ENGAGING WITH A SECURITY SERVICES ISSUER

SIGNATORY TYPE	**Investment manager**
OPERATING REGION	**Europe**
ASSETS UNDER MANAGEMENT (AUM)	**€123bn***
CREDITS AUM	**€13bn***
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WHY ENGAGE WITH ISSUERS?

The main driver behind bondholder engagement at MN is credit risk, with a focus on downward risk. Concerns over poor ESG practices can materialise in lower perceived credit quality and/or reduce investor appetite, affecting liquidity.

MN could initiate engagement with corporate bond issuers if they display a lack of transparency in public reporting, or low or declining performance of financial and extra-financial indicators. Third party research highlighting issues that could affect credit quality may also lead us to engage with them.

Our bondholder engagement activities focus on our internally-managed credits (EUR investment grade) which comprise companies which are well-known by our credit analysts. This provides us easier company access and more insights for flagging a change in ESG risks or opportunities for aligning investments more with the UN Sustainable Development Goals (SDGs).

As a pension fund asset manager, we consider it our responsibility to make a positive contribution to society. It is our intention to align more investments with the SDGs which – in line with the OECD guidelines for institutional investors –has led us to widen the scope of our continuous investment due diligence.

* As at 31 December 2016

Figure 1: MN credits engagement process. Source: MN

STEP 1
Reviewing ESG reporting and third-party research
	■ Credit analysts regularly review public reporting and/or cross-check and verify third party research.
	■ Engagement with credit issuers may be required to better assess credit risks and/or opportunities for investments which are aligned with the SDGs.
	■ Preconditions for bondholder engagement include:
	  ■ Bondholding belongs to MN's investable universe/benchmark.
	  ■ Lack of transparency (including ESG considerations).
	  ■ Poor performance (including ESG considerations). For instance, we look at the recurrence and gravity of financial and non-financial news stories, how the company responds and follows up to scandals, and public scrutiny of the company.

STEP 2 Discussing findings with other credits team and responsible investment and governance team members	■ Credit analysts discuss their findings with other members of the credits team, as well as members of the responsible investment and governance team. ■ Equity team members may also be informed and/or consulted. Especially with respect to ESG considerations, we consider whether the issue has already been identified and if there has been any engagement. If yes, we consider what the outcomes were.
STEP 3 Initiating bondholder dialogue	■ As the credit analysts know the company best, they keep relevant parties (credit team members, responsible investment and governance team, equities) updated on engagement progress. ■ Where relevant and no conflicts of interest arise, we may engage in our capacity both as a bondholder and a shareholder. ■ Pre-issuance, the first point of contact tends to be face-to-face if possible, such as during a company roadshow. Post issuance, the first point of contact with companies tends to be in writing, preferably by email.
STEP 4 Assessing issuer response	■ After receiving a response from a company, if necessary, we may follow up to clarify any outstanding questions. ■ Contentious or complex issues often require more detailed engagement between bondholders and issuers. For that reason, we may arrange conference calls or have face-to-face meetings.
STEP 5 Maintaining continuous due diligence during engagement	■ The bond and performance of the issuer is monitored throughout the duration of the issue. ■ If the company does not respond to our requests for engagement, our first point of action would be to lower our credit assessment of the issuer.
STEP 6 Reflecting engagement outcomes into investment process	■ If we see a risk for credit quality, we may require a higher premium before investing or otherwise lower our risk exposure or decide not to invest. ■ If we identify an opportunity for positive impact that is also likely to enhance or strengthen a company's business profile, we may increase our exposure, conditional on the risk-return tradeoff.

ENGAGEMENT IN PRACTICE

PRIORITISING G4S FOR ENGAGEMENT

In early 2016, the private security company G4S dominated news headlines because of its use of excessive force on inmates in UK youth detention centres. This was preceded by a number of scandals such as a failure to provide well-trained staff for the London Olympics, misconduct in South African prisons and overcharging of prisoner electronic tagging contracts. Soon after, the company announced it would sell the controversial youth jail contracts with the UK government.

The company's high indebtedness and limited ability to absorb any major setbacks had already raised concerns at our credit team, as a rating downgrade to non-IG would make it no longer investable. The youth detention scandal raised doubts about employee screening, training and management practices. It also made us question whether we could invest in industries with extremely vulnerable stakeholders that could be at risk of abuses of power – even though that risk was very low.

Another concern was that the company's weak financial position could possibly encourage more aggressive cost cutting at the expense of inmates. This would present a higher risk of unrest in facilities and subsequent criticism from the public. In order to better understand the issue at hand and to further develop our view on whether or not this type of activity could be reconciled with investing responsibly, we made it our priority to engage with the company to gather further information.

With our shareholder engagement team, we initiated an investor dialogue with G4S by email. This was shortly followed by a conference call with a member of G4S's CSR department, where we discussed our main concerns in more detail. As a follow-up to our discussion, the company provided us with additional information on responses to inspection reports and documents on employee screening processes. G4S understood that we were genuinely concerned by the detected misconduct in the youth detention centres and offered us open and transparent communications. We believe that the close cooperation between the MN credit and shareholder engagement teams increased the possible effect of our engagement with G4S.

FOLLOWING UP

G4S followed up by organising an SRI day and inviting investors to the centre to see day-to-day running for themselves. Our shareholder engagement representative attended and spoke to G4S employees, inmates and the executive board about human rights topics.

We identified improvements in corporate practices and assessed the company's ability to prevent similar issues from occurring again. For instance, the company was more aware that risk management not only encompasses pre-employment screening, but also group behaviour, accountability, and a safe and transparent working environment. In case of negative publicity, we think it is key to invest in additional communications with investors from all asset classes.

Following intensive monitoring and feedback from the shareholder engagement team, we concluded that the company had shown progress in risk management and presented a lower risk for our bond investment.

NEXT STEPS

G4S remains closely monitored on our watch list. However, considering its willingness to discuss and address managerial and operational challenges, we concluded that the company displayed sufficient awareness of their shortcomings and also acted upon them by discontinuing certain controversial activities. As such, the company is still viewed as "investable". Within credits, the position was held upon maturity, given its short duration.

The credits team didn't participate in new bond issues with a seven-year duration, but instead decided to wait for signs of further de-risking (by divestments, further debt reduction and fading out of "legacy" costs) and signs of an improving company reputation. This is because, although G4S addressed risk and project management issues, there is still a great deal of risk associated with the industry, which requires more caution.

Although the long-term nature of the bond contracts allows G4S some time to manage incidents and restore client trust, contract break-up clauses may apply for severe issues and so can result in direct negative financial effects. This poses a risk to the low (BBB-, neg outlook) IG status, which is a prerequisite for us. The recently completed disposals of the US Youth Services and G4S Israel are an encouraging sign, but disappointedly G4S remains mired in scandals.