IR+M
INCOME RESEARCH + MANAGEMENT

IR+M ENGAGEMENT REPORT 2021
ESG INVESTING

At IR+M, we believe engagement is an integral part of good credit analysis. Engaging with issuers on material themes allows us to gain additional insights into complex risks and opportunities not otherwise captured in traditional research or ratings. As a lender on behalf of our clients, engagement is an important facet of responsible investment stewardship, which complements our robust, bottom-up research process.

2021 ESG Engagement Summary

Environmental, Social and Governance (ESG) topics are especially nuanced and continue to evolve within industries and sectors. Our dynamic stewardship program allows our Investment Team to engage on and research the most pressing ESG risks and opportunities.

Our Investment Team focuses on fostering an effective and ongoing dialogue with management, which includes addressing ESG factors that drive long-term value. Our Investment Team also participates in collaborative engagements through credit rating agencies, investment banks, and other industry groups. As part of our bottom-up research process, engagements are conducted by our Research Analysts across asset classes, ensuring robust due diligence and ESG research is applied across holdings.

Our ESG research and proprietary ESG ranks are guided by our Key Issues Map, which outlines material risks and opportunities across asset classes, sectors and industries. Our Key Issues Map also guides our engagements by illustrating potential engagement topics for our Investment Team to raise with issuers. This year we have engaged across industries on several environmental and social topics.

Case Studies

Real Estate Investment Trusts (REITs)

- Engagements with REITs are largely focused on green building standards, an important key risk factor for the sector.
- Leaders in the REIT sector are setting energy reduction goals based on science-based targets, alongside developing LEED-gold or higher buildings.
- REITs within the triple-net lease sector are further behind, partly due to the lease structure where the tenant has operational control of the asset and is responsible for all operating costs. Some issuers are beginning to establish ways to monitor and implement benchmarking, a promising development to observe over the next several years.

State Municipal Bonds

- Engagement with state finance division provided additional insights about the environmental and social impact of municipal bonds.
- States are often frustrated with ratings agencies as they can fail to capture nuances such as differentiated regulatory environments, demographics and economies that shape specific ESG key issues.
- Discussions with officials allowed us to factor these nuances into our analysis. In particular, we evaluated social key issues such as Access to Health Care and Social Services, Access to Education, Affordable Housing and Infrastructure and Resiliency.

IR+M
INCOME RESEARCH + MANAGEMENT

IR+M ENGAGEMENT REPORT 2021
ESG INVESTING

Engagement Spotlight: Diversity, Equity and Inclusion (DEI) Engagement Program

- **DEI is at the forefront of many investors' minds.** Demographic changes, social protests, and updated attitudes towards social equity have promoted renewed focus on diversity, equity and inclusion (DEI). DEI is a pillar of human capital across sectors, yet there is a lack of robust data and consistent reporting to capture DEI's various facets and variables within an organization.
- **We sought to collect more information with a direct, internal effort.** Our Analysts engaged the firm's top holdings across a variety of topics related to DEI: disclosure of racial and ethnic representation, initiatives and policies, pipeline efforts and management oversight. With no public standard for disclosing diversity, we categorized disclosure levels consistent with current trends.
    - Intersectional Data Disclosures: Disclosures consistent with issuers' reported data in United States Equal Employment Opportunity Commission's EEO-1 filings.
    - Detailed Data Disclosures: Includes the number or share (%) of employees who identify at least as Asian, Black, or Latinx/Hispanic.
    - Non-White Data Disclosures: Includes the number or share (%) of employees that are non-white (often described as 'underrepresented' or 'people of color').

Racial and Ethnic Diversity
Disclosing these metrics alongside gender and other characteristics increases transparency and accountability.

DEI Initiatives and Policies
Exploring how organizations may turn intent into action.

Pipeline Efforts
How issuers improve diversity within recruitment and hiring pools and ensure retention of diverse employees.

Management Oversight
How issuers prioritize DEI and track progress within an organization.

Findings

- **Engaged across credit and securitized issuers:** Our Investment Team engaged with the firm's top holdings across asset classes, industries and ESG ranks.
- **Varying Diversity Disclosures:** The varying levels of diversity disclosures are dispersed among engaged issuers, signaling a lack of standardization but increasing growth toward detailed and intersectional diversity disclosures.
- **DEI Matters:** 94% of respondents have a DEI Commitment Statement, Initiative or Policy. A vast majority of these issuers also have a formal DEI Committee and/or Taskforce to carry out these policies.
- **CDO:** 83% of engaged issuers have a Chief Diversity Officer (CDO) or equivalent. This is consistent with findings that the role of Chief Diversity Officer is one of the fastest growing positions in the field.
- **DEI Goal Setting:** 83% of issuers with DEI Policies have linked goals or key performance indicators (KPIs). A majority also ties diversity and inclusion goals to executive performance reviews.

Source: Responses collected from the IR+M DE&I Engagement Questionnaire. The views contained in this report are those of IR+M and are based on information obtained by IR+M from sources that are believed to be reliable but IR+M makes no guarantee as to the accuracy or completeness of the underlying third-party data used to form IR+M's views and opinions. This report is for informational purposes only and is not intended to provide specific advice, recommendations, or projected returns for any particular IR+M product. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission from Income Research + Management.

Engagement Spotlight: Diversity, Equity and Inclusion (DEI) Engagement Program

Areas of Improvement

- **Public Diversity Disclosures:** About a third of engaged issuers publicly disclose intersectional diversity data, consistent with their EEO-1 filings. Increasing intersectional disclosures, reporting on workforce makeup by race, ethnicity and gender, would allow a more robust view of an organization's workforce diversity.
- **Salary Transparency:** The majority of issuers we engaged with do not disclose any form of salary transparency. Of those that do, several noted mandatory disclosures due to local regulations. We expect a continued push from regulatory bodies and markets to increase pay transparency.
- **Pay Gap Studies:** A little over half of engaged issuers report conducting pay gap studies. Examining the interaction of renumeration and social variables such as gender, race, or ethnicity is a pivotal step towards pay equity.

Key Takeaways

- **Effective DEI strategies can lead to diversity of thought and greater innovation**. How an organization harnesses diversity and integrates equity and inclusion practices is key to this success. Continuing to focus on issuers' human capital management may provide intuitive insights into management quality and issuers' sustainability.
- **Issuers who chose to engage with us have shown a commitment to managing their human capital through a DEI lens.** By engaging with issuers on this material issue, we can capture additional value not otherwise found in ESG ratings. The additional insight gained from our DEI Engagement Program complements our research and proprietary ESG ranks for each issuer.
- **DEI policies, practices and efforts will continue to evolve in the market**. Cultural changes and attitudes will continue to promote greater diversity, equity and inclusion within the workforce, likely ushering in new standards. We also expect regulatory landscapes to follow suit, shifting current disclosure requirements.

As lenders, we believe that management teams that are focused on ESG issues are more likely to increase efficiency of resources, sustain enterprise value, and decrease event and credit risk. Therefore, incorporating ESG considerations into our analysis leads to a more complete understanding of potential issues, and we expect this to ultimately result in superior risk-adjusted returns over the long-term.

Engagement is an influential facet of our ESG research process and to the responsible stewardship of clients' assets. Environmental, Social, and Governance themes will continue to evolve in markets and express varying levels of risks and opportunities. In order to capture value not otherwise found within ESG ratings, a robust research process that includes engagement will remain key.