



WESTERN ASSET



Working Toward a Shared Future

Stewardship Report
October 2022



Stewardship Report

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A Long Tradition of Serving Clients Since 1971

Western Asset has been partnering with clients for more than 50 years to deliver superior risk-adjusted returns over the long-term by investing in multiple diversified strategies. Now more than ever, we are working with and for our clients toward a shared future.

For more than half a century, we have proudly served our clients in alignment with our core values of **trust, honesty, integrity, teamwork, diversity, mutual respect** and **personal responsibility**. We have also adhered to five guiding principles that we remain committed to:

- **We put our clients first in everything we do.**

We listen, understand and seek to help our clients succeed.

- **We are dedicated to active fixed-income.**

We believe that by dedicating all of our resources to active fixed-income, we can provide superior investment capabilities and service to our clients. We believe that active, value-driven investing can add significant return and reduce portfolio volatility over a market cycle.

- **We have a team-based culture.**

At all levels of our organisation, professionals around the globe work together to enhance the quality of our investment thinking and decision-making by communicating information, sharing investment ideas and collaborating on strategy.

- **We are globally integrated.**

We think and act on a global basis, with specialists around the world who share their expertise and diverse opinions to broaden our opportunity set meaningfully and to improve our ability to diversify investments.

- **Risk management is fundamental to how we manage assets.**

We integrate risk management into the portfolio construction process and use robust communication and escalation procedures to strengthen our effectiveness and bring transparency to our risk management process.

With extensive development of our infrastructure over the last year, we are confident that our ESG integration practices enhance our ability to provide more comprehensive responsible investing solutions, and are consistent with our goal to meet or exceed our clients' investment objectives within their risk tolerance. We appreciate that ESG indicators can affect the creditworthiness of fixed-income issuers' securities and impact investment performance. As such, we incorporate ESG considerations as a matter of prudent investing and have adopted an ESG investment policy that integrates these factors into our analysis of debt issuers across different fixed-income sectors.

These practices are also consistent with the Firm's strategy for ESG at a corporate level. As a signatory to the United Nations-supported Principles for Responsible Investment (PRI) Initiative since 2016 and a signatory of the UK Stewardship Code since 2022, we work alongside other institutional investors around the globe to advance responsible investment in a manner we believe will deliver real change for a shared future. These shared goals include enhancing the integration of ESG into the investment process, increasing the quality of non-financial disclosures by issuers, engaging with management to help mitigate ESG risks, and elevating awareness and acceptance of ESG through collaborative initiatives.

Western Asset is proud we have evolved the governance of our business for the benefit of our clients and staff. Through this Stewardship Report we hope you will gain specific insights into our ESG programme: the practical applications, our rationale, as well as the investment into our ESG infrastructure over the past year. Should you have any questions or comments, please do reach out to your Western Asset representative.

Thank you for your interest in Western Asset.



James W. Hirschmann III
President and Chief Executive Officer



"At Western Asset, we honour the trust our clients place in us as stewards of their capital. We maintain that trust by understanding and meeting our clients' investment objectives.

To help us manage the impact of the unique geopolitical and economic challenges of the last year, we have successfully deployed resources from across our Firm in partnership with our clients."

James W. Hirschmann III

Introduction

Western Asset Commitment to the UK Stewardship Code

Western Asset has been a steward for its clients' assets since 1971, providing active fixed-income diversified portfolio solutions for clients and delivering long-term results over many economic and business cycles. In 2020, Western Asset welcomed the expansion of the UK Stewardship Code across all asset classes, including fixed-income. Western Asset prepared its first Stewardship Code Report (Stewardship Report) in 2021 and was recognised as a signatory by the Financial Reporting Council (FRC) in 2022. The expansion of the UK Stewardship Code to consider a broader set of asset classes has allowed the Firm to align formally with the UK Stewardship Code's 12 Principles, and to demonstrate its commitment to responsible allocation, management and oversight of capital to create long-term value for clients and their beneficiaries. Western Asset engages with issuers of debt securities to ensure it delivers long-term financial and sustainable outcomes for its clients. Importantly, stewardship must consider how these non-financial factors can impact the value of our clients' assets. To that end, Western Asset has been collaborating on a selective basis with organisations such as PRI, Transition Pathway Initiative (TPI), Climate Action 100+ (CA100+) and the Assessing Sovereign Climate Opportunities and Risks (ASCOR) project to advance investor and issuer practices and to support our clients in the area of stewardship and ESG investing. Western Asset has a comprehensive Diversity, Equity and Inclusion plan to help improve its employee recruiting, retention and satisfaction, and ultimately to enhance the quality of its service to clients.


