Sleeping Giants II:

how asset owners should act on corporate bond investments

ShareAction»

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About ShareAction

ShareAction is an independent charity and an expert on responsible investment.

We set ambitious standards for how financial institutions, through their investment decisions, can protect our planet and its people and campaign for this approach to become the norm. We convene shareholders to collectively push companies to tackle climate crisis, protect nature, improve workers' rights and shape healthier societies. In the UK and EU, we advocate for financial regulation that has society's best interests at its core.

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Authors

Katie Stewart, Laure Philippon CFA

Contact

To discuss this brief, please reach out to ShareAction's Investor Engagement team at investorengagement@shareaction.org.

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Why should asset owners prioritise bond stewardship?

Corporate bonds are a key part of the financing chain because they increase or renew the capital available to companies. This direct financing relationship makes the impact of bond investments particularly relevant for long-term, highly diversified asset owners such as pension funds or insurance companies who must manage system-level risk across their portfolios. It makes them potential sources of financing for harmful corporate activities – but also levers of change.

This gives asset owners (and their service providers) influence. Many corporations are reliant on investors to continue to purchase their bonds, either to finance current or new activity or to repay existing bonds which have reached maturity. By choosing not to participate or placing conditions on participation in future bond issuances, asset owners can signal concerns with company strategy and an expectation for companies to improve sustainability performance - and avoid their capital being used for purposes which misalign with their beneficiaries' interest and values.

But most asset owners aren't using this lever. Most stewardship continues to focus primarily or exclusively on listed equity. Where bond engagement does occur, it often focuses on unambitious asks – such as ESG disclosures– rather than meaningful attempts to influence the company strategy, and with little evidence of escalation.

We are calling for bonds to be placed at the heart of asset owner stewardship strategies. Given the role of bonds in counterfactually enabling new corporate activity, they deserve much more attention from investors. We are calling on asset owners to implement meaningful standards in relation to their bond investments, and reflect those standards in their mandates with asset managers investing assets on their behalf.

The case for asset owners to focus on bond stewardship

- **System-level risk:** bonds may directly allocate capital to harmful activities that destabilise the economic and planetary systems or undermine sustainable growth, increasing financial, societal and environmental risk for long-term asset owners and their beneficiaries.
- **Credit risk:** sustainability risks may pose downgrade or default risks for individual bonds, and bonds may be vulnerable to sudden climate-driven repricing.
- **Litigation risk:** bonds may raise future litigation risk for investors who have facilitated systemically harmful activities, particularly with in relation to pension fiduciary duties.

- **Harm to people and planet:** many corporate activities actively drive harm to people and planet, including ecosystem damage from overextraction, the exploitation of workers, and health risks to communities arising from pollution.

Five key principles (and a caveat) for asset owner bond stewardship

1. **Asset owners should set red lines to exclude the most harmful fixed income investments from the start.** Asset owners should set clear red lines, setting exclusions to prevent their capital facilitating activities which contribute to systemic harms and send a clear signal to the relevant sector about minimum standards of corporate behaviour. New products such as bond indices which specifically exclude the most harmful assets are being developed, enabling investors to access off-the-shelf products while minimising harm from investments.

2. **Asset owners should apply a 'debt recycling' framework for active bond investments (both primary and secondary),** whereby they redirect capital and engagement resource away from companies which are misaligned with their sustainability goals and towards those that are actively taking steps to mitigate environmental and social risk - creating an incentive for positive steps towards transition.

3. **Bond engagement strategies must include willingness to escalate, divest and refusal to refinance.** Asset owners should set clear and measurable expectations of retained portfolio companies (either directly or via their fund managers). These should be integrated across asset classes and underpinned by time-bound milestones, upon which participation in future issuances will be contingent.

4. **Asset owners should ensure that 'green' or sustainability-linked bonds (SLBs) include meaningful targets and provide a robust check on company behaviour.** Investors should be wary of 'green' bonds which promise a sustainable 'use of proceeds' but risk simply displacing capital that could be redeployed elsewhere in the company, or SLBs with weak targets and weak consequences for failure to meet KPIs.

5. **Asset owners should engage the wider bond ecosystem.** Asset owners should engage syndicating banks, fund managers and index providers on the need for a stronger baseline standards and sustainability covenants - and work collaboratively with other asset owners to create a more sustainable architecture for bond investments.

And if asset owners feel they face genuine barriers to implementing these principles...

6. **Be honest about it and advocate for policy or regulatory change to address these barriers.** Where asset owners feel they are unable to meaningfully act to mitigate the harms of their bond investments for commercial or legal reasons, they should be transparent about this to enable an honest conversation on the limits of responsible investment; and engage in dialogue with policymakers to urge removal of these barriers and for wider regulation to address harms that asset owners themselves cannot.

Principles in practice: fossil fuels

Climate change poses a major risk to people, planet and economies. Scientific consensus suggests the scale of potential devastation from unabated climate change poses significant system-level risk; credit risks could emerge quickly in relation to climate events and government regulation; and investors may face increasing litigation risk in the coming years in relation to their financing of the most harmful industries.

Together, this makes a clear rationale for ceasing to allocate capital to companies expanding fossil fuel production beyond planetary limits. Below we indicate how these principles could be applied to fossil fuel bond investments.

Principle 1: set red lines

- Divest existing debt holdings from all firms expanding fossil fuel production.
- Set clear exclusions to cease purchasing new primary or secondary debt in both active and passive funds from firms expanding fossil fuel production.

Principle 2: robustly engage and apply an escalation framework

- Focus bondholder engagement on banks, downstream users and other key nodes in the fossil fuel supply and financing chain, with the most emphasis on companies with a realistic prospect of reducing fossil fuel dependence.
- Set clear timebound milestones for all climate engagements and a plan to refuse refinancing if asks are not met.
- Where secondary equity holdings are retained, align voting activity to vote against directors at companies actively lobbying against climate action or without a credible transition plan or that are backtracking on their climate commitments.

Principle 3: apply a debt recycling framework to allocate engagement and capital resource

- For other companies in the supply chain, including non-expanding fossil fuel companies, upstream financiers (e.g. banks) or downstream users of fossil fuels (e.g. steel, aviation), recycle primary and secondary debt holdings from those companies least aligned with a 1.5C trajectory to those most aligned.

Principle 4: ensure robust mechanisms for 'green bonds' and SLBs

- Decline to purchase debt, including SLBs or 'green bonds', from firms in the downstream supply chain expanding use of fossil fuels.

Principle 5: engage the wider ecosystem

- Collaborate with other asset owners to advocate for standard bond covenants for transition and fossil fuel use indicators.
- Engage investee and syndicating banks to commit to halt syndication of bonds from companies expanding fossil fuel production.
- Engage index providers to exclude fossil fuels from new and existing indices.
- Endorse the Fossil Fuel Non-Proliferation Treaty.

