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Whitepaper

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Buy-and-maintain credit

Taking the road to net zero

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Buy-and-maintain credit



Key takeaways

Buy-and-maintain investors must decide whether to introduce explicit sustainability objectives into their investment mandate, or to take an integrated approach, where the investment outcome is the sole objective, albeit acknowledging the importance of environmental, social and governance (ESG).

Investing for sustainable outcomes, such as in a net-zero portfolio, will require investors to set explicit targets, and a pathway to achieving them. But an integration-led approach can still support sustainability objectives, through engagement with firms and other stakeholders.

Investors also need to decide on their primary measure of net-zero progress. The two main options today are point-in-time portfolio metrics and the percentage of the portfolio invested in net-zero-aligned companies.

Although neither measure is perfect, the investment industry is making rapid progress. Uncertainty remains as the entire economy needs to transform to align to the Paris goals, but we cannot wait for perfection.

Introduction

The goal of buy-and-maintain credit investing is to provide clients with long-term excess returns over government bonds while remaining within a defined credit risk-budget. But over the timespans involved ESG risks presented by secular shifts can impact managers' ability to deliver those returns. Climate change is an example of such a seismic physical, regulatory, and reputational risk and requires foresight and strategic planning.

Asset owners are increasingly looking to incorporate sustainability goals, including climate objectives such as net zero by 2050, into their investment mandates. The more effectively can buy-and-maintain portfolio managers identify and understand such long-term ESG dynamics, the better they should be able to meet clients' desired net-zero and investment outcomes.

The challenge is ensuring corporate issuers of longer-dated debt held in portfolios are aligned to what the future – both environmental and societal – is likely to resemble.

But while managers need to keep their clients' long-term net-zero target in mind, they also need to define and deliver interim objectives along the way.

In this paper, we consider the importance of ESG integration, sustainable outcomes and impact; the benefits of forward-looking and “point-in-time” approaches to measuring progress; data challenges; and why investors should not wait for perfection before taking action.

Setting the scene

Every investor is different, but for the purposes of this exercise, we will assume the client is a UK defined-benefit pension scheme, with an existing buy-and-maintain portfolio containing long-dated investments. We assume the portfolio is still in its reinvestment phase, with a stable target duration, as the scheme contains long-dated liabilities. While we will assume the scheme has a run-off strategy, determining long-term sustainability objectives is still likely to make sense for schemes targeting a buy-out.

In this context, the portfolio will comprise investments across global fixed-income markets, with an investment-grade and local-currency (sterling) bias.

The portfolio will be invested in bonds issued by traditional financial institutions and companies, other entities such as universities, foundations and housing associations, property-backed transactions, sovereign-linked and supranational entities, and developed and emerging-market governments. This means the investor cannot take a one-size-fits-all approach; in particular, they will need to leverage both corporate and sovereign stewardship approaches.

