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EMERGING MARKET DEBT
IMPLEMENTING AN IMPACT INVESTING STRATEGY

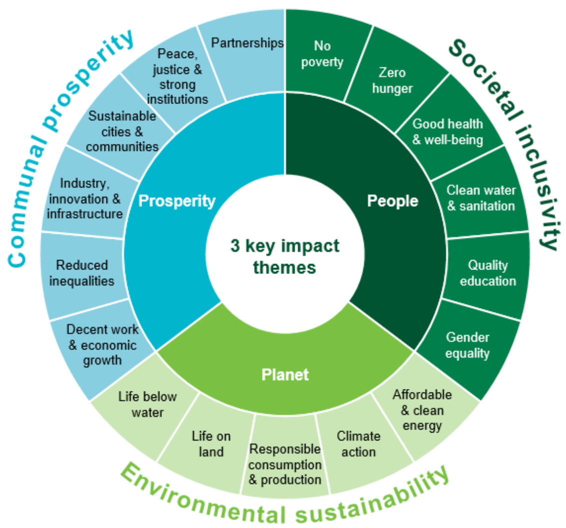
EMERGING MARKETS ARGUABLY OFFER AN UNPARALLELED OPPORTUNITY FOR INVESTORS SEEKING TO MAKE AN IMPACT. THIS SECOND PAPER IN A SERIES ON EMERGING MARKET DEBT IMPACT INVESTING EXPLAINS HOW INSIGHT SEEKS TO CAPTURE THE POTENTIAL WE SEE FOR LONG-TERM RETURNS AND LONG-TERM IMPACT FOR INVESTORS FROM THE ASSET CLASS.

THE OPPORTUNITIES FOR GLOBAL IMPACT

Emerging markets (EM) provide investors an opportunity to make a meaningful impact. As our previous paper – EM debt for impacting investing – highlighted, they are home to 85%[1] of the world's population, cover 77%[2] of the world's land mass, and over 70%[3] of the energy supply is reliant on fossil fuels.

Bondholders are the principal provider of public capital to emerging market corporate bond issuers, given over 60% of them have no publicly listed equity[4] (source: Bloomberg). It can place bondholders in a unique position to partner with issuers over the long term to help them achieve meaningful impacts.

Figure 1: SDGs and impact themes[5]



When considering our strategy of investing for impact in EM, we initially group the 17 United Nations Sustainable Development Goals (SDGs) into three subsets, representing key impact themes, covering **People**-oriented goals, **Planet**-oriented goals and **Prosperity**-oriented goals.

BROADENING THE OPPORTUNITY SET

The first generation of EM impact strategies and funds mostly focussed purely on green bonds, those with specific projects targeting environmental outcomes. As the broader market has evolved and matured, we believe there is now a wider opportunity set to exploit, improving both potential financial returns and the potential breadth and depth of impact.

Consequently, we seek to access the best ideas across the entire impact opportunity set in public fixed income by targeting across three routes to impact:

Impact bonds

Impact bonds, also known as 'use of proceeds' bonds, are issues where the proceeds will be used to finance or refinance projects targeting positive environmental and/or social outcomes. They generally include such issues as green bonds, sustainability bonds and social bonds. Issuance has grown dramatically over the past few years, particularly in response to the COVID-19 pandemic.

Impact issuers

Impact issuers are broadly defined as companies with business activities that support positive environmental and/or social outcomes. One way of identifying such issuers, which Insight

[1] Source: Insight analysis as at December 2021, using International Monetary Fund (IMF) data and categorisation of Advanced, Developing and Emerging countries (Emerging markets = Developing and Emerging countries).

[2] Source: Insight analysis using World Bank data. As at September 2021.

[3] Source: BloombergNEF, New Energy Outlook 2020 dataset

[4] Source: Bloomberg. As at 31 December 2022

[5] Source: United Nations Sustainable Development Goals, Insight. As at February 2023.

adopts, is to use the UN SDGs as a guide to target or to confirm economic activities are compliant with the EU Taxonomy Regulation. That may be in the form of a renewable energy producer, a telecoms tower operator, or a healthcare provider, for example.

Improving issuers

Improving issuers are companies with concrete plans to develop their activities to improve their impact on the environment and/or society, such as an energy company seeking to shift towards renewable energy sources. One approach to identifying improving issuers is to focus on companies with core investment plans that are compliant with the EU Taxonomy Regulation.

OUR IMPACT APPROACH

A dual objective of tangible, measurable impact and attractive financial returns runs through how we approach investing for our emerging market debt impact strategy. In our view, you need to consider them alongside each other, in order to adequately deliver both.

We believe it is important to have an investment horizon that stretches into the medium-to-long term, targeting the **People**, **Planet** and **Prosperity** themes. Every investment in our strategy (except those held for cash or liquidity purposes) needs to pass our impact assessment frameworks analysing ESG performance, impact alignment, and impact reporting. We aim, where appropriate, to assign relevant key performance indicators (KPIs) for each holding to track their impact performance over time.

