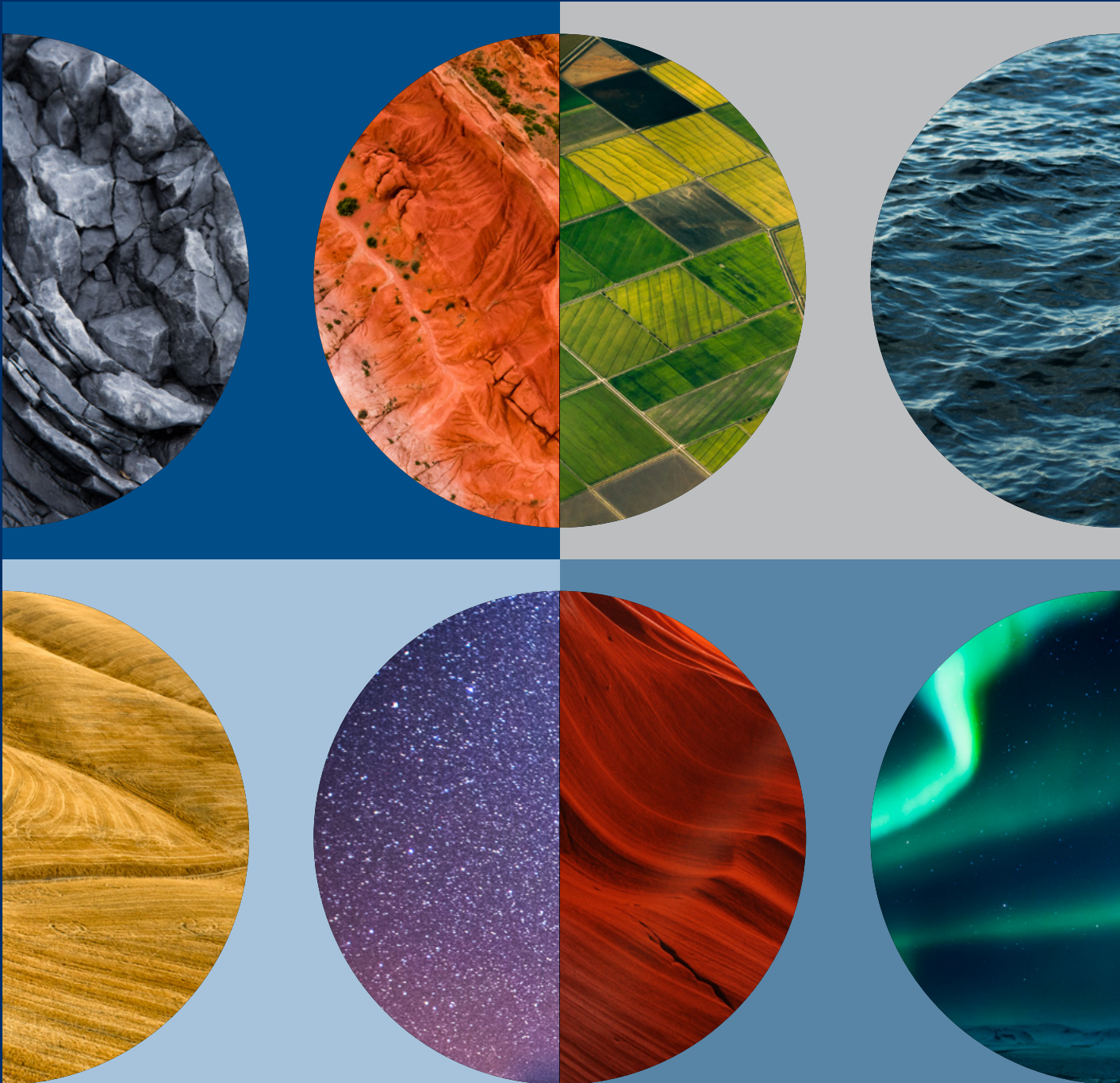
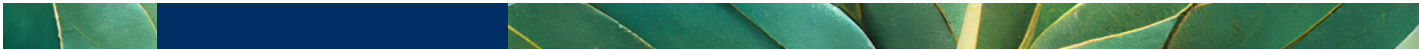


# Responsible Investing for Our Clients

Western Asset  
October 2023





# 2023

# Stewardship Report

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## Foreword

For more than 50 years, Western Asset's objective has been to deliver superior risk-adjusted returns to our clients. Western Asset is a multi-national firm with offices in nine locations around the world, each reflecting its own unique local culture. We offer a broad range of investment strategies for a diverse set of clients and invest across an equally wide range of fixed-income instruments.

We have always been intensely focused on our fiduciary duties—meeting client investment objectives and maintaining infrastructure and policies that enable us to satisfy our obligations. We work to strengthen areas that are less mature and evolve other areas as necessary. Some areas of focus require additional time as our approach becomes more refined, better documented and further integrated into the day-to-day services we provide to our clients.

Over the last few years we have worked to integrate what we believe to be the most material environmental, social and governance (ESG) considerations impacting long-term issuer creditworthiness and performance of fixed-income investment portfolios. We believe that understanding financially material ESG factors plays an important role in delivering long-term value creation for our clients.

**This commitment is illustrated by our five guiding principles:**

1. We put clients first in everything we do.
2. We foster a team-based culture of collaboration and diversity throughout the Firm, working together to enhance the quality of our investment thinking and decision-making.
3. We offer globally integrated capabilities and expertise that improve our ability to diversify investments.
4. We integrate risk management as a critical part of our successful portfolio management process.
5. We focus on active fixed-income to provide superior investment capabilities and service to our clients, and to enhance the long-term, risk-adjusted performance of our portfolios.

Our approach to sustainable investing builds on these principles and is key to our investment philosophy. We integrate ESG factors into our analysis of debt issuers across different fixed-income sectors. Experienced research analysts include ESG considerations as part of the Firm's general research process, applying proprietary sector-specific frameworks that take ESG factors into account in conjunction with traditional metrics. Portfolio managers synthesise the fundamental value opinions of the research analysts with the input of the traders and risk managers to construct portfolios that address each client's objectives.

We understand and deeply appreciate that our clients' requirements and targets on sustainability vary widely and are subject to different regulations in each jurisdiction. As stewards of our clients' capital, we seek to partner with them to help them meet their goals. Given this variation in our clients' investment and sustainability needs, we seek opportunities for sharing best practices, transferring knowledge and designing customised solutions for clients. Ultimately, our individual clients' investment needs drive the development of our solutions, keeping our focus on long-term value and diversified strategies. Western Asset continues to develop a variety of proprietary sustainable investing strategies for clients with more specific sustainable investment objectives and will continue to do so as the ESG landscape evolves.

I welcome your interest in our stewardship approach and the work that we have accomplished in 2022/2023. Should you have any questions, please reach out to your Western Asset representative.



**Michael B. Zelouf, CFA**

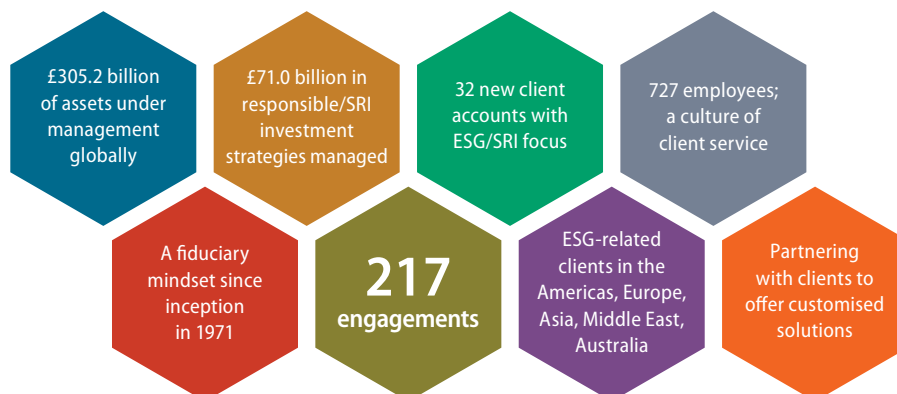
Head of London Office, Western Asset Management Company Limited

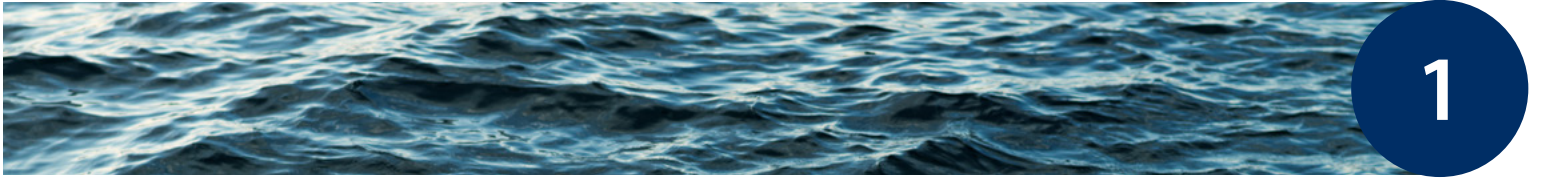


*“At Western Asset, we understand the importance that our clients place on sustainable investing alongside their traditional investment objectives, and we continue to work to align with these goals. Data is at the core of our ESG integration mission, and this year we have improved and expanded our analysis and reporting of key sustainability metrics in our clients’ portfolios. As bond managers, we appreciate the vital role of issuer engagement in our stewardship journey and have enhanced our documentation and monitoring of these activities. We remain committed to maintaining our clients’ trust by partnering with them as stewards of their capital.”*

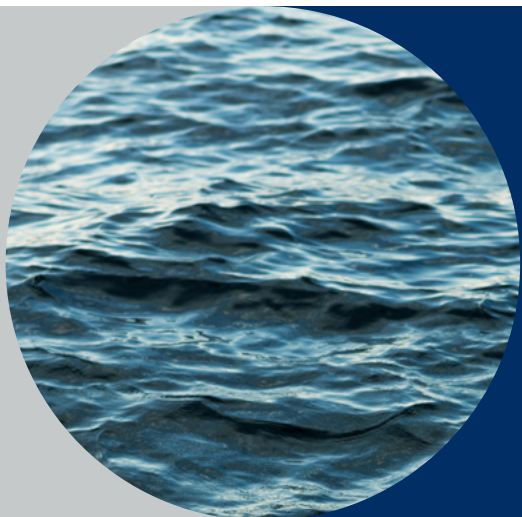
– Michael B. Zelouf, CFA

### Reporting Period in Numbers: 1 July 2022 – 30 June 2023





*“Signatories’ purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, the environment and society.”*

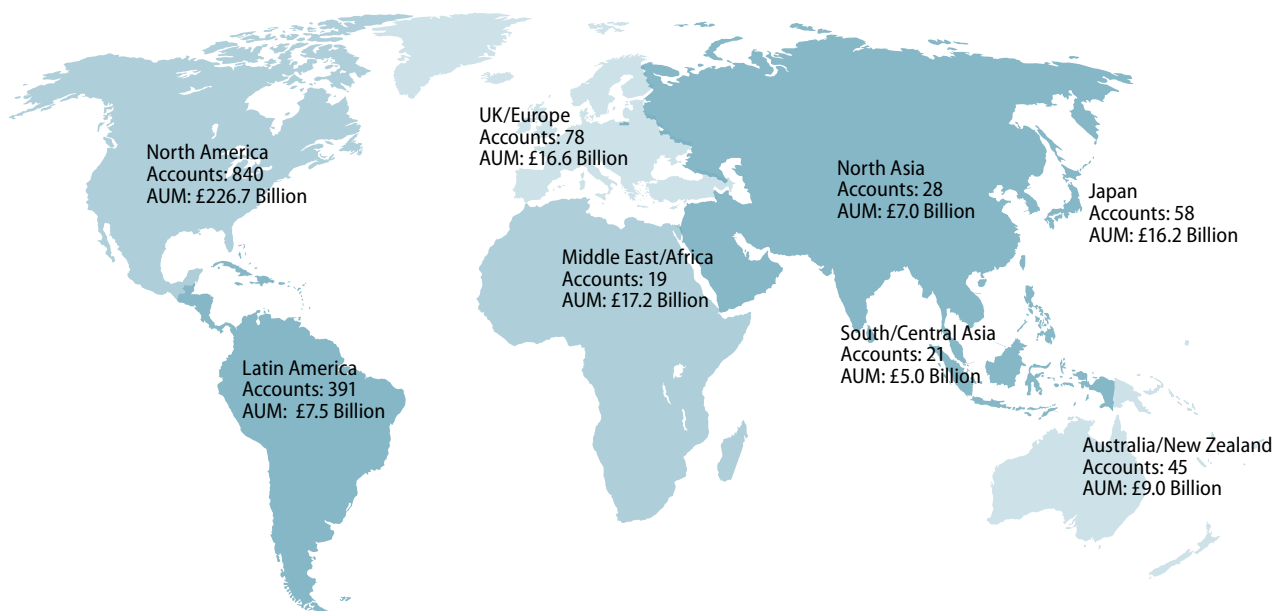


“Signatories’ purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, the environment and society.”

### Our Purpose

Western Asset<sup>1</sup> is one of the world’s leading investment management firms. Our mission is to remain a leader in diversified fixed-income investment management with integrated global operations exercising uncompromising standards of excellence and ethics in all aspects of our business. The Firm’s client base primarily includes professional investors, retirement plans and pension plan sponsors, fund selectors, and investment advisers. As clients have a wide range of investing objectives and needs, Western Asset collaborates closely with clients to help them meet their goals, including the creation of customised guidelines tailored to clients’ specific return objectives, risk tolerances, investment horizons and liquidity needs.

### Western Asset Assets Under Management (AUM) and Client Accounts by Client Region



#### Western Asset at a Glance

- Founded in 1971. Specialist Investment Manager of Franklin Resources, Inc. since 31 Jul 2020
- Fixed-income value investors
- £305.2 billion (GBP) AUM
  - £262.5 billion (GBP) long-term assets
  - £42.8 billion (GBP) cash and cash equivalent assets
- 727 employees

As of 30 Jun 2023.

#### Organisational Pillars

- Clients first
- Globally integrated
- Team-based
- Active fixed-income
- Integrated risk management

#### AUM by Sector Total £305.2 billion (GBP)

▪ Global Investment Grade Corporate	£92
▪ MBS/ABS	£54
▪ Cash & Cash Equivalents	£43
▪ Sovereign, Treasuries, Agencies	£37
▪ Emerging Market Debt	£27
▪ Local Authority & Municipals	£16
▪ Global High Yield	£14
▪ Global Inflation-Linked	£3
▪ Other	£19

<sup>1</sup> Western Asset is a global investment asset management firm comprised of six legal entities: Western Asset Management Company, LLC (Pasadena and New York); Western Asset Management Company Distribuidora de Títulos e Valores Mobiliarios Limitada (São Paulo); Western Asset Management Company Limited (London and Zurich); Western Asset Management Company Pte. Ltd. (Singapore); Western Asset Management Company Ltd (Tokyo); and Western Asset Management Company Pty Ltd (Melbourne).

## Our Investment Philosophy

**Long-term fundamental value investing** has been at the core of Western Asset's investment philosophy since its inception, and responsible stewardship has always been an essential part of our culture:

- **Markets often misprice securities.** Prices can deviate from fundamental fair value, but over time, they adjust to reflect inflation, credit quality fundamentals and liquidity conditions. Consistently investing in undervalued securities can deliver superior investment returns.
- **We seek to systematically identify mispricings** and to identify and capitalise on markets and securities that are priced below fundamental fair value. We do this through disciplined and rigorous analysis, comparing prices to the fundamental fair values estimated by our macroeconomic and credit research teams around the globe.
- **Our portfolios emphasise our highest convictions.** The greater the difference between our view of fair value and the markets' pricing, the bigger the potential value opportunity. The greater the degree of confidence in its view of fundamentals, the greater the emphasis of the strategy in our portfolios.

## Multiple Diversified Strategies

We seek diversified sources of returns. Our objective is to meet or exceed our investors' performance objectives within their risk tolerances. We seek to diversify investments and add value across interest-rate duration, yield curve, sector allocation, security selection, country and currency strategies. We deploy multiple diversified strategies that benefit in different environments so no one strategy dominates performance, helping to dampen volatility.

## Risk Management

Risk management is an integral part of our portfolio management. At Western Asset, this is a team effort involving client service executives, risk managers and portfolio managers, who work together to understand client risk tolerances and to construct portfolios that seek to achieve our clients' objectives while remaining within those parameters. After understanding and quantifying these objectives and tolerances, Western Asset analyses current and potential risks in client mandates, as well as in other portfolio constructs that portfolio managers may be considering. Western Asset then assesses the risks to see that they are appropriately rewarded.

Exposures that lead to risk without reward should be limited or hedged, when possible, in line with client investment guidelines applicable to a specific mandate. Western Asset seeks to align risk exposures so they are sized appropriately for the client's objectives and risk tolerances.

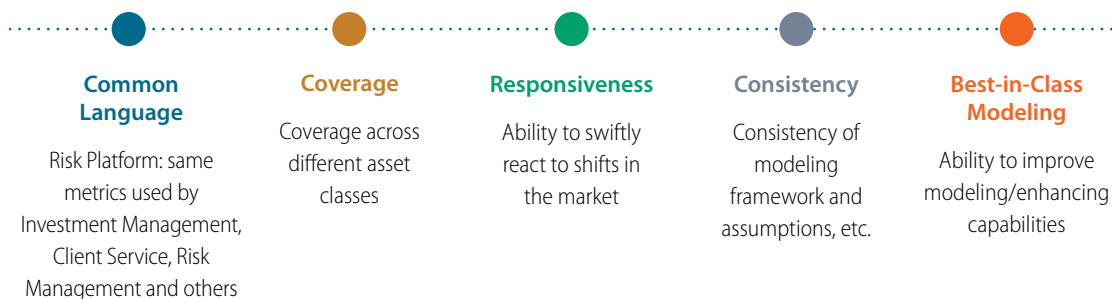
To do this effectively, a strong flow of communication between risk managers and portfolio managers is essential. Western Asset's Risk Management & Quantitative Solutions Department (the Risk Management Team) is independent from the Investment Management Team and therefore provides an important counterbalance. Members of the Risk Management and Investment Management Teams collaborate and communicate regularly in person, in formal meetings, and electronically. This collaboration results in an integrated risk management platform within the Firm's global team environment. Account specific risk limits, set out at the inception of an account, form the basis for Western Asset's risk monitoring warning level process, and utilise escalating trigger points to incite portfolio manager action.

Western Asset believes that material E, S and G considerations—such as the physical and transition risks of climate change and environmental management, product safety and security, health and injury risks, shifts in consumer sentiment, human rights and supply-chain management, transparency in reporting, as well as good corporate governance and management—are key factors that should form part of an issuer's assessment. Therefore, the Firm's research analysts have designed ESG frameworks that identify such E, S and G risks across sovereigns, various credit sectors and securitised fixed-income asset classes.

As part of the Firm's comprehensive risk management capabilities, Western Asset has developed a proprietary methodology that can be utilised to conduct climate stress tests on client portfolios from a bond manager's perspective.

These climate stress tests are designed to help the team understand and estimate the impact of climate-related risks in a variety of scenarios. The Risk Management Team has also developed an optimiser tool that proposes asset swaps within a portfolio to achieve lower carbon intensity, while maintaining other risk characteristics such as duration, yield and sector exposure. The optimiser may be utilised on a number of different investment strategies managed by Western Asset.

#### WISER—A Multi-Factor Risk Management System Built by Western Asset



#### ESG Philosophy

ESG considerations are an important tenet of the Firm's investment process and are incorporated across a range of fixed-income strategies managed by the Firm to meet the needs of our clients. Western Asset believes that financially material ESG factors can affect the creditworthiness of fixed-income issuers' securities and therefore impact the performance of fixed-income investment portfolios. Our foremost focus is on our clients' goals, and considering these ESG factors is wholly consistent with the Firm's long-term, fundamental value-oriented investment philosophy.