Western Asset is proud of its achievements over the past year. At the same time, we continue to improve and are working further to deepen ESG practises across all our offices and strategies, and to explore the evolution of client portfolios with respect to ESG.

Reporting Period in Numbers

1 July 2021 – 30 June 2022



Western Asset's Stewardship Journey

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- 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.
 - 2018**
Western Asset appoints a dedicated Global Head of ESG Investments.
 - 2019**
Western Asset adds a formal ESG Engagement Policy to advance its stewardship efforts, becomes a supporter of the Task Force on Climate-related Financial Disclosures (TCFD) and TPI, and hires a dedicated ESG Research Analyst.
 - 2021**
Western Asset becomes a signatory and participant of the CA100+. Additionally, Western Asset hires a dedicated ESG Product Specialist.
 - 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.

How we view stewardship at Western Asset has evolved over the last five decades. We remain as committed as ever to our role as a fiduciary and to our goal of delivering strong risk-adjusted returns. While we have incorporated ESG analysis into our investment process for many years, the Firm has strengthened its commitment to ESG over the last few years by formalising research frameworks, integrating ESG data into portfolio risk reports and compliance systems, and dedicating additional resources to ESG efforts.

Western Asset is a multi-national Firm. We have offices in nine locations around the world, each reflecting its own unique local culture. We offer a broad range of investment strategies for our clients and invest in a wide range of instruments. We serve a diverse set of clients. Our stewardship journey involves continual improvement. While we have always been intensely focused on our fiduciary duties—meeting client investment objectives and maintaining infrastructure and policies that enable us to meet our obligations—the Firm recognises that our stewardship journey remains a work in progress. We continually work to strengthen areas that are less mature and evolve other areas as necessary, including tool development and data availability. Some areas of focus require time as our approach becomes more refined, better documented and further integrated into the day-to-day services we provide clients—

especially as client views on responsible investing evolve over time. Some strategies and instruments, for example, have different ESG implications and require programme development to address more fully and thoughtfully as we understand these dynamics with increasing clarity.

Market practice is always subject to ongoing evolution, regulatory changes, data availability and new investment perspectives, all of which will continue to inform this journey. We have intentionally made our stewardship programme more inclusive by fully broadening participation from all operational areas of the Firm during the Reporting Year, while also continuing to incorporate different perspectives and experiences from new team members. As with any firm that makes the commitments described in this Stewardship Report, a degree of candour is required to recognise that applying its principles in practice is a process. We humbly strive to improve our practice every day.

A Year in Review

As part of Western Asset's commitment to align with our clients' priorities and offer innovative solutions that meet their expectations, the Firm has made investments during the past year across a range of data services, investment strategies, systems and human resources as highlighted below:

- **Product launches:** Since our last Stewardship Report submission Western Asset launched a new Article 8 fund under the EU Sustainable Finance Disclosure Regulation (SFDR)—Sustainable Global Corporate Bond Fund—and led the conversion of the Short Duration Blue Chip Bond Fund from its erstwhile Article 6 status. In addition, the Firm is also completing the conversion of eight additional funds to Article 8 status. Moreover, Western Asset was appointed to manage a segregated account for a large European institutional asset owner that has been classified as Article 8. Another large European institutional asset owner awarded the Firm with a segregated account that has decarbonisation goals.
- **Data integration:** The Firm has sought access to additional third-party data providers such as ISS, in addition to MSCI, as part of our commitment to review data quality and gauge suitability. As data needs and alignment to ESG metrics and regulatory disclosures increase, it is important to have access to more data providers to allow for more meaningful assessment of issuers based on ESG characteristics and to validate underlying data quality where material.
- **VerityRMS:** As part of the Firm's commitment to investing in technology, we have engaged and deployed VerityRMS, which houses Western Asset's research and engagements in a centralised manner allowing research analysts to document, monitor and share their issuer assessments.
- **Reporting tools:** Western Asset believes in transparency and has actively worked with clients and prospects with various mandates to provide them with information to meet their customised responsible investing requirements. Some of these include data on ESG, individual E, S and G scores, weighted average carbon intensity (WACI) breakdown across sectors, alignment to net zero targets, top- and bottom-10 issuers on a range of ESG criteria, including engagement participation information and alignment with UN Sustainable Development Goals (SDGs).
- **Western Asset Information System for Estimating Risk (WISER) developments:** The Firm has developed proprietary methodologies to assess physical and transition risks stemming from climate change for corporate bond portfolios. We took this approach as a result of unsuitable third-party resources that focus primarily on listed large cap equities and assessments based on equity ownership. The Firm has also enhanced its carbon optimiser tool that assists in 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.