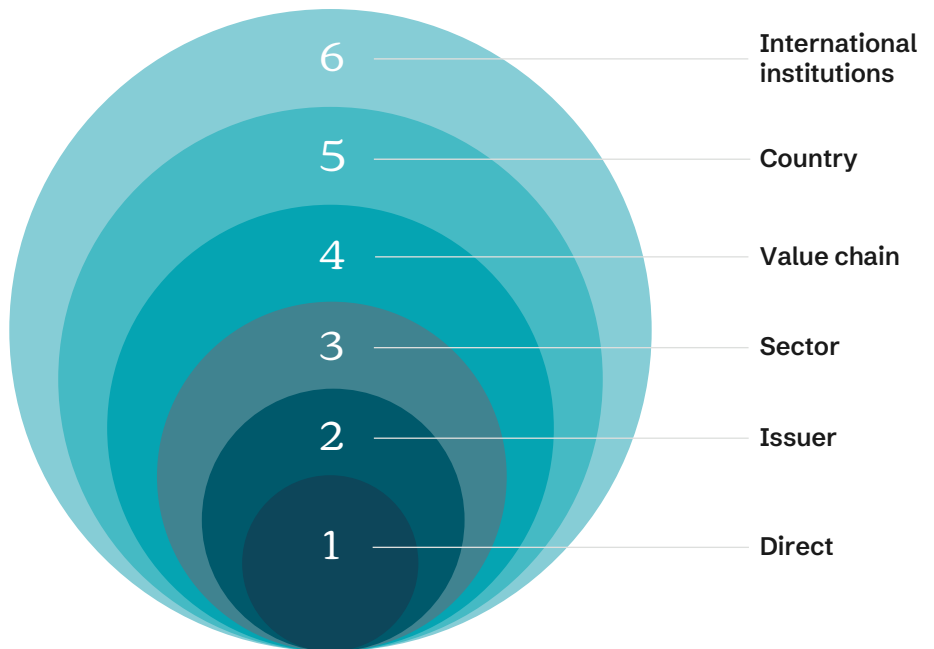
Defining a sustainability objective

The first step is for investors to decide whether they want to introduce explicit sustainability objectives into their investment mandate: is the goal to take an integrated approach, where the investment outcome is the sole objective, albeit acknowledging the importance of ESG as an integral component of the investment process? Is it to achieve a specific environmental and/ or social outcome in addition to the investment outcome? Or is it to achieve real-world impact, potentially at the cost of investment returns?

Investing for sustainable outcomes, such as in a net-zero portfolio, will require investors to set explicit targets as well.

For example, having interim targets for the portfolio in 2030 before reaching net zero in 2050. In contrast, an integration-led approach will not have any such targets but can still support sustainability objectives and the climate transition through engagement, with investors using their influence at different levels of the financial system – an approach we call Levels of influence (see Figure 1).¹

Figure 1. Levels of influence



Source: Aviva Investors, November 2024.

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ESG integration and net zero

As discussed, integration involves incorporating ESG considerations into the investment and risk-management processes. At the micro-stewardship level, it can also include engagement activities to improve portfolio companies' ESG profiles by encouraging them to adopt best practices.

For the buy-and-maintain portfolio manager, the focus is on ensuring that the corporate issuers of longer-dated debt held in their portfolios demonstrate sustainable behaviour over the investment horizon.

Where asset managers have signed up to the Net Zero Asset Managers Alliance, this includes a commitment to support investing aligned with net-zero emissions by 2050 or sooner, including through engagement efforts.²

By integrating ESG risks into its investment views – bottom-up credit views and sector allocations in particular – the manager will reduce the portfolio's exposure to firms with poor outlooks and exclude holdings in companies not aligned to its core investment philosophy.

Where a portfolio has a net-zero objective, and where there are associated engagement, divestment and exclusion policies in place, its holdings will over time become increasingly weighted towards firms that support the transition.

Stewardship considerations

Often, asset managers will have a stewardship strategy targeting climate change, engaging with issuers to accelerate their net-zero alignment efforts. If, despite sustained engagement, a company's management remains unable to demonstrate how it would navigate the long-term structural challenges linked to climate change, divestment may be the final option, even though the buy-and-maintain portfolio manager's initial expectation was to hold the bonds to maturity.

This means investors must think carefully about the implications of investing in organisations that don't yet meet their net-zero expectations. They must be aware any engagement can fail, and plan accordingly.

One approach to managing this risk is to limit the term of any investment in such issuers, for example, by only investing in bonds that mature before 2030. If the company does evolve its approach to climate change risks, the portfolio manager can look to switch to bonds with longer maturities.

However, it is also important to understand companies' operating and regulatory environment, taking a nuanced, case-by-case view and a holistic stewardship approach to assess and engage at the different levels of influence. For instance, one company may not be able to move faster towards net zero because of regulatory or supply-chain constraints. Asset managers should therefore also consider engaging for system-wide change.