Bonds: an underappreciated lever

Introduction: why bonds are an underappreciated lever

In 2019, ShareAction published a report – *Sleeping giants: are bond investors ready to act on climate change?*[1] – which made the case that investors should co-ordinate and utilise the power they wield during debt re-financing and issuance to communicate to issuers that, unless a robust strategy to manage climate-related risks and impacts is adopted, they will cease to invest in a company's bonds.

While we have seen some progress in this time on fixed income stewardship, it is too slow; in many cases, bond investment decisions remain siloed from wider responsible investment practice, without clear evidence of a willingness to escalate or apply consequence where those investments are enabling corporate harm. For long-term investors such as pension funds, who must deal with the impacts of decisions on the economy decades from now, this is a critically overlooked factor.

What we need - and are calling for – is a shift change in how asset owners engage on their bond investments: for greater recognition of both the harm that bond investments finance, and their use as a lever to mitigate environmental and social risks to people, planet and beneficiaries.

In this report, we present asset owners with a practical framework to do so.

Corporate bonds provide new capital to companies – making them a crucial risk consideration for long-term investors

Corporate bonds are a key part of the financing chain because they increase or maintain the capital available to companies, either by providing new capital or refinancing debt.[2]

When an investor buys a share in a company, it's usually from another investor, making it effectively a second-hand good. While this gives the investors certain rights to vote at company AGMs, the company in question does not directly gain or lose capital as a result. Indeed, shares have often been a net *negative* source of capital for companies as more capital is often extracted to shareholders via dividends than is put into the company.[i]

But bonds – along with other sources of funding such as bank loans and, to a certain extent, private capital - are different as they provide companies with money they otherwise may not have available. When a large number of investors are interested in purchasing a bond, this

[1] Available at : **https://shareaction.org/reports/sleeping-giants-are-bond-investors-ready-to-act-on-climate-change**

[2] While we recognise many investors are also purchasers of sovereign bonds, these need a different approach and we do not cover them in this paper.

can decrease the *cost of capital* for companies by enabling a lower coupon (interest) rate.[ii] The lower the coupon rate, the less a company must pay out to investors.

When those activities are driving significant harm to people and planet, investors are enabling those activities by providing the capital for them to continue. For example, in 2018, a study found that 29% of new financial flows to fossil fuels came from bonds, compared to 66% from bank loans and just 5% from new equity issuance.[iii] 'Sin' companies (companies engaged heavily in activities considered unethical, such as tobacco or gambling) use bond markets for financing more than average, and sectors with high emissions footprints such as banks are significant users of the bond market.[iv] This makes corporate bonds a key aspect in thinking about asset owners' impacts on – and influence over – corporate harms.

This gives asset owners influence...

Many corporations are reliant on investors to continue to purchase their bonds, either to finance new activity or to repay existing bonds which have reached maturity. This gives investors an important lever of influence; by choosing not to participate in future bond issuances, investors can signal discontent with company strategy.

Critically, engaging on bonds also gives investors the ability to influence private market companies and state-owned entities which are not listed on the stock market, or listed companies which are majority-controlled by a few investors (meaning a stewardship strategy focused primarily on listed equity may leave them unaddressed). For example, while Mark Zuckerberg famously controls over 60% of votes at Meta via a dual share class structure, meaning that investors have limited ability to apply consequence for poor corporate behaviour via their shares, Meta is also a periodic user of the bond market, including a $30bn offering in 2025 to fund AI R&D.[v] A 2024 report from the London Stock Exchange Group on carbon-intensive debt identified that, of $5.5trn total debt outstanding from carbon-intensive companies (excluding green bonds), $3.6trn was issued by private companies (of which $1.5trn was from state-owned companies and $2.1trn from other private companies) compared to $1.9trn issued by listed companies.[vi]

This is particularly important for the pension sector. Pension funds are major investors in corporate bonds, given their perceived status as often low-risk, stable, long-term assets. Allocation to bonds has risen among the seven largest global pension markets from 29% in 2004 to 33% in 2024; this ranged from 14% of assets in Australia to 56% in the UK.[vii]

...but bond stewardship is not given the attention that listed equity is

In ShareAction's 2024 assessment of asset manager practices, only three of 76 sampled asset managers indicated they applied stronger climate restrictions to new corporate debt purchases than secondary assets such as listed equity, despite the outsized role of bonds in providing new capital for fossil fuel companies.[viii]

Where bond engagement does occur, it often focuses on relatively unambitious asks – such as disclosure or understanding of ESG risks and targets – rather than a meaningful attempt to influence the company strategy, and with little evidence of escalation. Only 20% of the sampled asset managers said they had refused to repurchase/refinance debt on ESG grounds – down from 40% in 2022 - and 26% indicated they had engaged in partial or total divestment of corporate bond holdings, compared to 33% which had done so for equity.

Furthermore, for some investors, stewardship teams have limited power to influence a decision to refinance or repurchase a bond – which instead sits with fund managers - resulting in an inability to escalate engagement or apply meaningful consequence. This can result in mixed signals to a company, such as the investor escalating using votes at their listed equity holdings while simultaneously taking a sizeable position in a new bond deal.

This raises serious questions about the extent to which asset managers and owners are meaningfully engaging on bond holdings, and integrating this with equity and responsible investment strategies. At best, investors are often not utilising all the tools available to them; at worst, it may undermine stewardship strategies as there is reduced incentive for the company to meaningfully acquiesce to investors' asks if investors are continuing to provide new capital without question.

We are calling for bonds to be placed at the heart of asset owner stewardship strategies

Given the role of bonds in financing and enabling new activity, we believe they deserve much more attention from investors. We are calling on asset owners to ensure that bond stewardship is placed at least on a par with listed equities in stewardship strategies.

In **chapter 2**, we set out the case for long-term asset owners to place more emphasis on their bondholdings. In **chapter 3,** we provide 5 key principles (and a caveat) for meaningful bond stewardship. In **chapter 4**, we set out how this framework could apply in the case of fossil fuels. And in **chapter 5**, we direct asset owners towards further resources they can use to develop their bond stewardship capacity.

The case for asset owner bond stewardship

The case for greater asset owner focus on bonds

As noted above, bond purchases deserve greater attention by the sector given their role in providing new capital to companies. As well as the harm to people and planet, bonds may present specific system, credit and litigation risks that are particularly relevant for long-term asset owners. We provide an overview below.

System-level risk

Firstly, and most obviously, purchasing bonds can cause harm to people and planet, by enabling the continuation or expansion of harmful activities that create severe environmental and social risks. In some cases, these harms may pose risks to the stability of the planetary, social and political systems that underpin our economy. Companies acting in a way that directly exacerbates these risks are extremely unlikely to be working in the long-term interests of asset owners, their beneficiaries or the wider economy.