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- **Investment in people:** As complexities surrounding sustainability risks increase, Western Asset has hired a sustainability risk manager who joined the Firm's ESG Team with a focus on developing tools both to measure and mitigate portfolio sustainability risk.
 - **Client education and support:** As part of our deep commitment to serving clients, Western Asset has partnered with them in an increasing manner to help them better understand the implications of ESG decisions in designing their portfolios. To mention a few examples, this includes discussions on the implications of inclusions versus exclusions, analysing the impact of concentration limits, thematic tilts, minimum ESG ratings on the investible investment universe, and the effectiveness of alignment with various ESG initiatives.
 - **Issuer engagements covering E, S and G matters increase by 34%:** As part of our fiduciary duty towards our clients, Western Asset has significantly amplified engagements on a range of issues. As active fixed-income investors we believe engagement is imperative to mitigate risks, help issuers improve and hold them accountable to stated targets.



“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.”

UK Stewardship Code 2022

“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.”

Purpose

Western Asset¹ is one of the world’s leading investment management firms. Its primary business since its inception in 1971 is managing fixed-income portfolios. Western Asset’s mission is to be a leader in diversified fixed-income investment management with integrated global operations, exercising uncompromising standards of excellence and ethics in all aspects of the Firm’s business with the goal of delivering the best outcomes for its clients. This is achieved by delivering strong risk-adjusted returns and optimising client portfolios for the changing financial markets and world we live in. In 2021, Western Asset marked its 50-year anniversary; this was a milestone that celebrated a long-standing partnership with clients, and a proud history of delivering value through investments, providing advice and sharing incisive thought leadership.

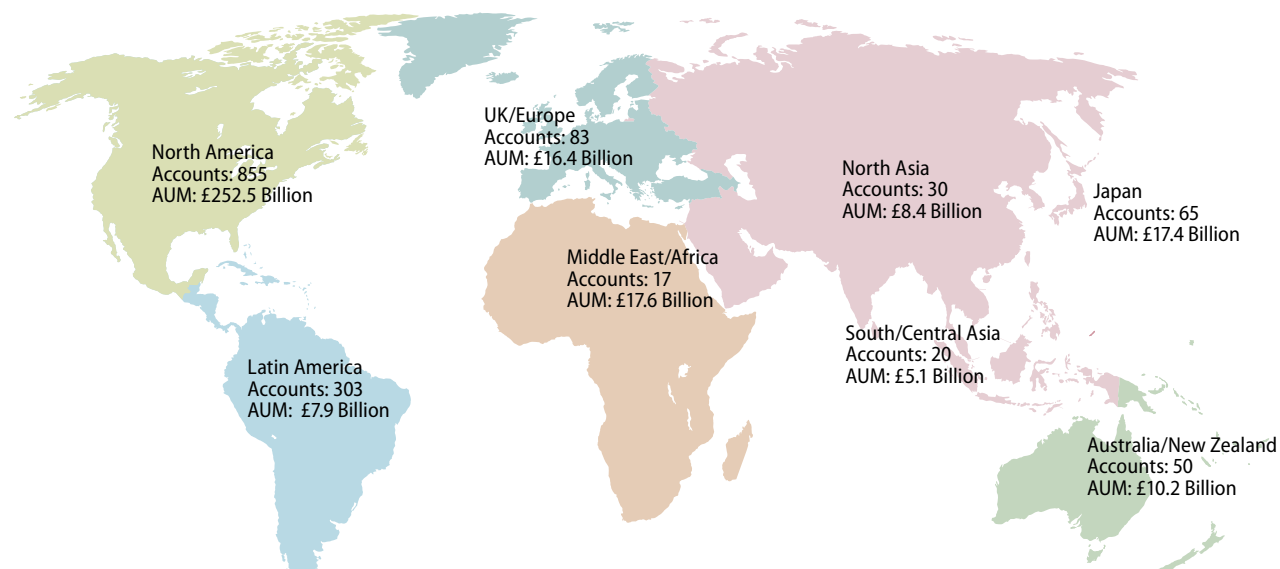
The Firm’s client base primarily includes professional investors, retirement plan and pension plan sponsors, fund selectors, and investment advisors. Because clients have a wide range of investing objectives and needs, regulatory and risk constraints, and organisational models, Western Asset strives to offer a wide variety of strategies across the fixed-income spectrum. Recognising the diversity of client needs and objectives, the Firm focuses on collaborating closely with clients through dialogue, offering thought leadership and creating customised guidelines tailored to clients’ specific return objectives, risk tolerance, investment horizons and liquidity needs.

