# Investor Stewardship of Sovereign Debt Portfolios: is Real-World Impact Possible?

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**Abstract**

Investor stewardship is increasingly being deployed as a strategy for driving positive environmental outcomes. The majority of research on stewardship has concentrated on public equities, while other asset classes have been largely overlooked. Consequently, our understanding of the nuances and complexities of sovereign debt stewardship remains limited, despite its critical role in the global economy and its importance in the transition to net zero. Drawing conceptually from a burgeoning literature on investor impact creation, we undertake document analysis and conduct 20 semi-structured interviews with key stakeholders to explore the levers available to institutional investors as they seek to generate real-world impact on environmental issues through sovereign debt investment. We argue that investors can generate impact through their capital allocation, most effectively by investing in sovereign sustainability-linked bonds, and by signalling demand for environmental action through overweighting Use-of-Proceeds bonds in their portfolios. We present new evidence that shows investors are routinely engaging with sovereign nations on environmental policy, and we discuss the nuances inherent in deploying engagement to create impact in this asset class. We conclude that there is strong potential for positive impact through engagement, but we highlight risks associated with the practice, most notably the potential to infringe on the sovereignty of the engaged country.

Keywords: Stewardship, sovereign debt, impact, engagement, green bonds, active ownership, sustainable finance, sustainable investing

## 1. Introduction

Investment impact creation is a contested concept with various interpretations (Daggers and Nicholls 2016). Contentions range from the question of whether financial concessions are necessitated (Fiedrich and Fulton 2009) to conceptual concerns of ‘additionality’ (Harris 2021), which in turn translate to debates on how impact could be created and measured. Importantly, ‘impact generation’ entails more radical stewardship interventions than ‘impact aligned’ approaches (Busch et al. 2021), as the former seeks to actively contribute to solutions and transformations that are necessary to avoid climate- and biodiversity-related financial system collapse. Literature has put forward several mechanisms through which investors could generate this impact, including altering the cost of capital for (un)sustainable assets, altering access to capital for (un)sustainable assets (providing or denying liquidity), and investor engagement (Caldecott et al. 2022; Kolbel et al. 2020; Gollier and Pouget 2014). Kolbel et al. (2020) further suggest that investors could generate ‘indirect impacts’, by influencing a third party (such as other investors or the wider public). The authors divide the mechanism into stigmatization, endorsement, benchmarking, and demonstration, though note little evidence exists for the viability of these mechanisms. Similarly, Marti et al. (2023, 5) suggest a ‘field-building’ mechanism, defined as ‘all activities in which shareholders interact with other stakeholders who are active in the fields in which companies are embedded and may thus influence companies [countries].’ In the fixed income space, Hoepner and Schneider (2024) suggest denial of debt refinancing as a mechanism associated with cost of capital.

Broadly, however, investors are increasingly driven to generate real-economy impact through stewardship, defined as ‘the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society’ (FRC 2023), to address and mitigate the systemic risks presented by climate change (Freshfields 2022). As these risks are systemic, we suggest that systemic approaches to stewardship are best placed to create the level of impact necessary to contribute to mitigation and adaptation efforts; interventions that seeks to drive change in the economic system as a whole, rather than targeting individual companies. In this paper, therefore, we focus on how sovereign debt investors could create real-world environmental impact through various stewardship strategies. Impact creation in this asset class holds the potential of creating significant real-economy impact due to the influence wielded by the counterparty through highly influential policy changes. Despite this potential, literature on creating impact through sustainable investment has not yet considered how investors in sovereign debt could create impact.

Defining and demonstrating impact in sovereign debt investment is challenging as governments are critically dissimilar to corporates, which have been the empirical focus of the bulk of literature on stewardship and investor impact generation. Firstly, government spending necessarily spans numerous departments and activities, many of which are unlikely to be considered aligned with an ethical investment motivation; the most obvious examples being defence spending and fossil fuel subsidies. As of 2024, no country is considered aligned with the 1.5C Paris Agreement goal (Climate Action Tracker 2024). When investing in public debt, it is often not possible to isolate the use of proceeds towards sustainable activities (the exception being labelled debt, discussed later in this paper). Secondly, the number of countries issuing debt is far lower than companies issuing debt. This implies a lack of options for sovereign bond investors seeking to align with investment with sustainability objectives, and a lack of substitute investment should investors wish to divest.

Engagement is considered an effective tool for investors to create impact (Kolbel et al. 2020). Engagement is defined as an investor 'communicating with current or potential investees/issuers to improve ESG practices, sustainability outcomes or public disclosure' (Belsom et al. 2021, 3). However, the application of engagement to the sovereign debt asset class is sparsely studied in academic literature, despite the acknowledgement from UNPRI as an emergent strategy to drive change (UNPRI 2020). Uniquely compared to other investment asset classes, sovereign bond engagement creates impact on the policy, people, and environment of an entire country, rather than stake/shareholders of a company. To this end, engagement with governments raises questions around sovereignty and the ethics of private investors driving influence that impacts an entire citizenry.

To address this emergent trend in the industry, we put forward three Research Questions to investigate the mechanisms of impact creation in the sovereign debt asset class:

> *Research Question 1: How can investors provide positive, real-world impact through their stewardship of sovereign debt portfolios?*
> *Research Question 2: How do the impact mechanisms established in the literature apply to the sovereign debt asset class?*
> *Research Question 3: What are the nuances particular to this asset class that investors must take into account (but may not be) when pursuing engagement with governments to optimise outcomes and avoid serious negative externalities?*

To answer these research questions, we bring literature related to investor impact and stewardship together with political economy literature to conceptualise sovereign debt stewardship in theory and practice. Drawing from the mechanisms of impact generation put forward by Kolbel et al. (2020) and Caldecott et al. (2022), we examine practical impact-creation tools and strategies available to sovereign debt investors. For each mechanism, we consider the literature as applied to other asset classes, most pertinently corporate debt, and determine junctures of overlapping theory. We examine the ecosystem of impact, the barriers to its generation, and the nuances that define investor's ability to effect real-world change. By addressing the knowledge gap, we provide insights for investors who seek impact in this asset class. Further, we broaden the burgeoning literature on the mechanisms for impact through investor stewardship, bringing the critically important sovereign debt asset class into discussions and determining the efficacy of applying each mechanism.

The remainder of this paper is structured as follows. Section 2 provides a background of the literature and landscape of impact investing in sovereign markets. Section 3 outlines the paper's Methodology. Section 4 presents and discusses the results from the document analysis and interview data, and Section 5 concludes.

## 2. Background

'Sovereign debt', used interchangeably with 'public debt' in the financial sector, refers to loan and bond obligations that arise when national governments borrow money from investors (Tomz and Wright 2013). As of 2023, sovereign debt comprised around 21% of all investable assets weighted by market capitalisation (Warken et al. 2023).

Sovereign bonds occupy a unique position in the financial system and broader political economic contexts. For investors, sovereign bonds are typically seen as liquid and low-risk relative to other asset classes (Martinez et al. 2022), and are often an integral component of portfolios of long-term investors such as pension funds that value their low-risk and low beta (correlation with other asset classes). For the broader financial system, sovereign bonds, particularly those issued by the most economically developed countries, are often used as a proxy for the risk-free rate of return, which in turn bears broader influence on the valuations of other asset classes (Pinzon et al. 2020). For nation-states, public sector borrowing is a critical lever in financing government policy, needing to be carefully balanced with taxation and money supply to manage sustainable debt levels (Slav'yuk and Slaviuk 2018), economic stability (Perera 2010), and political popularity (Griffiths 2018),

In the face of contemporary climate challenges, sovereign debt plays a critical role as nations decarbonise on their pathways to net zero, a transition estimated to require $9.2 trillion on average per year, representing an annual increase of $3.5 trillion from 2020 (Mckinsey 2022). 2010-2020 saw approximately equal spending on climate finance from public and private sources (Naran et al. 2022), yet climate adaptation remains heavily dependent on public financing owing to the unfavourable risk-return profiles of adaptation projects (Climate Policy Initiative 2021). As adaptation becomes an increasingly prominent and costly item on the climate action agenda, sovereign bonds are expected to play an increasingly important role in global climate actions (Monnin et al. 2024; Banga 2019).