Additional complexity arises from the fact corporate issuers are often engaged in multiple activities with different investment and ESG considerations. Where debt is issued at the holding company level, investors must decide whether to support firms that may be developing climate-friendly technology such as carbon capture and storage in one part of their operations while conducting carbon-intensive activities in another part of the business.

In some cases, debt may be issued at the individual operating entity level, so investors can provide capital to those entities supporting the transition.

For some types of firms, particularly utilities and energy companies, investors also need to consider different aspects of government policy. For instance, they may want to assess the impact the government's implicit or explicit support can have on operations and profitability, the likelihood of windfall taxes, views on nuclear power and the prospect of nationalisation.

Investors might also want to consider the political risk arising from a country's energy transition, and whether nationally defined contributions (NDCs) of the sovereign are aligned to the investor's own targets.

These considerations are important given that, as well as providing portfolio diversification today, utilities and energy providers will play a central role in the transition over the long term.

Given this complexity, some clients may choose to avoid investment in certain sectors like firms undertaking oil and gas exploration. Alternatively, they may wish to engage with these firms – and the broader system in which they operate – and push them towards a sustainable transition.

The power of engagement

Engagement is a key component of integration, driving change through portfolio exposures as the asset manager engages with firms and other stakeholders across a range of ESG issues through bilateral meetings, coordination with equity portfolio managers to vote at AGMs, letters setting out specific asks and through joint engagement in collaboration with other investors.

For example, in 2022, we set out expectations to firms and governments in letters to CEOs and to 27 countries' central banks and finance ministers.³ In 2024, we also sent a letter to over 50 finance ministries outlining our perspective on the features of new NDCs that could catalyse private sector investment, including by setting ambitious emission reduction targets alongside sector pathways that guide implementation.⁴

Engagement is often presented as an equity story, but it should not be. Buy-and-maintain investors provide long-term funding to businesses (sometimes up to 30 years or more); if this support is withheld, it can raise a firm's cost of capital materially. Long-term credit investors have a particularly strong voice when engaging with housing associations, charitable foundations, universities and others that lack equity funding.

As for listed firms, they issue debt far more often than equity, creating many more opportunities for bond investors to engage with them. This gives long-term credit investors real weight, for example to encourage firms in challenging positions, such as utilities, transport companies and banks, to adopt science-based targets (SBTs) to try to meet net-zero objectives.⁵

It is important investors have a seat at the table, particularly now the green and sustainability-linked bond market is maturing.

As they can influence companies on the type of bonds they issue, as well as on their overall approach to ESG. Investors can engage through their asset manager, directly and through joint initiatives like the Net Zero Asset Owners' Alliance, to harness the power of collective engagement.

Delivering sustainable outcomes

Investors who want to target tangible sustainable outcomes – including emissions reduction – as well as portfolio returns can adjust their investment approach (such as portfolio-level sustainability targets or security selection requirements). Through holistic stewardship, investors can also use their influence to engage with issuers pre-issuance (for instance to help with structure, use-of proceeds, etc.), post-investment on company behaviours, supply chain issues and policies, but also with the market and financial industry on broader topics like green bond standards.

The first step is to decide what sustainable outcomes the portfolio is trying to achieve.

This could be progress towards one or more of the Sustainable Development Goals (SDGs), or more specific metrics aimed at social, natural capital or climate-related outcomes (see [Figure 2](#) for an example of the Asset Owners' Net Zero Alliance target-setting approach).