Western Asset investment professionals consider a wide range of macroeconomic and geopolitical factors in composing an outlook that describes the challenges and opportunities facing sovereigns, industries and companies. This process guides our approach of integrating ESG considerations into a given portfolio.

The types and importance of the ESG factors that the Firm's research analysts study depend on the asset class, sector and individual issuer. Research analysts are critical in defining these factors for each issuer they cover, and in subsequently providing investment rationales to portfolio managers for consideration. The primary responsibility of a Western Asset portfolio manager is to synthesise the fundamental and relative value opinions of the research analysts with the technical input of the traders and risk managers in order to construct a portfolio that reflects the Investment Management Team's views within the context of each mandate's guidelines and risk tolerance. Investments that do not meet Western Asset's ESG expectations are treated as having higher risk, as their future ability to pay may be adversely affected by developments such as legal sanctions, the introduction of new regulations or shifts in consumer sentiment. We then evaluate whether the market is appropriately pricing the issuer's performance based on those ESG factors.

A growing number of the issuers we consider for investment have exposure to environmental factors that must be weighed when constructing portfolios. Traditionally, these have included utilities with respect to which regulation places precise requirements around environmental quality factors. Western Asset has also long recognised the environmental challenges inherent in heavy industry sectors such as metals and mining, machinery, and oil and gas. However, environmental concerns apply across many other sectors as changes in energy costs and in climate conditions may have pervasive effects.

Social factors can also impact consumer perception of an issuer as well as the issuer's operations. We consider a number of social factors, including employee relations, workplace safety practices, consumer protection policies, recruiting and talent development, and community relations. Social considerations are particularly important in our



evaluation of sovereign issuers where demographic composition, socioeconomic trends and income distribution can affect the growth trajectory of a country.

Governance plays a critical role in Western Asset's ESG analysis, as it lays the foundation for a well-run, sustainable business. We consider 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. If an issuer does not have superior governance practices, which include proactive management, robust reporting and strong risk controls, Western Asset cannot have confidence that the issuer's leadership and integrity will be in place with respect to environmental and social factors.

With all ESG factors, we seek to evaluate the extent to which each issuer is adapting to improve its practices in the changing environment. Western Asset views corporate sustainability initiatives and disclosures as important indicators of how issuers manage their operational costs, and we further develop our understanding through dialogue with such issuers.

### Our Strategies

As an investment manager focused primarily on fixed-income, Western Asset offers a full range of investment solutions that can be tailored to meet the needs of our clients.

Our offering of ESG products has expanded during the period from 1 October 2022 to 30 June 2023 (the Reporting Year). Western Asset recently converted eight existing Article 6 UCITS funds to Article 8 under EU SFDR (Sustainable Finance Disclosure Regulation). These include FTGF Western Asset Global Core Plus Bond Fund, FTGF Western Asset Global High Yield Fund, FTGF Western Asset Global Multi Strategy Fund, FTGF Western Asset US Corporate Bond Fund, FTGF Western Asset UK Investment Grade Fund, FTGF Western Asset US Core Bond Fund, FTGF Western Asset US Core Plus Bond Fund, and FTGF Western Asset US High Yield Fund. The conversion of these funds adds to the range of existing sustainable solutions, including FTGF Western Asset Sustainable Corporate and FTGF Western Asset Short Duration Blue Chip Bond Funds.<sup>2</sup>

Identifying Investment Solutions to Align with Client Objectives and Risk Tolerances		
<ul style="list-style-type: none"> <li>Protect from rising rates</li> <li>Protect from inflation</li> <li>Preserve capital</li> </ul>	<ul style="list-style-type: none"> <li>Diversify globally</li> <li>Hedge liabilities</li> <li>Enhance income</li> </ul>	<ul style="list-style-type: none"> <li>Generate tax-free income</li> <li>Generate total return</li> <li>Achieve ESG objectives</li> </ul>
Selected Investment Strategies		
<p><b>Broad Market</b></p> <ul style="list-style-type: none"> <li>Global Aggregate</li> <li>Regional Core/Core Plus</li> <li>Regional Intermediate</li> <li>Global Sovereign</li> </ul> <p><b>Long Duration/LDI</b></p> <ul style="list-style-type: none"> <li>Long Duration</li> <li>Long Credit</li> <li>Liability-Driven Investing</li> </ul> <p><b>Inflation-Linked</b></p> <ul style="list-style-type: none"> <li>US TIPS</li> <li>Global Inflation-Linked</li> <li>Regional Inflation-Linked</li> </ul>	<p><b>Credit</b></p> <ul style="list-style-type: none"> <li>Global Credit</li> <li>Investment Grade Credit</li> <li>Global High Yield</li> <li>US Bank Loans</li> <li>US High Yield</li> <li>Short Duration High Income</li> </ul> <p><b>Mortgage and Consumer Credit</b></p> <ul style="list-style-type: none"> <li>US Agency MBS</li> <li>US Agency MBS Plus</li> <li>Structured Product</li> <li>Select Credit Opportunities in Real Estate (SCORE)</li> </ul> <p><b>US Municipals</b></p> <ul style="list-style-type: none"> <li>US Taxable Municipal</li> <li>US Tax-Exempt Municipal</li> </ul>	<p><b>Unconstrained/Alternatives</b></p> <ul style="list-style-type: none"> <li>Macro Opportunities</li> <li>Total Return Unconstrained</li> <li>Multi-Asset Credit</li> <li>Global Multi-Sector</li> <li>Tail Risk Protection</li> </ul> <p><b>Emerging Markets</b></p> <ul style="list-style-type: none"> <li>EM Diversified</li> <li>EM Corporate</li> </ul> <p><b>Liquidity/Short Duration</b></p> <ul style="list-style-type: none"> <li>Liquidity</li> <li>Enhanced Liquidity</li> <li>Short Duration Constrained</li> <li>Short Duration</li> </ul>

<sup>2</sup> For Illustrative Purposes only. Products, services and information may not be available in all jurisdictions and are offered by Western Asset affiliates and/or their distributors as local laws and regulation permit. Please consult your own financial professional or Western Asset contact for further information on availability of products and services in your jurisdiction.



We continue to listen to our clients and are looking for opportunities to further expand our ESG offerings via our flagship UCITS funds range as well as through other investment solutions.




### Our Culture

As noted above, our mission is to remain a leader in diversified fixed-income investment management with integrated global operations, exercising uncompromising standards of excellence and ethics in all aspects of our business. Key to this mission are our core values of **Trust, Honesty, Integrity, Teamwork, Diversity, Mutual Respect and Personal Responsibility**. Continuously shared and applied throughout the Firm, our values enrich and enhance our efforts to excel, for our clients, our people and our organisation.

<p><b>Our Clients</b></p>	<ul style="list-style-type: none"> <li>▪ We put our clients first in everything we do</li> <li>▪ We listen, understand and help them to succeed</li> <li>▪ We think and act on a global basis</li> <li>▪ By meeting or exceeding our clients' expectations, our success will follow</li> </ul>
<p><b>Our People</b></p>	<ul style="list-style-type: none"> <li>▪ Our people are our greatest asset</li> <li>▪ We treat each other with dignity and respect</li> <li>▪ We foster our diversity and individual growth</li> <li>▪ We exercise uncompromising standards of excellence</li> <li>▪ We understand that we are only as good as our people's knowledge, enthusiasm and commitment</li> </ul>
<p><b>Our Organization</b></p>	<ul style="list-style-type: none"> <li>▪ We manage our business with an entrepreneurial spirit</li> <li>▪ We emphasise teamwork to produce the best results</li> <li>▪ We stimulate creativity and embrace change</li> <li>▪ Our values and success make Western Asset a great place to work</li> </ul>





### Diversity, Equity and Inclusion (DEI)

Western Asset believes that a diverse workforce helps us provide superior client service. In terms of the Firm's critical competitive advantages, DEI ensures that we are able to recruit and retain the best talent and create a team of world-class investment and client-support professionals who provide the highest level of investment services to our clients.

 <p><b>Diversity</b></p> <p>Diversity represents the range of human differences, including but not limited to race/ethnicity, gender identity, religion, sexual orientation and unique experiences that each individual brings to the Firm.</p> <p>Fostering different perspectives produces variations of thinking, communication styles, skills and behaviours which ultimately lead to innovative ideas.</p> <p>Western Asset is committed to creating and maintaining a diverse workforce throughout our entire Firm.</p>	 <p><b>Equity</b></p> <p>Ensuring equity is a business practice that means everyone has access to the same opportunities.</p> <p>Equity arises in a process that begins with acknowledging unequal starting places and the existence of systemic barriers.</p> <p>Western Asset remains committed to identifying and addressing these imbalances so that all of our employees can thrive and participate fully in the success of the Firm.</p>	 <p><b>Inclusion</b></p> <p>While diversity is essential, it is not sufficient in and of itself. A company can be both diverse and non-inclusive at the same time. Thus, a sustained practice of creating inclusive environments is necessary for success.</p> <p>Inclusion means supporting a work environment where all employees are respected and valued, and can participate fully as their authentic selves in the success of our Firm.</p> <p>Western Asset is committed to active and ongoing inclusion engagement that fosters the promotion of unique business ideas and favourable investment outcomes.</p>
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In January 2021, the Firm formed the Western Asset Diversity, Equity and Inclusion Committee (DEI Committee), which comprises of 13 senior colleagues from four of our nine global offices. The DEI Committee is tasked with developing and implementing a comprehensive DEI Programme integrated into the Firm’s vision, people and business strategy, as well as with monitoring the success of the DEI Programme.

In August 2022, the DEI Committee completed designing and the Firm adopted a comprehensive formal framework to help ensure that our global DEI goals and priorities are clear and can continue into the future. This includes the establishment of a globally integrated DEI policy based on the requirements of each local office; a dedicated DEI budget; key strategic DEI recruiting partnerships; formal recruitment policies that will ensure that our employee candidate slates be comprised of people from under-represented groups; and programmes focused on internships, mentorships, and employee development planning—all of which focus on developing our next generation of leaders.

How Will Western Asset Generate DEI change?		
Establish a DEI Function	Hire Dedicated DEI Headcount	Allocate a Budget for DEI
 <p><b>Recruiting</b></p>	<ol style="list-style-type: none"> <li>1. Broaden our diversity recruitment outreach programme. Focus our energy on establishing three key strategic DEI partnerships and develop an internal “Recruitment Ambassador” programme.</li> <li>2. Develop policies that ensure diverse candidate slates. A key recommendation is to require that 40% of any candidate slate be comprised of persons from “under-represented” groups as defined by the DEI Committee.</li> <li>3. Enhance the interview process by increasing the diversity of interviewers; providing bias training for hiring managers and interviewers; and standardising a portion of interviewer questions.</li> </ol>	
 <p><b>Training &amp; Development</b></p>	<ol style="list-style-type: none"> <li>4. Improve our current internship programme. Programme enhancements may include establishing returnships, junior analyst positions and rotational programmes.</li> <li>5. Provide diversity-focused training on topics such as microaggressions, inclusion, belonging, cultural awareness and unconscious bias.</li> <li>6. Develop mentorship, sponsorship and development planning programmes (currently in development within the UNITE employee resource group).</li> </ol>	
 <p><b>Accountability, Metrics &amp; Reporting</b></p>	<ol style="list-style-type: none"> <li>7. Modify incentive structures to encourage policy adoption (contingent upon clear articulation of the Firm’s DEI goals and training).</li> <li>8. Implement procedures and systems to track and monitor progress. Adjust our strategy as needed.</li> </ol>	
 <p><b>Communications</b></p>	<ol style="list-style-type: none"> <li>9. Communicate DEI progress internally and externally to facilitate transparency and common understanding of the Firm’s DEI goals.</li> <li>10. Develop and implement a strong employee feedback process including conducting DEI surveys on an annual basis. Use feedback to adjust our strategy as needed.</li> </ol>	
 <p><b>DEI</b></p>	<ol style="list-style-type: none"> <li>11. Develop a globally integrated DEI policy based on the requirements of each local office.</li> </ol>	

Source: Western Asset. As of 30 Jun 23.

## Employee Resource Groups

Western Asset encourages, supports and promotes the creation and growth of employee resource groups (ERGs) globally as a way to accelerate its DEI impact. These groups offer engagement opportunities for employees around a variety of shared interests and perspectives. Through ERGs, the Firm encourages employees to engage in open, authentic conversations around DEI, learn about diversity, demonstrate ally-ship towards colleagues and develop a sense of community. Each ERG is supported by an executive sponsor from the senior leadership team. The sponsor not only lends credence to the ERG but regularly attends meetings, participates in dialogue, advocates for the ERG, and helps to remove barriers and roadblocks.



Western Asset's ERGs provide support to staff by fostering an inclusive and safe working environment and providing opportunities for employees to develop both personally and professionally. Through ERGs, the Firm encourages employees to engage in open, authentic, global conversations around DEI; learn productively about diversity at the Firm; demonstrate the spirit of ally-ship towards their colleagues and develop a collaborative sense of community as Western Asset continues on our DEI journey.

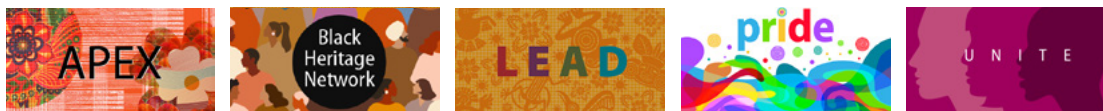
Western Asset's dedication to our ERGs has resulted in an environment that encourages staff to further support the Firm's values by:

- Strengthening our culture to help minorities, women and LGBTQ+ individuals succeed;
- Empowering minorities, women and LGBTQ+ individuals to develop their leadership skills;
- Actively encouraging minorities, women and LGBTQ+ individuals to innovate;
- Celebrating those who have had successes in these areas;
- Building an inclusive community that is respectful of all backgrounds, experience and knowledge; and
- Actively reaching out to the communities we serve to strengthen these initiatives.

### The ERGs include:

- **APEX (Asian Pacific Islanders for Engagement and Excellence).** Sponsored by the Head of IT and Head of Consultant Relations, APEX's mission is to celebrate and support Asian-Pacific Islander culture within Western Asset by embracing differences and promoting professional and personal development.
- **BHN (Black Heritage Network).** Sponsored by the Head of the New York Office, BHN's mission is to facilitate professional development of Black employees by providing an educational forum, creating connections and promoting an inclusive environment at the Firm.
- **LEAD (Latinos for Engagement, Advancement and Development).** Sponsored by the Head of Global Client Service & Marketing, LEAD's mission is to cultivate a community within Western Asset that promotes and integrates Latin/Hispanic cultures and traditions, provides support for professional development and contributes to the success of the Firm's mission.
- **Pride.** Sponsored by the Firm's General Counsel, Pride's mission is to provide a forum for education and awareness, supporting the professional growth of LGBTQ+ individuals by fostering a safe environment within Western Asset for staff to be authentic in the workplace.

- **UNITE (Unify, Network, Inspire, Teach & Empower).** Sponsored by the Director of Portfolio Operations, UNITE's mission is to empower women through education, leadership, technology and mentorship. UNITE aids in forging alliances with a broad coalition of allies and leaders and strives to build an inclusive community that is respectful of all backgrounds, experiences and cultures.



## Performance Evaluations and Training

Western Asset scores employees on their commitment to our core values and business goals. This includes:

- **Authenticity:** Fostering a work environment that encourages people to act with integrity and treat each other and their ideas with respect, creating and protecting a high trust environment by setting an example; advocating for others in the face of challenges, removing barriers to trust, and rewarding others for demonstrating behaviours that cultivate trust.
- **Consistently Adheres to Core Values:** Consistently adhering to and influencing others to adhere to the Firm's core values of Mutual Respect, Personal Responsibility, Diversity, Trust, Honesty, Integrity and Teamwork.
- **Building Organisational Talent:** Developing others to reach their full potential and satisfy work requirements.
- **Client Focus:** Ensuring that a client's perspective is the driving force behind strategic priorities, business needs and processes.

These standards, among other performance criteria, reinforce our client-focused and inclusive culture. In addition, employees create annual goals to establish additional markers for growth at Western Asset. Information on the Firm's remuneration policy is found under Principle 2.

Western Asset also provides a variety of training options for employees, including:

- DEI training and workshops on topics such as psychological safety and unconscious bias;
- Orientation classes on general topics such as Firm culture, methodologies and position responsibilities, as well as specialised sessions on topics such as anti-harassment and the Firm's Code of Ethics;
- Western Asset University (WAU), a global forum for e-learning, is leveraged to provide a wide range of trainings around diversity, discrimination and harassment, appropriate workplace behaviour, performance management, communication and collaboration. Currently, there are over 25 courses on inclusion and over 30 courses on diversity; and
- A video series called "All In," featuring Western Asset leadership, has been initiated and is designed to empower leaders across the organisation to model inclusive behaviours.

## Environmental Initiatives

Western Asset's global offices are united in the pursuit of leaving a smaller environmental footprint on the planet. Each office works with their respective building management, local vendors and suppliers to reduce water and other resource use, recycle, to convert to renewable sources of energy, to implement more sustainable processes, and to enhance the well-being of our employees. Some recent highlights include:

### London

- 100% renewable energy is used in the office building;
- The building is fully BREEAM (Building Research Establishment Environmental Assessment Methodology) certified;
- Confidential waste paper is shredded onsite then used by manufacturers to produce notebooks;
- We institute a paper-light policy, encouraging double-sided printing and the elimination of paper records, where possible;
- Green philosophy and accreditations are considered in the selection process for new suppliers/vendors; and
- We support employee participation in energy efficiency programs, such as WWF Earth Hour.

### Melbourne

- The office has 5.27 Star NABERS (National Australian Built Environmental Rating System) Energy weighted average rating; and
- 4.77 Star NABERS Water rated average rating, with 15% reduction in water consumption, 36% waste diverted from landfill and 34% reduction in emissions.

### Singapore

- 100% renewable energy is used in the office building; and
- 27% year-on-year reduction in electricity consumption (as of March 2023).

### Tokyo


- 100% renewable energy is used in the office building;
- The Tokyo office is a member of the building's Environmental Committee;
- It is the Tokyo office's 11th year participating in "Eco Turn Delivery System," whereby paper is delivered in plastic boxes, which are then collected for reuse; and
- The PET Bottle Caps Project is a collection and donation of OET bottle caps to support Japan Committee Vaccine for the World's Children. Caps are converted to recycled materials and sold, with proceeds going toward vaccines to children in developing countries.

### São Paulo

- The office building has achieved the LEED GOLD and PROCEL certificates.

### US Offices: New York and Pasadena

- Office lights are on sensors and are off during non-business hours, and all lighting is LED;
- All unwanted IT equipment is sent to e-waste, and majority of the office utilises laptop computers which use less energy;
- Offices provide recycling stations throughout for various materials; and
- The offices utilise cups made from plant-based materials and provide filtered water fountains to minimise use of plastic wherever possible.