We expect to maintain at least 50% of portfolios invested in impact bonds, with the remainder invested in bonds from impact issuers or improving issuers. To invest in impact bonds, we require 100% of an issue's proceeds to be used for positive impact objectives. Our impact bond framework seeks to assess every bond selected for purchase, determining the issuer's overall ESG profile, use of proceeds, project monitoring and reporting to ensure we are able to measure the actual impact achieved.

For impact issuers, we require 50% or more of the issuer's revenue to be aligned to positive environmental and/or social impacts using the UN SDGs as a guide to targets or where their economic activities are compliant with the EU Taxonomy Regulation. Our impact issuer framework seeks to verify that alignment considers the measurability of impact, and any significant misalignment or controversies elsewhere in the business which may negate that impact. This is to help ensure the issuer overall is delivering real positive impact.

For an improving issuer, the core investment plans compliant with the EU Taxonomy Regulation should affect at least 50% of the issuer's revenue streams, capital expenditure, or operating expenditure, which includes non-capitalised costs that represent research and development. To be considered for investment, the issuer's core investment plans must reach that 50% threshold.

To provide investors and others with helpful information relating to the achievements and progress of the overall strategy and its holdings, we plan an annual impact report. The report is expected to include information both at an individual security and overall strategy level, that tracks impact alignment, activity, and outcomes.

We are value investors in this strategy, both in terms of financials and impact. We also embrace a 'best ideas' approach, that seeks to concentrate on issuer selection and country evaluation, believing fundamentals ultimately drive both long-term returns and an issuer's environmental and/or social impact.

ACHIEVING IMPACT

Our plan is to invest in issues and issuers that are, or we expect to be, making a strong and meaningful impact on the world's pressing environmental and/or social challenges.

We aim for our approach to enable us to identify, measure and report the tangible impact our investments are making through the lens of our **People**, **Planet** and **Prosperity** themes. These may take the form of identifying the annual amount of greenhouse gas emissions that have been avoided being produced, or the amount of renewable energy produced, or the energy savings achieved due to more efficient technology.

DELIVERING FINANCIAL RETURNS

In addition to achieving a meaningful and measurable positive impact on behalf of clients, we seek to deliver financial returns, with appropriate consideration for risk, applying the investment process we have used for many years, and outlined below.

The intention is to populate our portfolios with bonds that represent attractive value and have the capacity to generate returns. To achieve that satisfactorily, we believe it is beneficial to make investment decisions at country and issuer level, and to avoid focussing on one particular attribute. We also believe that we should seek not to constrain portfolios to one or a small group of industries or sustainable objectives. For example, while climate change may be a popular topic, we do not believe it would be appropriate to only identify bonds or issuers focused on UN SDG 13 (Climate action) and/or SDG 7 (Affordable and clean energy). We aim to include those which focus on social SDGs, that aim to benefit people specifically or society at large.

By extending our investment universe beyond pure impact bonds, we believe it will be possible to achieve a superior yield than a traditional green bond index. It also allows us more scope to improve portfolio diversification by issuer, sector, geography, and impact type.

INVESTMENT PROCESS

In determining which investments to incorporate into our impact portfolios, we aim to consider some key elements (see Figure 2).

Figure 2: Key elements of the Insight emerging market debt impact strategy's investment process

Country evaluation
- Analyse country risk rather than make 'index weight' related decisions
- Seek catalysts indicating credit improvement/ deterioration
- Avoid rapidly deteriorating countries, which may overwhelm issuer fundamentals

Fundamental assessment
- Filter universe to ensure minimum market liquidity, transparency and potential impact
- Target issuers with a clear path to repayment
- Analyse in a global sector context to capture structural premium

Impact assessment
- Access the whole opportunity set: impact bonds, impact issuers, improving issuers
- Analyse potential impact on People, Planet or Prosperity
- Focus on generating tangible, measurable positive impact

Asset allocation
- Global macro framework determining EM sensitivity factors
- Asset allocation decisions made through 3 lenses: macro, valuations, technicals
- Proprietary framework to determine overall and relative Units of Risk

Source: Insight. As at February 2023. For illustrative purposes.

Each element is intended to help us create a suitable diverse portfolio for achieving the objectives of the strategy and may be undertaken separately and independently.

- **Country evaluation:** In evaluating each country, we will consider the risks and potential opportunities associated with holding investments domiciled in, or exposed to, that country.
- **Fundamental assessment:** Within the fundamental assessment, we filter the universe to ensure we can achieve minimum levels of liquidity, transparency and potential impact as well as identify robust issuers capable of repayment.
- **Impact assessment:** Assessing the impact potential involves identifying the expected tangible, measurable impact to our key themes, from each of the three investment types: impact bonds, issues from impact issuers and issues from improving issuers, as we define them.
- **Asset allocation:** The asset allocation decision employs our existing frameworks, considering macro, valuation and technical factors to help us determine the appropriate application of risk for opportunity.