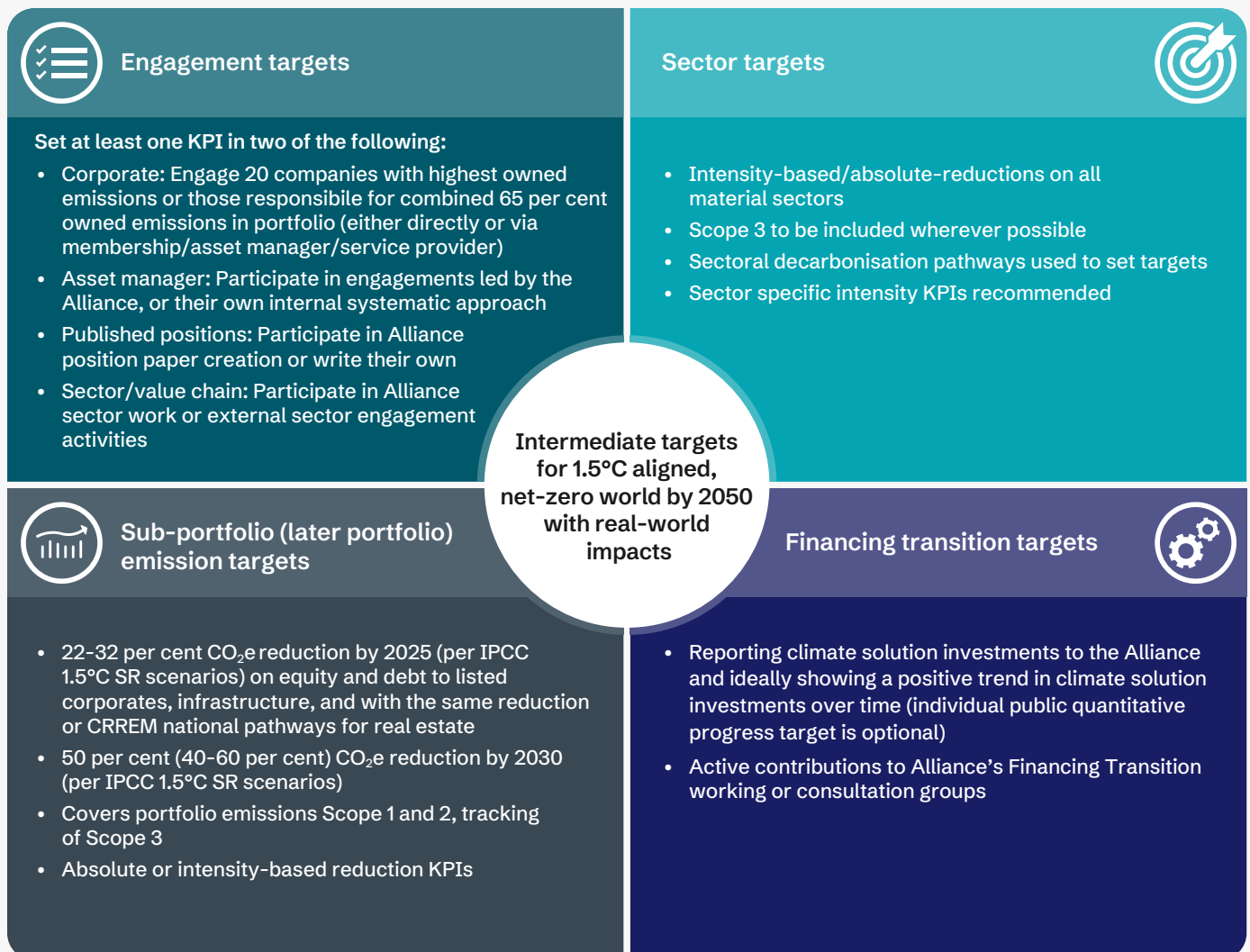
If the chosen outcome is climate change, in addition to specific net-zero targets which would consider the portfolio's emissions trajectory against accepted emissions pathways, the portfolio could apply exclusions on fossil-fuel value-chain sectors or companies deemed to be laggards on climate action. The portfolio could also include positive selection criteria, for instance targeting a proportion of investments that support or drive the transition to a net-zero economy by delivering climate solutions or adapting their business models.

