



ALLIANCEBERNSTEIN (AB)

# Fixed Income ESG Investing: Governance Considerations

At AB, we invest responsibly—constantly assessing, engaging on and integrating material issues, including environmental, social and governance (ESG) and climate change considerations. We take an active approach as we carry out our stewardship duties throughout the investment process.

Among ESG issues, governance is a core factor we consider when managing investment risks. Governance practices reflect the accountability of the owners, management and board of investee entities.

AB's Fixed Income team integrates governance considerations throughout our investment frameworks. Although equity and credit investors are broadly aligned on many governance principles, there are a few concerns that are specific to credit investors (*Display 1*).

## Display 1: Equity vs. Credit Investor Governance Considerations

<p><b>Equity and Credit Investors</b></p>	<p><b>Credit Investors</b></p> <ul style="list-style-type: none"> <li>• Board of Directors' and company management's stewardship of company</li> <li>• Fair treatment of all stakeholders</li> <li>• Accuracy and transparency of reporting and disclosure</li> <li>• Minimization of conflicts of interest between insiders and company</li> <li>• Suitable management compensation and incentivization of appropriate risk-taking</li> <li>• Respectable reputation and track record of management and owners             <ul style="list-style-type: none"> <li>• Historical fact pattern of transactions regarding sister companies, especially when privately owned (controlling family, private equity, state-owned enterprise)</li> </ul> </li> </ul>
<p><b>Creditors Only</b></p>	<ul style="list-style-type: none"> <li>• Willingness of company to test covenants that limit credit-negative/questionable governance activities</li> <li>• Strong efficacy of bankruptcy regime</li> </ul>

We believe that governance issues can cause credit underperformance by either increasing the likelihood of a negative credit event or by increasing the severity of a negative credit event. For example,

a negative credit event might be more likely if poor governance practices allow for accounting fraud. A negative credit event might be more severe if an owner uses covenant loopholes to make a

coercive distress-debt exchange, limiting bondholders' recovery. Certain governance metrics can indicate the increased likelihood or severity of a negative credit event (*Display 2*).

## Display 2: Governance Evaluation: Corporate Debt

Governance Metrics Associated with Corporate Credit Underperformance	
Increased Likelihood of Negative Credit Events	Increased Severity of Negative Credit Events
<p><b>Compensation</b></p> <ul style="list-style-type: none"> <li>• Tied to short-term goals</li> <li>• Not based on cash flows</li> <li>• Cannot be clawed back</li> <li>• Tied to out-of-the-money stock options instead of shares</li> <li>• Board not aligned with business success and without a wide range of expertise</li> </ul> <p><b>Related-party transactions or vested interests</b></p> <p><b>Low level and quality of corporate transparency without proper accounting disclosures</b></p>	<p><b>Owners and management</b></p> <ul style="list-style-type: none"> <li>• Reputation/past experience in difficult scenarios</li> <li>• Experience of relevant sister companies</li> <li>• Underlying incentives misaligned with creditors</li> </ul> <p><b>Willingness of company to aggressively test covenants or use known loopholes</b></p> <p><b>Challenged efficacy of bankruptcy regime</b></p> <ul style="list-style-type: none"> <li>• No absolute priority rule</li> </ul> <p><b>Timeliness of board and management reacting to governance problems</b></p> <ul style="list-style-type: none"> <li>• Actions as companies approach the zone of insolvency or junk status</li> </ul>

Similarly, governance issues can affect the riskiness of noncorporate debt (*Display 3*). For example, for government debt, weak governance can slow economic development, reduce the stability of an

administration or increase the likelihood of debt restructuring. For municipal debt, weak governance can erode public trust, causing residents and businesses to move away from the jurisdiction, limiting its tax revenues.

Additionally, weak governance may cause budgeting challenges and failure to plan for future liabilities or pension outlays.