In the case of climate and nature breakdown, for example, studies have predicted that the global economy could face significant loss. Norges Bank Investment Management, for example, has assessed that climate breakdown could decrease its fund value by a fifth[ix]; others have highlighted the risk for wider instability caused by food and water shortages and mass migration (see chapter 4 for more detail).[x] As well as the outright devastation to people and communities, this is highly likely to affect returns for long-term highly diversified asset owners which depend on a stable and growing economy. Other economic risks such as antimicrobial resistance, pandemics and inequality – all driven in part by corporate activities – may similarly result in unstable systems and/or counterfactual loss to economic productivity, and thus likely diversified returns, over time.[xi]

Bonds directly *enable* the *expansion* and *deepening* of this system-level risk by financing the activity that drives it. While individual bonds in a portfolio may have a short time horizon by themselves, the harm they drive may be systemic: they may have wider and long-term impacts on other assets, including equity holdings, and the price of secondary bond holdings. If asset owners do not take this wider impact into account, they may be left dealing with the question of how to mitigate system-level impacts on the portfolio to which their own bond investments are contributing.

Credit risk

Secondly, environmental and social issues may be an underappreciated source of credit risk for bonds. There's the obvious one: sustainability risks – for example, vulnerability to regulation or public controversy - may cause additional credit risk or downgrades. But the nature of the bond market may also mean that assets across portfolios are more vulnerable to sudden repricing.

It is sometimes assumed that because many bonds are short-dated, the majority of sustainability risks will not emerge in the bond's lifecycle. However, this does not take into account that issuers are often relying on issuing future debt to repay earlier bonds, as companies rarely pay debt from existing liquidity. The probability of default of a six year bond or loan may in part therefore depend whether debt investors can be persuaded to provide new financing from year seven onwards, for another five to ten years. This means the ability to refinance *after* the maturity date can affect default risk and price for *current* bonds.

This is particularly relevant in the case of system-level risks such as climate breakdown, where changing market sentiment in light of major shocks could result in repricing 'contagion'. If, for example, governments take meaningful action to decarbonise, bonds and assets that are particularly dirty may be at risk of becoming stranded assets in the present if the market reprices – posing a particular risk to pension funds, insurers and other long-term asset owners who are large holders of long-dated bonds. While many investors and credit rating agencies integrate sustainability risks into the assessment for individual issuers, these are typically analysed in relation to the current risk for a single issuer, and in relation to default risk over relatively short- to medium-term time horizons, rather than vulnerability in the context of market contagion or a sudden loss of investor confidence in a sector.

There is also a risk that companies use long-dated bonds to defer the risks of refinancing difficulties in future arising from environmental or social risks. For example, analysis by the Anthropocene Fixed Income Institute (AFII) of bond issuance patterns in the food sector has raised a red flag that some companies could be aiming to lock in financing at a lower rate in anticipation of increases in the cost of capital as environmental regulations increase, potentially affecting risk profiles or prices in the secondary market.[xii] Similarly, AFII analysis found that while the average maturity of bond issuance has shortened in recent years, reflecting interest rate moves, the same is not true of large oil producers, with average maturity almost doubling.[xiii] This could raise the risk for investors who are not effectively anticipating sustainability risks and regulation – and how they might affect asset values and default risk - over this longer timeframe.

Litigation risk

As noted above, bonds provide capital which enables the continuation or expansion of corporate activities. Where these activities cause harm, there could be future litigation risks relating to these financing relationships, in particular in relation to pension fund fiduciary duties where investments are perceived to be potentially at odds with members' interests.

In 2022, for example, NGO ClientEarth wrote to UK pension fund trustees raising the issue of whether bond investments were compatible with a scheme's duties in light of climate risk. The letter called for schemes to condition participation in energy sector bonds on the borrower having a 1.5°C-aligned transition plan and for the inclusion of covenants that set out "legitimate and proportionate financial consequences" should a company fail to adhere to this. Similarly, in 2025 the Net Zero Lawyers Alliance highlighted that *'in view of the new evidence on the impacts of climate change on portfolio value, [fiduciaries] now have not just a mere discretion to exclude investments in new unabated high-emission projects, but obligations, too, to exclude such investments in the best interests of their beneficiaries. At the very least, they should bear the burden of proof that on balance, the investment is not contributing to damage under a general 'do no harm' approach"*, submitting that this should particularly apply to bonds and other sources of primary financing.[xiv]

This may become more acute in the coming years as new questions arise about intergenerational fairness. Pension funds have a responsibility to be even-handed to underlying beneficiaries; as younger people in schemes are more likely to feel the impacts on their lives and economies as a result of climate breakdown, this calls into question whether investing in assets such as fossil fuel bonds which enable long-term economic and planetary harm are a breach of this duty to younger members. As of 2026, this is the basis for a lawsuit against the Canada Pension Plan Investment Board (CPPIB) by four young scheme members, alleging that the plan has breached its fiduciary duty by failing to effectively manage climate risks, including materially contributing to the financial risk by 'investing in the expansion of fossil fuel production and supply'.[xv]

Harm to people and planet

Finally, many corporate activities actively drive harm to people and planet. In addition to headline-grabbing scandals, this includes day-to-day harm such as ecosystem damage from overextraction, the exploitation of workers, and health risks to communities arising from pollution.

As above, this is particularly important when considering bonds as they are directly providing corporations with the capital to continue activities that cause serious harm, as well as providing a signal of approval to the market and corporate leadership teams.

We understand that some investors feel they may not be able to act without clear legal backing, and many asset owners – including pension funds – are in a catch-22 situation given the structure of an economic system which compels them to invest in harmful activities in order to attain sufficient financial returns. Nonetheless, it is worth pointing out that these are not morally neutral activities. If asset owners feel compelled to continue to provide capital to firms which cause significant harm to people or planet, then being honest about this situation and advocating for policy change to avoid this trap is a first step.

Key principles for bond stewardship

Five principles (and a caveat) for meaningful bond stewardship

As we have argued above, bond stewardship should therefore be given **as much, if not more, attention in stewardship strategies as listed equity**. However, this engagement must also be robust. Below we set out five principles (and a caveat) for meaningful bond stewardship.

We urge asset owners to **adopt these principles** themselves, and/or ask their asset manager to do so on their behalf, ideally by **writing expectations into the mandate**. In the appendix we provide indicative questions for asset managers and KPIs in line with these principles.

1 Set exclusions and 'red lines'

As bonds are a capital transfer, the most harmful companies should be excluded from the start

As set out in chapter 1, bonds are a direct capital transfer. This make the investor accountable and responsible for the impacts that their money is financing. Asset owners must set clear red lines where investments are contributing to systemic harms, by **implementing clear exclusions to prevent their capital facilitating these activities** (or asking their asset manager to do so on their behalf). Setting red lines helps to send a clear signal to the sector about minimum standards of corporate behaviour, which may help socialise these standards throughout the sector and beyond direct portfolios.