Western Asset Environmental Efforts by Office Location										Building Rating
										
Pasadena	●	●	●	●	●	●	●	●		ENERGY STAR US EPA
New York	●	●	●	●	●	●	●	●	●	WELL Health-Safety UL Tier II Verified
London	●	●	●	●	●	●	●	●	●	RICS SKA Gold
São Paulo	●	●	●	●	●	●	●	●		LEED Gold, Procel
Melbourne	●	●	●	●	●	●	●	●	●	5.1 Star NABERS
Singapore	●	●	●	●	●	●	●	●	●	BCA Green Mark Goldplus
Tokyo	●	●	●	●	●	●	●	●	●	DBJ Green Building Certification (received in October 2022)

-  Recycles
-  Paperless Initiatives
-  Limits Plastic Use
-  Uses Recycled Products
-  Energy-efficient Electronics
-  Reduces Water
-  Utilises Local Suppliers
-  Uses Renewable Energy
-  Carpool/Public Transit

Source: Western Asset. As of 30 Jun 23

### Our Stewardship Journey

This integration of ESG considerations into our investments is fundamental to our stewardship efforts. Western Asset signed the PRI (Principles of Responsible Investment) in 2016, and continually evaluates collaboration with initiatives that offer meaningful involvement and impact. For instance, Western Asset became a founding member of the PRI Sustainable Development Goals (SDG) Advisory Committee, Sovereign Debt Advisory Committee and SFDR Working Group, Sub-Sovereign Debt Advisory Committee, and Plastic Investor Working Group.<sup>2</sup> As a signatory to the UK Stewardship Code since 2022, we work alongside other institutional investors around the globe to advance responsible investing. Furthermore, Western Asset engages directly with issuers to help advance their ESG practices and their green, social and sustainability bond issuance.

## Western Asset's Stewardship Journey

- 1971**  
 Western Asset Management Company, LLC was founded in October 1971 by United California Bank (which later became First Interstate), and became an SEC-registered investment adviser in December of that year.
- 1986**  
 Western Asset begins managing mandates against Socially Responsible Investment (SRI) guidelines.
- 2012**  
 Western Asset adopts an ESG Investment Policy with a mission to advance integration and enable clients to meet their sustainability objectives.
- 2015**  
 ESG Integration added to the Firm's Strategic Business Priorities.
- 2016**  
 Western Asset becomes a signatory of the UN-supported PRI.<sup>3</sup>
- 2019**  
 Western Asset adopts a formal ESG Engagement Policy and Cluster Munitions Policy to advance its stewardship efforts, and becomes a supporter of the Task Force on Climate-related Financial Disclosures (TCFD) and the Transition Pathway Initiative (TPI).
- 2020**  
 Western Asset launches its first ESG-focused fund.
- 2021**  
 Western Asset adopts the SFDR Sustainability Risk Policy to support its EU-domiciled clients, launches its first Article 8 designated fund under SFDR and hires a dedicated ESG Product Specialist. The Firm also launches its Employee Resource Group programme to support DEI amongst staff.
- 2022**  
 Western Asset launches additional sustainable investment strategies and hires a Sustainability Risk Manager. The Firm also becomes a signatory to the UK Stewardship Code.
- 2023**  
 Western Asset continues to strengthen its governance infrastructure by formalising the ESG Strategic Steering Committee charter and other policies and procedures to support its sustainable investment programme.



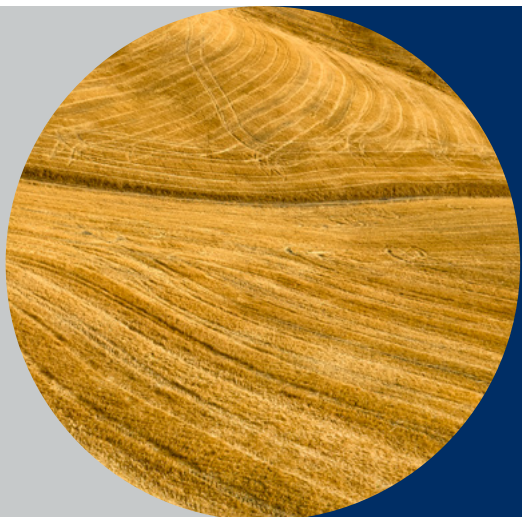
*"By incorporating material sustainability-related risks into our investment process, we believe that we can help our clients achieve their financial objectives, while at the same time address some of the systemic challenges facing our society today. We strive to be thoughtful in our evaluation of the integrity and relevance of emerging data so that we can better identify investment opportunities for clients committed to sustainable investing."*

*– Bonnie Wongtrakool, Global Head of ESG Investments/Portfolio Manager*

<sup>3</sup> The goals or initiatives of organisations that Western Asset is affiliated with or in some way supports do not necessarily reflect Western Asset's investment views or philosophy. However, these organisations may prove useful in helping Western Asset evaluate material ESG factors. Western Asset's investment philosophy remains long-term fundamental value investing in line with client investment guidelines and objectives.



*“Signatories’ governance, resources and incentives support stewardship.”*



## “Signatories’ governance, resources and incentives support stewardship.”

Sustainable investing considerations are integrated throughout the Firm, including our governance and investment approach given that we are a long-term, fundamental fixed-income investor, and we believe that these considerations as well as engagement with issuers are key to delivering value for our clients.

### Our Governance

Western Asset’s sustainable investing efforts are led by the Global Head of ESG Investments with the support of our ESG Product Specialist and Sustainability Risk Managers, along with the dedicated teams described below. Of note:

- The Firm’s ESG framework is supervised by the Firm’s Co-Chief Investment Officer, Director of Portfolio Operations and Global Head of ESG Investments.
- Our governance framework for effective stewardship and sustainable investing has oversight from Western Asset’s Executive Committee.
- The Firm’s ESG Strategic Steering Committee (ESGSSC) is central to sustainable investing governance, and its membership spans across our investment desks, product development, business heads, and heads of risk, client service and compliance.

**ESGSSC.** This committee was established to coordinate the Firm’s global sustainable investing initiatives and products, subject to the direction of the Firm’s Executive Committee. The ESGSSC debates key themes impacting the industry and how to align Firm policy to client needs, regulatory obligations and operational initiatives. Meetings are held regularly on a broad variety of topics ranging from key developments, investments, sales and client requirements, and risk- and regulatory-related issues. Team members have different reporting lines that offer independent perspective and allow for more thorough discussions of issues.

### ESG Strategic Steering Committee

<b>Connie Fischer</b> Co-Chairperson Portfolio Operations		<b>Bonnie Wongtrakool, CFA</b> Co-Chairperson Investment Management	
<b>ESG Committee Members</b>			
<b>Roberto Apelfeld, PhD</b> Risk Management	<b>Marzo Bernardi</b> Client Service & Marketing	<b>Ryan K. Brist, CFA</b> Investment Management	<b>Michael Borowske</b> Investment Management, Research
<b>Ahmet E. Kocagil, PhD</b> Risk Management	<b>Brishni Mukhopadhyay, CFA</b> Product Management	<b>Jan A. Pieterse</b> Product Management	<b>Annabel Rudebeck</b> Investment Management
<b>Paul Svoboda</b> Client Service, Australia/New Zealand	<b>Michael B. Zelouf, CFA</b> Client Service, UK/Europe/ME	<b>Courtney A. Hoffmann</b> Regulatory Affairs & Compliance – US	<b>Jelena Petrovic</b> Regulatory Affairs & Compliance – UK

**ESG Cross-Mandate Task Force.** The ESG Task Force was established to better align the investment process and ensure consistency of approach to sub-asset classes within fixed-income. It consists of representatives of various investment desks such as senior research analysts and portfolio managers. It meets regularly and is charged with maintaining lists of issuers that are deemed to have higher ESG risk and as a result require increased monitoring and engagement.

**Sustainability Risk Team.** This team consists of the heads of the Risk Management Team globally. The team meets at least monthly to discuss a range of issues on sustainability risk such as how to measure the physical and transition effects of climate change on credit portfolios, implications for portfolio allocation, and risk tolerances based on decarbonisation targets. Members of the Sustainability Risk Team report to our Chief Risk Officer.

### Our Team Resources

While many Western Asset employees are involved in the Firm's ESG efforts, the following are key members of our ESG team, along with others with sustainable investment related responsibilities:



**Bonnie M. Wongtrakool, CFA**, has served as the Firm's Global Head of ESG Investments since 2018. In this role, she oversees, implements and manages the Firm's cross-sector ESG strategies, capabilities, analysis, research and engagement across the Firm.



**Brishni Mukhopadhyay, CFA**, has served as the Firm's ESG Product Specialist since 2021, and operates as a steward for our clients' ESG integration needs. Mr. Mukhopadhyay is strategically positioned in the Firm's London office based on increasing client demand and regulatory requirements. He is also engaged by the University of Cambridge Institute for Sustainability Leadership to provide ongoing training for mid- and senior-level executives from corporate and financial institutions on sustainable finance and business strategy topics, and he Chairs the Chartered Financial Analyst Institute's ESG Advisory Panel.



**Connie Fischer** joined the Firm in 2023 as the Firm's Director of Portfolio Operations, and she oversees our ESG programme.

The Sustainability Risk Team comprises:



**Tania Labastida Garcia** has served as Sustainability Risk Manager for the Firm since 2022. Ms. Labastida Garcia previously worked as a risk manager at Western Asset focused on assessing the implications of decarbonisation of portfolios from a risk management perspective. Ms. Labastida Garcia works closely with the Risk Management Team.



**Roberto Apelfeld, PhD**, has served as our Manager of Pacific Rim Portfolio Risk & Head of Client Solutions since 2009, and serves on our Sustainability Risk Team.



**Marjan Zahedi, PhD**, has served as a Portfolio Risk Manager for the Firm since 2022 and EMEA Credit Sustainability Risk Manager since 2018.



**Paulo Caricati, CFA**, has served as our Head of EMEA & LATAM Risk Management and Sustainability Risk Manager since 2021, having joined the Firm in 2005. Mr. Caricati is also a member of our Sustainability Risk Team

Additionally, the Firm's sustainable investing efforts are supported by our IT and Compliance staff who devote a significant portion of their efforts to ESG matters:

**Midori Murata** has served as our Data Analysis & Insights Manager since 2006. For the last five years, Ms. Murata has worked on the development of IT tools that drive and support our ESG framework.

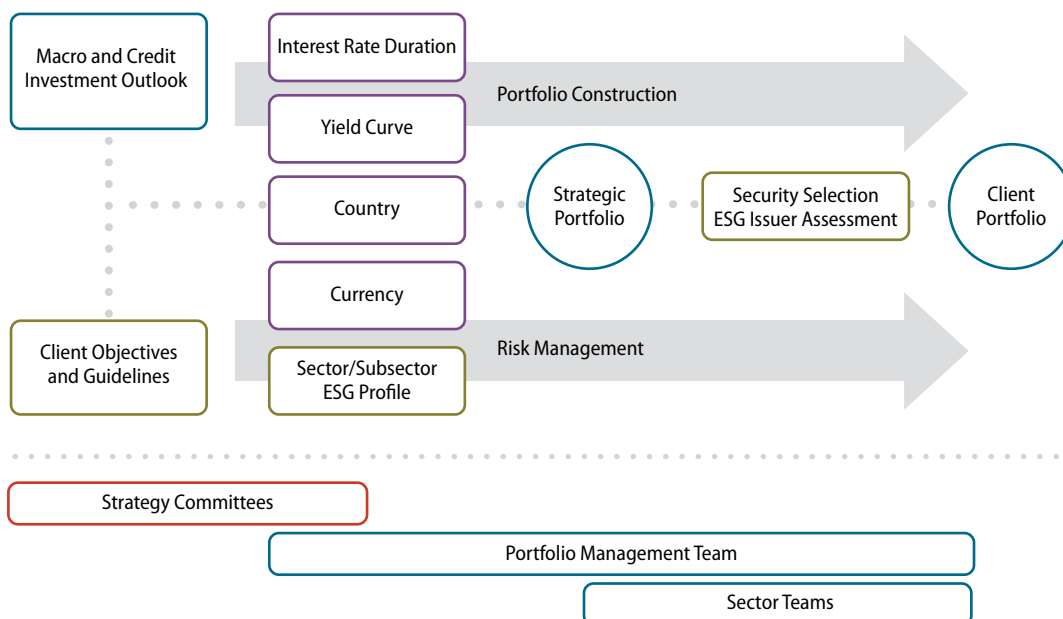
**Jelena Petrovic** has served as the Head of London Regulatory Affairs and Compliance, since 2012 and has led the ESG regulatory integration efforts since 2020.

In addition, investment professionals, with both sector and product responsibilities, work together as a single unit across the Firm's global offices. The primary responsibility of portfolio managers is to synthesise the fundamental and relative value analysis of the research analysts with the technical input of the traders and risk managers to construct a portfolio that reflects the Investment Management Team's views within the context of each mandate's guidelines and risk tolerance.

Western Asset's research analysts are responsible for providing fundamental analysis at the industry and issuer levels, and for opining on industry and issuer risk/reward characteristics. They seek to assess the impact of ESG factors on individual issuers and to understand the underlying risks and opportunities, which may affect the creditworthiness of the issuer. These aspects are taken into consideration in formulating the credit and risk profile of the investment. Western Asset expects that the research analysts document new corporate bond purchases and those E, S and G factors deemed relevant for the issuer. They opine on the ESG factors' influence on the sustainability of the issuer's business model and on the risk premium appropriate to its ESG profile.

Western Asset believes that it is imperative for research analysts to take a holistic approach and implement material ESG considerations as well as for portfolio managers to incorporate material ESG factors when constructing portfolios, rather than having a separate ESG team that focuses solely on sustainable investing. This structure is consistent with our philosophy that ESG considerations can affect valuations and should be integrated by everyone involved in investing client capital, as opposed to having a siloed team perform this function.

Western Asset's approach is to integrate ESG considerations, amongst other factors, into the research, engagement, portfolio construction and risk management portions of our investment process as illustrated below:



The Global Head of ESG Investments and ESG Product Specialist work with the Firm's research analysts across our international offices to advance our credit and sovereign ESG analysis and ensure that ESG analysis is applied consistently.

### Our Technology and Data Resources

Central to the successful sustainable investing programme is technology and data integration. As a result, Western Asset continued to invest during the Reporting Year in a robust infrastructure to meet client stewardship requirements.

**VerityRMS improvements.** Over the last two years, Western Asset has invested in VerityRMS, which houses the Firm's research and engagements in a centralised manner, allowing research analysts to document, monitor and share their issuer assessments. VerityRMS has now been calibrated to standardise research content and to provide various types of information via automated reports, including daily notification of new research, as well as to monitor research analyst productivity. Different sector teams have integrated new elements into their templates such as a sovereign ESG letter score in addition to the existing numerical score, while other enhancements included improving ease of use of the system, and better monitoring of the engagement journey. The system now also showcases the compliance dashboard to support the oversight efforts of the Firm's sustainable investing initiatives. With this system, research analysts can engage with issuers and directly log these engagements, including details such as the date and theme of the engagement, notes, potential next steps, outcomes, impact on ESG characteristics and investment decisions,

**Data integration.** The focus for the Reporting Year was to further integrate numerous data sources, including MSCI and ISS, into the Firm's systems. Data integration is central to Western Asset's ability to provide more in-depth assessment of issuers, to monitor client account compliance as well as regulatory obligations, and to provide a wider range of solutions and tools for our clients. This demonstrates our commitment to our clients and provides first class solutions from investments to monitoring and reporting capabilities. During the reporting period, Western Asset created an ESG data warehouse to centralise ESG data, and to integrate ESG data into the trade pre-clearance workflow within Compliance Service, the Firm's proprietary portfolio compliance monitoring system, allowing for a broader set of guidelines to be monitored on an ongoing basis and allowing for greater customisation that our clients expect.

**WISER (Western Asset Information System for Estimating Risk) developments.** The Firm has developed proprietary methodologies from a bond manager's perspective to assess physical and transition risks stemming from climate change for corporate bond portfolios. We took this approach as we have found third-party resources to be unsuitable given their primary focus on listed equities. Additionally, the Firm has also enhanced our carbon optimiser tool that assists in the allocation to issuers with low WACI or emissions and away from those with WACI or carbon emissions, while minimising the drift in risk targets such as portfolio tracking error, duration and spread duration, to the extent possible. Furthermore, the Firm also developed internal tools to assess sovereign decarbonisation pathways based on commitments made by sovereigns. Queries from clients globally have shown an increased need for such tools to address client sustainable investing needs.

We also made a number of other enhancements via other systems we utilise, including a report on Principal Adverse Impact (PAI) indicators, engagement dashboard, and Sovereign Carbon Intensity report.

### Our Training and Education Resources

The Firm believes that regular formal and informal learning opportunities are essential to sustainable investing integration and delivering value for our clients. In addition to individual client consultations, Western Asset also presents at global industry conferences and events to help educate investors on ESG integration and topical ESG-related issues.

As part of the Firm's ongoing efforts to advance our internal ESG capabilities, our dedicated ESG professionals conduct training sessions, including for the Investment Management Team, client-facing professionals and Risk, Legal and

Compliance staff. Western Asset also supports attendance at ESG conferences and external ESG roundtables as well as internal presentations and communications of ESG issues. A few examples of Western Asset's continued internal ESG training include:

- Weekly presentations by the Firm's research analysts that may include the incorporation of ESG factors into their coverage universe;
- SFDR training for the Investment Management Team to ensure it is fully aligned with the evolving expectations of SFDR and the regulatory considerations around Principal Adverse Impacts, as well as "do no significant harm" assessments for Article 8 funds;
- Regular IT led meetings to train Compliance and Investment Management Team staff on how to utilise new compliance and trading systems capabilities, including data availability for rule programming as well as reporting tool developments;
- Ad-hoc training sessions conducted by the ESG Team for the Investment and Client Service & Marketing teams across the Firm's offices to familiarise our Client Service and Product Specialist professionals on the ESG research, data, modelling, risk tools and reporting the Firm has developed for our clients; and
- Firm sponsorship for employees to earn the CFA Institute's Certificate in ESG Investing.

### Our Incentives

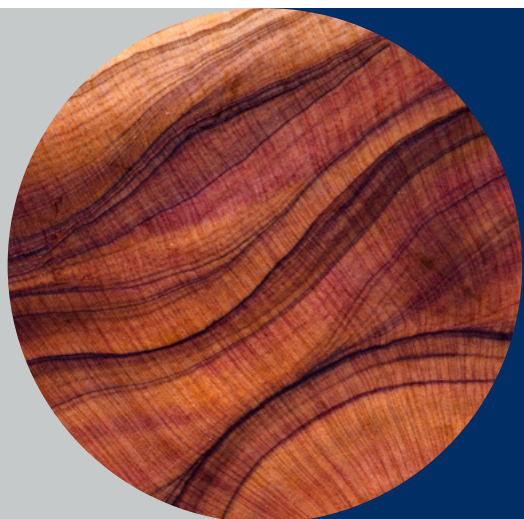
Western Asset's compensation philosophy is deeply grounded in the Firm's mission and core values of Trust, Honesty, Integrity, Teamwork, Diversity, Mutual Respect and Personal Responsibility. Western Asset's compensation structure, covering all employees, is also designed to ensure that the interests of the Firm's personnel are aligned with client interests.

In line with this approach, the Firm's investment professional incentive programme is structured to reward the entire Investment Management Team (consisting of portfolio managers, research analysts and traders) for their contributions to the Firm, as well as for relative performance of their specific strategies and client portfolios. Compensation is determined by job function and performance is measured, primarily qualitatively, by the review process. Adherence to the Firm's ESG framework is part of the compensation analysis, among other requirements, for portfolio managers and research analysts. Research analyst productivity is tracked through VerityRMS.

### Outcome

Western Asset's governance structure, supported by further technology and data enhancements made during the Reporting Year, provide for a strong foundation for ongoing stewardship of our clients' assets. The evolved governance structure allows for knowledge sharing, robust discussion, monitoring of sustainable investing outcomes, innovation and problem solving to support the Firm's client investment and stewardship agenda. This is achieved through ongoing cooperation involving all relevant investment professionals and senior leadership. More clients than ever relied on Western Asset expertise and stewardship to assess their mandates from a sustainability perspective and the tools that we have built out have aided us in achieving this task.