However, sovereign bonds are also sensitive to the risks posed by climate change. The cost of a country's debt (the spread they pay over a risk-free asset such as a Treasury bond) is positively related to perceived risk (Bingler 2022) and evidence is emerging that vulnerability to climate change (for example, an inability to manage climate-related disasters) is increasing these costs for sovereign issuers (Beirne et al. 2020; Boitan and Marchewka-Bartkowiak 2022; Cevik and Jalles 2022; Naifar 2023). Similarly, sovereign debt spreads are negatively impacted by downgrades from ratings agencies, which are predicted to become much more common as both acute and chronic effects of climate change directly undermine economic stability through physical and transitional climate risks (Klusak et al. 2023).

As nations seek credit for their climate-related expenditure, they have begun to issue labelled bonds earmarked for climate-related expenditure. Labelled bonds belong to two key categories: use-of-proceeds (UoP) bonds, where the proceeds of the bond are exclusively earmarked for 'green' destinations, and sustainability-linked bonds (SLBs), where the proceeds of the bond can spent for general purposes upon the condition the issuer meets pre-determined sustainability performance targets (SPT) when the bond matures (bouzidi and Papaioannou 2021). Most SLBs have 'step-up' structures, whereby the interest on the bond increases (steps up) if the issuer fails to meet the SPT, thus putting financial *pressure* on the issuer to commit to the SPT (Ramel Michaelsen 2020). Less commonly, a step-down structure exists when achieving a target is met with a decrease in the coupon. Both of these structures are intended to integrate sustainability risk exposure with the cost of capital considerations.

Emergent evidence suggests the presence of a greenium in labelled debt, whereby issuers of green bonds enjoy a lower cost of borrowing owing to the large demand for labelled bonds (Aruga 2024; Hachenberg and Schiereck 2018; Karpf and Mandel 2018; Zerbib 2019). Zhang et al. (2021) show how the issuance of UoP bonds can depress cost of capital for the whole issuing firm, not just the bond itself. These effects suggest investors can influence both the cost of capital and access to capital mechanisms. However, evidence from corporate issuances also highlights the shortcomings of these instruments in delivering real-world sustainability outcomes (Flammer 2018; Leung et al. 2023; Maltais and Nykvist 2020). UoP bonds have been found to support projects that bring marginal or negative environmental outcomes (Jones et al. 2020; Springer et al., 2022). While green finance taxonomies are beginning to govern contested definitions of what counts as 'green', governance standards and regulations remain lenient, geographically disparate, and at times slow to update (Gilchrist et al. 2021; Larsen 2022). UoP bonds have also been known to refinance already-existing projects that were originally financed with conventional bonds, rendering their additional impact questionable (Bongaerts and Schoenmaker 2019; Tuhkanen and Vulturius 2022). However, many studies claim that, even if the market is imperfect, green bond issuance has positive effects such as credibly signalling the issuer's green commitments to investors (Flammer 2018; Shi et al. 2023) and lowering the issuer's financing costs (Wang et al. 2022). Wagemans et al. (2024) provide evidence that suggests investors believe their investments in UoP bonds should be considered 'impact'.

Similarly, SLBs have faced criticisms of greenwashing, owing to unambitious SPTs (Kolbel and Lambillon 2022) and lenient reporting and monitoring structures that fall short of holding issuers accountable for reporting their progress of meeting SPTs in a rigorous and timely manner (Ul Haq and Doumbia 2022). Notably, issuers have delayed SPT target dates and sold off carbon-intensive assets (rather than seeking to decarbonise their operations) to prevent step-up penalties. As of 2024, only two countries have succeeded in issuing an SLB; Chile and Uruguay. Both issuances were recent (2022 and 2023 respectively) and as such their efficacy and impact remain to be seen. In theory, however, such products have the potential for impact given the change in cost of capital based on environmental outcomes, and as such these products are made a focus of the interviews undertaken as part of the methods of this research paper.

While the purchase of labelled bonds generates impact primarily by adjusting access and cost of capital, there is emerging interest amongst fixed-income investors in leveraging the engagement mechanism to drive issuer behavioural change (van Zanten et al. 2021). Little research has been conducted into engagement with sovereigns, yet system-level engagement is beginning to be recognised; macro-stewardship' (Versey 2022) and 'systemic stewardship' (Gordon 2022; Furgiuele 2022) have both been proffered as terms to describe policy-level engagements. Engagement can be conducted in numerous forms, ranging from bilateral correspondence of requests to a large-scale, collaborative engagement demanding significant changes in ESG policies and performance (Dimson et al. 2015). There is an emergent literature that considers engagement as an effective strategy to generate impact, especially in times when the investor has limited control over the cost or access to capital (Kolbel et al. 2020; Caldecott et al. 2022).

While there is limited theoretical and empirical literature on how bondholder engagement is conducted, and the determinants of bondholder engagement efficacy (Gomtsian 2022), transferable lessons can be drawn from the wealth of shareholder engagement literature. Notably, ‘stakeholder salience theory’ suggests influence is positively related to attributes of power (stakeholder’s ability to achieve their outcomes regardless of corporate concession or resistance), legitimacy (society attribution of stakeholder rights to exert influence), and urgency (stakeholders’ ability to command immediate attention and action) (Mitchel et al. 1997; Gifford 2010). Bondholders do not enjoy voting rights, a key pillar of shareholder salience and one of the most important tools for stewardship, nor can they file proposals. Sovereign bondholders have additional limitations; there are no board roles to influence, and litigation is more complicated, albeit not necessarily impossible (Gomtsian 2022). However, there are other levers to exert influence at bondholder’s disposal, including engagement during investor roadshows and, at the critical juncture of bond refinancing, bondholders wield power through the threat of withholding investment (Hoepner and Schneider 2024; Inderst and Stewart 2018).

Considerations of sovereign bondholder salience require the consideration of additional nuances. Historically, investor influence over sovereign nations through bond holdings has sparked controversy, with accusations that debt crises have been exacerbated by investor pressure in less economically developed nations (Paddock 2002). Questions have been raised over the sovereignty, democratic and ethical implications of private financial institutions in effectively taking on the role of policymakers through interactions with sovereigns (Baker 2010; Igan et al. 2012; Kalaitzake 2017). Moreover, the leverage creditors have over sovereigns may undermine the power, willingness, or effectiveness of states in regulating the financial sector (Baker, 2013). The profile of these investors adds to the consternation. The largest private investors are concentrated in

Global North countries (mostly Europe and the US), whose contribution to global emissions has dwarfed other countries (Ritchie and Roser 2024).