Given the nature of buy-and-maintain portfolios, and the typical credit-risk appetite of the clients who invest in them, it can be harder to support pure-play providers of nascent technologies, as these are often rated below investment grade. As a result, investment in solution providers is often linked to larger multinational firms which have themselves chosen to back such technologies. Buy-and-maintain portfolio managers can also seek to understand the long-term themes and evolution of new technologies and identify potential investment opportunities as they approach investment grade.

Impact investing sets the highest bar for delivering real-world sustainable outcomes. There is an intentional target for impact, which must aim to achieve real-world change in a way that would not have happened without the investment (achieving a net-zero portfolio does not in itself meet the definition of impact, as it may be achieved without anything changing in the real economy).

Moreover, the impact objective must be embedded throughout the investment process and therefore may result in a trade-off against risk and return. The impact objective also generally stems from a theory of change, which helps determine a specific key performance indicator (KPI) with which to track the intended impact for each investment in the portfolio. Impact investments have a key commitment to avoid harm as well, making exclusions a tenet of impact investing.

Figure 2. Net Zero Asset Owners' Alliance four-part target-setting approach



Source: United Nations Environment Programme, January 2023.⁶

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How to assess progress?

Investors also need to decide on their primary measure of net-zero progress, two main options being available today. The first is an assessment of point-in-time portfolio metrics and future target levels – for example, the portfolio’s overall carbon footprint at a given date, and a target footprint for 2030. The second option is to gauge the percentage of the portfolio invested in companies with externally validated, forward-looking, science-based commitments.

To align with a 2050 net-zero Science-Based Targets initiative (SBTi) target, financial institutions must commit to having 100 per cent of their borrowers and/or investees set their own SBTi-validated science-based targets by 2040.⁷

Over time, the difference between these two approaches is likely to reduce as more granular, and robust, projection scenarios and forward-looking models are developed (see [Data is never perfect](#)), and as data becomes increasingly available. For now, investors can monitor their portfolio using both approaches.

How do science-based targets work?

Science-based targets (SBTs) are designed to ensure organisations have set up greenhouse-gas reduction strategies aligned to specific climate objectives.

SBTs specify by how much and how quickly companies need to reduce emissions and provide a clearly defined path to achieve this. The process analyses each sector’s contribution to current emissions before determining what that sector’s pathway will look like out to 2050.

That in turn makes it possible to set each company within a sector an emissions pathway. For example, when setting SBTs, firms must include Scope 3 emissions where they account for more than 40 per cent of the total. This means companies must also put pressure on suppliers and users of their products to curb their carbon footprint.⁸

Using portfolio metrics

A standard approach consists in focusing on a specific portfolio metric, generally one adopted by several businesses, such as the targets set by the Net Zero Asset Owners' Alliance. It provides a simple measure that can be reported externally, to demonstrate a portfolio's annual progress and offer comparability with peers.

The chosen metric could be the weighted-average carbon intensity of a bond portfolio, which measures CO₂-equivalent emissions per dollar of revenue at the companies held, the weighted-average carbon intensity of a bond portfolio by enterprise value including cash (EVIC), or other portfolio-level measures such as absolute emissions.

There may then be a goal to reduce the measure progressively, or to achieve reductions by specific future dates, until net zero is reached by or before 2050.

Alternative metrics may allow for better comparisons within sectors. For example considering emissions per kWh instead of revenue within the electricity generation sector, but these can't be applied at a portfolio level.

It is important to understand the nature of these metrics – for example, those based on emissions per dollar of revenue for oil and gas producers may, in the short term, be driven more by energy price volatility than changing emissions.

There may also be a focus on Scope 1 and Scope 2 emissions, given the more limited data available on Scope 3 – the distribution of firms' emissions between Scope 1, 2, and 3 can be very different, so different investment decisions may be taken based on the defined target.

More widely, investors will need to determine how they want their manager to allow for incomplete data coverage – an issue that can be more material for buy-and-maintain portfolios given their allocations to unlisted issuers.