*“Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.”*



## “Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.”

As a fiduciary, Western Asset provides services in the best interests of our clients. Western Asset has adopted compliance policies and procedures to address a wide range of potential conflicts of interest that could impact client portfolios. These policies are set out in compliance manuals and personal trading policies that reflect Western Asset’s global business approach and are also tailored for specific offices and their local regulatory and market environments. Western Asset’s Statement on Conflicts of Interest, which brings together commentary on different potential conflicts, may be found on our [website](#). Additionally, conflicts of interest disclosures are provided in our Form [ADV Part 2](#).

From a stewardship perspective, these conflicts of interest policies principally focus on ensuring that:

- All similarly managed accounts are provided the same investment opportunities, subject to any guideline, regulatory or cash flow differentials;
- Where there are opportunities to engage in proxy voting, which is limited for fixed-income managers, that these are carried out in the client portfolio’s best interest; and
- Where investment opportunities arise where Western Asset has an interest, financial or otherwise, the best interest of our clients remains paramount.

### Identification and Mitigation of Conflicts of Interest

Western Asset takes steps to identify and address actual and potential conflicts that could arise through our role as an investment manager. In addition, these potential conflicts are monitored, managed and controlled on an ongoing basis. Not all potential conflicts are actual or significant conflicts. The Firm seeks to focus on addressing those conflicts most likely to have an impact on decisions made for, or advice given to, clients. The process of identifying and addressing conflicts is ongoing to ensure the Firm’s approach remains current in light of business, market or regulatory changes.

At least once annually, the Legal and Compliance Department reviews the schedule of all identified actual or potential conflicts of interests. The schedule also consists of preventative controls, detection methods and controls, as well as dedicated policies for each conflict of interest. Generally, Western Asset’s business does not appreciably change year-over-year, and as a result the conflicts of interest schedule has remained consistent over the years. Separately, employees may escalate to their line manager, as well as to the Legal and Compliance Department, conflicts of interest that they become aware of through their role. Finally, all staff are annually required to attest to any conflicts of interest that relate to their role and outside activities.

Examples of common potential conflict of interest areas include:

- Management of multiple client portfolios;
- Breach and error management;
- Stewardship, engagement and proxy voting;
- Gifts and entertainment;
- Personal trading, including investments with business contacts;
- Outside business activities; and
- Political contributions.



Western Asset is also mindful of other circumstances that may give rise to a conflict as a result of the structure and business activities of other members of the group. These include:

- Product development;
- Investment research and advice;
- Proprietary trading; and
- Corporate finance activities.

Western Asset takes measures to reinforce and strengthen our client-first culture through new joiner and annual training, compensation philosophy, segregation of duties and reporting lines, escalation procedures, and a compliance programme tailored for the Firm's business and its risks. The Firm's compliance training programme is developed and administered in-house, which allows it to be customised and tailored as regulations and risks evolve, and is delivered by Legal and Compliance staff rather than a one-size-fits-all third-party vendor.

The Firm also maintains ongoing compliance monitoring programmes that are specifically designed to identify conflicts and risks, then tests to validate that the Firm's control structure has integrity. The monitoring programme allows the Firm to stay close to changes in the business and gives comfort that the Firm's practices match its expectations. The commitment of resources to support the programme is another tangible sign of the Firm's priorities.

### Resolution of Conflicts Through Committees

As highlighted in our response to Principle 2, Western Asset has a range of committees to help analyse, debate and resolve key issues related to stewardship and its implementation. Members of the ESG Task Force and ESGSSC, amongst their other responsibilities, look to understand the implications of potential conflicts arising from investments and actions to be taken. While different investment teams may take different views based on their clients' expectations and strategies managed, the ability to debate conflicts and consequent implications is necessary to arrive at a nuanced decision that reflects our clients' best interests.

### Example of Conflicts of Interest: Investment Opportunities

Western Asset manages a wide range of strategies to meet different client needs and objectives. Western Asset owes a fiduciary duty to all of our clients and their respective accounts. Accordingly, the Firm strives to ensure that accounts are neither favoured nor neglected. The Firm also often trades for multiple accounts in the same strategy at the same time. It is important to ensure that each mandate with similar guidelines and objectives is treated with equal attention and consideration. An additional consideration is that there may be limited quantities available. Designing technology tools and maintaining consistent practices on a day-by-day basis and trade-by-trade basis helps to ensure each client is treated fairly. The Firm takes steps to identify where such incentives might exist and then adopts measures of mitigation and/or disclosure where appropriate. For instance, the Firm's Compensation Philosophy and Process ensures that the Investment Management Team is not remunerated on the merits of a single portfolio but on a team-based, risk-adjusted and long-term basis. There will also be instances where the Firm constructs investment portfolios differently for clients with similar mandates depending on each client's specific ESG preferences and restrictions. For example, Western Asset firmly believes that in instances where potential conflicts arise relating to investment in issuers that are not explicitly excluded by the mandate's guidelines, the matter should be raised with the clients as part of our fiduciary responsibilities.

Western Asset manages similar mandates on an aggregated basis wherever possible. Given our broad client base, views on sustainability investing differ and as a result require a more tailored approach for certain clients. For example, a subset of our Global Aggregate mandates has a greater focus on ESG themes. As a result, the Investment Management Team responsible for managing these mandates requested an additional investment filter to ensure that those

issuers with highest ESG risk, as identified by Western Asset, are highlighted at time of an intended transaction and are thereafter monitored or removed from the investment universe, by utilising the Firm's ESG Red and ESG Watch Lists, as well as other portfolio manager driven considerations.

#### Example of Conflicts of Interest: Affiliations

When Western Asset makes trading decisions for our clients, we are obligated to make those decisions on the merits of our clients' best interests. Two potential conflicts of interest are in broker and issuer selection. Western Asset operates as part of a larger financial services company and does not issue any publicly traded securities. Our parent, Franklin Resources, Inc., is a public company, issues publicly traded securities and has other lines of business. If Western Asset were to recommend that clients invest in securities of our parent company, clients might question if corporate affiliation influenced the Firm's investment decision. Western Asset has identified this potential conflict of interest and opts to abstain from such affiliated transactions.

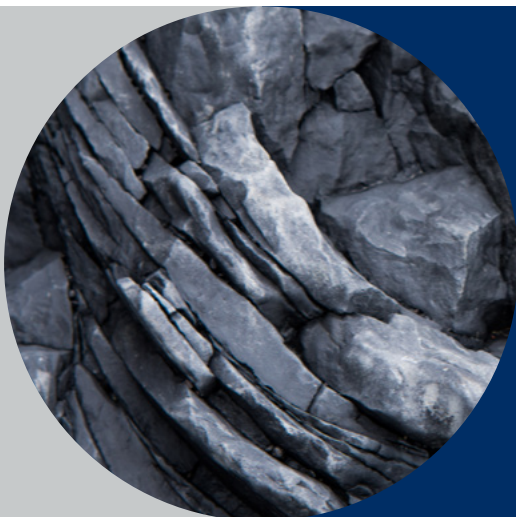
A key control for avoiding conflicts of interest with counterparties is the Firm's Broker Review Committee in each office where trading is carried out. The Broker Review Committee ensures that counterparties that will be utilised are thoroughly vetted based on several grounds, including credit assessment, affiliation and operational quality of execution. Once the required assessments have been carried out, the Firm's internal broker administration system is updated to allow the broker to be utilised when trading. Additionally, certain brokers, while approved at the Firm level, may be blocked for clients that may have their own restrictions, including affiliations to specific brokers.

#### Example of Conflicts of Interest: Personal Trading

Western Asset's staff make decisions in managing their own personal affairs. However, they should not be taking inappropriate advantage of information they learn in the course and scope of their employment. Western Asset has designed personal trading policies to balance the potential conflict of interest with staff's need to manage their own assets. For example, potential investments into commingled fund vehicles managed by the Firm are subject to pre-clearance and minimum holding periods. Potential investments in many instruments the Firm may trade on behalf of clients are subject to pre-clearance. While the actual risks of an employee trading inappropriately may be modest, these types of measures mitigate that risk and also help to reinforce the Firm's culture and fiduciary duty.

In order to support the oversight of personal transactions, Western Asset's US offices have been utilising My Compliance Office (MCO), which is currently being expanded to the UK office, thus providing greater automation across the Firm. The system contains employees' personal brokerage accounts and data feeds with trading activities. MCO allows for conflicts of interest assessment against various customised business rules including security holding periods, restricted lists, IPO participation prohibitions, front-running, insider trading and trading frequency limits. Employees can submit pre-clearance requests using the system. The Firm's restricted list is updated regularly and exceptions will be noted if an employee trades an item on the restricted list without pre-clearance approval. Front-running is coded for employees on the Investment Management Team and employee trades will be checked against the Firm's trades to ensure there are no conflicts of interest.

*“Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.”*



## “Signatories identify and respond to market-wide and systemic risks to promote a well- functioning financial system.”

As previously mentioned, Western Asset’s investment philosophy focuses on long-term value investing, using multiple diversified strategies. We integrate financially material ESG considerations across our strategies with the goal of delivering superior long-term investment results to our clients while adhering to our high standards of personal and corporate accountability.

We take a sector-specific approach to identify the ESG factors that can significantly affect an issuer’s long-term sustainability and exposure to ESG risks, such as greenhouse gas emissions, water usage, gender and ethnic diversity, and regulatory shifts, which, if they occur, could have a negative impact on the value of an investment. Investments that do not meet the Firm’s ESG standards are treated as having higher risk, as their future ability to pay may be adversely affected by developments such as legal sanctions, the introduction of new regulations or shifts in consumer sentiment. The Firm then evaluates whether the market is appropriately pricing the issuer’s performance based on those ESG factors, amongst other risk considerations, and Western Asset’s assessment of the risks to which the issuer is exposed.

While Western Asset’s Investment Management Team is provided with information on ESG risks and takes ESG risks into account when making investment decisions, ESG risks may not preclude Western Asset from making an investment. Instead, ESG risks factor into the overall risk evaluation and management process, and are one of many considerations which may, depending on the specific investment opportunity, be relevant to the determination of issuer risk. Furthermore, Western Asset does not apply any absolute limits or thresholds defined exclusively by ESG risks as a distinct category of risk.

Our Risk Management Team provides an independent assessment of portfolio and Firmwide risk and is critical to successful portfolio management. Integrating risk management into portfolio construction strengthens its effectiveness. The Firm’s culture of robust communication, along with escalation procedures, underpin the independence and transparency of this function.

### Our Risk Management Process

Western Asset has a robust set of systems and processes that form its integrated global risk management platform. As an active fixed-income manager, Western Asset positions its portfolios to outperform if future expectations unfold as the Firm expects, and to limit underperformance if these expectations do not materialise.

To do this effectively, very strong communication amongst risk managers and portfolio managers is essential. Maintaining the Risk Management Team’s independence from the Investment Management Team provides an important counterbalance. The Firm places substantial emphasis on this collaborative approach, which results in an integrated risk management platform.

Robust risk management is integrated into Western Asset’s disciplined investment process. Research analysts seek to incorporate an assessment of material ESG risks such as climate change (physical risks and transition risks from a move to a low carbon economy), human rights and supply-chain management, product safety and security, diversity and development of talent, transparency, board structure and governance, among others, to better assess the risks that are likely to affect creditworthiness and valuation. Research analysts understand that a failure by issuers to manage material E, S and G risks could impair their ability to meet debt obligations. Therefore, our proprietary investment research framework seeks to identify and assess financially material E, S and G risks. Based on the research, analysts provide an ESG score that we believe is reflective of the underlying ESG risk.

## Climate Change and Risk Management

Climate change is increasingly identified as a systemic risk with the potential to disrupt financial markets and the global economy and to impact investment returns. The risks can be physical or transitional. For instance, this could include a transition process to a lower carbon society with attendant costs, taxes, policy changes, prohibitions, subsidies, gainers and losers, corporate losses and defaults, sovereign fiscal difficulties, credit downgrades, and political tensions. It could also include physical effects of higher temperatures, including rising sea level, floods, droughts, migration, political tensions, as well as an increased financial risk on corporate and national capital stock, as well as revenues as a result of climate events.

To evaluate these risks, Western Asset's Risk Management Department established a dedicated Sustainability Risk Research group. This team focuses on applying quantitative tools, including the Firm's carbon optimiser and Climate Risk Stress Test models, to analyse potential paths for decarbonisation of portfolios, the potential impact of net zero carbon emissions commitments, greenhouse gas (GHG) reduction targets and the potential impact of transition and physical risks to the default probability of companies. Of note, this team:

- Fine-tuned its climate risk assessment model for measuring transition risks from climate change and developed its own model for measuring physical risks from climate change for corporations;
- Developed a model to assess sovereign alignment on decarbonisation, based on various commitments. The carbon optimiser framework allows Western Asset to construct and rebalance portfolios over time, including being overweight in issuers with low carbon intensity while underweighting those with high carbon intensity. The framework also allows the Firm to reward those issuers that have strong and well-developed carbon transition plans or are industry leaders in moving to a greener economy. This serves as a useful tool when modelling portfolios to assess the impact of decarbonisation targets on portfolios, and
- Utilised a climate risk stress test, which allows Western Asset to measure the exposure of the portfolio to various climate change scenarios, as outlined by the Intergovernmental Panel on Climate Change (IPCC). This stress test is run in WISER (Western Asset's proprietary risk management system).

## Helping Clients Understand the Implications of Climate Change

Our clients have a broad range of investment and sustainability goals. We have worked with our clients during the Reporting Year, as in years' past, to assess climate risk in their portfolios and help understand the implications of climate change. Some of these discussions included:

- Where clients sought decarbonisation goals to be incorporated in addition to investment objectives and instances where we have highlighted our concerns around aggressive decarbonisation targets on the investment objectives; and
- On-risk assessment resulting from higher concentration risks in specific sectors and issuers, and consequent portfolio implications given client's risk and return targets.

We believe that our clients appreciate our responsible investing, rigorous approach to assessment and candour in discussing portfolio implications of decarbonisation and that they value our knowledge sharing sessions. In some instances, this has led to clients adopting a new set of guidelines focused on integration of certain sustainability goals, while in others it has led to further discussions to explore investment options.

Western Asset seeks to understand the nuances of dynamics between climate risks and a well-functioning financial market, particularly during periods of market stress. As a fiduciary, the Firm seeks to avoid unmitigated risks that would run counter to our approach as responsible stewards of our clients' capital. As part of our engagement efforts on climate change, Western Asset has also been a supporter of TCFD and TPI since 2019. Western Asset is a member of the ASCOR working group and has been involved in formulating a methodology to develop a framework for assessing sovereign decarbonisation and the consequent implications of these on the financial markets. As part of these

collaborative initiatives, Western Asset continues to identify and analyse climate-related risks and opportunities within the fixed-income investment universe, and to engage as appropriate to help issuers set decarbonisation targets where none have been set.

#### Case Study: Emerging Market Sovereign on Climate Goals

Western Asset recently engaged the Center for Climate Finance and Multilateral Policy and the G20 Sustainable Finance Working Group (SFWG) regarding an emerging market sovereign's transition to net zero. We were interested in how this sovereign's goal of shortening the net zero target from 2060 to 2050 could be achieved in light of existing contracts with coal-powered facilities that extend out to 2056 and whether the issuer had considered the financial implications of such a transition.

Our goal was to understand specific areas where we could expect, from the country's increased ambition on the shift toward renewable energy, abatement of coal-fired generation capacity, and the transition to net zero. New investment in renewables must be balanced with a challenging context for (mostly) coal abatement. We also wanted to get a sense of the sensitivities in the local political economy.

► **Outcome:** The result of our engagement was improved clarity on the emerging market sovereign's ability to shorten climate goals, including risks of oversupply in electricity markets if renewable sources were adopted too quickly, which would ultimately damage the long-term investability of the sector. Through our engagement the sovereign was able to determine what they spend on climate, estimate needs, and then determine how much of that gap could be funded with their own resources. Identifying financing needs to aid in this transition was facilitated by the sovereign's experience with implementing climate budget tagging (CBT).

#### Case Study: European-Domiciled Automobile Issuer on Social and Environmental Implications of Energy Transition

Western Asset met with a European domiciled auto issuer as part of its new green bond framework roadshow. Topics discussed included the impact on employee headcount arising from the transition of the issuer to producing electric vehicles (EVs) and the supply of lithium and similar inputs. Our goal was to understand the issuer's training and recycling goals and evaluate the financial impact on the issuer.

► **Outcome:** Western Asset initiated the engagement to understand whether the issuer was considering both environmental and social aspects of their energy transition plan which can have a significant impact on both, and as a result, financial consequences for the issuer.

The issuer shared their efforts on up/reskilling 10,000 people on cybersecurity, software, EVs and circular economy.

With respect to recycling, the issuer indicated that it would be some time before a high volume of batteries would reach retirement age. The issuer highlighted an approach to reduce sourcing from the traditional high carbon sources in the supply chain.

Western Asset understands the challenges that energy transition can present for people and was therefore pleased that the issuer acknowledged our concerns and had been working to implement plans to reskill its employees. Given that the issue of recycling EV battery components is nascent, the Firm continues to monitor progress made by the issuer on its stated approach and the financial implications of the energy transition for the issuer.

#### Promoting a Well-Functioning Financial System

As a leading global fixed-income manager, Western Asset regularly engages with our trading counterparties and bond syndicate teams at investment banks to help promote a well-functioning market. This includes the development of new instruments in the fixed-income markets such as "green bonds" and "sustainability-linked bonds."

In our efforts to effectively advance sustainable investing, Western Asset regularly assesses opportunities to participate in industry groups and initiatives.<sup>4</sup> The Firm seeks to participate in initiatives that align with our role in the financial system as a fixed-income investment specialist, and we have been active in the following areas over the reporting period:

- **UN PRI Working Sub-Group on SFDR & EU Taxonomy.** We assessed potential implications of SFDR and the Taxonomy regulations for sovereign debt markets to avoid negative or unexpected impacts to these markets. This work has highlighted areas of needed engagement with sovereign issuers and multilaterals to promote greater disclosure on climate and social dimensions of government budgets.
- **Institute of International Finance Principles Consultative Working Group.** We helped revise the Principles for Stable Capital Flows and Fair Debt Restructuring, which serve as a framework for crisis prevention and resolution, particularly in the cases of sovereign debt distress or restructuring, as well as to address recent developments across sovereign debt markets.
- **Institute of International Finance Committee on Sovereign Risk Management (CSRМ).** The CSRМ was convened in response to the COVID-19 pandemic to help coordinate the private sector's response to stress in sovereign debt markets. The principal role of the CSRМ, to date, has been to shape the private sector response to the G20's proposal for private sector participation in its Debt Service Suspension Initiative (DSSI).
- **Debt Restructurings.** We periodically serve as a member of restructuring credit committees (see also Principle 12), and actively engaged with the issuer, other creditors, legal and financial advisors to ultimately improve terms.
- **IPREO Steering Committee.** IPREO (owned by IHS Markit) is one of two platforms that enable primary deals to be brought to the market (investment-grade, high-yield and rates). We are a member of the buy-side steering committee with the aim of fine-tuning the platform for all industry participants and to smooth-line the entire primary deal process from the announcement of roadshows to pricing. We are working to help expand the information that IPREO provides per deal to increase usefulness on the buy-side.
- **TradeWeb.** This is an electronic platform (approved multi-lateral trading facility) with which we are engaged with the aim of improving Request for Quotes (RFQs) for the buy-side as a whole.
- **MarketAxess.** This is an electronic trading platform (approved multi-lateral trading facility) with which we have been exploring the possibility of trading the secondary European bank loans on the MarketAxess platform. This would allow for a better overall trade and settlement process.
- **DirectBooks.** This is a communication platform for structured deal data, documentation and information exchange in the primary markets. We have been working with DirectBooks to improve system access, and to enhance the interface for greater ease of use. We are also a member of the DirectBooks Steering Committee.
- **CFA Institute.** Mr. Brishni Mukhopadhyay, CFA, our ESG Product Specialist, leads the CFA Institute's ESG Advisory Panel and is a member of the CFA Institute's ESG Technical Committee that discusses various policies and best practices relevant for the investment industry and financial markets.