Western Asset’s clients also benefit from working with an investment manager that has a team-based culture spanning multiple geographies and cultures. The Firm’s international clients from across the globe help form a deeper understanding of different types of clients with their own unique markets, cultures and investment objectives. As a fiduciary, the inherent diversity of the Firm’s investing universe and business operations give it a unique platform to help clients meet their investment objectives. The Firm’s offices have their areas of expertise and act as advocates for their home markets, but they do not operate in silos. The Firm’s overall objective is to be able to most effectively manage client assets with the most appropriate resources, servicing clients where they would like to be serviced (typically as close to their home location as possible), and generally to strive to help our clients meet their investment objectives.

With a diverse client base and the wide geographic footprint of operations, the Firm has a history of investing for the long-term on behalf of its clients across global markets.

¹ Western Asset is a global asset management firm comprised of six legal entities operating as one firm. The entities include: Western Asset Management Company, LLC (the Pasadena and New York offices); Western Asset Management Company Distribuidora de Títulos e Valores Mobiliários Limitada (the São Paulo office); Western Asset Management Company Limited (the London and Zurich offices); Western Asset Management Company Pte. Ltd. (the Singapore office); Western Asset Management Company Ltd (the Tokyo office); and Western Asset Management Company Pty Ltd (the Melbourne office).

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
- £335.5 billion (GBP) AUM
 - £294.1 billion (GBP) long-term assets
 - £41.4 billion (GBP) cash and cash equivalent assets
- 748 employees

As of 30 Jun 2022.

Organisational Pillars

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

AUM by Sector Total £335.5 billion (GBP)

- Global Investment Grade Corporate £99
- MBS/ABS £54
- Sovereign, Treasuries, Agencies £52
- Cash & Cash Equivalents £41
- Emerging Market Debt £31
- Global High Yield £19
- Local Authority & Municipals £16
- Global Inflation-Linked £3
- Other £21

Western Asset's Investment Philosophy

The Firm's focus on long-term investing has been at the core of our investment philosophy since our inception and responsible stewardship has always been an essential part of our culture. This drives us to meet client needs, contribute to well-functioning markets and aligns with the Stewardship Code's objectives of investing with a longer-term perspective in mind.

The overarching investment philosophy of Western Asset is long-term fundamental value investing employing multiple diversified strategies. This investment philosophy has not changed since Western Asset's founding in 1971, and it is consistently implemented across all of the Firm's investment strategies. Western Asset's investment decision-making process and organisation are specifically designed to align with and to support this philosophy.

Long-term, Fundamental Value

- Markets often misprice securities. Prices can deviate from fundamental fair value but over time they typically adjust to reflect inflation, credit quality fundamentals and liquidity conditions. Consistently investing in undervalued securities may deliver superior investment returns.

- Western Asset seeks systematically to identify mis-pricings and capitalise on markets and securities that are priced below fundamental fair value. The Firm does so through disciplined and rigorous analysis, comparing prices via the analysis of its macroeconomic and credit research teams around the globe.
- Western Asset's portfolios emphasises its highest convictions. The greater the difference between the Firm's view of fair value and markets' pricing, the greater the potential value opportunity. The greater the degree of confidence in its view of fundamentals, the greater the emphasis of the strategies in Western Asset's portfolios.

