

# Public Fixed Income Sustainable Investing



## ESG at Our Firm

Over the past decade, sustainability—and environmental, social and governance (ESG) approaches in particular—has gained increasing recognition among investment management firms. At MetLife Investment Management (MIM), our bottom-up credit culture seeks to identify companies, projects and real estate that are sustainable over the long-term. As ESG factors today move to the forefront of the investment conversation, MIM is renewing our focus on the sustainability practices that have been at the core of our investment processes during MetLife’s 150-year history.

### *Our Approach to ESG Integration*

Our view is that investors are best served when ESG risk analysis is embedded throughout the credit research process—while recognizing that it is also important to apply in-depth knowledge of specific industry sectors in order to arrive at a meaningful understanding of ESG risk.

In short, we believe that investors should consider ESG risks sector-by-sector as well as issuer-by-issuer. The following examples illustrate the value of a sector-specific ESG risk analysis.

- An analyst with deep experience in the health care sector may recognize early on that certain pharmaceutical companies are vulnerable to litigation related to the opioid crisis or may be impacted by an investigation into generic drug pricing.
- For a large, multi-national manufacturer, ESG analysis may uncover unsafe or unfair labor practices used by overseas participants in their supply chain—a major social issue.
- In the energy sector, an analysis of ESG risk has led many investors to avoid the bonds of coal producers, a segment that has suffered from underperformance and even some bankruptcies.

Examples of ESG factors considered as part of our qualitative assessment include:

### Environmental

Matters pertaining to environmental issues are identified and discussed to determine the issuers’ impact on the environment (air, water, land protection, climate change and resource use) and the risk that such issues present to the credit profile or business.

We also evaluate prospective liabilities of an issuer resulting from its environmental impacts, including payments relating to penalties imposed by government agencies, litigation risk or future remediation spending requirements.

### Social

How a company manages relationships with its employees, suppliers, customers and the communities in which it operates is a factor in our credit analysis. We evaluate issues related to labor unrest, health and safety, compliance with labor regulations, and general labor relations and conditions. We also review risks associated with product safety and suitability to ensure companies have sustainable business operations.

### Governance

MIM evaluates the diversity, independence and qualifications of corporate boards to ensure companies are prepared to face future risks and act in the best interests of the business. We focus on identifying management teams that clearly communicate information regarding ESG factors material to their respective business.

We have dedicated resources offering support and advisory services specific to ESG-related matters. The Sustainable Investment Strategies (SIS) team is responsible for the development, implementation and oversight of MIM's sustainable investment strategy and acts as an advisor to MetLife's Global Sustainability function and our investment teams. Our SIS team ensures that our portfolio managers and credit analysts implement responsible investing practices and adhere to the firm's ESG investment policy. MIM may implement investment screens at the direction of clients allowing clients to decide on the screens they prefer to implement regarding their separate account.

### ***Active Engagement***

We believe it's important for investors that a manager's ESG analysis be more than a "mathematical exercise." In that regard, engagement with companies is crucial. Investors can benefit when managers talk to companies about ESG issues. Having an open line of communication with company management is essential to gain a fuller understanding of all the pertinent risks, including ESG, and to ensure these risks are taken into account when constructing portfolios.

Asset managers are focused on their goal of optimizing risk-adjusted returns for their investors, while investors increasingly seek to assess the impact of ESG factors on those returns. Integrating a rigorous ESG assessment into the credit analysis process – informed by deep sector knowledge – can help provide investors with a comprehensive picture of the risks to the value and performance of their investment portfolios.

### ***Industry Initiatives***

MIM is a signatory to the Principles for Responsible Investment (PRI) initiative and is committed to the adoption and implementation of PRI's six principles. We are committed to responsible investing through active participation in industry groups, such as the Global Real Estate Sustainability Benchmark (GRESB) survey and we have participated in the ShareAction Asset Owners Disclosure Project's asset manager survey.

We are also a member of the Global Impact Investing Network (GIIN). Our parent, MetLife, participates in the CDP survey (formerly Carbon Disclosure Project), as well as the annual, insurance industry-specific, NAIC Climate Risk Survey and others. MetLife is listed on the Dow Jones Sustainability Index (North America), the FTSE4Good, and has received significant third-party recognition for its ESG integration efforts.