<sup>4</sup> The goals or initiatives of organisations that Western Asset is affiliated with or in some way supports do not necessarily reflect Western Asset's investment views or philosophy. However, these organisations may prove useful in helping Western Asset evaluate material ESG factors. Western Asset's investment philosophy remains long-term fundamental value investing in line with client investment guidelines and objectives.

*“Signatories review their policies, assure their processes and assess the effectiveness of their activities.”*



## “Signatories review their policies, assure their processes and assess the effectiveness of their activities.”

Western Asset’s approach to ESG and stewardship is outlined in the Firm’s ESG policies, which encapsulate our approach to engagement, our processes for considering ESG matters in investment decision-making, and our application of exclusion lists as well as SFDR regulatory-related requirements. The ESG policies are maintained by the ESG Team, which is further supported by the Legal and Compliance Department. Western Asset’s ESG programme is assessed through a multi-layered approach including independent PRI and FRC assessments, internal audits, and committee and working group oversight. Additionally, through the suite of reports the Firm has developed, clients are able to measure the effectiveness of our ESG programme on their mandates.

### Our ESG Policy Review

The Firm’s ESGSSC is responsible for adopting, maintaining and overseeing the implementation of all policies, procedures, and controls relating to ESG. The ESGSSC also reports to and engages with the Firm’s Executive Committee on these matters, as necessary. Western Asset’s ESG policies and procedures are reviewed regularly, continue to evolve with client needs and regulatory developments, and include:

- The ESG Investment Policy, formalised in 2018, which provides that investment professionals consider a wide range of macroeconomic and geopolitical factors in order to form an outlook for the challenges and opportunities facing sovereigns, industries and companies. These considerations include analysing how raw material consumption, climate change, demographics and socioeconomic development will affect income, wealth and global growth in the future.
- The ESG Engagement Policy, formalised in 2019, which provides how Western Asset identifies relative value opportunities via exploration of a wide range of investments, encompassing many private as well as public issuers. Engagement with issuers—via conversation with management, for example—is a key component in evaluating these opportunities, as it enables Western Asset’s research analysts to obtain additional perspective and develop a more informed investment outlook.
- The Cluster Munitions Investment Policy, formalised in 2019, which recognises the importance of the Firm’s role as an investment manager in making ethically sound investments. This policy requires compliance with the global regulations with respect to investments in companies involved in the manufacturing of cluster munitions as identified by the December 2008 Convention on Cluster Munitions (the Oslo Convention). The policy is applied to all assets under management.

### PRI Assessment

As a PRI signatory, Western Asset is required to publicly report on our sustainable investment activity annually through the UN PRI Reporting Framework. Western Asset’s 2021 Public Transparency Report is publicly available at: <https://ctp.unpri.org/dataportalv2/transparency>

### Our Internal Monitoring

Firm committees and working groups, including the ESGSSC, ESG Task Force and Sustainability Risk Team, collaborate regarding best practices in the arena of sustainable investing. Separately, the Firm’s Global Regulatory Developments Working Group monitors for ESG regulatory changes, ensuring that any such developments are properly considered. Through this forum, the Firm assesses the impact of various ESG regulatory changes, such as the SFDR, EU Taxonomy

Regulation, UK TCFD, and the SEC ESG Disclosure Rules. These teams provide valuable oversight of the Firm's ESG programme and effectiveness, including with respect to data needs, investment decisions, client requirements, operational support and regulatory implications.

### Compliance and Internal Audit Oversight

The Firm's Legal and Compliance Department conducts annual and specific training for all Firm personnel on global regulatory requirements, policies and procedures. The Legal and Compliance Department has three key functions: Regulatory Affairs, Portfolio Compliance and Global Legal. These three functions are performed across Western Asset's offices globally through a combination of staffing structures and reporting lines. The Firm strives to maintain consistency in approaches across offices while recognising unique local regulatory obligations and market needs. The day-to-day integration of the Legal and Compliance staff in the Firm's operations results in staff being better informed of the Firm's practices, thus mitigating the risk of failing to identify a risk, an obligation or a disclosure misstatement. This structure also serves to support the Firm's ESG investment process by integrating Legal and Compliance into day-to-day ESG processes as well as projects. The Regulatory Affairs and Portfolio Compliance teams are particularly integral to ensuring that the Firm's ESG policies, procedures and controls are effective.

#### Regulatory Affairs

The Regulatory Affairs function takes the lead with respect to regulatory requirements, including timely and appropriate identification, assessment and implementation. Carrying out this function involves close coordination with various teams across the Firm to understand Western Asset's existing capabilities and to guide the implementation of system and process enhancements necessary to comply with regulatory obligations and best practices for ESG investing. As such, members of Regulatory Affairs are likewise members of project working groups that implement ESG changes, and can ensure regulatory implications are considered. Another key role that members of Regulatory Affairs play is providing oversight of defence controls in relation to ESG investments.

#### Portfolio Compliance

Our Compliance Team has a three-level approach to controlling the investment environment.

- The first level is the Start-Up and Integration Team (SUIT), which spearheads the negotiation and coding of guidelines. Guideline rules are coded into the Compliance Service, the Firm's proprietary monitoring system. This system is designed to address all client guidelines, including ESG-related parameters.
- The second level is ongoing monitoring that evaluates trades and accounts, on both a pre-and post-trade basis. Compliance Officers support ESG investing by monitoring compliance with client guidelines and regulatory ESG restrictions on a pre- and post-trade basis, by implementing and monitoring ESG-related screens, and by assisting with client reporting or certifications.
- The third level involves working with colleagues, prospects and clients to understand investment objectives and proposed guidelines. This often involves conducting scenario analyses to understand the potential impact of various ESG investment parameters and guideline approaches. This allows clients to make well informed decisions in order to transition their mandates to sustainable investments, where they desire to do so.

#### Internal Audit

The internal audit activities coordinated with Western Asset's parent, Franklin Resources, provide additional oversight of our sustainable investing programme. The internal audit team is comprised of both an in-house team and external, co-sourced Deloitte resources.

### Case Study: Process Enhancement

Western Asset has previously adopted an approach to identify clients with sustainable or SRI requirements that are embedded in their investment objectives. During the Reporting Year, this approach was reviewed by the members of the ESGSSC together with the Investment Management Team and the Client Service Department to ensure that it can be consistently utilised across the Firm for both client reporting requirements as well as for investment management purposes.

► **Outcome:** As a result of the review, we adopted a new policy and enhanced an internal system utilised for client information management so that it now maintains more detailed information on each client account. This system is now able to support more customised client reporting as well as more targeted sustainable investing considerations.



*“We recognise the importance of strong governance in order to support our clients on their sustainable investing journey, and have worked more than ever to strengthen our framework through our committees and systems.”*

*– Jelena Petrovic, Regulatory Affairs & Compliance – UK*



*“Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.”*



## “Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.”

### Understanding Clients’ Expectations Can Lead to Success

Our goal is to have clients see us as an extension of their own businesses, and we collaborate closely with them to build customised solutions that meet their investment objectives, including ESG solutions where desired. We put clients first in everything we do, and work to help our clients achieve their investment goals.

We provide our extensive investment expertise to help clients identify investment strategies that will best meet their specific needs. To complement that effort, we provide an exemplary level of client service, including assigning each client their own Client Service Executive and supporting team. Client Service Executives function as a voice for their clients and champion their clients’ needs. We believe that positioning our Client Service Executives to take the lead role in a client relationship delivers a greater level of hands-on service and allows Western Asset’s portfolio managers to devote their attention to their top priority: actively managing our clients’ investments.

We work with clients during the onboarding process to customise investment guidelines that suit the specific aims and objectives of each mandate, including ESG targets. A few examples of how we have helped our clients understand the implications of ESG integration during the Reporting Year include discussions about:

- The reduction of the investment universe stemming from SRI exclusions;
- Potential changes in alpha targets or tracking error as a result of incorporating ESG screens;
- Implications of portfolio decarbonisation; and
- Regulatory implications of various approaches to sustainable investing.

### Example Tools for ESG Portfolio Analysis

	Characteristics
<b>Reporting and ESG Analytical Tools</b>	
<b>Principal Adverse Impact (PAI) Tool</b>	The tool enables portfolio managers and other stakeholders to monitor performance of Article 8 products under SFDR with respect to PAIs as well as identify laggards. It also serves as an analytical tool to enable SFDR reporting for Article 8 products.
<b>TCFD Tool</b>	The TCFD report computes aggregate calculation of the different emissions measures, as recommended by TCFD, for portfolios and benchmarks. It serves as a basis for TCFD client reporting.
<b>ESG Sovereign CO2 Intensity Impact</b>	The report enables attribution analysis of the drivers of emissions intensity within the sovereign asset class.
<b>ESG Portfolio Report</b>	The report computes aggregate ESG analytics and enables reporting on ESG scores, CO2 emissions, forward-looking ESG targets, Sustainable Development Goals alignment, ESG research and engagements, among others.
<b>ESG Analysis Tool</b>	The report enables comparison of the ESG performance of a portfolio to another and over time.
<b>ESG Research Coverage Tool</b>	The tool enables the Firm to monitor the coverage of Western Asset’s proprietary ESG research and engagements.

ESG Research Tools		Characteristics
Verity RMS	The tool enables the Investment Team to document and disseminate their ESG research and engagements to the rest of the Firm.	
MSCI ESG Rating Change	The report alerts research analysts of ESG downgrades and upgrades for their issuer coverage.	
MSCI Controversy Severity Report	The report alerts research analysts of severe and very severe controversies.	
MSCI ESG Report	The report aims to integrate and disseminate MSCI ESG research to research analysts and portfolio managers.	
MSCI Industry Report	The report circulates third-party sectorial ESG frameworks to research analysts.	
ESG Issuer Tear Sheet	The report enables issuer analysis of its ESG performance versus its peers.	

Regular client engagement helps us assess whether what is being implemented from an ESG perspective meets client expectations, and to escalate where there may be potential mismatches between expectations and risk-return targets. We also work with clients to set appropriate investment horizons—which are generally long-term in nature—and, as a result, we describe how we can plan to meet sustainable investing targets that align with client-specific timelines.

We work with each client to develop a communication strategy that is unique to them. While most clients prefer structured quarterly meetings (in person or via video conferences), some may have additional communication needs. Client communication can range from structured meetings (e.g., covering investment performance, portfolio positioning and investment strategy) to ad hoc discussions about topical issues and fixed-income markets. In total, during the Reporting Year, Western Asset conducted over 4,500 client interactions.

As a testament to our standards, Western Asset has been named a Greenwich Quality Leader in Overall U.S. Institutional Investment Management Service by Coalition Greenwich for two years running (awarded in 2020 and 2021). The distinction is reserved for investment management firms that “deliver superior levels of client service that help institutional investors achieve their investment goals and objectives.” We are grateful for the trust that our clients have placed in us.

#### Case Study: System Enhancement

During the Reporting Year, Western Asset enhanced our client documentation system, Client Account Reference System (CARS), to maintain additional details about the regulatory status of our clients who focus on sustainable investing, whether this be limited to SRI screens or broader ESG guidelines (such as Article 8 status under SFDR). To support this additional detail, all client mandates were reviewed and re-assessed on an enhanced set of criteria and in line with the new data points to be recorded in CARS.

► **Outcome:** The client mandate assessment and CARS enhancements have enabled the Firm to provide even more targeted support to those clients who wish to prioritise sustainable investing in their mandates.

#### Sustainable Investment Solutions

While Western Asset considers ESG factors and risks in our investment solutions broadly, the Firm provides both a variety of best-in-class ESG investment vehicles as well as customised segregated mandate solutions for clients. These best-in-class strategies apply an enhanced focus on sustainability factors above and beyond the ESG integration utilised in existing mandates.

During the Reporting Year, we had over 784 ESG-related discussions with clients and prospects. In these discussions, the Firm's Investment Management Team, client service professionals and ESG Team worked to understand client concerns, as well as their needs and expectations around ESG. Many of these discussions resulted in dedicated ESG portfolio assessments and impact analysis.

#### Case Study: Implications of Decarbonisation Guidelines for a Sustainable Mandate

One of our existing clients wanted to understand the implications of aligning their current portfolio with net zero emissions with a request to halve emissions by 2030. The current portfolio is comprised of sovereigns, corporates and securitised fixed-income investments. We were able to help the client understand the differences between equity and bond mandates, particularly when it comes to implementing net zero type solutions for portfolios comprising sovereigns, corporates and securitised fixed-income issuers. Through the use of models, we were able to demonstrate the potential portfolio implications of such a requirement on the investment universe.

► **Outcome:** The client took on board our analysis and appreciated the partnership that we share with them. The client understood the implications of different decarbonisation rates for different fixed-income sectors and the implications that this had on portfolio concentration. The client confirmed that they would review our study internally and revert with any further questions. While the client did not revert with any specific queries, follow-ups or changes in guidelines in this instance, Western Asset looks at engagements with our clients as a continuous process and we work closely to align portfolios with their expectations.

#### Transparent and Detailed Reporting

The Firm has developed a comprehensive reporting suite that allows us to measure a portfolio's alignment on key sustainability indicators that can be customised to accommodate specific client needs. In addition to monitoring and reporting on economic performance and portfolio risk, we are also able to monitor and report on the following upon request:

- The ESG score and WACI at an overall portfolio level and across sectors;
- UN SDG allocation based on the Firm's proprietary framework;
- Exposure to issuers with carbon reduction, water consumption, use of cleaner energy sources, toxic emission reduction and management targets;
- Distribution of ESG ratings for the portfolio and across sectors;
- ESG rating momentum;
- Alignment with Paris-aligned climate scenario;
- Top- and bottom-10 ESG contributors and detractors;
- Engagement summary reports;
- Portfolio ESG rating and split across sectors;
- Portfolio WACI and WACI split across sectors;
- Top- and bottom-10 ESG laggards and leaders;
- Issuers with environmental targets; and
- Investments in labelled thematic bonds (e.g., green, social, sustainable and sustainability-linked bonds).

As part of engagement reporting, we include details such as the date engaged, the issuer, the issue discussed, details of engagement, next steps, credible timeline, escalation (if relevant), ESG outlook and impact on investment decision, where material. We believe in setting credible timelines to meet clients' expectations and match with the issuer's progress. Timelines may be based on the magnitude and severity of the theme being discussed, credibility of constraints highlighted by the issuer and the potential impact on the issuer's valuations that may affect clients' portfolios.

We also provide clients with climate-mandate-specific reports that include data on the WACI, which is the recommended metric by TCFD. Also disclosed as requested is information such as alignment with Net Zero initiatives, alignment with SDGs (such as SDG 7 on Affordable and Clean Energy and SDG 13 on Climate Action), issuers with decarbonisation, water consumption, and toxic emissions reduction targets.

### Thought Leadership

Thought leadership is key to our clients' understanding of our ESG philosophy and considerations. Our growing library now includes:

#### ESG-Focused White Papers:

- [Physical Risks of Climate Change: Estimating the Impact on Corporate Bond Portfolios](#)
- [Decarbonize to Survive: Estimating the Impact of Transition Risks on Corporate Defaults](#)
- [Integrating Natural Capital into Investment Decisions](#)
- [Portfolio Risk and Climate Change: Transition Risks in Credit Portfolios An ESG Guide for Asset Owners](#)
- [An ESG Guide for Asset Owners](#)
- [ESG and Bond Portfolio Performance](#)
- [An ESG Perspective on the Automotive Industry](#)
- [Indonesia and ESG Investing: A Sovereign Case Study](#)
- [ESG Investing in Sovereigns: Navigating the Challenges and Opportunities](#)
- [How to Differentiate ESG Approaches Among Asset Managers](#)
- [ESG Essentials: What You Need to Know About Environmental, Social and Governance Investing](#)

#### ESG-Focused Blog Posts:

- [ESG Assessment of Securitized Products](#)
- [Gender Equality in Asset Management Benefits Everyone Assessing Climate Risk in Client Portfolios](#)
- [How Can Investors in Sovereign Debt Help Address the Climate Crisis](#)
- [Assessing Climate Risk in Fixed-Income Portfolios](#)
- [Weekly Municipal Monitor: ESG in Focus During Climate Week](#)
- [Build Back Better" to Boost ESG](#)
- [ESG and the Election - Can Red and Blue Make Green?](#)
- [ESG and COVID-19 - Prepare for the New Normal](#)
- [ESG Investing with Taxable Municipal Bonds](#)
- [The Burden and Benefit of European ESG Regulations](#)
- [Doing Well While Doing Good Can Limit ESG Downgrade Risk ESG From Fringe to Mainstream](#)



### Evolving to Meet our Clients' Needs

Western Asset's teams continuously work towards the development of new tools and systems to support the ever-growing demands on sustainable investing. To advance the integration of ESG into the portfolio management process and address the evolving needs of our global clients, the Firm continues to work with our clients to develop solutions as well as customise segregated mandates that address their sustainable investing and financial objectives. This includes working with clients to understand the relevance and consequences of incorporating ESG criteria into model portfolios and calculated expected risk and return parameters. We also help clients understand the implications of future trajectories and trends on portfolio construction from a risk/return perspective, based on ESG guidelines. Integration of ESG requirements in existing portfolios with set investment objectives, guidelines and risk tolerances is complex and requires considerable thought and analysis. Western Asset seeks to support our clients' ESG advancement intentions, while informing them of unintended consequences and helping them to optimise portfolios to achieve the relevant objectives. Integration of ESG considerations is data focused, and as a result, we have been integrating ever greater quantities of data to enable us to monitor a broader set of sustainable investment guidelines and provide our Investment Management Team with actionable information in relation to relevant issuers.

To assist our clients in fulfilling their stewardship reporting needs to their beneficiaries, during regularly scheduled client review meetings, Western Asset helps to document and discuss details of recent stewardship and ESG-related investment activities and their outcomes. Western Asset has considered feedback from our clients and has increased and enhanced the quality of ESG reporting in our reporting materials, including details of portfolio ESG metrics and engagements with companies over the reporting period.



*"At Western Asset we believe it is imperative to understand, align with and explain the implications of clients' sustainable and investment objectives when negotiating mandate guidelines, given the implications for portfolio construction."*

*– Brishni Mukhopadhyay, CFA, Product Management*

*“Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfill their responsibilities.”*



**“Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfill their responsibilities.”**

### Our ESG Integration

As noted previously, Western Asset investment professionals consider a wide range of macroeconomic and geopolitical factors in composing an outlook that describes the challenges and opportunities facing sovereigns, industries and companies. This process guides our approach of integrating ESG considerations into a given portfolio.

Western Asset’s research analysts examine ESG factors at the issuer level, focusing on those that can potentially affect creditworthiness. We draw upon proprietary research 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 Western Asset’s standards are treated as having higher risk, as their future ability to pay may be adversely affected by developments such as legal sanctions, the introduction of new regulations or shifts in consumer sentiment. We then evaluate whether the market is appropriately pricing the issuer’s performance based on those ESG factors.

A growing number of the issuers we consider for investment have exposure to environmental factors that must be weighed when building portfolios. Traditionally, these have included utilities with respect to which regulation places precise requirements around environmental quality factors. Western Asset has also long recognised the environmental challenges inherent in heavy industry sectors such as metals and mining, machinery, and oil and gas. However, environmental concerns apply across many other sectors as changes in energy costs and in climate conditions may have pervasive effects.