Importantly, these red lines should apply across both active and passive funds. Many asset owners purchase bonds through index funds. These track a given benchmark, meaning asset owners often feel they have little power to exclude specific companies. However, it is possible for new products to be developed specifically excluding the most harmful assets, enabling asset owners to access off-the-shelf passive products while minimising harm from investments (as in the case study below). If pension funds and other asset owners can't find off-the-shelf investment products that meet their needs, they can also use their position as major investors to invite the sector to create them.

Setting red lines is particularly important given that purchasing multi-year dated bonds may create a disincentive for investors to meaningfully escalate and divest where needed for fear of impacting market perception and price of their other, later-dated bonds or secondary assets. It's worth pausing to consider the implications here: if an investor feels unable to engage in meaningful stewardship for fear of affecting the short-term price of their other assets, this raises a significant conflict of interest if those same assets are driving harms that create long-term risk. This is precisely the reason why it's vitally important that that asset owners avoid buying the most harmful bonds to begin with.

Case study 1: developing a corporate debt index to exclude fossil fuel expansion [3]

In October 2020, the University of Cambridge announced that it would divest from fossil fuels across all asset classes. In reviewing its fixed income portfolio, the University found that there were no suitable off-the-shelf bond index products that met its requirements.

University academics subsequently launched a research project that has resulted in the development of a new corporate bond index: the Bloomberg Cambridge University Corporate Indices (BCam Indices). This draws on the research findings that the risk of exclusion from an index can be a powerful engagement tool.

The BCam Indices draw on criteria developed by the University of Cambridge that focus on current real-economy fossil fuel activity, assessing whether companies are ending fossil fuel expansion and phasing out fossil fuels at a sufficient rate. A key innovation of the indices is that they allow for the possibility of companies being (re)included if they cease expanding fossil fuel activities and are decreasing activities at a credible rate.

The University is also developing a stewardship strategy to support investors with bondholder engagement. An Academic Board will identify companies on publicly available lists for investors to engage with, and will provide briefing notes for investors wishing to undertake evidence-based engagements.

2 Implement a debt recycling framework

Capital should be purposefully allocated to the most sustainable companies and those making verifiable progress

Bonds are fungible, given that the maximum profit is capped; unlike buying a star high-performing stock, in which investors may make significant returns on their original investment, the total value of a bond is known from the start. This makes it easier for investors to exclude bonds from a particular issuer in favour of those from another issuer with a similar risk profile without a trade-off to upside returns.[xvi]

Investors can use this as a lever by **'recycling' capital – including both primary and secondary bond purchases - towards companies taking meaningful steps to reducing harm** and positive progress on a given priority environmental or social objective. Simultaneously, engagement resource can be 'recycled' towards companies which have a

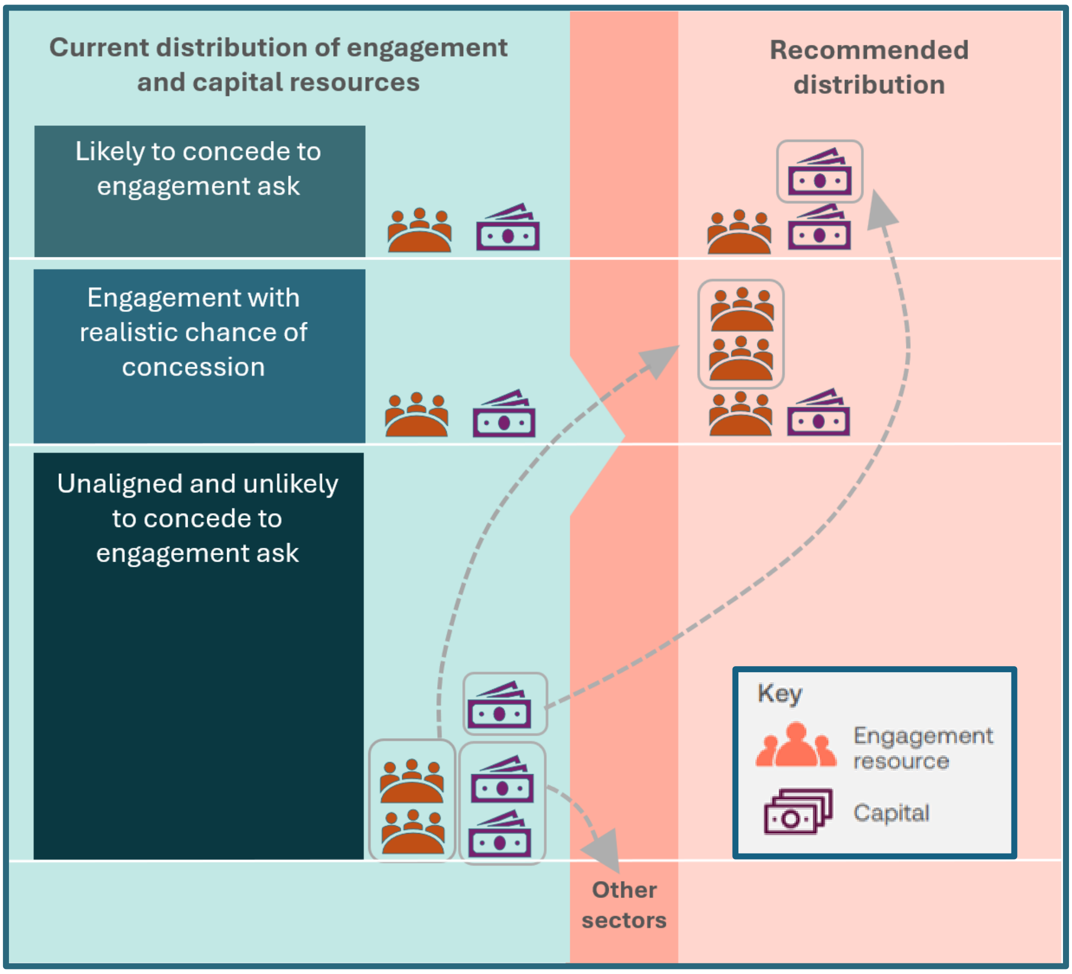
[3] See more at: https://www.landecon.cam.ac.uk/finance-for-systemic-change/news/university-cambridge-develop-first-global-bond-index-address

realistic chance of reducing harm; and capital fully withdrawn from those not taking meaningful steps to address the harm with the potential for reinvestment if it does so.

For example, if an investor sets an engagement objective to increase the number of companies with SBTi targets, they can use capital allocation by directing the majority of bond purchases towards companies with existing validation; directing some capital and the majority of engagement resource to companies who are taking meaningful and verifiable steps towards doing so; and withdrawing capital from the rest, with the provision to re-engage and re-allocate should the company agree to seek validation.

