.S. and beyond that are highlighting the unequal treatment often experienced by people of color. There are many studies that suggest diversity of thought, experience, background, gender, and race can improve performance. We are also seeing shifts in consumer behavior. Younger generations, especially

Millennials, are using their purchasing power to align with brands that have a strong purpose, that actually stand for a social mission.

Touching briefly on human capital management, we are seeing companies formalize their strategy on how they manage people, which we think is very important. Being able to attract, retain, and engage the right employees, especially in this time, could often give businesses an edge. Key social data points that we're looking at are things like employee turnover, engagement, and sentiment as well as formalization of these strategies at an executive level. We are asking:

- Do you have a committee that oversees human capital strategies?
- Can you explain your strategy to our engagement analysts or fundamental analysts?
- Can you communicate what you're looking for in employees and your human capital management strategy?

We expect to see lasting changes in the global workplace. Given how many people are unemployed globally, I think it's inevitable that work is reallocated in the future. We do not expect people to return to work that have been laid off in exactly the same capacity. So there could be long term advantages for firms who are able to respond quickly, who are able to innovate today. And those that fail to innovate, that fail to meet these challenges, they are at risk of losing key talent in this human capital redistribution.

### **Our active engagement with companies amid COVID**

**Albrecht:** As COVID-19 started to unfold, our first priority was to talk to companies and gather information about their initial response and crisis management. Some examples of our engagements and conversations would be:

- Asking companies to increase transparency on the immediate and long term risks that they are facing.
- Asking how companies are treating their employees and if they are extending benefits in the short term.
- And lastly, we are focused on improving our understanding of companies' full supply chains, getting better transparency over the value chain, and understanding how they are responding to this kind of disruption.

We believe good engagement really goes hand in hand with good research. As we have long term relationships with these companies, we are able to help identify what best practice looks like and assist companies meet those best practices. We are starting to see some leading social practices come out of this crisis:

- First and foremost, protecting essential workers, to ensure their health and safety.
- Improving benefits and flexibility – i.e. extending mental health counseling or expanding telehealth options.
- Supporting suppliers – those with a transparent value chain are better able to support suppliers.
- And of course, maintaining workforces throughout the disruption is very important for a stable recovery. We understand that maintaining workforces might not be possible for every single company, but some that have been hardest hit and could not maintain their employment have found innovative solutions to maintaining health and other critical insurance.

### **Climate pledges take a backseat in 2020**

**Brons:** Overall, in light of the global pandemic, we have noticed that the strategic climate pledges from companies and countries still remain in place. While we expect that the pace of progress towards a lower carbon future to be a bit slower in the short term due to these lower oil and gas prices, the key thing is that these long term climate commitments remain in place. We have recently seen some interesting examples of major players in the oil and utilities industries switching away from coal to renewable energy, and issuing green bonds, to be in accordance with the Paris Agreement

The latest oil shock has been brutal for business models that rely on sustained higher oil prices, and it is not just companies, it is some countries as well. We have seen several defaults in the energy sector in the U.S. and that

is something that ESG focused investors have been able to avoid. For example, in our climate bond strategy, we obviously have no exposure to the fossil fuel industry and our exposure to the renewable energy sector and select green bonds have fared relatively well.

### **Engaging on Climate Action (Sustainable Development Goal 13)**

**Brons:** All of PIMCO's ESG portfolios have basically no fossil fuel exposure – we will not lend to typical energy companies in these ESG strategies, we will have no coal exposure, no oil sector exposure. There are some exceptions in the case of utility companies, if they are moving away from coal and into renewable energy, we typically would then invest in their green bonds. The utility companies supporting the renewables transition are prime targets for us to engage with on their climate plans, targets, and progress.

Additionally, there are some large energy companies that unfortunately have not yet issued green bonds, but we are engaging with them and encouraging them to issue green bonds that will fit with their strategic goals of moving into renewable energy.

### **How to avoid greenwashing in bonds**

**Brons:** When a new green bond comes to market, our analysts produce a new issue writeup that goes to all the portfolio managers and it includes the green bond scoring framework in addition to all the usual writeup items like relative value, internal scores and whether we should buy or not. We want to make sure the green bonds adhere to certain standards:

- First, do the green bonds' objectives and use of proceeds actually align with the company's ESG strategy?
- Second, do we see evidence of a significant positive outcome?