## Display 3: Governance Evaluation: Noncorporate Debt

Governance Metrics Associated with Risk		
Government Bonds	Municipal Bonds	Securitized Bonds
<p><b>Corruption</b></p> <ul style="list-style-type: none"> <li>• Pervasiveness</li> <li>• Perception</li> <li>• Openness of contracts</li> </ul> <p><b>Checks and balances</b></p> <ul style="list-style-type: none"> <li>• Limits of government power</li> <li>• Judicial independence</li> </ul> <p><b>Rights</b></p> <ul style="list-style-type: none"> <li>• Personal</li> <li>• Private property</li> <li>• Unbiased regulations</li> </ul>	<p><b>Political gridlock</b></p> <ul style="list-style-type: none"> <li>• Ability to pass timely legislation</li> <li>• Uncertainty of public policy</li> </ul> <p><b>Funded status of liabilities</b></p> <ul style="list-style-type: none"> <li>• Expected future pension spending</li> <li>• Direct debt per capita</li> <li>• Rainy-day funds</li> </ul>	<p><b>Risk-retention rules</b></p> <ul style="list-style-type: none"> <li>• Compel underwriters to hold some of their newly created securities</li> </ul> <p><b>Mortgage governance</b></p> <ul style="list-style-type: none"> <li>• Evaluation of the fluctuations in credit standards associated with economic cycles</li> </ul> <p><b>Evaluation of the issuer's governance structure</b></p>

As responsible stewards of our clients' capital, we integrate ESG factors in most of our actively managed strategies. Governance

is an area in which we understand and appreciate the nuanced difference in perspectives between shareholders and

bondholders, and we use our expertise as deep, fundamental researchers to evaluate these issues on behalf of our clients.

**Note to All Readers:** The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates. References to specific securities are presented to illustrate the application of our investment philosophy only and are not to be considered recommendations by AB. The specific securities identified and described in this presentation do not represent all the securities purchased, sold or recommended for the portfolio, and it should not be assumed that investments in the securities identified were or will be profitable. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI. References to specific securities are provided solely in the context of the analysis presented and are not to be considered recommendations by AllianceBernstein. AllianceBernstein and its affiliates may have positions in, and may effect transactions in, the markets, industry sectors and companies described herein. **The value of an investment can go down as well as up and investors may not get back the full amount they invested.** **Note to Readers in the United Kingdom:** For Investment Professional use only. Not for inspection by, distribution or quotation to, the general public. This document has been approved by AllianceBernstein Limited, an affiliate of AllianceBernstein L.P. **Note to Readers in Europe:** This information is issued by AllianceBernstein (Luxembourg) S.à r.l. Société à responsabilité limitée, R.C.S. Luxembourg B 34 305, 2-4, rue Eugène Ruppert, L-2453 Luxembourg. Authorised in Luxembourg and regulated by the Commission de Surveillance du Secteur Financier (CSSF). **Note to Readers in Canada:** This publication has been provided by AllianceBernstein Canada, Inc. or Sanford C. Bernstein & Co., LLC, and is for general information purposes only. It should not be construed as advice as to the investing in or the buying or selling of securities, or as an activity in furtherance of a trade in securities. Neither AllianceBernstein Institutional Investments nor AllianceBernstein L.P. provides investment advice or deals in securities in Canada. **Note to Readers in Japan:** This document has been provided by AllianceBernstein Japan Ltd. AllianceBernstein Japan Ltd. is a registered investment-management company (registration number: Kanto Local Financial Bureau no. 303). It is also a member of the Japan Investment Advisers Association; the Investment Trusts Association, Japan; the Japan Securities Dealers Association; and the Type II Financial Instruments Firms Association. The product/service may not be offered or sold in Japan; this document is not made to solicit investment. **Note to Readers in Australia and New Zealand:** This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is intended only for persons who qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia) or the Financial Advisers Act 2008 (New Zealand), and is general in nature and does not take into account any person's objectives, financial situation or needs. **Note to Readers in Singapore:** This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSL", Company Registration No. 199703364C). AllianceBernstein (Luxembourg) S.à r.l. is the management company of the portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative. AllianceBernstein (Singapore) Ltd. is regulated by the Monetary Authority of Singapore. This advertisement has not been reviewed by the Monetary Authority of Singapore. **Note to Readers in Hong Kong:** This document is issued in Hong Kong by AllianceBernstein Hong Kong Limited, a licensed entity regulated by the Hong Kong Securities and Futures Commission. This document has not been reviewed by the Hong Kong Securities and Futures Commission. **Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia, China, Taiwan and India:** This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein L.P. is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries. **Note to Readers in Malaysia:** Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund management services, advice, analysis or a report concerning securities. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AllianceBernstein does not hold a capital markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial planning services in Malaysia.

The [A/B] logo is a service mark of AllianceBernstein and AllianceBernstein® is a registered trademark used by permission of the owner, AllianceBernstein L.P.

© 2022 AllianceBernstein L.P., 501 Commerce Street, Nashville, TN 37203

**For Investment Professional use only. Not for inspection by, distribution or quotation to, the general public**



OABG-252218-2022-03-02

INS-8159-0322

**AllianceBernstein.com**