ENGAGEMENT – CREATING 'PARTNERSHIPS FOR CHANGE'

Engaging with issuers can offer an extension to the relationship between investors and investees. It can help to provide flows of information, feedback, guidance and support and can be an important supplement to the impact investment process. We may seek to engage with select issuers to achieve specific goals and an engagement may take a number of forms. It could include requesting issuers complete simple or detailed surveys seeking information on activities, practices and policies. It may also be through extensive bilateral dialogue or as part of institutional lobbying, among others. Through the process of engagement with issuers independently or collectively, we can attempt to help stimulate further improvements in the environmental and social impact. By seeking to raise awareness, improve the provision and accuracy of data, as well as to raise standards, we believe we can help the issuers improve the impact they can achieve and improve the overall impact of our portfolios.

Our engagement model aims to provide us with valuable intelligence to support credible and measurable improvement plans, avoid weak issuers that are not open to change and to exit issuers that consistently fail to meet their targets.

We then assess, measure and report regularly on the extent and success of our engagement activities and publish them on the responsible investment section of our website.

WHY CHOOSE INSIGHT FOR EM DEBT IMPACT?

Broad approach: We aim to access the entire impact opportunity set, targeting our themes of People, the Planet and Prosperity.

Apply challenging criteria: We seek tangible, measurable impact from each investment we make (other than those held for specific purposes such as hedging and liquidity), supported by applying rigorous requirements of issuers and the securities we hold.

Transparent: We aim to report annually on the impact achieved by our EM debt impact strategy and, where possible, by each investment.

Expertise: Insight has been investing in EM debt for more than 20 years, and EM corporate debt for more than 10 years. We also have a long-established focus on responsible investment, having aspired to integrate ESG factors into select decision-making processes for over a decade. Our expertise stretches across responsible, sustainable and impact strategies.

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies over time, and/or prevailing market conditions and are not an exact indicator. They are speculative in nature and are only an estimate. What you will get will vary depending on how the market performs and how long you keep the investment/product. Strategies which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

ASSOCIATED INVESTMENT RISKS

ESG

- **Investment type**: The application and overall influence of ESG approaches may differ, potentially materially, across asset classes, geographies, sectors, specific investments or portfolios due to the nature of the specific securities and instruments available, the wide range of ESG factors which may be applied and ESG industry practices applicable in a particular investable universe.
- **Integration**: The integration of ESG factors refers to the inclusion of ESG risk factors alongside financial risk factors in investment analysis and research to judge the fair value of a particular investment and may also include the monitoring and reporting of such risks within a portfolio. Integrating ESG factors in this way will not typically restrict the potential investable universe, but rather aims to ensure that relevant and material ESG risks are taken into account by analysts and/or portfolio managers in their decision-making, alongside other relevant and material financial risks.
- **Ratings**: The use and influence of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on a number of factors including the nature of the asset class and the structure of the investment mandate involved. For an investment portfolio with a financial objective, and without specific ESG or sustainability objectives, a high or low ESG rating may not automatically lead to a buy or sell decision: the rating will be one factor among others that may help a portfolio manager in evaluating potential investments consistently.
- **Engagement activity**: The applicability of Insight firm level ESG engagement activity and the outcomes of this activity relating to buy, hold and sell decisions made within specific investment strategies will vary, potentially significantly, depending on the nature of the asset class and the structure of the investment mandate involved.
- **Reporting**: The ESG approach shown is indicative and there is no guarantee that the specific approach will be applied across the whole portfolio.
- **Performance/quality**: The influence of ESG criteria on the overall risk and return characteristics of a portfolio is likely to vary over time depending on the investment universe, investment strategy and objective and the influence of ESG factors directly applicable on valuations which will vary over time.
- **Costs**: The costs described will have an impact on the amount of the investment and expected returns.
- **Forward looking commitments and related targets**: Where we are required to provide details of forward-looking targets in line with commitments to external organisations, e.g. Net Zero Asset Managers Initiative, these goals are aspirational and defined to the extent that we are able and in accordance with the third party guidance provided. As such we do not guarantee that we will meet them in whole or in part or that the guidance will not evolve over time. Assumptions will vary, but include whether the investable universe evolves to make suitable investments available to us over time and the approval of our clients to allow us to align their assets with goals in the context of the implications for their investments and issues such as their fiduciary duty to beneficiaries.

Insight applies a wide range of customised ESG criteria to mandates which are tailored to reflect individual client requirements. Individual investor experience will vary depending on the investment strategy, investment objectives and the specific ESG criteria applicable to a Fund or portfolio. Please refer to the investment management agreement or offering documents such as the prospectus, Key Investor Information Document (KIID) or the latest Report and Accounts which can be found at www.insightinvestment.com and where applicable information in the following link for mandates in scope of certain EU sustainability regulations https://www.insightinvestment.com/regulatory-home/sustainability-regulations/; alternatively, speak to your main point of contact in order to obtain details of specific ESG parameters applicable to your investment.

Fixed income

- Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.
- A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.
- The issuer of a debt security may not pay income or repay capital to the bondholder when due.
- Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.
- Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.
- Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.
- Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

- The investment manager may invest in instruments which can be difficult to sell when markets are stressed.
- Exposure to international markets means exposure to changes in currency rates which could affect the value of the portfolio.
- Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.

FIND OUT MORE

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