ESG Policy

November 2020

Our ESG Philosophy

At Stone Harbor, we have long held a fiduciary responsibility to our clients to generate superior excess returns across the fixed income asset classes we manage, while striving to incorporate sustainability into all aspects of our business.

Across all strategies, we view material Environmental, Social, and Governance (ESG) factors as integral components of our investment process. These sustainability factors are elements of thorough fundamental credit analysis, the basis for all Stone Harbor investment decisions, subject to client preferences and applicable regulations such as ERISA. Engagement with issuers and policymakers is an important component of this analysis, and an important aspect of the stewardship of our clients' assets. Through our investment decision making and active engagement as market participants, we aim to create incentives for corporate and sovereign issuers to improve ESG performance and ultimately support their economic development and financial results.

We further support our clients' investment objectives and values by developing new sustainable investment solutions and customizing mandates to specific requirements such as exclusions, tailored benchmarks, and various other parameters. We recognize the importance of measuring and reporting ESG factors, both for integrating into the investment process, and supporting our clients' needs. We are committed to continued development and enhancement of related tools, frameworks, and processes.

In our ongoing support of responsible investing, we have endorsed multiple global initiatives that contribute to an increasingly sustainable, inclusive, and principled investment management environment.

This policy document summarizes our approach to ESG integration in all our investment strategies.

Key ESG Factors

ESG factors cover a broad range of topics not limited to those described below.

Climate Change

Risks arising from climate change vary substantially across countries depending on direct exposures and a sovereign's readiness to mitigate the economic impact of potential climate change. Ongoing and potential future efforts to slow climate change through "de-carbonization" of economic systems can trigger drastic changes for specific industries or even whole economies. Information access in this area is becoming increasingly critical for managers and asset owners, notably including carbon exposure. This includes company involvement with specific products with high carbon footprints, as well as their ability to adapt to less carbon-intensive technologies. In addition to integrating these factors into our fundamental research, we are working to support our clients in managing climate change exposure by customizing mandates and developing new strategies and relevant reporting in this important area.

Environment

Beyond climate change, other environmental issues increasingly impact both sovereign and corporate issuers. Generally, the sustainability of environmental resource use for sovereigns is relevant in many areas including agriculture, fisheries, protection of natural habitat, and public health. For corporate issuers, management of downside risks arising from unexpected costs due to environmental issues is extremely important in certain sectors. We scrutinize companies' attitudes towards safety and their responses to lapses and accidents. We also typically examine issuers' attitudes towards environmental pollution, as evidenced by their historical track record.

Social Risks

We recognize the importance of social issues as a key driver of a country's politics and policies. Popular discontent can trigger drastic political and/or policy changes later on. It can also limit a government's ability to implement intended policy plans with far-ranging implications of its ability and willingness to service debt. Social factors that we consider for sovereign issuers include personal freedoms, civil liberties, safety & security, functioning of the government, among others. For corporate issuers, our areas of focus include worker rights, fair pay, diversity/opportunity policies, unionization, privacy/data security, among others.

Governance

Governance is a key factor impacting the long-term economic performance for sovereign and corporate issuers. For sovereign debt, we focus on the rule of law, corruption, the robustness and integrity of a country's institutional framework, property rights, and the levels of political stability and security. At the corporate level, we strive to invest in companies that are good corporate citizens who recognize their responsibility to the societies in which they operate. We examine areas including ethical business practices, the reputation and track record of management and dominant shareholders, management compensation policy, and Board independence and diversity, among others.

ESG Implementation at Stone Harbor

Our ESG Committee, headed by senior members of our investment teams, brings together professionals from across the firm's functional areas including portfolio management, research, risk, legal, compliance, client service, and business development. The Committee leads the development of ESG policies and processes, coordinates ongoing efforts to enhance our ESG activities, and facilitates and oversees implementation across the firm. The Committee is our conduit for ensuring our ongoing awareness of industry developments and innovation in this rapidly developing area. In efforts to ensure ownership, deep integration into the investment process, and effective issuer engagement, we believe it is important that responsibility for implementing our ESG policy rests with the relevant investment teams. However, investment decisions are only made after reaching a thorough understanding of the relevant environmental, social, and governance factors. Our ESG Committee monitors implementation.

Exclusions, Minimum Restrictions and Targeted Solutions

Stone Harbor complies with all applicable economic sanctions, including the Office of Foreign Assets Control sanctions regulations (OFAC Sanctions), the various UK Statutory Instruments that implement EU sanctions regulations (EU Sanctions), the Australian Department of Foreign Affairs and Trade sanctions regulations (DFAT Sanctions), and the United Nations Security Council sanctions (UNSC Sanctions). Similarly, Stone Harbor carefully observes all regulations in countries where we invest or where our clients are domiciled.

In separate accounts, we work with our clients to establish targeted solutions and implement appropriate exclusion policies for specific mandates. This can mean excluding certain countries, industries, companies, or other criteria, along with quantitative thresholds. In our commingled vehicles, we establish relevant exclusion criteria, if any, for the specific asset class and strategy.