Social factors can also impact consumers’ perception of an issuer as well as the issuer’s operations. We consider a number of social factors, including employee relations, workplace safety practices, consumer protection policies, recruiting and talent development, and community relations. Social considerations are particularly important in our evaluation of sovereign issuers, where demographic composition, socioeconomic trends and income distribution can affect the growth trajectory of a country.

Governance plays a critical role in Western Asset’s ESG analysis, as it lays the foundation for a well-run, sustainable business. We consider 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. If an issuer does not have superior governance practices, which include proactive management, robust reporting and strong risk controls, Western Asset cannot have confidence that leadership and integrity will be in place for environmental and social factors.

### Our ESG Engagement

Because Western Asset explores a wide range of investment opportunities that encompass many private and public issuers, dialogue between our research analysts and issuers’ management is key to evaluating these opportunities. What’s more, due to our size and presence in the marketplace, we can often influence how debt issuers structure the securities we invest in on our clients’ behalf, helping us meet our clients’ stewardship expectations.

Engagement with issuer management allows our research analysts to obtain additional perspective on ESG concerns that are inadequately addressed by existing issuer policies and disclosures. In some cases, particularly with privately held issuers, the research analysts can serve to increase awareness of the importance of ESG considerations through their conversations with management. We further detail this engagement in response to Principle 9.

### Our ESG Approach

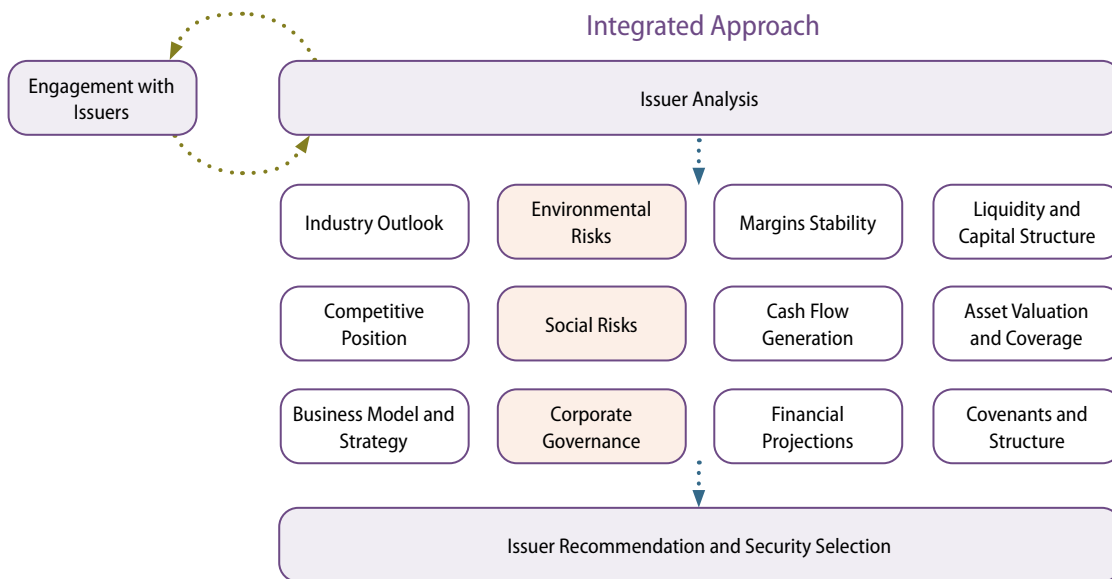
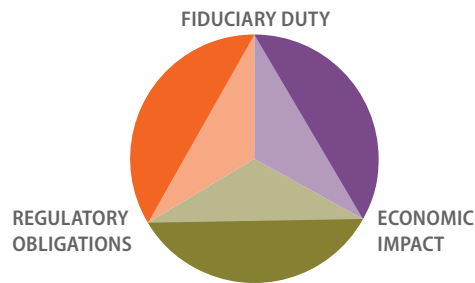
We recognise there is no universal standard for evaluating ESG investments. Over time we have developed our own methodologies and work closely with issuers and clients to communicate transparently and improve our approach.

Asset owners can vary greatly in terms of the specific values and themes they seek to express in their portfolios. While we have historically integrated sustainability analysis into all of our portfolios as part of our fundamental value research, we also closely partner with clients committed to sustainable investing who desire to overlay views of a more specific nature (e.g., environmental preservation or exclusion of specific business activities).

Looking forward, we recognise that sustainable investing across fixed-income sectors is evolving.

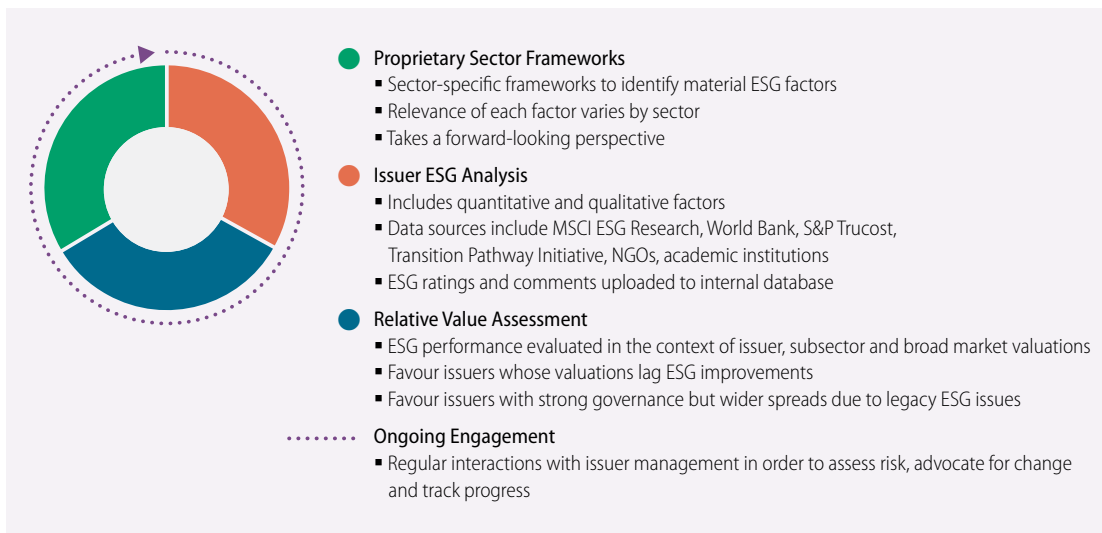
**Integrated approach to ESG investments incorporates ESG analysis throughout the overall investment process without emphasis on any particular factor. By analysing many factors that may impact future cashflow, including environmental, social and governance concerns and engaging with issuers, we believe we can meet both fiduciary and regulatory obligations while making a positive economic impact.**

Engaging with borrowers on the need for accurate and consistent disclosure of ESG risk exposures and seeing how well they are managed—being clear that this has direct influence on their borrowing costs—can create a positive feedback loop. Better disclosure and ESG risk management can improve borrowers’ financial performance and lead to more sustainable long-term portfolio returns.



## Integrating ESG Across Multiple Functions at Western Asset

ESG considerations are fully integrated into Western Asset's research, portfolio construction and risk management processes.



### Research

Research analysts at Western Asset are responsible for providing fundamental analysis at the industry and issuer levels. They also opine on industry and issuer risk/reward characteristics by incorporating financially material ESG considerations. Western Asset's research analysts have developed proprietary investment frameworks to help evaluate ESG risks and opportunities for issuers in the credit, sovereign and structured product asset classes. Research analysts evaluate the impact of individual issuers' ESG factors, which are taken into consideration in formulating the credit and risk profile of the investment. They have a keen understanding of the ESG factors that are very contextual in nature as well as ESG risks and opportunities that vary across sectors. By incorporating an assessment of financially material risks and opportunities, based on ESG considerations, research analysts are better able to assess the key issues likely to affect the creditworthiness of issuers. Research analysts also engage actively with issuers to understand the issuer's ability to address ESG concerns, which allows them to formulate forward-looking perspective of an issuer rather than rely solely on third-party information, which can be dated. They opine on the ESG factors' influence on the sustainability of the issuer's business model and on the risk premium appropriate to its ESG profile. The Firm seeks to identify issuers with improving but undervalued ESG profiles and, perhaps most importantly, avoid issuers with deteriorating or overvalued ESG profiles. We believe that our research analysts are best equipped to analyse ESG factors in conjunction with traditional metrics given their deep expertise in the sectors and industries they cover.

A sample ESG framework for the utilities sector, for instance, looks to assess considerations such as GHG emissions, toxic emissions where relevant, opportunities in renewable energy, capex allocation to meet decarbonisation goals, human capital development such as on labour disputes, health and safety standards, governance considerations such as ownership and control, accounting quality and tax practices, and management practices.

Western Asset also developed a proprietary UN SDG framework that seeks to identify issuers that contribute to the advancement of the UN SDGs—either through their issuance of bonds with sustainability-aligned use of proceeds or through their best-in-class sustainability practices. Currently, we have chosen to focus on eight specific SDGs for which data is available and that we can credibly demonstrate alignment with as depicted in the illustration below.

## UN Sustainable Development Goals



### Portfolio Construction

Western Asset's portfolio managers build on the ESG research conducted by our research analysts and construct portfolios with ESG risks in mind, among other relevant risks, while also seeking to benefit from opportunities. Each portfolio undergoes rigorous top-down analysis that draws on ESG considerations, among a number of other factors. Duration and yield-curve positioning are set based on the Firm's macroeconomic views. The Firm's ESG industry and subsector outlook supplements the portfolio construction process.

Western Asset is a fiduciary for our clients, and as a result, we first and foremost follow the investment guidelines set out by each client. Our clients include large financial institutions and corporations, investment funds, sovereign wealth funds and central banks, pension schemes, insurance companies and endowments and foundations. As a result, the investment guidelines differ from client to client and may have different responsible investing beliefs and exclusions. Western Asset seeks to work with each client to develop the most appropriate set of investment guidelines that will meet their specific investment needs. For instance, a pension plan client might require extensive engagement with issuers, the application of stricter risk measures and higher reporting requirements. In contrast, a central bank client may place higher emphasis on staff training and helping them understand investment concepts and global financial markets. Regardless of the specific circumstances, we collaborate with each client to come up with a solution that fulfils their particular requirements.

### Risk Management

Robust risk management is integrated into Western Asset's disciplined investment process. Research analysts' role is to assess factors impacting creditworthiness and to evaluate the risk premiums issuers need to offer to compensate for these risks. The research analysts complement fundamental credit research and analysis with an assessment of material ESG risks such as climate change (physical risks and transition risks from the move to a low-carbon economy), human rights and supply-chain management, product safety and security, diversity and development of talent, transparency, board structure and governance.

Western Asset has also developed a proprietary methodology to conduct climate stress tests on client portfolios. These climate stress tests are run through the Firm's proprietary risk system, WISER, to allow us to understand and measure the impact of climate related risks in a variety of scenarios. We can apply a shadow carbon price based on emissions to calculate impact on the issuer's ability to meet debt obligations. The methodology uses climate pathways, based

on data published by the IPCC linking potential future carbon prices to temperature rise. Western Asset's Risk Management Department has also developed an optimiser that proposes asset swaps within a portfolio to achieve lower carbon intensity while maintaining other risk characteristics such as duration, yield and sector exposure. This tool can be utilised across a number of strategies that Western Asset manages.

#### Engagement Case Study: Assess Implications of Complex Bond Structure Issued by a European Electric Utility

Western Asset engaged with a European electric utility issuer to understand the structure of and the rationale for issuing a US dollar hybrid bond. The issuer explained that they issued over a billion dollars in corporate hybrid bonds to replace an existing one, which is callable in 2024 and under tender offer. The issuer's treasurer highlighted that this new structure provides more flexibility, as they would not have to call the bond at first call date, should market conditions be unfavourable. Additionally, the issuer surmised, this would also give more visibility to investors, as after the first call date, the next call date would be every five years. The issuer also stated their belief that this structure is one that US investors are more familiar with.

► **Outcome:** Western Asset believes that the US dollar hybrid structure presents greater risk than existing hybrids due to greater extension risk, noting that investors and clients would need to be compensated for this extra risk. However, we noted that the rating agencies give the same level of equity content as the other hybrids and the features highlighted by the issuer. Based on the risk profile, Western Asset was comfortable investing in the short term.

#### Engagement Case Study: Assess Credibility of Scope 3 Emissions Targets for a Telecommunications Issuer

Western Asset engaged with a telecommunications issuer to assess credibility of reducing its published Scope 3 emissions targets and strategies on engaging with its supply chain. We wished to understand the issuer's strategy if supply chains do not decarbonise and how that will impact their business, including whether alternative sustainable sources had been identified and if potential costs would be assumed to be passed on to consumers. We escalated concerns to the issuer that it may have adopted an optimistic view that all the entities in its supply chain will decarbonise at a fast rate. From a social perspective, we also inquired on the effects of personnel redeployment arising from decarbonisation goals.

► **Outcome:** The issuer failed to provide detailed responses to most of our questions and concerns. The lack of detail in responses suggested a lack of credibility in meeting stated goals and failed to assure us that there was a well thought out plan to meet the set targets. We eventually divested from the issuer for certain mandates based on credit spreads tightening towards our target levels.



*“Signatories monitor and hold to account managers and/or service providers.”*





## “Signatories monitor and hold to account managers and/or service providers.”

### ESG Data Service Providers

Western Asset subscribes to a variety of third-party data providers to complement our proprietary ESG research. The table below illustrates the ESG data resources the Firm leveraged during the Reporting Year.

ESG Data Provider	Description	ESG Data Provider	Description
MSCI-ESG Research	<ul style="list-style-type: none"> <li>ESG Research</li> </ul>	ISS-Excessive Executive Compensation	<ul style="list-style-type: none"> <li>Executive Compensation Risk Scores</li> </ul>
MSCI-SRI	<ul style="list-style-type: none"> <li>Business Involvement Screening</li> <li>ESG Controversy Intelligence</li> <li>Global Sanctions</li> </ul>	S&P Trucost-Climate Solutions	<ul style="list-style-type: none"> <li>Sovereign Emissions Data</li> <li>Environmental Data</li> <li>Fossil Fuel Screening</li> <li>Climate Scenario Alignment</li> <li>Climate VaR</li> <li>Physical Risks</li> </ul>
MSCI-Climate Solutions	<ul style="list-style-type: none"> <li>Forward-Looking Targets</li> <li>Climate VaR</li> <li>Implied Temperature Rise</li> <li>Fossil Fuel Screening</li> </ul>	S&P Trucost-Regulatory Solutions	<ul style="list-style-type: none"> <li>EU Taxonomy</li> <li>SFDR PAI</li> </ul>
MSCI-Sustainable Impact	<ul style="list-style-type: none"> <li>SDGs</li> </ul>	Bloomberg	<ul style="list-style-type: none"> <li>ESG Data</li> <li>ESG-Labelled Bonds</li> <li>CDP Integrated Performance Score</li> <li>ICMA Principals Indicator</li> </ul>
MSCI-Regulatory Solutions	<ul style="list-style-type: none"> <li>SFDR Principle Adverse Impact (PAI)</li> <li>EU Taxonomy</li> </ul>	Transition Pathway Initiative (TPI)	<ul style="list-style-type: none"> <li>Climate Alignment</li> </ul>
ISS-Climate Solutions	<ul style="list-style-type: none"> <li>Climate Data</li> <li>Climate Scenario Alignment</li> <li>Fossil Fuel Screening</li> <li>Avoided Emissions Data</li> <li>Sovereign Emissions Data</li> <li>Physical Risks</li> <li>Carbon Risk Rating</li> </ul>	Science-Based Target Initiative (SBTi)	<ul style="list-style-type: none"> <li>Climate Alignment</li> </ul>
ISS-Regulatory Solutions	<ul style="list-style-type: none"> <li>EU Taxonomy Alignment</li> <li>SFDR PAI</li> </ul>	Urgewald	<ul style="list-style-type: none"> <li>Thermal Coal</li> </ul>
		World Bank	<ul style="list-style-type: none"> <li>Sovereign GHG Emissions</li> </ul>

### Oversight of Third-Party Relationships

All third-party relationships are managed on a day-to-day basis by the relevant business area. Oversight activities include regular management meetings, monitoring of service level agreements or other relevant metrics, review of key control reports (e.g., SOC1 or SOC2) and monitoring of the vendor’s financial health. Our Enterprise Risk Management Group also runs a broad vendor management programme, which includes a Vendor Management Committee consisting of senior individuals from across the Firm. The programme’s goal is to ensure a consistent approach to monitoring the operational, information security and resilience risks of any of our vendor or service providers.

### Engaging with Data Providers to Improve Data Quality

Before commencing any engagement, we work with third-party agencies to understand their views and rationale around ESG considerations where relevant. We are also aware that third parties may revise their assessment and we seek to understand the rationale where such revisions are not fully explained. Over the course of the Reporting Year, Western Asset had multiple engagements with various data providers on a range of themes. These included highlighting concerns on data quality where relevant, assessing various tools offered and evaluating alignment with regulatory requirements.

For example, Western Asset had a discussion around how a key global rating agency factors commodity pricing into ratings decisions and how ESG factors into its ratings as the linkage is not always immediately clear. Following engagement with the rating agency on this issue, the research analyst was able to get a better understanding of how the

rating agency factors commodity pricing into credit analysis and ratings decisions. This gave us comfort in evaluating issuers and relying on third-party data utilised during that process.

#### Case Study: Engaging With a Data Provider on Their Data Accuracy and Quality

The Firm's Municipal Bond Investment Management Team routinely performs assessments on the use of proceeds of municipal bonds. As a result, they are able to determine whether securities are green, social or sustainability-linked bonds. In this case, the team found inconsistencies between its assessment of the use of proceeds and that of a service provider. The Investment Management Team escalated the issue to our Enterprise Data Management Team. The latter communicated the inconsistencies with the data provider and requested a review and justification of their assessment.

► **Outcome:** The ESG data service provider was able to confirm inaccuracies of its use of proceeds tags for some bonds and were able to justify their assessment for the remaining bonds. The data provider was able to rectify the erroneously ESG-labelled bond tags in their data feed and platform.

#### Case Study: Engagement With a Data Service Provider

In order to ensure compliance with EU SFDR requirements for our and our clients' Article 8 funds, Western Asset utilises third-party data on Principle Adverse Impacts (PAIs) and "do no significant harm" (DNSH) data. Given the evolving regulatory interpretation of EU SFDR, and how PAI and DNSH data should be obtained and reported, Western Asset, together with our peers, participated in a session organised by one of the largest third-party data providers to share feedback on potential changes to the third-party vendor's approach with respect to PAI and DNSH data. The workshop aimed to address low data availability for PAIs and the lack of regulatory clarity on DNSH thresholds (i.e., the meaning of "significant harm"). The workshop provided several solutions to be considered by the participants:

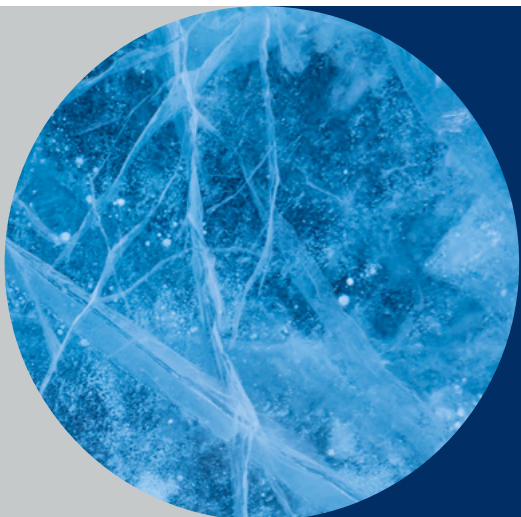
- Options to allow for self-assessment of DNSH across portfolio holdings;
- Options to enhance the DNSH criteria for the data provider's sustainable investment screen; and
- Options to estimate missing data which would then be utilised by the data provider's clients in their own models.

