abrdn Position Statement – Sovereign ESG Engagement

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Why do we have position statements?

Our position statements align to the **Principles for Responsible Investment's (PRI's) guidance** on what constitutes a responsible investment policy. "Responsible investment can be integrated into investment policies in many ways, including high-level public statements, codes of business practice, a standalone responsible investment policy or by embedding responsible investment considerations into an organisation's main investment policy". They cover specific sustainability topics to help our clients understand our view on those topics and the actions we are taking.

The issue

The investment industry plays an important role in sovereign debt markets yet the industry's interaction with sovereign issuers on sustainability related topics remains limited. As governments worldwide play a pivotal role in shaping policies and allocating resources, engaging with them on ESG topics can encourage responsible decision-making, promote transparency, and foster alignment with global sustainability goals.

Engagement is an important part of our investment process. Whilst our approach to engaging on sovereign debt may differ to that for corporate debt, we believe that meaningful engagement with each can add value to investors and issuers alike.

Challenges

Engaging with sovereign entities on ESG presents unique challenges for investors, as they are primarily accountable to their citizens and not investors. However, engagement does provide sovereign debt investors an opportunity to establish a constructive dialogue and emphasise the long-term benefits of sustainable policies for both citizens and the broader economy. Additionally, by focusing on collaborative efforts and fostering partnerships with multilateral organisations, debt investors can demonstrate their commitment to supporting sovereign issuers in achieving their sustainable development goals, while respecting their autonomy and decision-making authority.

Another challenge arises from the complex and diverse nature of sovereign entities, which means we cannot simply take a one-size-fits-all engagement approach. As investors, we must tailor engagement strategies to the specific context and priorities of each sovereign issuer, promoting ESG practices that align with their unique cultural, political, and economic landscape.

In the sovereign space, it can be difficult to set milestones on sustainability issues due to:

- Lack of access to the relevant policy decision makers
- Inherent politics
- Time horizon mismatches with relevant policy actions that take years to have a measurable impact – often beyond the mandate of an incumbent government
- Absence of timely and accurate data.

However, sovereign issuers regularly seek feedback on their labelled bond frameworks and here we can play a much more active role in shaping allocations to sustainable outcomes.

We also observe differences in our level of influence when engaging with developed market sovereign issuers compared to emerging market sovereign issuers. Owing to the larger size, well-established market and benchmark presence, and higher creditworthiness of most developed market sovereign issuers, we are less likely to unilaterally drive changes in policy or decision-making. Whilst influence may remain limited, emerging market sovereign issuers may offer more opportunities for investor engagement to impact policies and decisions.

Corporate vs Sovereign Engagement

The following table provides a comparative overview of the nuances between sovereign and corporate engagement.

	Sovereign	Corporate
Accountability	Sovereign issuers are primarily accountable to their citizens.	Corporations are primarily accountable to their shareholders and investors.
Scope	Engagement topics often encompass broad policy issues, macroeconomic factors, and national development goals.	Engagement topics typically focus on company-specific ESG risks, opportunities, and performance.
Regulatory Environment	Sovereign issuers operate in diverse regulatory environments, which may require understanding and navigating various national and international policies.	Corporations are subject to industry-specific regulations and standards, which may be more homogeneous within a sector.
Access & Communication	Engaging with sovereign issuers may involve working with multiple government agencies, ministries, or diplomatic channels.	Engagement with corporations often involves direct communication with management, investor relations, or board members.
Data	Sovereign ESG data is often characterised by a lack of timeliness, independence, and comparability, presenting challenges for investors in evaluating and benchmarking sustainability performance across various countries.	Typically sourced from company reports, third parties and public data. Data is often comparable within industry.
Influence & Impact	Whilst debt investors may have limited direct influence on sovereign issuers, the impact of a positive outcome can be substantial, particularly in emerging markets. Investors can promote sustainable practices through partnerships and collaboration with multilateral organisations.	Shareholders and debt investors can exert direct influence on corporations through shareholder voting rights, capital allocation decisions, or board representation.

Why is this important for investors?

In 2020, sovereign bonds accounted for more than 50% of the global bond market, underscoring their significant influence on the global financial ecosystem.[1] Despite their prominence, the integration of ESG considerations when engaging with sovereign debt issuers lags behind the progress seen in the corporate space. Yet, the potential for governments to drive sustainable outcomes through policy and regulatory measures is substantial. We believe the impact of such national level changes can potentially yield far greater real world positive outcomes than the efforts of any single company.

Recent findings indicate that the pace at which many governments are advancing towards their Nationally Determined Contributions (NDCs) and Sustainable Development Goals (SDGs) is insufficient.[2] This gap underscores the critical need to enhance ESG considerations in sovereign debt investing and investors may play a pivotal role in driving positive change. They can leverage their influence to promote ESG data transparency and actively encourage sovereign issuers to fulfil their sustainability aims, including those outlined in the SDGs and the Paris Agreement.

Effective engagement with sovereign issuers should utilise existing communication channels to initiate meaningful dialogues on ESG themes. Such interactions should not be perceived as unilateral demands but as a collaborative platform for exchange. For example, investors can bring insights from the corporate labelled bond market, offering perspectives that can help sovereign issuers align more closely with global sustainability benchmarks.

Additionally, the relationship between sovereign ESG risk and credit spreads is particularly noteworthy, especially in the context of higher-yielding emerging markets. Recent empirical evidence suggests a significant correlation between sovereign ESG risk assessments and sovereign credit risk.[3] This relationship underscores the financial materiality of ESG risks in sovereign debt instruments and highlights the fact that engaging with sovereign issuers on ESG themes not only promotes sustainability but can help inform credit risk assessments.

By fostering open, reciprocal conversations between investors, sovereign issuers, and other relevant stakeholders, we can enhance the likelihood of sustainability commitments leading to practical and impactful actions.

[1] **Bond Market Size » ICMA (icmagroup.org)**.

[2] **The-Sustainable-Development-Goals-Report-2024.pdf (un.org)**.

[3] **Evidencing Financial Materiality of Sovereign ESG Risk (lseg.com)**.

Our view and approach to sovereign debt

While the methods of sovereign debt engagement may vary in practice from those with corporates, the fundamental objectives guiding our interactions remain closely aligned. It involves regular conversations with national stakeholders including government, opposition, independent institutions and civil society to discuss a broad range of ESG issues that may be material to governments, including both risks and opportunities.

The mediums for engagement are largely similar to engagements with corporate issuers. Traditional avenues such as meetings, roadshows and research trips still form part of our engagement approach. These may be held with a variety of different sovereign stakeholders including a nation's Debt Management Office, Central Bank or Ministry of Finance.

Given the relatively low levels of influence that a single investor has within the sovereign debt market, collaborative engagements are often the most influential approach when engaging with sovereigns. abrdn is a member of several groups which collaboratively engage with sovereign issuers.

Promoting sustainability sits at the core of our objectives when engaging with sovereign issuers on ESG matters. Through constructive dialogue and collaboration, we aim to encourage governments to adopt long-term environmental conservation and social equity.

Below are examples of engagement priorities that may be a focus when engaging with sovereigns:

- Hold to account on progress towards existing policy commitments – i.e. Paris Agreement Nationally Determined Contributions (NDCs) or Sustainable Development Goals (SDGs)
- Promotion of best practice labelled bond issuance
- Encourage environmental, social and fiscal transparency
- Protection of biodiversity – especially in nations with vulnerable biomes
- Climate risk adaptation including water management.

Important Information

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