Indeed, the concept of climate debt is increasingly garnering attention; the notion that developed nations are indebted to less developed nations due to the former's responsibility in causing climate change (Matthews 2016; Pickering and Barry 2012). Beyond climate change, debt is also viewed by decolonial scholars as being used by the Global North to create vicious cycles of policy compliance, financial vulnerability, and dependency (Frank 1966; Toussaint 2019). Instead of continued lending or even concessional lending, unconditional debt relief and grant giving, is seen as a more just and appropriate approach for providing financial support to support Global South countries to achieve their climate targets (Táíwò 2022; Táíwò and Bigger 2021; Volz, U. et al. 2020). Present and historical injustices, and power dynamics between private investment institutions and governments, especially those in the Global South, are therefore critical for investors to consider when seeking impact through their sovereign debt investments.

## 3. Methodology

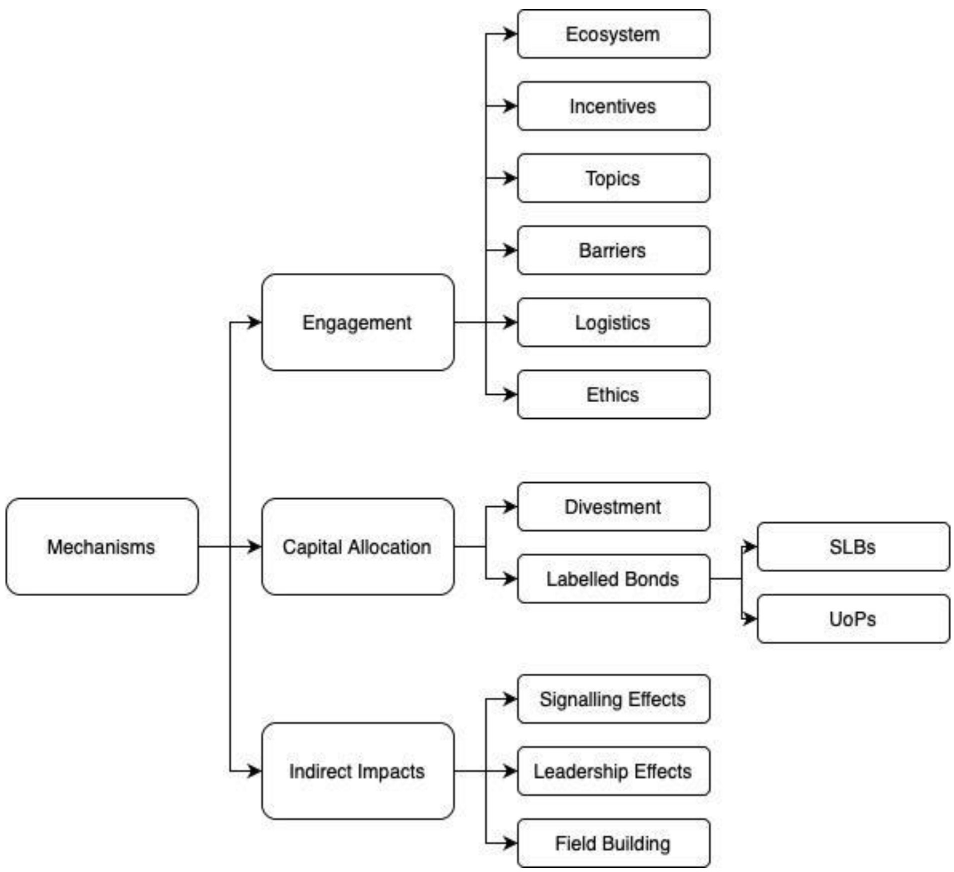
The bulk of existing research into stewardship, and engagement in particular, has been undertaken using quantitative approaches (for example, Dimson et al. 2015; Hoepner et al. 2018; Bauer et al. 2023; Barko et al. 2022). This is in part due to the focus on financial outcomes from such efforts, and in part due to the difficulty inherent in many appropriate qualitative approaches; for example, finding experts willing to be interviewed and institutions being wary of sharing insights. Qualitative analyses, however, uniquely enable a rich, thorough, and adaptable set of data that provide for an in-depth analysis of our research objectives that focus on the rationale, processes, and outcomes of sovereign debt engagement, which remains an overlooked aspect in the literature. To this end, we deploy an iterative, qualitative, analytical methodology drawing on two key data sources. First, policy documents, press releases, and NGO reports (totalling 46 documents) were collated and analysed to provide insights into the landscape of investor stewardship of sovereign debt portfolios. From institutions identified through the literature review as key members of the sovereign debt ecosystem, such as the largest global investors in sovereign debt, multilateral organisations, and NGOs, 23 examples of investors engaging with sovereign nations were identified (see Appendix C).

The content of these documents were analysed and categorised into themes in order to inform the second stage of the methodology involving semi-structured interviews with key actors from across the ecosystem of sovereign debt investment. The themes that emerged were used to develop both the list of experts to be approached for interviews, and the interview guides. For both aspects of the methodology, we focus only on sovereign bond obligations and not loans, as the latter are bilateral obligations with limited publicly available information.

20 online interviews, with durations ranging from 30 to 75 minutes, were conducted over Microsoft Teams between July 2023 and July 2024. 17 of these were audio-recorded and transcribed; 3 interviewees preferred not to be recorded, and in these cases notes were taken during the interviews. As is common practice for conducting business elite interviews (Harvey 2011), all interviews were undertaken on the basis of anonymity in order to ensure participants were able to share openly and honestly on potentially controversial subjects, without concern over potential negative consequences for the individuals or the institutions they represent (Kand and Hwang 2023). Recruiting appropriate interviewees was challenging due to the emergent and sensitive nature of the topic being researched. Despite this, 20 individuals agreed to be interviewed, which allowed an in-depth understanding to be developed of the topics under analysis. A breakdown of the type of the financial institutions represented can be found in Appendix A. Individuals chosen for interview were selected for their work for (or with) key market actors such as major sovereign debt investors, multilateral organisations involved in debt issuance and stewardship, collaborative engagement campaigns, and commercial banks. Ensuring this range of represented institutions was a deliberate aim, in order to attain views from across the sovereign debt ecosystem. Initially, invitations to interview were sent to individuals identified through web searches as being experts in the topics under analysis. Early interviewees were able to suggest further suitable interviewees, and this snowball approach yielded a much higher rate of acceptance.

A semi-structured approach is appropriate for this research; open-ended questions were asked in order to better-understand a topic with little prior academic knowledge (Wongsuphasawat et al. 2019), and to provide participants freedom to express their views and opinions whilst allowing for comparisons and cross-referencing between responses. An open coding process was used to identify key themes in the data (Chametzky 2016). The coding was initially based on the mechanisms for impact discussed in the literature (Kolbel et al. 2020; Caldecott et al. 2024) and the key themes that emerged from the document analysis. As interviews progressed, the coding adapted iteratively. These iterations allowed a hierarchical set of new themes to emerge, capturing the key issues and concepts necessary to examine to answer the research questions.

*Figure 1: Illustration of Categorisation of Key Themes*




Additionally, 10 unstructured, informal conversations with experts from institutions such as asset managers, asset owners, and regulators, were conducted over the same time period as the interviews. Due to the opaque nature of sovereign debt stewardship, particularly the practice of engaging with sovereigns, these conversations were used to identify institutions, individuals, and case studies, and to act as a sense check to ensure major themes were being identified correctly. Although the responses were not recorded or coded and are not formalised in this research paper, the contributions from these conversations were valuable in directing the research. This mix of data sources and methodologies form a triangulation approach, enhancing the validity and mitigating potential limitations of individual methods or data sources (Denzin 1970).