As a hypothetical example, if a large \$50 billion to \$100 billion U.S. utility has not issued a green bond for a long time, mainly because they have not been going into renewable energy, and they are issuing a \$300 million green bond in the market, and actually some of the proceeds actually go into natural gas, well, that is an example of what we consider a bad green bond. Here is why:

- The use of proceeds is partly going into natural gas, and looking at the size of the proceeds and the size of the company, it is probably not making a significant impact.
- If that issuer also has not come forward with a plan of moving into renewable energy in a very substantial way, that would raise some red flags. We also look for standard red flags, like misalignment with the Green Bond Principles (GBP) by ICMA (International Capital Market Association).

Just because a green bond comes to the market – we may even like the issuer fundamentally, from a pure credit perspective, but if the green bond is not structured well, if it does not have a good strategic fit with the company's policy, and we rate it poorly – we won't buy it.

### **PIMCO's ESG platform**

**Albrecht:** Our ESG platform is composed of two key areas:

1. ESG integration – how PIMCO is systematically incorporating material, environmental, and social factors into our broad investment process that touches the nearly \$2 trillion of assets that we manage.
2. ESG dedicated strategies – portfolios that are designed to achieve traditional PIMCO style risk adjusted returns, but also achieve sustainability objectives.

On firmwide ESG integration, this is implemented from a bottom up perspective, engaging with our analysts to incorporate these ESG factors into their valuation. Taking into account factors like climate change, regulatory

changes, consumer preferences may impact and influence our valuations of investment opportunities on behalf of our clients globally. And that integration spans across credit, sovereigns, municipalities, securitized assets.

Increasingly we also have to think about sustainability factors also from a top down perspective. Such as how we think about climate change and climate risk, and how that gets incorporated into our views on financial market stability. Similarly, with income inequality, how these factors play into our top down macro views as well.

Our ESG dedicated strategies leverage PIMCO's time tested investment process that starts with our secular and cyclical forum and views, we then translate those into market views, and ultimately put those into model portfolio targets in terms of the key risk factors. For example, we use our proprietary ESG scores to build portfolios that tilt towards the higher scoring issuers, that focus on carbon reduction in the portfolio, and emphasize green and sustainability linked bonds.

### **Sustainability in a post-COVID world – reasons for optimism**

**Mather:** Sustainability is going to garner a greater share of mind in society and especially in the business and investment community – and we believe that is key to maximizing growth and resilience in the long term. A greater collective focus on sustainability may likely benefit investors in two key ways: first, more data and transparency. And second, growth in new financial instruments that are aligned with the UN Sustainable development Goals (SDGs) as well as special COVID bonds, social bonds, and green bonds. So I think it will be a quite busy year in terms of innovation and new developments for investors.

**Brons:** A lot of people have realized that we can in fact have a future with clearer skies, cleaner air, with a healthier environment, with fewer and cleaner cars on the road, and overall less pollution – it is possible. Another major topic in the last month or two is the focus on inequality. The more we focus on these issues, the more progress can be made to reduce inequality based on race, income, and employment status. I'm very enthusiastic about where this is going. There will be significant change, and as investors we can help.

**Albrecht:** We have a unique chance in this moment to channel all the momentum around sustainable investing from issuers, regulators, asset managers, and asset owners into designing innovative solutions to these complicated, challenging problems like inequality and climate change.

For nearly 50 years, our investment process at PIMCO has been dedicated to helping millions of investors pursue their objectives, regardless of the shifting market conditions, and our leadership in ESG investing is essential to our commitment to delivering on our clients' objectives while supporting long term, sustainable economic growth globally. However, I think we can all recognize that we need to do more as investors, issuers, asset owners, and asset managers to push together in the same direction in order to bring cohesive change even sooner.

We hope that you will join us in bringing ESG past the rhetoric and into action. Let's make it happen.

**For more information about ESG at PIMCO, please visit [pimco.com/esg](https://pimco.com/esg)**

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