



ESG at  
Western Asset

ESG Governance  
at Western Asset

ESG Integration  
Into Western Asset's  
Investment Process

Western Asset Management

## Environmental, Social and Governance Statement

May 2024

Western Asset recognizes that there is no universal standard for evaluating investments from an Environmental, Social and Governance (ESG) perspective. Asset owners can vary greatly in terms of what specific values and themes they seek to express in their portfolios. As such, Western Asset's ESG framework has been developed to support our clients' investment needs and sustainability preferences.

Western Asset's sustainable investing efforts are led by the Global Head of ESG Investments and supported by our ESG Product Specialist, Sustainability Risk Managers and ESG Cross-Mandate Task Force. These activities are overseen by the Firm's ESG Strategic Steering Committee (ESGSSC), which reports to the Firm's Executive Committee.

- The membership of the Firm's ESGSSC spans across the investment desks, product development, business heads, and heads of risk, client service and compliance. This committee was established to coordinate the Firm's global sustainable investing initiatives and products.
- Western Asset's ESG Cross-Mandate Task Force brings together key senior professionals from across the investment team to discuss ESG-related issues and their potential impact on fixed-income strategies. The ESG Cross-Mandate Task Force is charged with identifying issuers that require increased monitoring and engagement, and that, in some cases, may require exclusion from certain mandates based on clients' sustainable objectives.

Western Asset's ESG Statement is reviewed at least once annually and approved by the ESGSSC.

### Investment Policy

As a fundamental, value-oriented asset manager, Western Asset seeks to invest in a diversified set of opportunities that will deliver superior risk-adjusted returns for its clients over the long term. When analyzing these opportunities, Western Asset's investment professionals consider many financially material issues that may impact future cash flow, including those that may be referred to as ESG factors. As a fiduciary to its clients, Western Asset believes that analysis of financially material ESG factors is essential to its investment process as these may affect the risk and return profile of its investments.

In order to align the Firm's sustainable investing framework with its clients' sustainability requirements, Western Asset is a signatory to the United Nations Principles for Responsible Investment (PRI) and the UK Stewardship Code, ensuring that our approach meets client expectations. As a signatory to the PRI, Western Asset works alongside other institutional investors around the globe to advance PRI's six [Principles for Responsible Investment](#). These shared goals include enhancing the integration of ESG considerations into the investment process, increasing the quality of non-financial disclosures by issuers, engaging with management to improve key ESG practices, and advancing ESG integration through collaboration with asset owners and other asset managers. Western Asset reports annually to the PRI and is evaluated on its activities and progress toward these goals.

Western Asset is also a signatory to the UK Stewardship Code, which defines “stewardship” as “the responsible allocation, management and oversight of capital to create long term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.” The UK Stewardship Code sets out a number of principles relating to investors’ purpose and governance, investment approach, engagement by investors with issuers and data providers with the objective of enhancing the quality of engagement, as well as exercising rights and responsibilities, to help improve long-term returns for shareholders. To ensure continued alignment with these principles, Western Asset prepares an annual report which is submitted to the Financial Reporting Council in the UK for review and approval. The ESG Team then ensures that any appropriate enhancements identified as part of the review are implemented by the Firm.

### ESG Research Approach

At the base level, investment professionals at Western Asset consider a wide range of macroeconomic and geo-political factors to form an outlook for the challenges and opportunities that issuers will face.

At the issuer level, Western Asset’s research analysts assess the potential impacts of financially material ESG factors alongside traditional financial and economic factors, seeking to determine whether an issuer’s ESG practices may present an investment opportunity or risk. Western Asset draws upon proprietary research as well as third-party data to assess an issuer’s ESG performance and outlook. The types and relative importance of factors vary depending on the sector as well as the individual issuer. Investments that do not meet the Firm’s standards, such as but not limited to ESG ratings, ability to respond timely to queries on material financial concerns, and sufficient transparency on key metrics, are treated as having higher risk, as their issuer’s future ability to repay debt may be adversely affected by developments such as legal sanctions, the introduction of new regulations or shifts in consumer sentiment. Assessments, which can be comprised of data analytics, of held issuers with financially material ESG concerns are documented in VerityRMS, research and engagement platform, alongside ESG ratings.

### Sample ESG Factors

Example factors that may be considered include, but are not limited to:

#### Macroeconomic

- Demographic and socioeconomic trends
- Resource consumption
- Risk of sanctions

#### Environmental

- Climate change
- Sector level analysis
- Energy costs
- Regulatory risks

#### Social

- Employee relations and workplace safety
- Diversity and inclusion
- Consumer protection policies

#### Governance

- Quality and integrity of leadership
- Transparency of disclosures

In some circumstances, ESG factors may not be assessed due to lack of materiality, data availability, lack of well-defined industry consensus on appropriate assessment of certain investments on their ESG characteristics, as well as where ESG themes may not play a determinative role in the investment decision as there may be other considerations that prevail.