Asset owners who invest primarily through asset managers can urge their asset managers to adopt such an approach, and/or solicit the sector for new corporate debt investment products which offer such a 'recycling' investment strategy.

Figure 1: indicative debt recycling framework



3

Escalate systematically

Meaningful bond stewardship must include a willingness to escalate, exclude and divest

As above, allocating capital to the companies demonstrating a credible commitment to improving their sustainability performance from the start is the strongest lever in a bond investor's toolbox. However, it may be difficult in some cases to substitute or divest an existing bond purchase. In these cases, investors may use engagement to address environmental and social harms.

Engagement without consequence, however, is toothless; **meaningful bond stewardship must involve a willingness to escalate by using stronger tactics**, including public statements, convening bondholder meetings, refusing to refinance and partially or fully divesting holdings from a company. Companies are sensitive to changes in pricing in primary-market transactions and the cost of capital[xvii] and ShareAction's own experience suggests that withholding refinancing or divestment is an effective form of escalation.[xviii] Some investors claim that divestment or refusing to refinance is not effective as it will result in a loss of influence. However this is not necessarily the end of an engagement dialogue; investors can continue to communicate the conditions under which they would re-invest. Furthermore, as bonds are a source of new capital, staying invested to 'preserve influence' may be doing more harm than good if engagement is not having an impact.

Asset owners therefore need to set **clear and measurable expectations of portfolio companies**, underpinned by time-bound milestones, upon which participation in future financings will be contingent: clearly signalling to companies the implications of its strategic choices for their access to investors' capital. Critically, this should ensure **consistent engagement objectives across equity and debt holdings** to ensure a joined-up approach and avoid counterproductive signals, such as a listed equity team escalating while a debt team discretionarily takes a sizeable position in a new bond deal. This should include clear cohesion across debt and listed equity teams on the risks of individual companies across both portfolios; joint attendance at engagement meetings; a joined-up strategy in relation to the provision of further financing; and shared decision-making over decisions to refinance based on engagement progress. Figure 2 provides an indicative framework to demonstrate how investors could escalate asks across equity and debt holdings.

Investors rarely hold a single bond from a company; many will own multiple issuances of varying timeframes. Asset owners (or their fund managers) can therefore have dialogues with companies well in anticipation of future issuances, including setting out clear expectations and red lines as to the standards a company must meet in order for them to invest in future issuances or refinance. For example, AFII host a 'Bond Horizon' tracker which gives investors notice of upcoming bond issuances, to enable them to communicate conditions for investment to the market at an early stage.[4] Having clear sectoral expectations can also help investors avoid lots of time engaging specific companies, given narrow syndication windows.

[4] See: **https://anthropocenefii.org/resources/bond-horizon**

Figure 2: indicative escalation framework across listed equity and corporate debt holdings

<table>
<tr><th></th><th>Listed equity</th><th>Corporate debt</th><th></th></tr>
<tr><td rowspan="3">Business as usual dialogue and monitoring</td><td colspan="2">Regular calls and meetings with the company

Set clear and time-bound expectations on material responsible investment issues</td><td rowspan="12">STRENGTH</td></tr>
<tr><td></td><td>Reiterate environmental and social expectations during bond syndication

Request contractual protections of environmental and social factors in documentation</td></tr>
<tr><td colspan="2">UNDERPINNED BY BROADER SYSTEMS ENGAGEMENT
(policy advocacy, sponsor academic research, contribute to investor forums, publish thought pieces etc)</td></tr>
<tr><td>Private persuasion (STEP ONE)</td><td colspan="2">Unilateral private calls/meetings with the company (non-routine, more frequent, with board members)

Unilateral letter(s) to senior management and/or the board</td></tr>
<tr><td>Broader challenge (STEP TWO)</td><td colspan="2">Collaborative calls/meetings with the senior management and/or the board

Collaborative private letters to senior management and/or the board

Challenge management on earnings calls, corporate events or roadshows

Unilateral public statements/letters to senior management and/or the board

Collaborative public statements/letters to senior management and/or the board

Be cited in the media challenging a company’s position</td></tr>
<tr><td>From talk to action (STEP THREE) Voting – 3.1</td><td>Vote against standing items incl. director (re)election, audited accounts, management compensation

Vote for shareholder resolutions on ESG topics, against management recommendation

Ask questions or making statements of intent at annual general meetings</td><td></td></tr>
<tr><td>Intensified actions – 3.2</td><td>Pre-disclose voting intention (private/public)

(Co)File shareholder resolutions</td><td>Reject documentation amendment request

Convene bondholder meeting (subject to holding threshold) and represent to company</td></tr>
<tr><td rowspan="2">Exceptional measures – 3.3</td><td>Seek board seats

Call an extraordinary general meeting</td><td></td></tr>
<tr><td colspan="2">Legal processes</td></tr>
<tr><td rowspan="2">Capital allocation decisions (STEP FOUR)</td><td colspan="2">Divest/exclude from labelled funds*

Reduce exposure/underweight in all funds*

Engage index provider to exclude company at next rebalancing</td></tr>
<tr><td></td><td>Do not participate in primary issuance (new debt/refinancings) for labelled funds*

Do not participate in primary issuance (new debt/refinancings) for all funds*</td></tr>
<tr><td>Levers of last resort (STEP FIVE)</td><td colspan="2">Divest and exclude (communicated privately to company)*

Divest and exclude (communicated publicly)*</td></tr>
</table>

Case study 2: escalating by denying debt[xix]

The Swiss Association for Responsible Investments (SVVK-ASIR) is a network of 12 major Swiss pension funds and insurance companies. On behalf of member institutions SVVK-ASIR has been engaging with the most carbon-intensive companies in members' investment portfolios to set credible targets for reducing emissions and to develop transparent road maps.

However, after 'several years' of engagement without the expected progress, SVVK-ASIR has chosen to escalate by issuing a 'deny debt' recommendation for seven companies to halt new debt investments and phase out existing debt investments over time: Chevron., ExxonMobil., Marathon Petroleum., PBF Energy Inc., Phillips 66, Saudi Arabian Oil Co. and Valero.

This is explicitly intended to avoid providing capital and contributing to a lower cost of capital for the companies involved, while retaining equity holdings to continue exercising voting rights as a further escalation measure.

4 Ensure robust mechanisms for 'green bonds' and SLBs

Be cautious of 'sustainable' bonds that simply displace capital

An increasing number of asset owners also invest in 'green' or 'sustainability-linked' bonds. 'Green' bonds mandate a sustainable 'use of proceeds', by ringfencing funds for a particular type of investment. Meanwhile 'sustainability linked bonds' (SLBs) are not ringfenced, but structure a bond issuance in a way that the issuer will pay a financial penalty (i.e. an increased coupon rate) if they fail to meet set sustainability targets, such as reduction in emissions, improved gender equality or reduction in deforestation.