► **Outcome:** We welcomed the opportunity to collectively address and solve for these industry wide-challenges and provided our views during the workshop. This included sharing our perspective on the materiality of specific metrics, data availability and quality issues that we have faced. We also highlighted the importance of considering all aspects of data across all asset classes, including fixed-income, as currently most of the focus has been confined to large capitalisation publicly traded equity issuers and relevant data. We expect to benefit from adoption of the new standard in the upcoming year.

At Western Asset we believe that it is important to share feedback and work with data providers to help them address gaps and improve the quality of data we utilise as part of our ongoing efforts as responsible stewards of clients' capital. The data we utilise forms the basis for our in-depth research process as well as ongoing monitoring of compliance with client investment and sustainability guidelines. We appreciate the scrutiny our clients face to ensure they comply with their investment objectives, and as such we work to ensure the data is available, accurate and actionable.



*“Signatories engage with issuers to maintain or enhance the value of assets.”*



## “Signatories engage with issuers to maintain or enhance the value of assets.”

As outlined in Principle 7, dialogue between our research analysts and issuer management is key to evaluating investment opportunities for our clients and permits us to obtain additional perspective on ESG concerns that may be otherwise inadequately addressed. Our dialogue is guided by our ESG Engagement Policy, which is based on UNGC Principle 2<sup>5</sup> and generally surrounds the following themes:

### Climate Risk and Environmental Management

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

### Diversity and Development of Talent

- Analyse skill set balance and representation by gender/ethnicity/sexual orientation at both the board and executive levels
- Understand issuer’s approach to diversity and encourage initiatives to develop talent across underrepresented groups

### Human Rights and Supply Chain Management

- Determine degree and nature of ESG risks within issuer’s supply chain
- Understand and encourage issuer policies and controls to reduce child and forced labour, and maintain humane working conditions

### 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 minimise 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 the relevant ESG issues and importance to investors

### Governance and Corporate Management

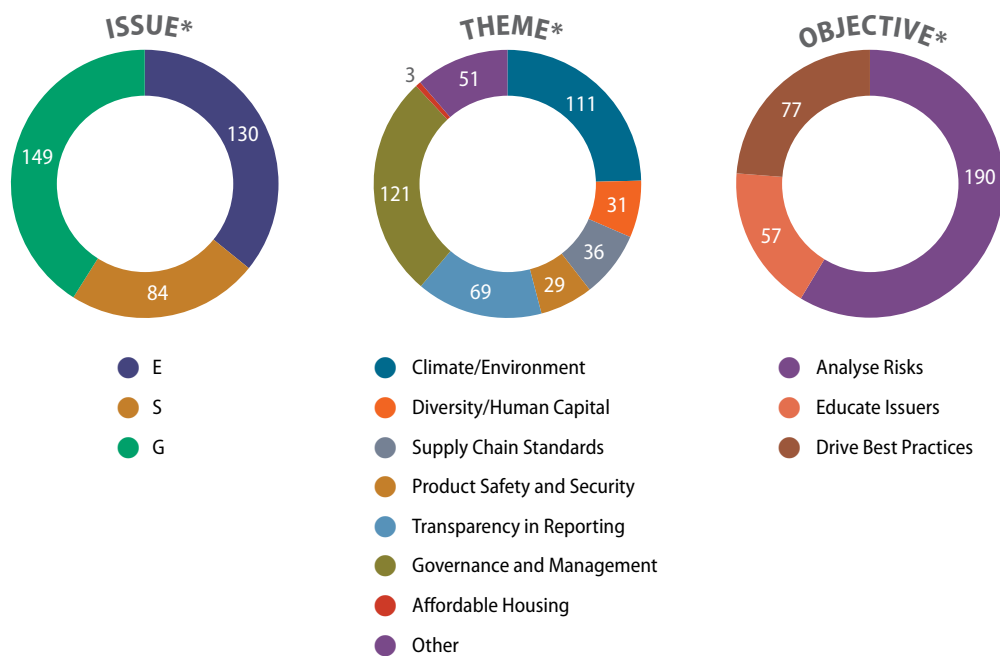
- Evaluate quality of leadership, ownership and corporate structure, and capital management
- Communicate governance concerns to issuer management and push for bondholder-favourable business practices

<sup>5</sup> The UNGC principles are widely accepted corporate sustainability principles that meet fundamental responsibilities in the areas of anti-corruption, human rights, labour and the environment, and are derived from the Universal Declaration of Human Rights, the International Labour Organisation’s Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

Engagement can also depend upon how critical or financially material an ESG factor might be, based on new information or news that emerges about a particular issuer. This is important as it allows us to understand the adequacy of issuers' ability to assess critical ESG issues and to incorporate them into their policies and operations.

Additionally, engagements can be based on wider themes. For example, in the wake of cybersecurity-related attacks on various industries in recent years, Western Asset initiated engagements with multiple firms across various sectors to assess their preparedness to withstand cyber-attacks, demonstrable audits of cybersecurity assessment and plans to implement cybersecurity policies and assessment where these were absent.

Although bondholders obviously possess very different legal rights than shareholders, Western Asset believes it can impact corporate ESG practices given its role in determining issuers' cost of debt capital. As long-term, value-oriented investors, we require compensation in wider spreads from issuers that lag their peers in ESG practices. Conversely, we seek to invest in issuers whose ESG profiles we believe will improve but whose spreads overcompensate for historical deficiencies.



Total Number of Engagements During the Reporting Period

**217\***

*\*Sometimes a single engagement will address multiple issues, themes and objectives; for this reason, the total number in these charts exceeds the number of actual engagements.*

## Our Engagement Process

Engagement activities are led primarily by the research analysts. Engagement is performed at a variety of touchpoints: around primary issuance, earnings reports, investor conferences, and ad hoc. At the outset, the Firm asks issuers to respond to questions, including with respect to plans to disclose and integrate sustainability into their business strategy.

As part of our engagements, our research analysts have access to senior executives of firms such as CEOs, CFOs, heads of sustainability, heads of investor relations and other relevant senior personnel best placed to understand and address our ESG concerns.

All engagements are documented in VerityRMS and include an assessment of issuers' progress on material issues. The timeframe for resolution of issues raised with issuer management is dependent upon the complexity and degree of change required. For example, a request to improve reporting might be expected to resolve more quickly than a request to set a long-term carbon reduction target. The Firm's engagement framework facilitates escalation where analysts conclude that issuers are deviating from or lagging in their implementation of publicly disclosed sustainability policies or referenced in previous engagements. Such escalation can result in a reduction in exposure to or divestment from the issuer in client portfolios.



### Engagement Case Study: Clinical Diversity in Pharmaceutical Trials

Western Asset participated in an engagement on clinical diversity with a pharmaceuticals issuer that set targets around interventional clinical trials and had a clear demographic plan aligned with disease epidemiology. The aim of the engagement was to ascertain how the issuer plans to implement its policies to meet stated goals on clinical diversity. Clinical diversity is an important facet as the safety and effectiveness of medication may vary across age, gender and ethnicity. Excluding a diverse sample when conducting clinical trials may lead to ineffective medication or potential recalls that could then have a negative impact on any pharmaceutical issuer. While the initial engagement focused on current work done by the issuer, Western Asset sought further clarification on:

- Available data and targets around HIV testers;
- Collection of data and targets for clinical trials beyond HIV;
- How these trial statistics compared to actual clinical diversity targets;
- Involvement of women of childbearing age who are historically under-represented; and
- Details of work done with respect to under-represented minorities beyond certain traditional under-represented demographics.

The issuer shared available data in relation to the requested metrics, while acknowledging that not all data may be readily available, and that other metrics may be shared only post conclusion of the study. The issuer also acknowledged that it is an industry-wide effort to make a change from “protect women from clinical trials” to “protect women with clinical trials” to ensure that women of child-bearing age, who have been typically excluded from trials, are now included. The approach is multi-faceted, from ensuring that inclusion/exclusion criteria are supportive, to encouraging awareness among health care providers and patients. This strategy would be consistent with efforts for many underserved populations. Furthermore, the issuer stated that trials were conducted only on certain under-represented demographics, not providing for a more diverse testing pool.

► **Outcome:** We acknowledge that work in this area is at a development stage for the pharmaceuticals sector generally, and we will continue to engage with the issuer to understand the challenges and opportunities around actual trial statistics versus clinical diversity targets and industry-wide efforts involving health care providers and patients, including women of childbearing age. Given the issuer's declared goals, Western Asset will seek to monitor progress made by the issuer.

#### Engagement Case Study: Impact of the United States Inflation Reduction Act (IRA) on Sustainable Aviation Fuels (SAF) and the Implications for an Airlines Issuer

Western Asset engaged with an airlines issuer to get a better understanding of the impact of the IRA on the usage of SAF. The issuer stated that it expected no major emissions reductions in the short-term as technology and SAF improvement will unlikely materialise in the near-term. The airlines issuer is a major SAF buyer, however the supply bottlenecks, as it appears, will remain despite IRA's SAF tax credits. The issuer views the IRA's tax credits as essential, but not sufficient to ease SAF infrastructure and supply bottlenecks, and conversations with leading oil and gas companies on expanding SAF supply have been disappointing. As a result of these constraints, the issuer is unlikely to decarbonise faster than its cost abatement curve. The issuer has successfully published a climate scenario analysis testing its strategy to the Below 2 Degrees Scenario and admitted that using a Below 1.5 Degree scenario will not change how they run their business today because the cost abatement curve is not aligned with that scenario. The issuer claims that it is trying to eliminate emissions as quickly as possible according to its cost abatement curve, buying every gallon of SAF that is in the vicinity of jet fuel prices, lobbying for incentives to improve SAF infrastructure and air traffic control, buying more efficient aircraft, as well as other available options as they arise. The issuer concluded by stating that other approaches would be unlikely to be a good usage of their time and focus.

► **Outcome:** Western Asset understands that different sectors face fundamentally diverse set of challenges when it comes to decarbonisation. A one size fits all approach to decarbonisation is likely to miss the constraints of technology, policy and market economics that companies face. The Firm therefore welcomed the transparency with which the issuer highlighted current constraints and will seek to assess how the issuer's approach evolves with changes in market economics, technology, government incentives and changes in consumer expectations to mention a few criteria.

#### Engagement Case Study: Evaluate a UK Brewery and Pub Owner on Environmental Targets

We engaged with a brewery and pub owner, noting that the rate of adoption of renewable electricity was lower than anticipated, per disclosures in their FY22 report versus the expected amount based on the management discussion in their FY21 report. We noted the issuer's intention to move towards electrification of the pub estate as a key focus area for 2023, but highlighted concerns around a lack of detail around the timelines. We also highlighted the inconsistency between the issuer's statement on a move to electricity backed by Renewable Energy Guarantees of Origin (REGO) certificates in 2021, and the absence of any mention of REGO certificates in their report for 2022.

► **Outcome:** In response, the issuer stated that while REGO certificates were relatively easier to procure in prior reporting years, availability has been a challenge, owing to the combination of the war in Ukraine and the increased demand in the marketplace. We acknowledge the nuances that different sectors and companies face. We found it noteworthy that the issuer had a better energy hedging strategy than the peer group, with gas fixed to March 2025 and electricity to March 2023. The need to balance exposure to volatile costs against the desire to move to fully renewable electricity was clearly a limiting factor on the pace of adoption. As we came to believe the issuer takes its responsibilities seriously, we determined we would continue to monitor the issuer's progress and continue to hold it across various portfolios.

### Engagement Case Study: Plastics Packaging Producer on Sustainable Packaging Goal

As part of a collaborative engagement, we engaged with a plastic packaging producer that had announced targets around circular plastics usage across its fast-moving consumer goods packaging by 2030 with interim goals for 2025, in line with Ellen MacArthur Foundation's New Plastics Economy vision.

The issuer is among the earliest to make a U.S. Food and Drug Administration (FDA) approved system to mechanical recycling that can turn polypropylene household waste into food-grade packaging. The issuer explained that it runs monthly meetings to monitor progress towards its circularity goals and organises educational trainings for relevant stakeholders on these KPIs.

We inquired which of the issuer's product-types see the most rapid growth of recycled resin use towards 2025 and 2030. The issuer did not have detailed information available, stating it depends on customer demand. The issuer was currently working with its clients to determine which product line had the most leverage to align with its circular usage targets. We discussed other roadblocks, including stakeholder opposition of chemical recycling, low appetite to pay for the premium of recycled content, laws that have not caught up to the sophistication of technology, and low supply of recycled resin.

► **Outcome:** The collaborative engagement shed light on some of the challenges that companies are confronted with given the complex interaction with broader industry participants and market factors such as inflation. We will further engage with the issuer to understand constraints and steps taken to meet its goals for 2025 and 2030.

### Engagement Case Study: Looking Beyond Labels on a Sustainability-Linked Bond for a Capital Goods Issuer

Western Asset engaged with a capital goods issuer on the issuance of their inaugural Sustainability Linked Bond (SLB), the framework for the SLB and specific sustainability-related KPIs. At time of issuance, the SLB bond would mature in approximately 10 years and the KPIs would be tested at the end of 2030, leaving the potential for less than two years of coupon step-up. The issuer's goals included reduction in Scope 1 and Scope 2 emissions, as well as non-recovered waste production.

Western Asset queried the credibility of emissions reduction and non-recovered production goals, given current levels achieved by the issuer. We noted that a third-party assessment by an external agency had a favourable opinion on the quality of the issuer's SLB framework while also highlighting that the KPIs were "ambitious".

► **Outcome:** Based on our concerns on the credibility of the emissions reduction goals, the challenge of reaching the non-recovered production targets given the current level achieved on these KPIs, and the third-party agency's comments on ambitious targets and concerns around valuation, Western Asset did not participate in this SLB issuance. Western Asset believes that issuers should set credible KPIs as failure to do so can expose the issuer to risks of erroneous marketing and reputational damage, as well as lack of investor support. Additionally, Western Asset believes that it is important to look at valuation considerations for labelled bonds alongside the suitability of sustainable KPIs. Moving forward, we will seek to engage with the issuer and monitor specific labelled bonds to assess credibility, progress made and suitability for inclusion in clients' mandates.



## Engagement Journey in VerityRMS

Engagements with issuers can be a journey entailing multiple points of interaction from identification to monitoring, follow-ups and escalation, where relevant. We log engagements (including those summarised above) into our research platform, VerityRMS. This allows us to better evaluate any progress made, potential impediments to progress, tangible outcomes, escalations, and relevant follow-ups where necessary. An illustration of the engagement journey for an issuer is shown below.

### Active Engagement – European Utility

A journey to assess credibility from a bond holder’s perspective

#### Assess Corporate Governance Structure:

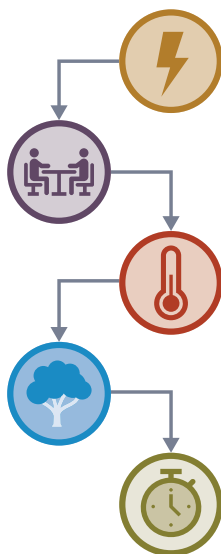
12<sup>th</sup> December 2020

- Robust governance; awarded European Corporate Governance leadership in 2018

#### Assess Credibility of Sustainability-Linked Bonds (SLBs):

15<sup>th</sup> December 2021

- Focus on acceleration to Net Zero while maintaining strong balance sheet
- SLB KPIs to reflect emissions reduction targets
- Credible given the 80% emissions reduction by 2024 is through phase out of coal powered plants



#### Assess credibility of decarbonisation plans:

12<sup>th</sup> December 2020

- Queried capex allocation to network & assess implications of renewable investment on balance sheet
- Monitor progress of 46% of the capex deployment into renewables would increase issuer's regulated asset base by 70% by 2030

#### Assess strategic plan towards net zero:

11<sup>th</sup> November 2021

- Issuer discussed its strategic (2021-2024) and longer-term plan to target net zero emissions
- €45bn of capex investment to 2024 to be split between renewables and networks. Targets €210bn of investments between 2021 and 2030
- Renewables: 84GW of new capacity and reach 129GW by 2030. Networks: Grow customer grid base by 12 million
- Expected increase in EBITDA of 5-6% CAGR. Net Debt / EBITDA expected to be stable at 2.9x

#### Assess credibility of decarbonisation plans:

11<sup>th</sup> November 2022

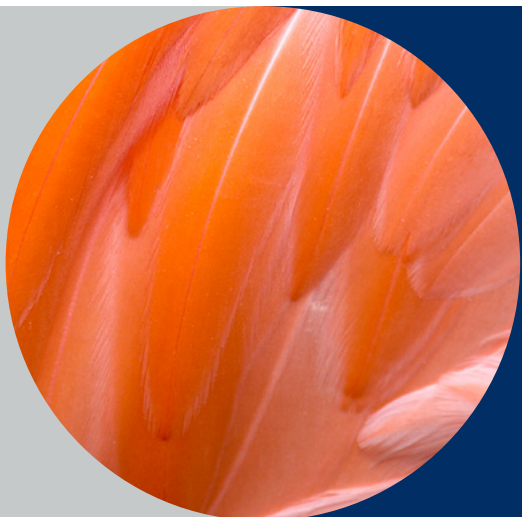
- Issuer targets moving to Net Zero by 2040 phasing our coal by 2027 and gas by 2040
- Largely financed through asset disposal freeing up management to focus on more stable and profitable geographies
- Expected Improvement in Net Debt/EBITDA to 2.4x-2.5x by 2030, FFO / Net Debt expected to increase to 28% in 2023 vs 17% in 2022



*“As a fiduciary, we believe that engagement plays an important role in our ability to assess risk and deliver long-term value for our clients.”*

– Connie Fischer, Director of Portfolio Operations

*“Signatories, where necessary, participate in collaborative engagement to influence issuers.”*



## “Signatories, where necessary, participate in collaborative engagement to influence issuers.”

Western Asset continually evaluates collaboration on initiatives where we feel we can have meaningful involvement and impact.<sup>6</sup> As explained in Principle 1, Western Asset became a founding member of the PRI SDG Advisory Committee, Sovereign Debt Advisory Committee and SFDR Working Group, Sub-Sovereign Debt Advisory Committee, and Plastic Investor Working Group. As a signatory of the UK Stewardship Code since our first filing in 2021, we work alongside other institutional investors and our clients to improve the quality of sustainable investing and its framework. Furthermore, Western Asset engages directly with issuers to help advance their ESG practices and their green, social and sustainability-linked bond issuance.

### Key ESG Milestones and Initiatives



- PRI signatory since 2016
- In 2017, as a founding member of the UN PRI SDG Advisory Committee, Western Asset advised the PRI Executive on activities to encourage and support signatory alignment of investment policies and asset allocations with the SDGs.
- In 2018, as a founding member of the PRI Sovereign Working Group, the Firm helped provide guidance for signatories to integrate ESG and conduct engagement in sovereign debt analysis.
- In 2019, the Firm adopted an ESG Engagement Policy to advance its stewardship efforts and became a supporter of the TCFD and TPI.
- In 2020, as a founding member of the UN PRI Sub-sovereign Debt Advisory Committee, Western Asset collectively engaged with other investors on plastics and circular economy with petrochemical and packaging companies among others.
- UN PRI Plastics Engagement Group: In 2020, Western Asset joined the PRI Plastics Engagement working group.
- In 2021, Western Asset became a representative for the Franklin Templeton organisation for the ASCOR project. The ASCOR project is a joint effort of a number of leading organisations in the area of sustainable investments, with the goal to develop tools that allow investors to evaluate sovereign exposure to climate risk and assess governments' climate-related commitments, their policy frameworks, and action plans to address these risks. Western Asset is a contributing member to working groups focused on climate policy and financing needs.
- In 2022, the Firm became a signatory to the UK Stewardship Code.
- Founding member of PRI Sovereign Debt Advisory Committee and SFDR Working Group
- Founding member of PRI Sub-sovereign Debt Advisory Committee
- Founding member of PRI Plastic Investor Working Group
- Participation in key industry climate initiatives
  - Supporter of TCFD
  - Supporter of TPI

<sup>6</sup>The goals or initiatives of organisations that Western Asset is affiliated with or in some way supports do not necessarily reflect Western Asset's investment views or philosophy. However, these organisations often prove useful in helping Western Asset evaluate material ESG factors. Western Asset's investment philosophy remains long-term fundamental value investing in line with client investment guidelines and objectives.