## 4. Results and Discussion

Our analysis suggests that a diverse range of sovereign bond engagement activity is taking place, and the practice is becoming increasingly widely adopted by investors (Amundi 2021; House and Row 2022; LGIM 2022). The causes pursued by investor coalitions include, but are not limited to, deforestation, financing of fossil fuels such as coal, green bond issuances, net zero policy, accession to weapons conventions, pandemic responses, and electoral integrity. Additionally, two major, collaborative, public sovereign engagement campaigns targeting specific sustainability issues have emerged in recent years. The first of such is the Investor Policy Dialogue on Deforestation (IPDD). Established in 2020, the IPDD began by targeting Brazil, before adding workstreams to target Indonesia and 'consumer countries', defined as the US, UK, EU, and China. In 2023, a UNPRI-led collaborative engagement was launched with the Australian Government (UNPRI 2023), targeting climate policy support. Whilst these two represent more high-profile bondholder coalitions, other collaborative activities include joint letters sent by investors to government officials. For example, in 2023, more than 400 institutions co-signed an open letter to the then UK Prime Minister Rishi Sunak laying out concerns over perceived weakening of net zero targets by his administration (Curtis-Moss et al. 2023). Despite this emergent trend, examples of reported engagement with governments, especially engagement coalitions, are sparse, reflecting the nascency of this practice and the barriers faced in its execution. Four key themes emerged from our interview data which provided insights to development trends of sovereign bond engagement on sustainability issues, namely: 'cost of capital and liquidity', 'ecosystem of engagement', 'barriers to engagement', and 'ethics' (See Table 1). We will deep dive into these themes in turn.

*Table 1: Summary of key findings*

Note that findings listed in the table are those with a reasonable degree of validity, that were affirmed by multiple interviewees and were not contradicted by any unless stated.

| Cost of Capital and Liquidity | Ecosystem of Engagement | Barriers to Engagement | Ethics |
|---|---|---|---|
| Impact through capital allocation is possible but difficult as many smaller countries have restricted access to capital markets and it can be impractical or expensive to buy their debt[1] | Investors routinely engage with sovereigns, including on environmental policy | Lack of expertise on the government side (tend to be experts in either finance or climate, not both) | There is a risk of infringing on a country's sovereignty when engaging |
| SLBs are liked by investors and in demand | Syndicating banks have a role in facilitating engagements | Government structures are difficult to navigate; multiple ministries are relevant but don't communicate between themselves effectively | Engagement with a domestic government circumvents some concerns around sovereignty infringement |
| Step-up structure is preferred by investors, but step-down preferred by governments[2] | ESG and Climate are becoming a larger part of the conversation and more investors are expected to engage with sovereigns on these topics in the future | Changes in Government (and policy) can derail or delay discussions | Divestment can be detrimental to the nation's population |
| SLBs are difficult for countries to issue due to the need for ministries to align and agree | Target governments are wide-ranging and include all sizes, developing and developed, autocratic and democratic | No real escalation strategies, other than different forms of engagement | Engaging investors don't want to be seen as lobbying |
| Full divestment is rarely a plausible strategy due to index weights and mandates | Largest investors have access right to the top, smaller struggle[1] | Developed market governments can have little incentive to engage with investors, as they face little/no difficulty issuing | No real escalation strategies, other than different forms of engagement |
| Expectation that if one Developed Market economy issues an SLB, others might follow, and this could be impactful in global transition efforts[3] | Secretariat role important | Additionality and causality are hard to prove (more so than in corporate debt) | |
| | Common targets include Treasury offices and environmental departments (and various other ministries), as well as regulators | Engagements are time and resource-intensive | |
| | | Lack of data | |

[1]Also a barrier
[2]The majority of investor interviewees preferred step-up, whilst a small number had no preference
[3]This observation was made proactively by two interviewees, and subsequently affirmed by each of the three others asked

### *4.1 Cost of Capital and Liquidity*

Interviewees talked about driving influence through altering the cost of capital and access to liquidity in tandem. The most radical form of these mechanisms - divestment - was seen as logistically difficult, owing to strict sovereign debt-holding investment mandates and a lack of substitute investments. Unlike corporate debt investment, sovereign debt is more often held in large quantities for liability matching, liquidity purposes, or risk diversification (Martinez et al. 2022), which creates an inelastic investment landscape where external factors, including changes in bond price, can have little effect on demand (Eren et al. 2023). Where divestment is possible, only a small impact on price or cost of capital could be created, if any, as is considered the case in other asset classes (Berk and van Binsbergen 2021). Interviewees were less dubious about the power of these mechanisms for smaller economies, yet many investors are not interested in the debt of these sovereigns to begin with due to the typically higher risk and higher transaction costs. However, Interview 17 noted that even very small impacts on the cost of capital can be critical for nations due to a strong reliance on debt for financing (Interview with NGO, 2024).

Interviewees were specifically prompted for their views on labelled bonds. Opinions on UoP bonds varied, with interviewees citing well-documented concerns over the lack of additionality and greenwashing (Bhutta et al. 2022). However, most agreed that even if the projects themselves are not additional and financing is not shifted towards sustainable practices, the strong demand for UoP bonds sends a positive signal to the market and to governments that highlights the importance of environmental action (Arévalo et al. 2024). Such impact fits into the signalling mechanism, and mirrors findings from the corporate debt asset class (Flammer 2018; Shi et al. 2023). Consensus was also clear that the visibility, ambition, and accountability frameworks for UoP issuances have been improving over time.

Contrastingly, interviewees' opinions about SLBs were overwhelmingly positive, with most hoping for the scaling of SLBs in both issuance numbers and volume. Interviewees pointed to the ability of SLBs to be tied to holistic transition plans (rather than individual projects as is the case for UoP bonds) (Vulturius et al. 2022) and the long-termism of target metrics as reasons for their viability and potential for impact. By embedding long-term environmental policy into SPTs, investors gain better foresight of future risks. Interview 17 also suggested that SLBs, even those where SPTs are unambitious, create the desired outcome of mandated reporting and disclosures relating to the SPTs (Interview with NGO, 2024).

Step-up structures are more appealing to investors, as the alternative step-down clause presents a more difficult pricing task. For step-down SLBs, investors face the potential for a financial loss in the future (if the country successfully hits an SPT) and therefore require financial compensation upfront. However, early evidence and research suggests this financial compensation is present in current corporate issues (Interview with NGO, 2024; Erlandsson et al. 2022). Another concern cited for step-down structures was their potential to be ‘gamed’ by countries; if it looks as though the target will be missed, the country has a financial and reputational incentive to manipulate their data outputs to appear to be meeting their targets (Interview 16, 2024). No interviewee suggested there has been evidence for this in practice at the sovereign level, and several demurred, saying they consider the risk of data manipulation by countries small, making this an area of disagreement among interviewees. If this is indeed a limitation for some investors, it could be addressed with better data governance, which was unanimously considered by informants to be lacking.

Notwithstanding optimism from investors that SLBs can be effective in generating impact through altering the cost of capital, interviewees cited barriers in scaling SLB issuance. First, the reputational risks and political risks of missed KPIs are considered considerable (Interviews 2, 7, 14, 15). The costs and difficulties associated with coordinating multiple ministries to agree on the bond structure and SPTs are also significant. To this end, informants revealed that Debt Management Offices of two major, Developed Market countries had flat-out rejected the prospect of near-term SLB issuance, although cautious optimism was prevalent for future shifts in this policy. Multiple interviews suggested that if one large economy were to issue an SLB, it could act as a market leader, spurring others to follow suit (Interviews 7, 17, 20). Interviewees were tentatively positive on the current sovereign SLB issuances of Chile and Uruguay, the former having a step-up coupon, the latter both a step-up and step-down.