**ESG is an important part of our credit analysis and is fully integrated into our research process.**



## Integrating ESG into Our Public Fixed Income Investment Process

At MIM, we believe ESG risk factors should be evaluated alongside other risks to determine a credit's fair value. The proper role of an investment manager, in our view, is to ensure that clients are aware of the relevant risks and are being compensated via the terms and structure of the investment. For example, consider how ESG factors can be incorporated into the key steps of the credit research framework:

- **Quality of the underlying asset.** As part of an effort to identify strategically well positioned and cost competitive businesses, it is important that analysts assess a company's carbon footprint and how it is managing environmental issues material to their business, as future regulations or environmental liabilities may impact the asset's valuation.
- **Assessing the management team.** When thinking about the quality of management, social factors such as diversity, and governance issues such as the board structure and compensation are important considerations.
- **Liability review.** In public fixed income investments, there is an extensive focus on the issuer's credit profile, but we feel that should not be limited only to debt liabilities. ESG factors in this case may include environmental liabilities, mediation liabilities, possible contingent liabilities from a litigation perspective and pension funding needs—in short, anything that may be a future draw on the company's cash and may impact the visibility and volatility of cash flow.

- **Relative value.** One of the most important considerations in credit analysis, relative value, is an assessment of how efficiently the market is pricing credit risk. Analyzing ESG issues, as well as a range of other factors, can help determine whether the market is mispricing credit risks.

An alternative to an integrated credit research process would be to conduct a separate ESG analysis. While some asset managers have taken that approach, we believe that a holistic view of a sector and individual issuers within it promotes a more comprehensive understanding of all the risks inherent in a business.

We also believe it is valuable, as part of an integrated and rigorous credit research process, for analysts to be able to cover the entire spectrum from investment grade to high-yield loans. The belief is that the ability to cover one credit, which may migrate from investment grade to high-yield and back, allows for consistency over time.



# ESG Case Studies<sup>1</sup>

The below case studies demonstrate how reviews of material ESG factors drive our investment process. These case studies illustrate MIM's approach to applying ESG across our investments in public fixed income.

## Energy Company

In 2020, this energy company, announced its agreement to sell its gas transmission and storage assets. The company also announced it was canceling one of its pipeline projects, a joint venture co-owned by other U.S. energy companies. The leverage neutral asset sale was made to help increase the company's regulated earnings profile and marks a concerted step in the company's decarbonization process.

With this asset sale transaction, the company appears to be firmly focused on establishing itself as one of the country's largest regulated renewable energy operators. Management has set ambitious targets of achieving a 70% zero-carbon generation mix by 2035 and a 100% zero-carbon generation mix by 2050, to be achieved via offshore wind and solar generation, and energy storage capabilities. Long-term improvements in renewable pricing and efficiency dynamics could continue to provide tailwinds for new projects, allowing the company to capture greater value from additional capex spending. A local clean economy act stipulates that the company take concrete steps to build out its clean energy profile, and we believe the divestiture of the company's natural gas assets and the cancellation of its pipeline project fit the bill.



The owners of the pipeline project cited development uncertainty and increased litigation risk as reasons behind the cancellation of the project, and we are pleased with the removal of any judicial specter. Following the announcements (along with a dividend cut), S&P raised the company's credit outlook, which we see as further indication that investors will continue to view ESG as a lens through which to evaluate the attractiveness of credits.

The above contributed to our decision to continue to invest in the company in our public fixed income portfolios.

*Sources for case study: company's 10K; company's 10Q; Company's Investor Update report, July, 2020; Standard & Poor's credit reports; and MIM analysis.*

<sup>1</sup> Case studies presented herein were selected to illustrate MIM's ESG process and were not selected on the basis of investment performance.

## Public Airline

In reviewing a public airline's new debt offer, the Public Fixed Income team noted key ESG factors that could present future risks to the company. The credit team felt the airline trailed peers or best practices in key ESG areas including:

- the lack of a GHG emission reduction target,
- no board member specifically responsible for climate change,
- no verification of scope 1 and scope 2 emissions and,
- executive compensation lacked any ESG components.

The above analysis contributed to our decision to avoid participating in the new issue offered by the airline.

Sources for case study: Company's 10K; company's 10Q; and MIM analysis.

<sup>1</sup> Case studies presented herein were selected to illustrate MIM's ESG process and were not selected on the basis of investment performance.



## About MetLife Investment Management

MetLife Investment Management (MIM),<sup>1</sup> which had over \$659 billion in total assets under management as of December 31, 2020,<sup>2</sup> serves institutional investors by combining a client-centric approach with deep and long-established asset class expertise. Focused on managing Public Fixed Income, Private Capital and Real Estate assets, we aim to deliver strong, risk-adjusted returns by building tailored portfolio solutions. We listen first, strategize second, and collaborate constantly as we strive to meet clients' long-term investment objectives. Leveraging the broader resources and 150-year history of the MetLife enterprise helps provide us with deep expertise in navigating ever changing markets. We are institutional, but far from typical.

For more information, visit: [investments.metlife.com](https://investments.metlife.com)

For more information regarding our ESG policy visit: [investments.metlife.com/about/esg-integration/](https://investments.metlife.com/about/esg-integration/)

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<sup>2</sup> At estimated fair value. Includes MetLife general account and separate account assets and unaffiliated/third party assets.

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