Both could play a role in transition by facilitating the flow of capital towards transition. However also pose a significant greenwash risk. In the case of 'green' bonds, there is a risk that these funds simply free up capital elsewhere in the company that would have been spent on transition, and may instead be now put to worse use. SLBs aim to avoid this by setting one or more whole-org sustainability-linked KPIs. However have been criticised for often not providing a strong incentive in practice, for example by setting easy-to-meet or gameable targets, or penalties that are in practice relatively small,[xx] or indeed by reducing the incentive for wider engagement as the investor is financially rewarded if the target is *not* met.

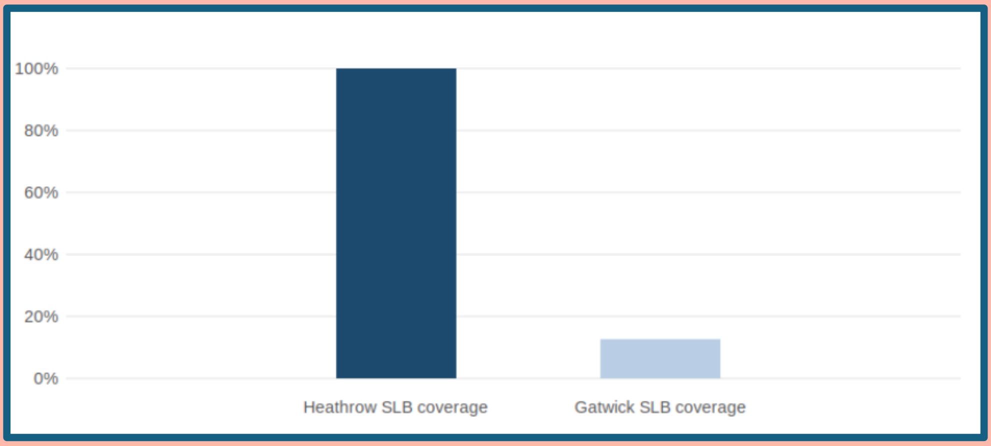
There are increasing standard frameworks in relation to SLBs and 'green' bonds, including the European Green Bond Standard (EuGB).[xxi] However, terms of investment are nonetheless set by the issuer and their syndicating banks, with an incentive to make these as easy as possible to meet - meaning investors who wish must take good care to ensure the terms will provide a meaningful constraint on company behaviour. For this reason, the IIGCC recommends taking an 'issuer-centric approach' by understanding of how an issuer's SLBs or green bonds align with its broader corporate and climate objectives.[xxii] Asset owners should therefore be cognizant of a significant risk of greenwash and capital displacement, and ensure SLBs and 'green' bonds are not used as an excuse to continue directing capital towards otherwise unsustainable companies without a meaningful plan to transition.

Case study 3: A tale of two airports

The robustness of an SLB is very sensitive to the specific coverage and KPIs. As an example, compare two recent SLB issuances by Heathrow and Gatwick airports in the UK, analysed by AFII[xxiii]:

- In 2023 and 2024, Heathrow Airport released a series of SLBs. These set two absolute targets for emissions reductions by 2030: a 15% cut to the emissions 'in the air' (those emitted during transit linked to the airport), and a 46.2% cut to emissions 'on the ground' (those emitted by the airport's direct operations).
- In 2024 and 2025, Gatwick Airport released two sustainability-linked bonds. While these set two absolute emission reduction targets, the first target included only scope 1 & 2 'on the ground' emissions, being ultimately a very small proportion of the total; and the second set a reduction in emissions *per passenger*, which gave scope for overall emissions to rise with passenger numbers. Also, while the latter included emissions from aircraft take-off and landing, unlike Heathrow the target excluded emissions released while aircraft climb, cruise and descent, which account for ~80% of 'in the air' emissions.

Figure 3: Emissions coverage of Heathrow and Gatwick SLBs



Comparison of Heathrow and Gatwick estimated SLB coverage as a percentage of total emissions: reproduced from AFII analysis

Importantly, however, these need to be also be understood in the wider context. While Heathrow's SLB issuances were structured in a more ambitious way than Gatwick's, the airport is continuing to lobby for an extension of runway capacity which would increase absolute emissions after the end of the SLB period – meaning that SLB financing, even while driving short-term emissions reductions, may enable the company to continue its expansion strategy. For this reason, asset owners need to consider the dynamics of financing in the round in terms of what activity their cash is ultimately facilitating.

5

Engage with the bond stewardship ecosystem

Asset owners should engage policy, service providers and peers to influence wider bond ecosystem sustainability

We recognise that aspects of the fixed income landscape – such as short syndication windows and oversubscription to investment-grade bonds – may make engaging on bond investments more difficult than listed equity.

However, the architecture of the bond investment universe is not set in stone, and investors can also engage with the wider ecosystem to help increase meaningful sustainability norms, genuinely sustainable product options, and legal certainty for investor action. This includes:

- **Engage with other asset owners.** Asset owners can participate proactively in collaborative engagements with other bondholders (subject to compliance with regulatory or legal requirements) to push for environmental and social progress. Notably, asset owners could collectively contribute to the development of standard bond covenants that reinforce sustainability expectations (see below).
- **Engaging with structuring and syndicating banks.** Asset owners can engage with syndicating banks on core sectoral expectations, disclosure requirements of borrowers, and critically on mechanisms for introducing covenants for high-risk issuers. An investor could for example decline to participate in a bond coming to market without a nature covenant included in the bond terms for issuers with material nature-related impacts and dependencies.

  Importantly, many syndicating banks are themselves listed companies and heavy users of the debt market, with bank debt having a material weighting in many fixed income portfolios. This means investors can also engage via their own holdings to push the bank to set higher standards for their investment banking activities and introduce stronger requirements during syndication activity.
- **Engage with index providers and fund managers.** Asset owners can engage with index providers on implementing minimum environmental and social criteria for inclusion in bond indices. They can also engage with fund managers to offer both active and passive products which exclude the most harmful companies, and/or 'recycle' debt and engagement resource to create a meaningful incentive to improve.
- **Explore the development of covenants**. Investors could require environmental or social 'covenants' as a condition for bond investments. Covenants set out clear requirements for actions a company should do (such as reporting) or not do (such as increase debt above a given level). These are used regularly in the high-yield market, although still emerging in the investment grade bond market. However, mobilising to increase their use could help to socialise more sustainable behaviour across a sector.