Another concern raised was that of the regulatory environment, as under current SFDR rules, unless the country issuing the debt was itself a 'sustainable' investment (a difficult claim to make given that, as of 2024, no country is 1.5C aligned (Climate Action Tracker (2024)), a portfolio invested in its debt cannot be marketed as Article 8 or 9 (considered a key marketing label for many funds) (Interview 7, 2023). Even SLBs with an environment-linked target would, under current legislation, fail to be considered 'sustainable'. This highlights the importance of the regulatory environment for stewardship practices; in this case, investors are motivated to purchase what they consider to be impactful assets but cannot for fear of falling foul of regulations. Moreover, in light of the lack of national-level policies and targets that are rigorously aligned with the Paris Agreement, investors find it challenging to establish environmentally credible metrics for sovereign SLBs. The difficulty of selecting KPIs was also noted, but the publication of the

International Capital Market Association's (ICMA) Sustainability-Linked Bonds Principles (2024) was considered a positive step towards standardisation.

Overall, interviews suggested that real-world environmental impact can be made through the capital allocation mechanism, although effects by individual institutions will likely be low. UoP bonds can provide additional impact through the signalling mechanism. SLBs were thought to have the potential to more significantly provide impact through altering the cost of capital and signalling if their issuance by sovereigns can become more commonplace.

### *4.2 Engagement*

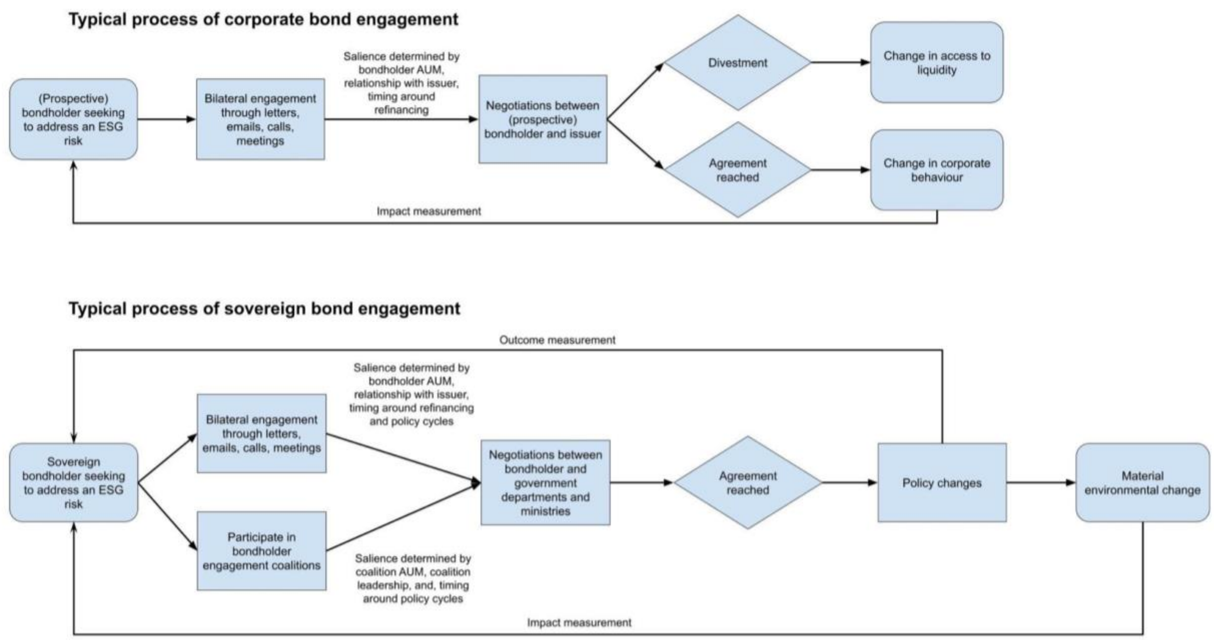



*Figure 2. Divergent bondholder engagement processes of corporate and sovereign bond engagement*

#### *4.2.1 Ecosystem of Engagement*

All interviewees representing investment institutions confirmed they engage regularly with governments whose bonds they have invested in. Investors engage across almost the full range of countries that issue debt, from the smallest island states to the major, global economies. Investors were generally reluctant to specify countries of engagement, but over the course of the interviews it became clear that even some of the very largest economies, such as the US, Germany, France, India, and the United Kingdom, are routinely targeted for engagement. No interviewee cited China as an engagement target. A significant pattern was the tendency for asset managers and owners, particularly pension funds or those representing pension funds, to engage heavily with the government of the country they are based, which represents their ultimate beneficiaries.

Interviewees were vague about the topic, processes, and targets of their sovereign engagement campaigns. Unanimously, interviewees cited the financial structure of labelled bonds and environmental policies as common topics of engagement. The structuring of green bond issuances and the content of green financing frameworks were commonly discussed. How proceeds are spent and managed in Use-of-Proceeds bonds was also a key target for engagements, with investors wanting to see ambition and additionality in the terms. SLBs were discussed less in relation to targets given their nascency in this asset class; most engagements around these were general calls for issuance. Environment policies such as deforestation commitments and measures, fossil fuel financing, and transition plans are regular themes for engagements, though interviewees did not elaborate on if and whether time-bound, quantitative targets are set in these dialogues.

The importance of these dialogues lies in their potential to address macro-level physical and transition risks associated with climate change. As previously reviewed, the literature suggests that sovereign bond spreads are sensitive to such risks (Bingler 2022). The presence of investor engagement on issues such as deforestation, fossil fuel financing, and transition planning reflects a broader strategy to influence sovereign policies that could mitigate these risks. For example, stronger deforestation policies can reduce the risk of environmental degradation and its associated economic impacts (Motel et al. 2011), while comprehensive transition plans can help countries manage the economic shifts needed to meet climate goals (Dikau et al. 2022). Thus, engagement campaigns targeting these policies are not only seen as risk management tools for specific investment portfolios, but also as mechanisms to drive broader impact in mitigating climate-related threats that affect the stability of financial and economic systems.

Unsurprisingly, the landscape of investor engagement is uneven and some financial institutions engage more proactively than others. Our analysis reveals that certain investors act as 'nodal players' who take leadership roles across multiple engagement campaigns, and actively publish white papers and participate in consultation processes to set the agenda for investor environmental expectations of sovereign issuers. These nodal players tend to be large institutions with a high proportion of pension fund and mutual fund clients. In other words, they can be categorised as 'Universal Owners' who own broad, representative slices of the market portfolio (Hawley and Williams 2000), which incentivises them to manage systemic risk through their sovereign engagements (Freshfields 2022). Research has found that pension funds tend to have more advanced ESG practices because of their reliance on the long-term health of the global economy (Amalric 2006). Nodal players also tended to be European-headquartered, aligning with the trend for European investors to be more active on sustainability (Cowlrick 2024). Beyond individual institutional investors, we also found that UNPRI plays an important role in providing administrative, organisation, and research support for multiple engagement coalitions, including the IPDD and organising a collaborative campaign of international investment institutions engaging with the Australian Government (UNPRI 2023). Notably, the UNPRI has set the agenda for sovereign debt engagement with a report on the practice, detailing the motivations for sovereign engagement, the potential benefits, and some of the barriers to its usage (UNPRI 2020).

Interestingly, sovereign wealth funds (SWFs) - a type of universal owner that, collectively, hold more than $12trn in assets (GlobalSWF 2024) - have not been openly involved in environmentally- or socially-driven sovereign debt engagement strategies. This is despite the absence of laws or regulations prohibiting SWFs from conducting engagement on these topics. On the surface, this appears to be a missed potential of the leverage SWF capital might have in driving positive outcomes (Junghanns and Kornerts 2022), but Interview 12 explained this owes primarily to the sensitive political positions SWF as state-owned institutions (Interview with SWF, 2024); engagement would be akin to sovereign-to-sovereign diplomacy that has previously attracted criticisms of disrupting financial markets (Truman, 2007). However, our SWF respondent did suggest their institution is engaging with nation-states on issues such as governance and, more rarely, the environment.