### Collaborative Engagement Case Study: Roundtable by the World Bank on Climate Budget Tagging

We participated in an investor roundtable that included 32 participating countries with the aim of conveying to the sovereign issuers the need for greater transparency, as well as clearer connectivity between capital flows and sustainability goals. We see an important connection between climate budget tagging (CBT) and stable capital flows in sovereigns. Specifically, we believe greater transparency on government spend on climate-related initiatives is critical to opening up the full suite of a country's debt to sustainable capital flows. Without that transparency, and the accompanying ability to identify how much a country spends on climate (or E more broadly), we would expect sustainable capital flows to be limited to green, social and sustainability issuances in the sovereign space, which significantly diminishes the scope to scale up sustainable capital flows to countries with the greatest need (typically due to elevated exposure to physical climate risks). Given this broader context, we continue to see CBT as a priority area for engagement from both an E and G perspective. This roundtable afforded us the opportunity to communicate these views and investors' perspectives to 32 ministries of finance and debt management offices.

► **Outcome:** Western Asset will continue to have engagement with sovereign issuers in collaboration with peers including through multilateral and intergovernmental organisations to build awareness and push toward greater transparency on climate (and E) expenditures and national budgets. Contributing to this collaborative engagement, the Firm highlighted the need to look at sovereign debt through the lens of SFDR and EU Taxonomy regulations, and the need to open up the full envelope of sovereign debt (not just green bonds) to sustainable capital flows. There was also agreement on the need to connect capital flows to impact. Without transparency on sovereign expenditure on climate, investors will find it hard to judge incremental impact from a green bond or sustainability linked bonds.

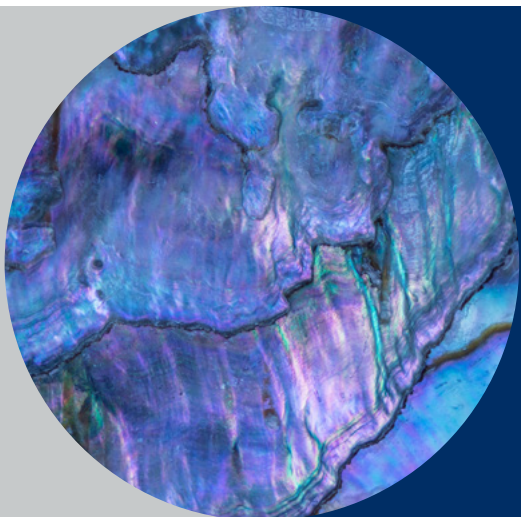
### Collaborative Case Study: Assessing Sovereign Climate Opportunities and Risks (ASCOR) Project

Western Asset is a participant in the ASCOR project, which is a joint effort of a number of leading organizations in the area of sustainable investments, with the goal of developing tools that allow investors to evaluate sovereign exposure to climate risk and assess governments' climate-related commitments, their policy frameworks, and action plans to address these risks. As part of this initiative, Western Asset has been involved in formulating a methodology to develop a framework for assessing sovereign decarbonisation and the consequent implications of these on the financial market.

Over the course of the year, Western Asset worked on two of the three pillars central to the project: Pillar 2 (Climate Policies) and Pillar 3 (Opportunities to finance the transition) with the TPI. We helped verify the first round of country-level assessments for accuracy and quality, including highlighting areas of concern, such as those on a specific emerging market sovereign (whether it should be seen to have "framework climate legislation" in place). Additionally, we participated in the North American Roundtable with stakeholders from other asset managers, asset owners, and representatives from the public sector and other international institutions. The Firm has also been a part of the discussion on the iterated ASCOR framework following the 1Q23 consultation process.

► **Outcome:** We believe the ASCOR project will provide an important tool for asset owners and asset managers to better understand countries' climate policies, their performance against 1.5°C objectives, the way countries spend on climate objectives, as well as areas where there is a need for additional financing. This, in turn, also provides sovereign issuers with a better understanding of the way that investors will assess their performance on climate, and ASCOR can therefore serve as a powerful tool for engagement.

*“Signatories, where necessary, escalate stewardship activities to influence issuers.”*



## “Signatories, where necessary, escalate stewardship activities to influence issuers.”

Western Asset recognises that sustainable investing across fixed-income sectors continues to evolve. Through collaboration with other institutional investors, and in response to our clients’ needs, we seek to shape its progress, in a method consistent with our investment policy of long-term fundamental value investing and in line with client investment guidelines and objectives. One of the key tools we utilise is engagement with the issuers in which we invest.

Our research analysts focus on ESG engagement objectives as part of their regular interactions with issuers. Progress is tracked on initiatives and improvements in our engagement reports. Ongoing and constructive dialogue with issuers is key to this process. Where necessary, research analysts can escalate engagement issues to our ESGSSC or ESG Task Force for discussion. Some reasons why engagements might be escalated include:

- Failure to meet the desired outcome on a material matter;
- A negative event occurring with no acceptable plan to resolve it; or
- An issuer being unwilling to engage in ESG-related discussions.

Escalation may lead to continued engagement or divestment depending on the severity and imminence of the underlying ESG concern. Often this turns on the requirements of particular client mandates. Based on client interactions and objectives, portfolio managers may divest from certain issuers, either in discussion with clients or when these issues are against clients’ sustainability objectives. In certain instances, despite escalation to corporate management, Western Asset may be unable to get suitable responses to address our concerns, which may lead to potential divestments across multiple mandates where the risk is deemed to be unsuitable to the clients’ investment and sustainability objectives.

### Escalation Case Study: Automobile Issuer Human Rights Controversy

In the course of our engagement, we learned that an automobile issuer was being investigated for human rights concerns within its broader supply chain, and a third-party data provider downgraded the issuer to a “Fail” under UNGC Guidelines. We engaged further with the issuer and learned that it was unable to fully address these matters due to limited alternatives for the commodities and parts needed for automobile manufacturing, outside the region in question.

We also discussed with the issuer certain communications between the issuer and UNGC on the purported “Fail” rating. We learned that UNGC did not confirm the “Fail” rating nor require the issuer’s exit from the organisation. Our further research indicated that it would take a much larger controversy at the core of the organisation to require an exit from the UNGC. As a message of reassurance, the issuer stated that a third-party auditor was being engaged on this issue.

As a result of the complexity and different data points, the matter was internally escalated for assessment by our ESG Task Force.

► **Outcome:** The ESG Task Force debated the specific concerns with respect to the issuer and recommended the issuer be placed on the Western Asset ESG Watch List with more engagements to monitor progress and highlight greater ESG risk. Being placed on the ESG Watch List implies portfolio managers may divest the issuer from certain mandates when they believe holding the relevant security contravenes the spirit of the client’s guidelines. However, they are not explicitly required to divest from the issuer from all mandates at the point of listing on the ESG Watch List.

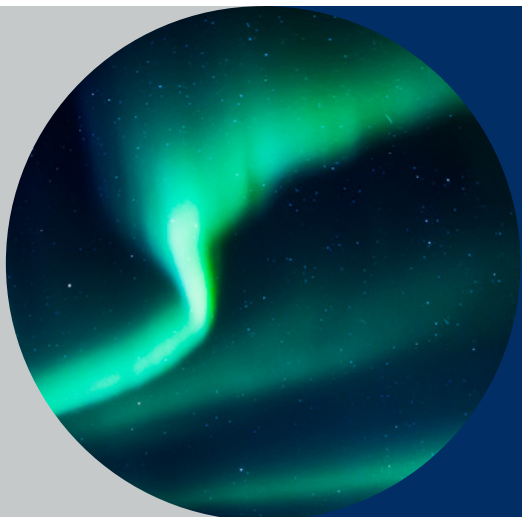
We determined we would continue engagement over the coming year to monitor the progress made by the issuer on the human rights concerns to determine whether it should remain on the ESG Watch List, get elevated to the ESG Red List (requiring divesture for certain mandates) or be removed from the ESG Watch List altogether if the higher ESG risk is addressed.

#### Engagement Case Study: Healthcare Software Solutions Firm on Governance Issues

We engaged with a healthcare software solutions firm on concerns about deterioration in performance, disclosure of an office raid by the country's finance police, potential employee involvement in fraudulent activity and a lack of transparency in reports available to the public for a significant period of time. We flagged the absence of reports from the issuer over the past fiscal year and the lack of relevant details in presentations. Furthermore, we raised concerns about management's competence, given the issuer's track record over the past two years, including a cybersecurity breach and operational challenges related to Enterprise Resource Planning implementation.

► **Outcome:** The issuer's response to our concerns was underwhelming and did not address our concerns nor provide the transparency we required in order to keep the holding. Based on our escalation to management not being addressed sufficiently to provide comfort, we divested from the issuer.

*“Signatories actively exercise their rights and responsibilities.”*





## “Signatories actively exercise their rights and responsibilities.”

Different asset classes provide different mechanisms and avenues for asset managers to engage with issuers. As a fixed-income manager, Western Asset primarily engages with issuers through direct communication with senior management where issues are discussed and expectations set. On a rare occasion Western Asset may be in a position to vote proxies. As part of new issues or work outs, Western Asset seeks to ensure that covenants serve the needs of our clients and the research analysts will participate in covenant negotiations. Finally, Western Asset may also participate in various types of debt restructurings where it can most directly shape the path forward for the issuer.

### Covenant Negotiation

We carry out extensive analysis of issuers in which we invest on behalf of our clients. Generally, research analysts will analyse quantitative, qualitative, and non-financial (including ESG) factors and trends that affect the issuer’s creditworthiness. This analysis includes a detailed assessment of the indentures and covenants of issuers’ specific bond issues. The analysis of bond issues’ indentures is focused on assessing the quality and robustness of covenants designed for bondholder protection. Examples of bond covenants include Change of Control (CoC) covenants that allow investors to put (sell) their bonds back to the company at 100% (or more) of the par value when majority ownership/control of the company changes and credit quality falls (therefore raising the risk of default). Research analysts will seek the strongest covenants from issuers on behalf of bondholders and the strength of covenants will determine whether and at what yield research analysts recommend an investment in a bond.

If the research analyst has concerns about the terms of an indenture or the details or absence of specific covenants, they will first escalate internally to the senior portfolio managers of the affected portfolios. Where there is sufficient interest to participate in the new issue, research analysts will communicate any covenant concerns to the issuer via the issuing bank’s bond syndication team. Where negotiations are not successful, Western Asset may decide not to participate in the new issue. In other cases, where there is a judgment that bondholder protections exist but could be stronger, the Firm may decide to limit the size of the investment and seek a higher spread over risk-free rates as a condition of investment.

During the Reporting Year, issuance of high-yield securities increased over the year prior. Despite the higher issuance year over year, the overall market continues to be restricted, which continued to limit our ability to engage through covenant negotiations, highlighting certain structural issues within fixed-income markets with respect to the toolset for engagement with issuers to improve sustainability, social impact and governance.

#### Engagement Case Study: Covenant Negotiation

Western Asset engaged a provider of solutions to the floating offshore oil and gas market specialising in deep water solutions. The issuer wanted to modify the covenants granted to existing private bond placements in which we invest when issuing new private placements.

The issuer’s request was for an amendment to the definition of “distributed cash” in the leverage covenants. However, this amendment would likely be seen as a relaxation of the terms of the previous issue, and thus a one-sided modification in favour of the issuer. Therefore, the issuer sought input on how to communicate the covenant change to other investors to limit the potential negative response.

We confirmed that, in our belief, even without this amendment request, there was limited concern about meeting the existing covenant levels. In our judgment, there were no concerns about the issuer’s compliance with the covenants, and the issuer had also expressed sufficient confidence. Therefore, we suggested not only modifying the definition

as requested by the issuer, but also to tighten the maximum leverage covenant or establish a separate covenant on the level of the distribution. We believed that this would make the covenant modification fair to investors rather than unilaterally favouring the issuer.

► **Outcome:** The issuer agreed that it would be best to strike a balance by setting stricter terms. The issuer then consulted other investors and rating agencies, and as a result, the revised proposal was approved by the investors by tightening the leverage covenants to a level commensurate with the expected increase in the distributed cash.

#### Engagement Case Study: Restructuring of Marine Aftermarket Issuer

Western Asset participated in a lender group that worked with a leading integrated, omni-channel provider in the marine aftermarket category, to assess the best path forward for the business. When we originally invested in the new issue, the issuer was experiencing several tailwinds that included (i) more participants entering the category, (ii) higher engagement within the category, and (iii) holding the dominant position versus the next competitor. However, during 2022 and 2023, the issuer faced unexpected headwinds from shifts in consumer spending and lingering disruptions to supply chains from COVID-19. This led to the issuer having a weakened liquidity profile as well as a significant debt burden.

► **Outcome:** The issuer completed an out-of-court restructuring of the capital structure that led to a more tenable debt burden, a capital injection and elongated liquidity runway to manage through the current environment. Western Asset was focused on maximising recovery to the first lien loans and helped with specific structuring points around negotiations with the financial sponsor and subordinated investors.

#### Proxy Voting

As a fixed-income manager, Western Asset generally does not vote proxies. When rare opportunities to vote proxies do arise, these are considered based on the investment merits of the instruments and strategies involved. In the Reporting Year, there were only nine proxy voting opportunities, four fewer than in the previous period. All of the proxy votes related to routine corporate matters and did not require specific input from our research analysts.

As a general proposition, Western Asset votes to encourage disclosure of information material to an issuer's business. This principle extends to ESG matters. What qualifies as 'material' can vary, so votes are cast on a case-by-case basis but consistent with the overarching principle. Western Asset recognises that objective standards and criteria may not be available or universally agreed and that there may be different views and subjective analysis regarding factors and their significance.

As a general matter, Western Asset votes to encourage management and governance practices that enhance the strength of the issuer, build value for investors and mitigate risks that might threaten their ability to operate and navigate competitive pressures.

Situations can arise in which different clients and strategies have explicit responsible investing objectives beyond ESG risks that are generally considered material. Votes may be cast for such clients with such objectives in mind. Votes involving ESG proposals that are not otherwise addressed in the Firm's policy will be voted on a case-by-case basis consistent with our fiduciary duties to our clients, the potential consequences to the investment thesis for that issuer, and the specific facts and circumstances of each proposal.

Targeted environmental or social issues that are the subject of a proxy vote are considered on a case-by-case basis; however, as stated previously, these are rare. Constructive proposals that seek to advance the health of the issuer and the prospect for risk-adjusted returns to Western Asset's clients are viewed more favourably than proposals that advance a single issue or limit the ability of management to meet its operating objectives.

## Debt Restructuring

At Western Asset, bond trading at distressed prices does not automatically trigger a sale absent a client instruction. The Investment Management Team may hold onto such securities when our analysis demonstrates a high probability of upside potential. When an issuer becomes distressed or moves into bankruptcy, we assign additional resources to review the credit and ensure clients' interests are protected.

We view debt restructurings as an unavoidable part of managing credit assets, which represent a significant portion of the assets we manage. While our intensive bottom-up research process attempts to minimise our exposure to companies and sovereigns that may default or restructure, our fiduciary duty to clients requires that we attempt to maximise recoveries if we find ourselves in these situations. There are times when new information about an issuer could merit a sell-down of the position, but we often try to work with fellow bondholders to achieve a better financial outcome.

## Creditor Committees

Since corporate bond restructurings or bankruptcy can be a medium- to long-term process, Western Asset must determine if involvement will have a positive impact on the portfolio before deciding to participate in any action. Questions we ask include: Can Western Asset influence the proceedings? Can the Firm add value? Is this in our portfolios' best interests? Would it protect our clients' interests? To that end, the Investment Management Team conducts a complete financial analysis, including scenario, step-down, and break-up value analyses, which in combination provide a reasonable estimate of asset value. Depending on the range of values and the corresponding upside potential, the Investment Management Team determines whether Western Asset should become involved in the creditor's committee, retain counsel outside of the creditor's committee, continue to hold and monitor or sell the bonds at market value.

If Western Asset decides to become an active participant, the Firm seeks to align our interests with the other members of the bondholders committee. Generally, Western Asset has sought a voice at the negotiating table, which typically is comprised of three to seven of the largest, most experienced bondholders. Western Asset's philosophy is to work closely with management and their financial and legal advisors in order to maximise value to the bondholders within a reasonable timeframe.

## Corporate Bond Restructurings

In the event that the business environment changes so that an issuer's ability to generate cash flow for interest payments is impaired, the Firm will revisit our asset valuation model to determine the relative value prospects of continuing to hold the issuer. The investment decision will be influenced by the determination of the analyst's review in terms of recovery value and time value of money. If the determination of the analyst is that the risk-adjusted total rate of return prospects are greater than that of other comparable investment options, the investment decision will be to hold the distressed or defaulted issuer. If specific portfolio guidelines restrict the holding of issuers rated below a certain rating, those guidelines will be honoured. However, a holding would not be sold specifically to avoid a default or avoid working through the recovery.

## Dedicated Distressed Analyst

Although one of Western Asset's top priorities is to preserve capital and avoid defaults, the reality is that defaults do occur in the global high-yield credit markets, and with some degree of frequency. When a default occurs, the workout period can be long, arduous, time-consuming and often complicated. Western Asset has a dedicated workout Portfolio Manager/Analyst who has worked on distressed situations for over 30 years, and who shepherds the Firm when it becomes party to a creditor's committee. Handing the workout over to the distressed analyst allows other credit analysts to continue to focus on current opportunities in the market rather than the legal complexities of a workout.



## Conclusion

During the Reporting Year, we continued to build our sustainable investing platform on our long-standing stewardship principles—in particular, putting our clients first in everything we do.

The importance of working proactively with clients as they transition their mandates towards sustainable investing was evident. We worked with our clients to understand their sustainability and investment objectives, to highlight the implications of aligning with these objectives, and to provide them with more information on the impact of the new ESG guidelines on the risk and returns on their mandates.

We worked to obtain access to more data, to build and enhance reports which help our clients see sustainability changes in their mandates more clearly and broadened our engagement activities with issuers. Integrating a greater diversity of data into our proprietary order management and portfolio compliance monitoring systems had two tangible benefits: we helped our Investment Management Team make more calibrated investment decisions, and we enabled our Compliance Team to monitor ever more complex ESG guidelines in real time and on an automated basis. We understand the regulatory obligations and reputational risks our clients face and have integrated responsible investment decisions in their mandates more robustly than ever.

During the Reporting Year we also strengthened our governance structures to enable us to have stronger oversight and better decision-making and to standardise our approach to sustainable investing across the Firm. We engaged with our peers, industry groups, and third-party data providers to seek to set better standards and improve our stewardship efforts.

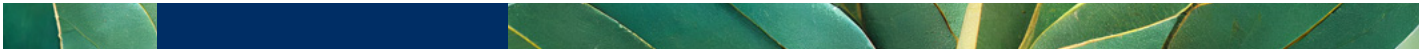
We hope our 2023 Stewardship Report demonstrates our deep commitment to stewardship at Western Asset and our growing achievements in this area. While we recognise that our work is never done, we believe that we have continued to help our clients achieve their sustainable investing objectives through our stewardship efforts.

*Western Asset has certain environmental, social and governance (ESG) goals or capabilities; however, not all strategies are managed to ESG oriented objectives.*

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