The chosen metric will necessarily influence investment decisions. If carbon intensity is the primary goal, the portfolio manager may have to exit certain positions (or restrict future investment in them) should the number become too high relative to its stated trajectory. This could mean the manager does not invest in corporate entities he or she considers core to the transition simply because they currently have a high carbon intensity.

For example, companies such as Linde and Air Liquide that produce industrial gases have relatively high Scope 1 and 2 emission intensity and may be excluded. However, among other gases, they produce hydrogen, which could be key to the transition (and does not produce further carbon emissions when used by their customers).

Using investee firms' commitments

A more qualitative approach would be to consider the portfolio's holdings in debt issued by investee firms with forward-looking, science-based commitments – such as SBTs or alignment to sector decarbonisation pathways.

This approach relies on a more qualitative assessment. The asset manager can consider multiple factors such as principal adverse impacts (which are the key areas to assess businesses on risks and exposures), robust transition plans with quantifiable and verifiable performance indicators, and the integration of climate accounting.

Integrating qualitative assessments of organisations' commitments and plans to achieve net zero are particularly important for buy-and-maintain portfolios.

Given how difficult it is to know where margins will be in 30 years' time, investors should give more weight to qualitative assessments of how the business will adapt to long-term trends. Sustainability is a critical part of making the investment case (see [“See the wood, not just the trees: How climate-focused credit investors can help drive real-world change”](#)).⁹

An example of a qualitative approach would be to set a target to hold a proportion of the portfolio in firms with externally approved SBTs that contribute to limiting global warming to 1.5 or well below two degrees Celsius – for example, setting a minimum percentage for such holdings by 2030.

Investors should be mindful to future-proof their targets, as other standards may emerge to replace SBTs or cover sectors that do not yet have them, such as the Energy Transitions Commissions' roadmaps for net zero for hard-to-decarbonise sectors.

Just because a sector isn't covered, that shouldn't make it uninvestable, and a qualitative view on its decarbonisation pathway, and related dependencies, is therefore paramount.

(Dependencies are other changes that need to happen to make the pathway achievable, such as supportive policies or necessary technology developments).

It is also important to consider whether equivalent targets should be permitted. For example, sovereign-owned entities may be integral to supporting a country's NDCs but unwilling to sign up to SBTs as a standalone entity, given they tend to align with their sovereign's strategy. In other instances, a sovereign-owned entity's primary target may be expressed in different terms than a carbon footprint. In the UK housing association sector, for example, the primary objective is to improve the energy performance certificate (EPC) ratings of the underlying housing stock. In such cases, investors should consider whether other targets – the country's NDCs or the housing stock's EPC rating – can be acceptable as an equivalent.

The question of *how* investee firms choose to decarbonise is also relevant. The approach of a company like Italian energy giant Enel, which is continuing to transition away from coal by converting power stations to gas, reduces global emissions.¹⁰ In contrast, an oil major selling its stake in arctic oil fields to a private equity business doesn't reduce and may even increase global emissions.

Whether using portfolio metrics or investee firms' commitments, asset managers can provide clients with complementary data, including a variety of further ESG measures such as principal adverse impacts. But whatever the approach, metrics are needed. Setting a target requires data, assumptions and projections, which is not straightforward despite recent progress.

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Data is never perfect

The finance industry needs to jointly agree on a better way to build forward-looking carbon models, with assumptions that reflect the way corporate behaviour will change over time. As Mirza Baig, Chief sustainable investing officer at Aviva Investors, explains, "Trends in regulation, technology, and supply-and-demand dynamics are all vital. These assumptions need to include realistic assessments about how likely it is companies can deliver what they say they will. There is also a lot of work to be done to project decarbonisation pathways for companies which currently make no formal disclosures."

Data coverage

In terms of data, coverage will never be exhaustive. Where there is no data for an investment from a given data provider, investors must decide whether to use alternative providers, exclude it from the calculation or use an estimate. Where there is no published data, the manager would also typically engage with the issuer to improve disclosure.