Desk-based analysis of industry publications also suggested that Debt Capital Markets (DCM) functions of syndicating banks could have a role in the facilitation of engagements, given their role as advisors in the structuring and sale of bond issuances. Our DCM interviewees concurred and discussed their institutions' activities in this space, such as hosting a 'speed dating-style' conference for sovereigns and their investors to discuss labelled bond issuances. Pre-issuance engagement was seen by respondents as particularly powerful, given the issuer incentive to listen and cooperate to lower the cost of their debt issuance. However, respondents also noted that it is difficult for investors to influence or insert covenants on non-labelled bonds, because bond structuring typically happens before investors are involved. Moreover, when there is healthy, stable demand for debt globally, sovereign issuers often have little incentive to change the structure based on a single investor's asks.

Contrasting to suggestions from asset management interviewees, however, interviewees representing syndicating banks recalled few investors proactively raising environmental and social considerations throughout the processes of bond structuring or in pricing risk. Moreover, in line with existing criticisms of the environmental benefits accrued by the green bond market (Jones et al. 2020), one interviewee observed that many investors do not appear to care about the environmental and social impact of a bond post-issuance unless their investment mandate explicitly demands post-issuance monitoring.

Across the different types of investors, sustainability-related financial risk management is the primary motivation to engage (all Interviews; Yamahaki and Marchewitz 2023). Whilst interviewees were sceptical as to whether successful engagements could lead to financial payoffs as some claim can occur when engaging with companies (Dimson et al. 2015; Bauer et al. 2021; Hoepner et al. 2018), engagement outcomes such as increased environmental information availability were seen as being material in the risk-profiling of countries, in the same way that financially material information is valuable to investors (Feng and Wu 2021; Flammer et al. 2021).

Interviewee 1 described their role as being 'a detective', looking for financially material environmental information in the same way they search for other risk factors (Interview with Investment Analyst, 2023). This detective work included engagement in the form of requests for information where such information was unavailable, but considered attainable. Interviewees also commonly cited systemic risk mitigation, an incentive to contribute to constructing a sustainable economy, reputational gain, and client desire for impact as motivations (Interview 7, 2023; Bauer et al. 2021).

The initial point of contact for the majority of engagements is usually the debt management office of the country, the body responsible for debt issuances and investor relations. Treasury offices, regulatory bodies, and departments responsible for environmental matters were also cited as avenues to seek a voice, as are government officials and elected policymakers. Interviewees claimed that engagement takes place throughout the entire issuance cycle, though sovereigns are more inclined to enter into productive dialogues when they are seeking refinancing. Roadshows, organised by sovereign issuers, were cited to be a common juncture for dialogue, particularly around labelled bond structuring, and interviewees suggested increasing sovereign interest in arranging them. Letters, both public and private, and meetings are also common methods by which investors enact their engagement. Private, bilateral engagements remain the most common strategy, where individual investment institutions regularly discuss policy and regulation with government officials, and request disclosures.

One common feature of engagement coalitions is the presence of secretariats. Interviewees pointed to their particular importance for sovereign engagements; not only have secretariats facilitated more efficient operations, but they have also importantly exerted indirect influence through field building (Marti et al. 2023). Interviewees representing asset management institutions involved in the IPDD commended the Tropical Forest Alliance, the secretariat for the coalition, as they provided crucial local knowledge and contacts that were advantageous for facilitating effective dialogue. Similarly, coalition members offer a depth of geographical or sectoral knowledge, as well as networks, which can drive more well-informed and far-reaching engagement. In describing their attempts to have impact, investors also pointed to membership and support for groups that produce research and tools for system-level change; groups such as the Transition Pathway Taskforce (created by the UK Government to aid disclosure requirements and regulation), ASCOR (a database to assess sovereign climate action), and the Institutional Investors Group on Climate Change (a collaborative initiative to address investor climate risk).

#### *4.2.2 Barriers*

From our document analysis, it is clear that sovereign engagement is not practised as widely, nor reported on with as much comprehensiveness and consistency, as corporate engagement. Interviewees attributed this to four main barriers they consistently face when engaging with sovereigns. None of the barriers discussed were considered insurmountable, and respondents consistently opined that they expect investors to scale up their sovereign engagement efforts in the future.

Of the barriers unique to the sovereign asset class, the structure of governments was the most commonly raised. Numerous ministries, each with responsibilities that overlap into climate policy and financing, must be engaged with, and coordinating across these ministries is difficult; meetings must be arranged with each ministry, their particular responsibilities and policy briefs determined, and the language and approach used by the investor for each may need to be different depending on expertise, which is often siloed within departments. From the government side, these ministries need to coordinate between themselves to agree policy changes and act on investor requests and this can require numerous rounds of drafts and discussions even within an administration. As Interviewee 9 put it, ‘governments are bad at talking to themselves’ (Interview with Academic, 2023). Individual country’s unique political and economic configurations are also a unique barrier to scaling up sovereign bond engagement. Rather than following a formulaic engagement strategy or framework, investors of sovereign debt must plan a bespoke strategy for each country and each sustainability issue to tailor to countries’ unique political and bureaucratic processes. This, in turn, increases the cost of engagement. Interestingly, change of government is not considered a barrier to effective engagement by many, as interviewees explained that most engagement efforts are undertaken with non-elected officials, and those that are undertaken with elected officials are not greatly impacted by changes in personnel or government mandate, as new officials are often open to ambitious environmental goals. That being said, where environmental concerns are politicised, the anticipation of government change can hinder engagement efforts.

Gaining access to government officials is also a unique barrier, although institutional investors with greater assets under management (AUM) appear to gain easier access with more senior government representatives, as is the case for corporates (Kruitwagen et al. 2017). Investors cited the size of the country and political-economic factors as key determinants of access. For example, the US and Germany enjoy high demand for their debt and as a result, their governments have less incentive to respond to investor demands on environmental and social matters. Respondents generally considered AUM to be correlated with the ability to create impact across all mechanisms.

The final barrier unique to sovereign engagement is the aforementioned inability to divest. A credible threat to divest is integral to an effective engagement and escalation plan. In the context of corporate engagement, failure to make progress through sustained engagement can be met with escalation through alternative channels, that often eventuates in divestment (Considine et al. 2023). In contrast, escalation is a much less powerful lever for sovereign debt investors as investors cannot deploy the threat of divestment as an 'ultimatum' for sovereigns to acquiesce to their requests (Admati and Pfleidere 2009). Indeed, interviewees mentioned that the only 'escalation' strategy they can deploy is to request more meetings with different departments, at most escalating the meetings to more senior officials.

In addition to these challenges unique to sovereign debt engagement, investors are also subjected to general challenges to debt engagement, notably related to the difficulty of forming cohesive engagement coalitions with other like-minded investors to aggregate investor 'voice' to pressure sovereigns to drive change, as well as the difficulty in measuring the impact of engagement campaigns so as to communicate and justify resource dedicated to engagement to beneficiaries. An example of the latter is the case of the IPDD, whose work began under one government and is ongoing under a second, whose leadership claims to be much more climate-conscious than its predecessor. The effect of a change in government on deforestation policy is likely to dwarf any investor impact the IPDD can achieve. It is challenging to quantify the pressure, leadership, and research that the IPDD has contributed towards a positive outcome. Whilst it may be impossible to definitively prove causality and additionality at a sovereign level, one interviewee proposed a probabilistic approach (Harris 2021; Carter et al. 2021), that evaluates the circumstances in which actions are more or less likely to be additional, thereby circumventing the need to prove causality of individual actions.