For investors seeking a dedicated ESG strategy, we have launched the Stone Harbor ESG Emerging Markets Debt Blend Fund, an Ireland-domiciled UCITS vehicle. The fund is managed against a blended JP Morgan ESG EMD benchmark and invests in a broad emerging markets debt universe. This fund builds on the ESG analysis that is integrated in our core strategies, seeks to further reduce ESG risks, implements negative screening of countries and corporates, and typically maintains a larger weight to green bonds. We anticipate expanding our ESG strategies to include global high yield, investment grade, and multi-sector credit fixed income.

ESG Research - Approach and Tools

Our ESG research draws on a broad variety of inputs, both quantitative and qualitative. At the country level, we have developed a proprietary ESG scoring model that combines a large set of climate, other environmental, social, and governance indicators using quantitative data from renowned independent institutions to derive ESG scores, including for specific ESG factors (e.g. greenhouse gas emissions, corruption, civil rights, etc.). This quantitative data is supplemented by commercial data sources (e.g. Sustainalytics), providing both quantitative scores and qualitative insights. Given our research-driven credit-based approach, we also rely heavily on findings of our team's research visits and discussions with issuers, policymakers, companies, politicians, political consultants, analysts, NGOs, journalists, think tanks and academics. Country review meetings among our investment team includes discussion of relevant ESG developments and outlook, with summaries included in country notes shared among the investment team, and incorporated in our proprietary database.

We have also developed an internal scoring system to evaluate corporate issuers. Our analysts grade all portfolio credits in each major ESG vertical in terms of both intrinsic company risk and management performance against their industry benchmarks. Research is based on critical drivers in each particular sector (e.g. pollution control, supply chain management, labor and community relations, product safety, data protection, Board independence, and transparency of management's goals, policies and performance), relying on qualitative and quantitative information to develop an internal ranking of credits. Furthermore, analysts perform due diligence on each portfolio credit, and monitor and encourage both adherence to specific ESG criteria and improvement in performance relative to relevant benchmarks. This scoring system aims to assign our own quantitative ESG ratings to reflect a credit's ESG risk and performance, and facilitate discussion and comparison across industries and rating services.

ESG scoring and related analysis is shared among our investment professionals in ongoing research discussions, and documented in our internal systems. This integration facilitates firm-wide data access for our investment teams' monitoring, analysis, and risk management activities, as well as for client reporting. As this is an area of rapid development and innovation, we are committed to continuously improving and expanding our data sources, integration, and processes.

At Stone Harbor, we apply our ESG philosophy consistently across all asset classes we manage, though the specific implementation varies depending on the materiality of various ESG factors for different countries or companies, developed or emerging markets, industries, and even specific issuers. We consider ESG factors to be financially material if they have significant potential to impact a corporate or sovereign issuer's financial results. This could mean influencing potential cash flows through company-specific events or shifts in broader business conditions including legal and regulatory developments. It could involve tail risks or more likely events, and may include the risk of changing market perceptions and risk premiums for specific issuers.

Engagement

Engagement is a key component in our research and decision making. For corporate bonds, beyond financial statement analysis and rigorous due diligence, our portfolio managers and credit analysts aim to speak with each of the companies held in our portfolios multiple times per year. Engagement activity is conducted on or off-site, at plant visits and/or in our offices, at investor roadshows and conferences, and virtually by phone or video calls. For sovereign issuers, we visit existing or potential portfolio countries as part of our fundamental research. These discussions are important for obtaining real-time information and insights on each country's macroeconomic and political environment. In addition, we interact with senior policymakers in various settings, both in person and virtually (including symposiums, road shows, and teleconferences, among others).

Issuer meetings provide valuable opportunities to engage on material ESG issues with key decision makers. While our influence to impact issuer activity is limited due to the lack of voting rights, we do aim to raise awareness of the importance of applicable ESG considerations. This includes emphasizing the impact of improved ESG performance on borrowing costs and access to funding markets, a link that will likely strengthen over time. Our engagement activity also entails advocating for the implementation of sound policies on material ESG issues.

We broadly encourage the issuance of green, social, or sustainability-linked bonds. We welcome capital market innovations that help alignment of issuers' and asset owners' goals and incentives, which ultimately help us serve our clients.

Proxy Voting

As a fixed income manager, Stone Harbor has few proxies to vote on behalf of our clients. Nevertheless, we are guided by fiduciary principles and vote according to the policy guidelines outlined in Stone Harbor's Proxy Voting Policies and Procedures.

Our Business Practices

We approach our own business practices with sustainability, environmental responsibility, inclusivity, and ethics in mind. As a 100% employee-owned firm with ownership broadly diversified among our employees, ours is an inclusive firm by its very nature. Our senior leaders are committed to maintaining an accessible, diverse, and collaborative work environment. As an equal opportunity employer, we support diversity efforts in recruiting, hiring, and management practices.

Support for ESG Initiatives and Promoting Best Practice

We recognize our responsibility to support ESG inclusion and adoption of best practices in the investment industry. As we believe that responsibility extends beyond our own investment practices, we have endorsed multiple global initiatives that contribute to a more sustainable, diverse, and principled investment management environment. We became a signatory to the UN Principles for Responsible Investment in 2012. Since that time, we have initiated support of the Carbon Disclosure Project, The Local Government Pension Scheme Advisory Board of Transparency, the Diversity Project, and the UK Stewardship Code 2020. We intend to expand this support going forward.

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