  For example pension fund Railpen has suggested climate covenants could include measures such as reporting on KPIs relating to the company's transition plan; investment restrictions to prohibit investments in high-emitting assets or companies with transition risk that is unaligned to the issuer's own transition strategy; restrictions on the issuer entering new emission-intensive lines of business; or caps on what the issuer is permitted to spend on non-green investments.[xxiv] Similarly, AFII have suggested attaching a transition-linked 'put option' (a form of early redemption right) to bonds could give investors the right to exit their investment during the bond's lifetime if a given sustainability target is not met.[xxv]

Asset owners may be concerned that advocating for covenants at individual companies could be difficult and time consuming putting potential investors at a disadvantage in the case of oversubscribed bonds. This emphasises the need for collaboration among asset owners to develop the field and indicate a preference to syndicating banks and companies for such covenants to create a critical mass. As we set out in #6, it is also important to reiterate that competition for returns is not by itself a justification for causing harm by investments.

...and a caveat...

6 Be honest about willingness to act

If asset owners can't do these things - be honest and advocate for policy change to remove said barriers

We recognise this is a step change for many asset owners and in some (but not all) cases there may be a difficult trade off with returns or portfolio diversification.

Where asset owners feel they are unable to engage meaningfully in mitigating the harms of their bonds, we urge them to be transparent about this with beneficiaries, policymakers and the public. They can engage in dialogue with policymakers to urge removal of these barriers and for wider regulation across the market to address harms that investors themselves cannot. This will enable an honest conversation about what the sector is, or is not willing to do in relation to truly 'responsible' investment.

Principles in practice: fossil fuels

Applying the principles to fossil fuel investments

In this section, we set out a framework for applying these principles in the case of fossil fuel bond purchases.

Climate breakdown will have a devastating impact on communities, people, and the planet. In a sensible system this alone should drive investors to act; however fiduciary duty laws mean many asset owners do not feel able to take action that is purely on moral grounds. Nonetheless, there are also economic reasons why climate is a key risk for asset owners:

- **System-level risk:** Climate breakdown poses a rapidly oncoming risk for long-term asset owners by threatening the ecological and social systems on which the economy depends. Norges Bank Investment Management, for example, has assessed that climate breakdown could decrease its fund value by a fifth,[xxvi] while the UK's Joint Intelligence Chiefs have assessed that cascading risks of ecosystem degradation are likely to include geopolitical instability, economic insecurity, conflict, food system collapse, migration and increased inter-state competition for resources.[xxvii] In such a case, climate breakdown facilitated and enabled by bond purchases may in turn undermine long-term stability and earnings of other assets in the portfolio, particularly by exacerbating the risk that we cross 'tipping point' thresholds that create 'doom loops' of climate and nature breakdown.[xxviii]

  Furthermore, if large and systemically important investors such as pension funds continue to hold significant bond investments from highly damaging companies, this may undermine the policy appetite to enact regulation that would devalue or strand these assets - thereby undermining the wider fight against climate stability.

- **Credit risk:** There is a risk that climate-related credit shocks could happen fast should the market reprice. Indeed, analysis by AFII found that credit risk may not be being priced effectively, given that fossil producers with different production and demand projections face very similar long-term credit spreads,[xxix] even in cases where such investments were inconsistent with net zero-compliant demand projections and stated climate policies.[xxx] This indicates that the market is not pricing in policy risk, and AFII notes that given the long duration of bonds, price moves could be 'substantial' should bonds be downgraded in the face of policies to limit demand.

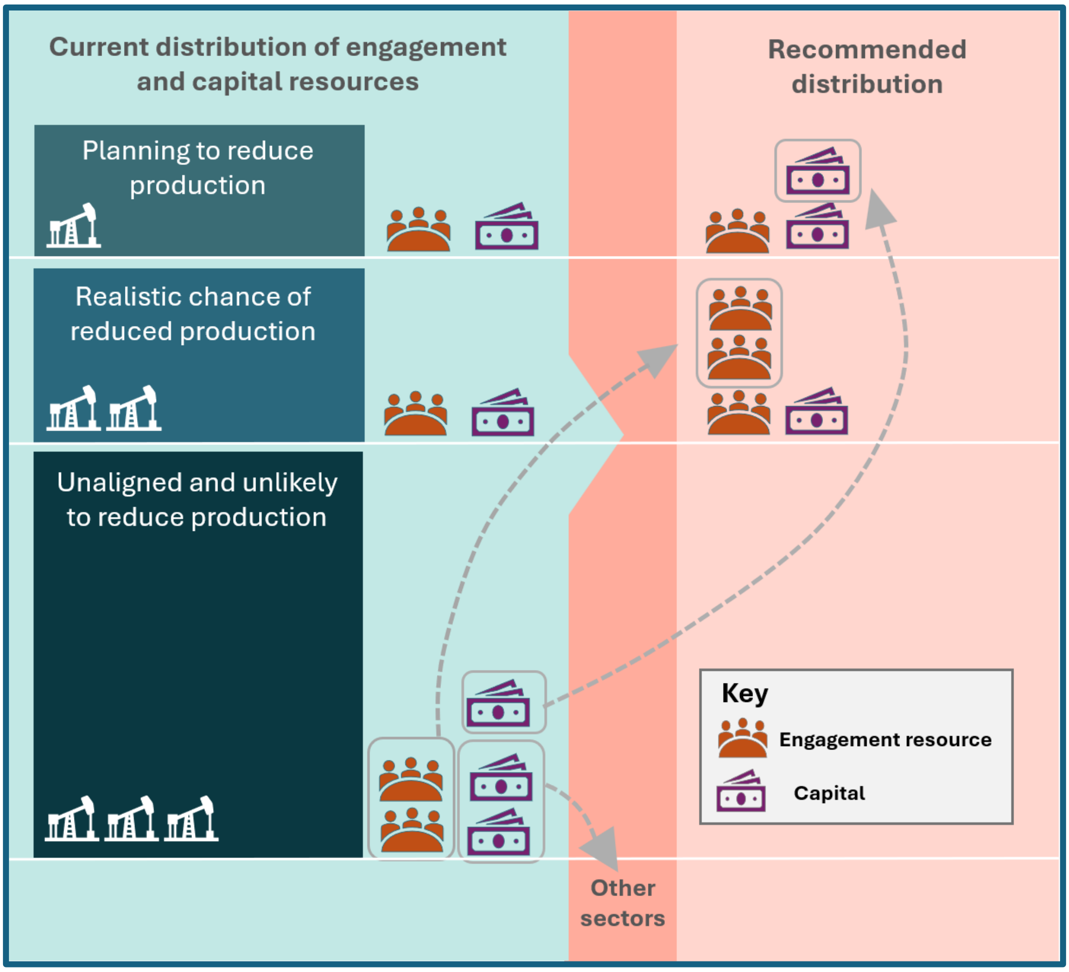
- **Litigation risk:** As climate risks to the economy grow, so too may the litigation risk for pension funds and other fiduciaries who are seen to have failed to act. In October 2025, a lawsuit was filed against the Canada Pension Plan Investment Board (CPPIB) by four young scheme members, alleging that the plan has breached its fiduciary duty by failing to effectively manage climate risks, including materially contributing to the financial risk by 'investing in the expansion of fossil fuel production and supply'.[xxxi] Further lawsuits are likely to follow, particularly in light of improvements in attribution science which enables analysis of how specific firms (and thus their financiers) have contributed to specific climate events.[xxxii]

Providing financing for firms actively planning to expand fossil fuel production exacerbates these risks. Below, we set out indicative recommendations for applying the five principles.