While a lack of data and reporting are consistently considered barriers to effective engagement efforts across asset classes (Fukami et al. 2022), both are particularly disparate at a country level, which hinders effectiveness in prioritising engagement targets and measuring successes. In practice, shareholder engagement has enjoyed a more sophisticated data provision and professional services infrastructure compared to what is available for debt holders (Gomtsian 2022). For sovereign debt holders, third-party research into sovereign sustainability performance is limited (Macfeely 2019). Interviews suggested data availability, comparability, and credibility were a problem. That said, there are clear indications of progression in this area such as the ASCOR project, which aims to provide a database to enable assessment of climate action and alignment of sovereign bond issuers. Such tools may begin to bridge the data gap for sovereign debt engagement in the future.

#### *4.2.3 Ethics*

Views on the ethical concerns involved in engaging sovereign governments ranged considerably. Those who espoused greater concern talked about the fine line between lobbying and engagement, and how private investors should not, in their minds, be responsible for finding the distinction; Interview 12, when asked specifically about the distinction between engagement and lobbying, responded ‘It’s a framing and narrative difference more than anything else’ (Interview with SWF, 2023). Concerns were centred around the legitimacy of developed market investors interfering with developing market governments. Whilst language of ‘Global North/South’ and coloniality were rarely used by interviewees, the concerns surrounding uneven power appear thematically aligned. Others did not raise concerns around ethics and were unperturbed by potential risks when asked. Some interviewees saw their engagements as being limited to requests (and support) for adherence to current policy (for example, commitment to the Paris Agreement, or IPDD’s support for Brazil to adhere to its deforestation policies), rather than attempts to impose policy changes, and therefore incapable of infringing on sovereignty. Others pointed to times their institution had been proactively approached by governments requesting dialogue on the financial materiality of their environmental policies. The importance of issuers receiving feedback from investors regarding the financial implications of environmental policies was highlighted several times.

In cases where investors took a more interventionist stance, such as the German bank Bank für Kirche und Caritas (BKC) engagement with the Namibian Government (a former German colony) on accession to the UN Biological Weapons Convention, some investors sought justification on the basis that corporate lobbying for ‘positive societal outcomes’ is at least better than the aforementioned historic practices, where debt crises have been exacerbated by investor influence (Paddock 2002). Who decides whether an outcome is positive, and for whom, remains contentious. The question, therefore, is who, and on what topics, investors are attempting to influence in private, and to what political-economic ends for the developing economy. Interview 10 critiqued: ‘fiduciary duty should not trump democracy’, and suggested that perhaps the full potential of sovereign debt engagement should be used reservedly to protect the democratic rights of sovereign nations (Interview with Academic, 2023). While investor interviewees tended to suggest a desire for transparency, non-investor interviewees suggested investors prefer their activities in this space to remain under the radar and thus unaccountable. The aforementioned opacity over engagement targets and topics lends some weight to this scepticism. The ethics of divestment, with the intent of increasing a nation’s cost of capital, are also questionable, as by definition government debt is issued to finance policy to the benefit of the citizenry.

Our paper asks whether investors can create an impact using their sovereign debt portfolios. Busch et al. (2021) call for the consideration of both positive and negative externalities in efforts to create impact. In this case, infringement of democracy and sovereignty appears to be a unique negative externality of sovereign debt engagement. Quantifying the negative externality created by attempting to engage foreign sovereign governments is reductionist and not constructive, and so the commonly-used cost-benefit analysis (Layard and Glaister 1994) is unsuitable here. As any attempt to influence a change in policy in a foreign country likely necessitates an unquantifiable negative externality, it is difficult for investors to assess the viability and legitimacy of their actions. Investors are also not best placed to determine the limits in this area, and they are not experts in the determinations of democratic agency, which suggests a need for external guidance and further research to guide practice. Requests for information relating to environmental and social concerns, as well as knowledge-sharing on the financial materiality of such issues, may be considered less controversial. Yet these activities may not meet the threshold for impact, and questions have been raised of the inherently neoliberal nature of disclosure requests that makes developing markets more 'legible' (Scott 1998), given the assumption of efficient free-market theories (Christophers 2017).

#### *4.2.4 Domestic Engagement*

Practically speaking, these results show that engagement with sovereigns is clearly a strategy being used by investors, yet views appear disparate as to the limits of acceptable targets, given concerns around sovereignty. When an institutional investor, domiciled in the same country as its beneficiaries, engages with the government of that same country, some of the concerns around sovereignty may be circumvented, since both investor and government ultimately serve the same beneficiaries (assuming a homogeneous set of beneficiaries such as a public pension fund). From a theoretical standpoint, this practice can be represented as one agent acting for a subset of another agent's principals. This practical extension of principal-agent theory, typically known as a Multi-Agent Principal-Agent problem (note that this only differs from the standard principal-agent theory when the agents interact, as is the case here (Lockwood 2000)), is less a problem relating to marginal costs, and more to the relationship dynamic between agents, and their incentives to work together. In this relationship, with both investor and government mandated to serve the best interests of a group of individuals, dialogue (theoretically) benefits all parties. In a relationship of investor and foreign government, the principals differ; the former serves a group of beneficiaries, the latter their own populace. Dialogue can remain beneficial to both agents, but the theoretical model is of two distinct principal-agent problems.

This type of engagement is common (at least, more commonly publicised), particularly with pension funds (Interview with Asset Manager, 2023). Investors are likely to find it generally easier to engage with the government of domicile; cultural and communication barriers are likely low to non-existent (Dimson et al. 2023). Outcomes of successful engagements may be more impactful to the beneficiaries; by engaging on issues relevant to the social well-being of clients, such as local flooding risk and water quality, the beneficiary benefits from both the lowered financial risk of their debt holding (assuming this relationship holds) and utility derived from the engagement outcome. As such, the fiduciary duty obligation is dually satisfied (Interview with Asset Owner, 2024). The case of a public pension fund can serve as a paradigm here; many will have obligations to hold liability-driven investments and very low-risk instruments, for which government bonds are commonly used. Large holdings of their government's debt increases the importance to investors of engaging on factors that can lower risk, and could also increase influence, assuming the aforementioned relationship holds.

## 5. Conclusion

This article has sought to shed light on the emerging phenomenon of private institutional investor stewardship of sovereign debt portfolios. We find evidence to suggest that investors do have the potential to contribute to positive, real-world impact through their stewardship of sovereign debt portfolios (RQ1) through each of the mechanisms analysed (RQ2), yet that difficulty proving additionality mutes the impact an investor can claim, and concerns over infringing on sovereignty necessitate careful consideration being given to the nuances of engaging in this asset class (RQ3). The findings of this paper suggest the cost of capital mechanism can be utilised by purchasing, and pushing for further issuances of, labelled bonds, most powerfully SLBs. These products can provide additional impact through the signalling mechanism.

We find that investors are routinely utilising the engagement mechanism to create sustainable outcomes. This mechanism can be powerful and impactful as outcomes address more systemic issues than corporate engagement. However, the potential for infringement on the sovereignty of democratically elected governments is clear, and future scaling of the practice should heed such concerns, particularly when engagements move beyond knowledge-sharing and disclosure requests to pushes for policy change. Understanding of the boundaries of engaging with foreign governments would benefit from further study and guidance from industry standards-setting bodies, with consideration for the specific political and cultural nuances involved with each potential target country. Whilst this study has focussed on the investor's perspective, further study could also focus on how governments react to investor engagement and subsequent implications on financial and environmental policy changes (or inertia). This would be particularly relevant in studying the continued potential to drive change through sovereign bond engagement in the present climate of political pushback against ESG (Papazian and Westphal 2024).