### Environmental Factors

Western Asset recognizes the importance of analyzing financially material transition and physical climate risks at the issuer as well as the portfolio level, and as a result the Firm's research analysts seek to identify and analyze financially material climate-related risks and opportunities as part of their overall research process. This research is supplemented by the Firm's ESG and risk management specialists. The Firm has developed climate risk assessment and reporting tools, that enable the Firm's Investment Team to get a better understanding of environmental factors, including:

- Weighted Average Carbon Intensity (WACI) tool enables the Investment Team to assess the WACI of any portfolio and its benchmark.
- The Firm can also assess portfolio metrics on greenhouse gas (GHG) emissions reduction targets, water consumption reduction targets and toxic waste management, to help gauge portfolio exposure to environmental risks.
- Stress testing tools, to assess impact from transitioning to lower-carbon economy and/or acute physical risks (event driven) resulting from climate-related events, are available where clients have a requirement to perform this type of analysis on their portfolios.
- Western Asset is able to identify and report portfolio allocation to issuers with emissions reduction targets that are aligned with standard climate scenarios and the Science Based Targets Initiative (SBTI).

### Social Factors

Social factors can impact consumers' perception of an issuer as well as the issuer's operations. Western Asset seeks to monitor financially material social factors such as, but not restricted to, supply-chain-related issues, employee relations, labor rights, cybersecurity, and health and safety practices. In addition to conducting primary research and engagement, Western Asset may also leverage third-party data to assess alignment with human capital. Social considerations are important in the Firm's evaluation of sovereign issuers, where demographic composition, socioeconomic trends and income distribution can significantly impact the growth trajectory of the country.

### Governance Factors

Governance risks play a critical role in Western Asset's ESG analysis, as governance lays the foundation for a well-run, sustainable business. The Firm considers governance crucial not only as a standalone risk factor, but also as a signal for how the issuer manages its long-term environmental and social issues. Without superior governance practices, which include proactive management, robust reporting and strong risk controls, Western Asset cannot have confidence that appropriate leadership and integrity will be in place for long-term sustainability. As a result, if there is lack of appropriate governance arrangements, the Firm's investment team professionals are unlikely to invest in issuers even if they have strong environmental or social credentials.

## Engagement Philosophy

When evaluating investment opportunities, Western Asset's research analysts seek to engage in dialogue with issuer management to obtain additional perspective and develop a more informed investment outlook. Western Asset views engagement as a tool to evaluate financial risks, including ESG related factors that are inadequately addressed by existing policies and disclosures. The Firm's research analysts may also engage to increase awareness of the importance of financially material ESG considerations through their conversations with management.

## Engagement Principles

Research analysts may engage issuers on materially deficient business practices. Although bondholders possess very different legal rights than shareholders, the Firm believes it can impact corporate practices, including those that relate to ESG matters, given its role in determining issuers' cost of debt capital. As long-term, value-oriented investors, the Firm may seek compensation in wider spreads from issuers that lag their peers in addressing financially material ESG risks. Conversely, the Firm may favor issuers whose ESG profiles we believe are likely to improve but whose spreads overcompensate for historical deficiencies.

Western Asset's engagement process is aligned with the United Nations Global Compact principles, widely accepted corporate sustainability guidelines that meet fundamental responsibilities in the areas of anti-corruption, human rights, labor and the environment. The Ten Principles of the United Nations Global Compact are derived from international norms established by the Universal Declaration of Human Rights, the International Labor Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

Some of the considerations Western Asset seeks to address through issuer engagement include the following themes:

### Climate Risk and Environmental Management

- Understand issuer's strategy for and commitment to managing climate and environmental risks within the company, value chain, including regulatory and reputational risks
- Encourage increased disclosure of relevant exposures and policies to address these risks such as emissions reduction targets

### Diversity and Development of Talent

- Analyze skill set balance and representation of underrepresented groups at board and executive levels
- Understand issuer's approach to diversity and initiatives to develop talent across underrepresented groups

### Human Rights and Supply Chain Management

- Assess resiliency of issuer's supply chain, including human rights-related considerations
- Understand and encourage issuer's policies and controls to reduce child and forced labor, and maintain humane working conditions

## Additional Policies and Information

### Western Asset Management's Environmental, Social and Governance (ESG) Investment Policy

#### Product Safety and Security

- Understand issuer's standards and controls for maintaining product safety and security, including cybersecurity
- Encourage best practices for quality control and safeguards to minimize incidence of harm

#### Transparency in Reporting

- Elevate the consistency and quality of reporting exposures to both financial and non-financial risks material to the issuer and sector
- Increase general awareness of financially material ESG issues and their importance to investors

#### Governance and Corporate Management

- Evaluate quality of leadership, ownership and corporate structure, and capital management
- Communicate governance concerns to issuer management and seek adoption of bondholder-favorable covenants and business practices

[UK Stewardship Code Statement](#)

[WA Cluster Munitions Policy](#)

[WA SFDR Sustainability Risk Policy](#)

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