

Policy Statement - Fixed Income

1. Preamble

- 1.1.** We apply our Christian approach to investing across all asset classes. This includes fixed income securities. Although ethical issues of concern apply to all asset classes, there are some differences in application to fixed income securities compared to equities.

2. Bonds and ethics

- 2.1.** The holding of debt raises some ethical questions. Some maintain that interest-bearing debt itself is unethical since it is a form of usury, as originally defined. The lender receives an income that has not been earned but is merely the compensation for not using the money elsewhere.

There is an extensive literature on the ethics of interest rates and their role in a market economy. However, the Church has taken a stance against excessively high interest rates (e.g. charged by payday lenders) whilst accepting that debt has a role to play.

- 2.2.** While share ownership implies shared responsibility and shareholders share in the profits a company makes from its activities, bond owners have no say in how a company is run, unless it is in administration when they may have a voice in any restructuring. Bond holders receive on maturity the repayment of the loan plus the cost to the company of borrowing.
- 2.3.** Nevertheless, bonds issued by a company – or government – around which there were significant ethical concerns would not sit well in an ethical portfolio. It follows that the approach to the exclusion of potential investments on ethical grounds should be consistent across equity and corporate bond markets.
- 2.4.** The potential level of engagement may differ from that experienced by a shareholder but the attempt should be made when an ethical issue arises. Our past engagement with bond issuers has been productive. Government bonds require a different approach, especially where the issuer is democratically elected, and worthwhile engagement may not always be possible.

3. Our ethical approach to holding fixed income securities

- 3.1.** Our fixed income securities are managed in a number of funds and portfolios. At present, all holdings are sterling denominated.

3.2. Gilts

Some of our fixed income portfolios may hold UK government bonds, both conventional and index (inflation) linked, known as gilts. Holdings in gilts link portfolios with the UK government in the sense that gilts are tradeable loans to the government. Such public sector debt enables government to function and provide the range of services that its citizens require.

It is not normal for responsible investment institutions to engage with governments on ethical issues and few can do so meaningfully. However, we benefit from engagement by the Methodist Church Joint Public Issues Team on a range of issues of concern.

3.3. Supranational and corporate bonds

Some of our fixed income portfolios may hold supranational or corporate bonds. The bonds are sterling denominated but can be issued by organisations or companies from other jurisdictions.

Corporate bonds (including Floating Rate Notes) are typically issued by:

- Supranational bodies e.g. the World Bank. These are backed by governments in the international community.
- Sub sovereign, or agency, entities e.g. Network Rail, Transport for London, KfW (German national investment bank). These are backed by their governments.
- Financial and non financial companies

All our ethical investment policies and ethical exclusions apply to corporate bonds as well as to equities. We will also engage with issuers not held in equity portfolios. For example, in the past we have engaged with Network Rail on concerns about health and safety and executive pay.

In the case of corporate bonds, there is relatively little impact of ethical exclusions upon investment returns in practice since alternative bonds can usually be found with the same or very similar characteristics to excluded names and exclusions in total will form a relatively small portion of the relevant benchmark.

While the application of ethics to financial and non financial companies which issue bonds should be straightforward, holding supranational and sub sovereign bonds links portfolios with non-UK governments. This raises some particular issues.

When considering bonds issued by sovereign, sub sovereign, or agency entities, we will consider the reputation of the relevant country, including assessments of: human rights; corruption; involvement in conflict; development. We will also be mindful of our policies and previous stances where reference is made of specific countries. However it is extremely unlikely we would be exposed to government issuers which have raised ethical concerns in the past, except via supranational issuers such as the World Bank.

3.4. Green bonds

Green bonds are bonds which are used to raise funds to undertake activities which meet certain environmental criteria. Mainstream companies issue green bonds. We will generally favour purchasing green bonds where we can and where the terms are attractive.

4. Conclusion

4.1. We apply our Christian approach to investing across all asset classes

4.2. There are differences between owning a share and owning a bond. Exclusions from investment on ethical grounds apply across all asset classes but the level of engagement possible as a bond holder may be different, since a bond holder owns debt rather than a share of a company. However, we will endeavour to engage where issues of ethical concern arise.

4.3. Supranational, sub sovereign, and agency bonds present potentially unique challenges since they could be backed by non-UK governments. However, we will also be aware of ethical concerns that might arise.