Additionally, the 'professionalisation' of sovereign stewardship could be an important avenue of future research; as this practice scales and becomes more commonplace, there may be the expansion of this section of the ecosystem with more specialised professional stewardship services providers and consultants, as has been the case with corporate stewardship (Sipiczki 2022).Whilst this may increase and diversify the scope and opportunities for impact, the risks discussed in this paper, most notable the concerns over infringement on sovereignty, may be exacerbated.

Engagement with the country of domicile has the potential to be impactful without questions of sovereignty, and we find evidence to suggest such activities are being undertaken routinely by many investors. However, there is a need to be realistic concerning the capacity for investors to prove real-world change through these avenues. Even where plausible and ethical, clients and beneficiaries should not expect asset managers to be able to consistently demonstrate clear, causal additionality.

Declaration of Interest Statement

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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# Appendices

*Appendix A: Details of Interviewees (*Interviewee 12 Location Redacted to Retain Confidentiality)*

| Number Assigned | Month/Year of Interview | Sector | Location |
|---|---|---|---|
| 1 | 07/23 | Asset Manager | UK |
| 2 | 07/23 | Bank | UK |
| 3 | 07/23 | Asset Manager | US |
| 4 | 07/23 | Asset Manager | Netherlands |
| 5 | 07/23 | Asset Manager | UK |
| 6 | 07/23 | Asset Manager | France |
| 7 | 08/23 | Asset Manager | UK |
| 8 | 09/23 | NGO | Switzerland |
| 9 | 09/23 | Multilateral | Australia |
| 10 | 10/23 | Academia | Sweden |
| 11 | 11/23 | Regulator | UK |
| 12 | 12/23 | Sovereign Wealth Fund | * |
| 13 | 12/23 | Asset Manager | UK |
| 14 | 12/23 | Asset Manager | UK |
| 15 | 03/24 | Asset Owner | Australia |
| 16 | 04/24 | NGO | Switzerland |
| 17 | 05/24 | NGO | UK |
| 18 | 05/24 | Asset Owner | UK |
| 19 | 06/24 | Asset Owner | UK |
| 20 | 07/24 | Bank | UK |

*Appendix B: Interview Topic Guide*

**Example Interview Guide**

*****Note that the following is a question bank that was tailored before each interview, as some topics were not relevant for all institutions. As the interviews were semi-structured and exploratory, typically only 5-10 questions were asked (plus follow-up questions), with open-ended answers often covering multiple topics.

**1. Background of the interviewee and organisation represented**

1.1 Please describe the purpose of your organisation and experience in relation to investor engagement, stewardship and active ownership.

1.2 Please describe your role and experience in relation to investor engagement, stewardship and active ownership.

1.3 Please describe the engagement strategy(ies) your organisation has adopted, both generally and with specific reference to sovereign debt.

1.4 Does your organisation engage with domestic regulators (for example, on stewardship codes) and if so, how? On what topics?

1.5 Please provide an overview of your organisations’ past sovereign debt engagement campaigns (countries targeted, membership of coalitions, aims, successes etc.).

**2 Theories of Change and Strategies**

2.2 Please explain your organisation's theory of change in designing engagement and stewardship policies, and any differences in the approaches between asset classes.
2.3 Please explain the process of designing engagement and stewardship policies, choosing engagement foci and determining engagement targets in sovereign debt.
2.4 How does your engagement strategy design differ across geographies and sectors?
2.5 What are the differences in the engagement strategies employed between equity, corporate debt, and sovereign debt asset classes?
2.6 What scope does your organisation have to influence or insert sovereign debt covenants pre-issue?
2.7 How does influence level differ over the financing cycle?
2.8 What hurdles do you face when engaging with countries in sovereign debt? (legal, regulatory, communication, fixed time horizons, political etc.)
2.9 What hurdles do you face as a debt engager that you do not face as an equity engager (if any, and if appropriate)?
2.10 Does your organisation knowledge-share with other investors? If so, how, and on what topics?

## 3 Investor Coalitions (If Applicable)

3.1 Why did your organisation choose to participate in various investor coalitions? If your organisation did not choose to participate, why not?
3.2 What is your organisation's role in the coalition?
3.3 How would you describe the effectiveness of the coalition?
3.4 What is the asset class composition of the investors in the coalition?
3.5 If multiple asset classes are represented, does this provide benefits (or challenges) to the coalition's effectiveness?
3.6 What are the factors which make the coalition(s) effective?
3.7 What have been the key challenges to effective outcomes in the initiative(s)?

## 4 Impact Measurement and Future Directions

4.1 What does your organisation consider as successful outcomes from your sovereign engagement activities?
4.2 How does your organisation measure the impact of your engagement strategies?
4.3 What datasets or data points, if any, does your organisation use to measure the impact of your engagement strategies?
4.4 How do you think sovereign debt engagement is being utilised across the investment industry?
4.5 What do you think are the next steps to take to enhance the sustainability impact of investor engagement and stewardship in sovereign debt?

Appendix C: *Table of Case Studies of Investor Engagement*

| Engager | Engaged Government | Topic | Reference |
|---|---|---|---|
| 32 Investors and Financial Institutions | UK | Net Zero Policy | Pfeiffer et al. (2023) |
| 81 Investment Institutions and Businesses | UK | Setting an NDC | Molho et al. (2020) |
| Amundi | Chile | Social Bond Issuance | Amundi (2021) |
| Amundi | Belize | Blue Bond Structuring | Amundi (2021) |
| Amundi | Australia, Kazakhstan, Turkey | Thermal Coal Policy | Amundi (2024) |
| APG | South Korea | Rights to file non-binding proposals | Marchant (2023) |
| Aviva | 21 Countries | Climate Action | Aviva (2023) |
| BKC and SfC | Namibia | UN Biological Weapons Convention | SfC (2022) |
| Coalition of UK Asset Owners | UK | Combustion Vehicle Phase-Out | Elwell et al. (2021b) |
| Coalition of UK Asset Owners | UK | Climate Action | Pfeiffer et al. (2022) |

| | | | |
|---|---|---|---|
| Coalition of UK Investment Institutions | UK | Climate Action | Elwell et al. (2021a) |
| Coalition of UK Investment Institutions | UK | Green Bond Issuance | Kinnersley et al. (2020) |
| Colchester | Numerous | Green Bond Issuance | Colchester (2020) |
| IPDD Coalition | Brazil | Deforestation | UNPRI (2023) |
| IPDD Coalition | Indonesia | Deforestation | UNPRI (2023) |
| IPDD Coalition | 'Consumer Countries' | Deforestation | UNPRI (2023) |
| LGIM | Japan and South Korea | Uptake of ISSB Standards | LGIM (2024) |
| NinetyOne | Thailand, Peru | Climate Action | Eerdmans (2020) |
| Payden and Rygel | Benin | Electoral Reform | FRC (2022) |
| Payden and Rygel | Ukraine | Anti-Corruption | FRC (2022) |
| Payden and Rygel | Guatemala | Social bond structuring | FRC (2022) |
| PRI and 27 Investment Institutions | Australia | Climate Action | UNPRI (2024) |
| PRI and Investor Group | EU | Reporting Requirements | Reynolds (2021) |

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