In addition, different parts of a business may all have the same reported carbon-intensity score as data may only be provided for the holding company.

This can be very different from the true carbon-intensity of the operating company in which the portfolio is invested, and investors should also push for added disclosure.

Metrics limitations

Metrics are imperfect, and investors must pay attention to detail. Do the metrics consistently include Scope 3 emissions, for instance, or just Scope 1 and 2?

The relative impact of measures can also have material implications for the attractiveness of a sector compared to others. For example, electricity distribution grid companies (whose Scope 2 emissions include those required to generate electricity lost through the network transmission process) can have higher carbon-intensity metrics than oil majors.

To reiterate, different parts of a business can have the same carbon-intensity score – that of the parent company – despite having different individual carbon footprints.

Again, these limitations can result in unintended exclusions, whereby an investor may be unable to incorporate an allocation to high-carbon segments that are essential to the transition, even where these have very small Scope 3 emissions, as in our earlier example of industrial-gas producers.



We can't wait for perfection

We need to transition our economies to net zero over time. Of course, we can't simply shut down all fossil fuels today, as this would have a dramatic impact on jobs, economies and societies – as shown by the energy crisis linked to geopolitical events of the past few years – but it must happen as fast as possible to meet the Paris goal of limiting temperature rises to 1.5 degrees.

Investors need to encourage companies to set clear decarbonisation pathways.

The primary focus must be on engaging with companies to help them reduce emissions where they can.

If investors engage and those industries are needed until a replacement fuel or technology exists, their bonds don't have to be excluded – unless the companies don't move fast enough.

But, as we discussed, companies are also deeply embedded in broader economic, market, industrial and social systems, which limits what can be achieved through corporate engagement alone. Investors should also use their influence at all levels, working with governments, multilateral institutions, supply chains and broader industry initiatives to help issuers transform at pace (see [“Only connect: How a holistic approach to investment stewardship can enhance client outcomes”](#)).¹¹

The investment industry is making rapid progress on what needs to be measured and how to set and implement net-zero pathways. Uncertainty remains as the entire economy needs to step up and align to the Paris goals (see our in-depth roadmap for the UK’s journey towards a low-carbon economy, which includes policy recommendations to unlock private investment in the transition: [“Boosting low-carbon investment in the UK: A Policy Roadmap”](#)).¹²

In portfolios, recent changes in sustainability disclosure requirements (SDR) in the UK and sustainable finance disclosure regulation (SFDR) in the EU are trying to make it simpler for investors to see what they are investing in and holding asset managers to account over how they invest. While there are regional differences on how sustainable assets are defined, investors increasingly look for transparency, specifically on metrics. For example, this could take the form of a percentage of holdings invested in sustainable assets, as defined by the EU taxonomy.

Targets, metrics and strategies will continue to evolve as these approaches mature and ambitions grow, and investors should keep a close eye on these developments. But we are running out of time to limit global warming, and we can’t wait for perfection. The time to act is now.

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Key risks



Investment risk

The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency and exchange rates. Investors may not get back the original amount invested.



Credit and interest rate risk

Bond values are affected by changes in interest rates and the bond issuer's creditworthiness. Bonds that offer the potential for a higher income typically have a greater risk of default.



Derivatives risk

Investments can be made in derivatives, which can be complex and highly volatile. Derivatives may not perform as expected, meaning significant losses may be incurred. Derivatives are instruments that can be complex and highly volatile, have some degree of unpredictability (especially in unusual market conditions), and can create losses significantly greater than the cost of the derivative itself.



Illiquid securities risk

Some investments could be hard to value or to sell at a desired time, or at a price considered to be fair (especially in large quantities), and as a result their prices can be volatile.

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Where relevant, information on our approach to the sustainability aspects of the strategy and the Sustainable Finance disclosure regulation (SFDR) including policies and procedures can be found on the following link:

www.avivainvestors.com/en-gb/capabilities/sustainable-finance-disclosure-regulation/

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