Principle	Recommendations[5]
Set red lines	• Set clear exclusions to cease purchasing new primary or secondary debt in both active and passive funds from fossil fuel firms expanding fossil fuel production • Divest existing debt holdings from all fossil fuel firms expanding production
Implement a debt recycling framework	• For other companies in the supply chain, including non-expanding fossil fuel companies, upstream financiers (e.g. banks) or downstream users of fossil fuels (e.g. steel, aviation), recycle primary and secondary debt holdings from those companies most unaligned with a 1.5C trajectory to those most aligned
Escalate systematically	• Focus bondholder engagement on banks, downstream users and other key nodes in the fossil fuel supply and financing chain, with the most emphasis on companies with a realistic prospect of reducing fossil fuel dependence. For those without a realistic prospect of reducing dependence, recycle debt to those with a greater prospect (as per #2) • Set clear timebound milestones for all climate engagements and a plan to refuse refinancing if asks are not met • Where secondary equity holdings are retained, align voting activity to vote against directors at companies actively lobbying against climate action or without a credible transition plan or that are backtracking on their climate commitments
Ensure robust KPIs for SLBs	• Decline to purchase SLBs or 'green bonds' from firms in the downstream supply chain which are expanding use of fossil fuels
Engage the ecosystem	• Collaborate with other asset owners to advocate for standard bond covenants for transition and fossil fuel use indicators • Engage investee and syndicating banks to commit to halt syndication of bonds from fossil fuel companies expanding production • Engage index providers to exclude fossil fuels companies from new and existing indices • Endorse the Fossil Fuel Non-Proliferation Treaty

[5] These recommendations draw on those produced for our **RISE paper on effective fossil fuel policies**

Figure 4: indicative debt recycling framework: fossil fuels



...and be transparent if you are unable to act

The climate crisis will affect – and likely harm - millions of people across the planet, particularly younger people and pension fund beneficiaries who will face the social, economic and planetary costs of climate breakdown in the coming decades. This means all asset owners have a responsibility to be transparent about the actions they are willing and able, or not willing or able, to take in relation to fossil fuel investments to enable an honest public conversation on the role of the investment sector.

Further resources and references

Further resources

- The **Institutional Investors Group on Climate Change (IIGCC)** has produced a series of resources on:
    - A guidance paper on Net Zero Bondholder Stewardship with specific recommendations for investors (alongside a **summary version**)
    - An engagement guide for asset owners on **engaging with 'labelled' debt** issuers (e.g. green bonds)

- The **Anthropocene Fixed Income Institute (AFII)** has developed two tools to support investors in planning engagement:
    - **Bond Horizon** gauges which of 265 monitored corporate bond issuers are most likely to access the bond markets in the following three months, to enable investors to plan engagement in advance of issuance.
    - **Deforestation Debt Universe** identifies issuers that have high to critical exposure to one or more of the commodities that are driving deforestation.
    - **The Box** provides league tables showing the proportion of syndication fees that banks have generated from both green and fossil fuel loan and bond issuances, to enable investors to use the data to engage and select banks.
    - **A Bondholder Engagement Toolkit** which responds to a practical gap in market resources by providing 11 engagement mechanisms or "tools". Each tool is designed to support debt-specific engagement strategies and is assessed for influence and feasibility.

- **ShareAction** has produced guidance papers for investors on **fossil fuel policies** and **escalation frameworks**, both including guidance on fixed income engagement.

Appendix 1: Questions for asset managers

Below, we provide a set of indicative questions that asset owners which outsource can adapt and use to explore their asset managers' policies on bond investments.

- **Set red lines**
    - Have you set any 'red lines' relating to activities you will not finance via bond or other primary market investments?
    - If yes, do these apply to both active and passive investments?
- **Implement a debt recycling framework**
    - Do you apply any 'best in class' ESG standards to bond investments in a given sector? If yes, is this communicated to companies which are on the margin?
- **Escalate systematically**
    - Do you have a clear escalation framework to apply to your debt investments?
    - If yes, does it have timebound milestones? If not, how do you determine when to escalate?
    - Is escalation integrated across equity and debt holdings? How is this managed in practice? Do the teams responsible for engagement and escalation hold a veto over decisions to purchase/refinance debt?
    - Can you give some examples where you have decided not to refinance, purchase new bonds or divest existing bonds for a given company due to environmental or social concerns in the last two years?
- **Ensure robust KPIs for SLBs and green bonds**
    - If you purchase 'green' bonds, how do you determine additionality (that the project would not have proceeded anyway without the new capital)?
    - If you purchase SLBs, how do you review the robustness of the KPI and conditions? What do you consider a meaningful penalty and why?
- **Engage the ecosystem**
    - Have you engaged with any institutions or bodies to develop the sustainable bond ecosystem?
    - Will you engage with syndicating banks to back mechanisms to introduce sustainability covenants for high-risk issuers? (Including engaging directly, and as investors via investments in listed banks.)
    - Will you engage index providers on the need to increase environmental and social criteria for inclusion?

Appendix 2: Indicative asset manager KPIs

Below, we provide a set of indicative KPIs that asset owners can use to monitor their asset manager's bond investing behaviours.

Exclusions and red lines	• Absolute value/number/relative proportion of bonds held from a given sector • E.g. for fossil fuels: Absolute value/number of bonds purchased by companies on **Global Coal Exit List** or **Global Oil and Gas Exit List** • Total participation in new debt financings grouped by material environmental & social risks & impacts (e.g. high-emitting sectors) • Value of bonds held in passive funds on a given theme (e.g. fossil fuel expansions)
Engagement strategy	• Proportion (as percentage of fixed income AUM) of corporate fixed income holdings subject to engagement in last two years • [On a given theme] • Proportion of corporate fixed income engagements in last two years escalated to next step* in a defined escalation framework • Proportion of corporate fixed income engagements in last two years that achieved the target outcome • Number of engagement meetings held jointly by equity and bond investment teams in last two years • Number/value/proportion of corporate bonds subject to partial or full divestment or refusal to repurchase new bonds* • Number/value/proportion of secondary corporate bonds subject to partial or full divestment in last two years **resulting from insufficient response/reaction from an issuer on sustainability expectations, or otherwise due to elevated environmental or social risks & impacts*
Use of covenants and SLBs	• Number/value/proportion of corporate bond purchases with sustainability covenants attached • Number/value/proportion of sustainability-linked bonds which achieved KPIs • Median / mean premium attached to sustainability-linked bond purchases

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