Multiple Diversified Strategies and a Culture of Client Service

- Western Asset seeks diversified sources of returns. Western Asset's objective is to meet or exceed its clients' performance objectives within their tolerances for risk. The Firm seeks to diversify investments and add value across interest-rate duration, yield curve, sector allocation, security selection, country and currency strategies. Western Asset deploys multiple diversified strategies that benefit in different environments, so that no single strategy dominates performance; this helps dampen volatility.

As an investment manager focused primarily on fixed-income,² Western Asset offers a full range of solutions that can be tailored to meet the needs of its clients:

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

² 0.18% of the Firm's AUM as of 30 Jun 2022 are in equity and other non-fixed-income strategies, which follow the same investment principles outlined above. These strategies are not featured in this Report due to their de minimus value versus the Firm's overall AUM.

While Western Asset considers ESG factors and risks in its investment advice broadly, the Firm also has developed a variety of proprietary responsible investment strategies for clients with more specific ESG investment objectives. For example, the Firm currently offers a range of solutions such as the flagship US ESG Core Plus in addition to the Sustainable Macro Opportunities, Global Aggregate ESG, Short Duration Blue Chip and Global Sustainable Corporate strategies. Most recently the Firm began offering the US Investment Grade ESG strategy to investors. These solutions go above and beyond Western Asset's traditional integration of ESG risks and opportunities, as these strategies focus on a combination of sustainable investment facets such as specific decarbonisation targets based on WACI reduction (either on a benchmark relative or absolute annualised basis), thematic alignment to SDGs, minimum portfolio ESG ratings and a range of SRI exclusions.

Western Asset Organisational Pillars

As a Firm, Western Asset is defined by five organisational pillars that enable us to implement our investment philosophy effectively:

Clients First	<ul style="list-style-type: none"> ▪ We put our clients first in everything we do. ▪ We listen, understand and help them succeed. ▪ By meeting or exceeding our clients' expectations, our success will follow.
Active Fixed-income	<ul style="list-style-type: none"> ▪ We believe that by focusing our resources on the management of fixed-income assets we can provide the best service to our clients. ▪ We believe active value-driven investing can add significant return and reduce portfolio volatility over a market cycle.
Team-Based	<ul style="list-style-type: none"> ▪ Our investment professionals around the globe regularly share investment ideas and collaborate on strategy, working together to enhance the quality of our investment thinking and decision-making.
Globally Integrated	<ul style="list-style-type: none"> ▪ Diversity of opinion and specialists based in global investment centres and focused on market sectors, subsectors, and individual issuers meaningfully broadens our opportunity set and improves our ability to diversify investments. ▪ We think and act on a global basis.
Integrated Risk Management	<ul style="list-style-type: none"> ▪ In our culture, effective risk management is critical to successful portfolio management. ▪ Integrating risk management into portfolio construction strengthens its effectiveness. ▪ Risk management is a team effort. ▪ Robust communication and escalation procedures underpin the independence and transparency of risk management.

For the last 50 years, these pillars have been an inherent part of Western Asset's culture and how it does business. The Firm has also recognised, however, that there are changes in client needs and objectives, and evolution in thinking about investing risks, priorities and opportunities that further enrich the engagement of its staff for the ultimate ben-

enefit of the Firm's clients. As such, Western Asset strives continually to cultivate what makes its business resilient and durable, and to take advantage of opportunities that make it stronger. ESG considerations are intrinsic to this process and to Western Asset's philosophy.

Western Asset's ESG Philosophy

Given its alignment with Western Asset's long-term fundamental value philosophy, ESG is an important tenet of the Firm's investment process and is incorporated across a range of fixed-income strategies that the Firm manages. ESG research is integrated within the Firm's comprehensive general research process and led by its sector specialists, who analyse ESG factors in conjunction with traditional metrics.

Western Asset believes that ESG factors can affect the creditworthiness of fixed-income issuers' securities and therefore impact the performance of fixed-income investment portfolios. These factors are wholly consistent with the Firm's long-term, fundamental value-oriented investment philosophy.

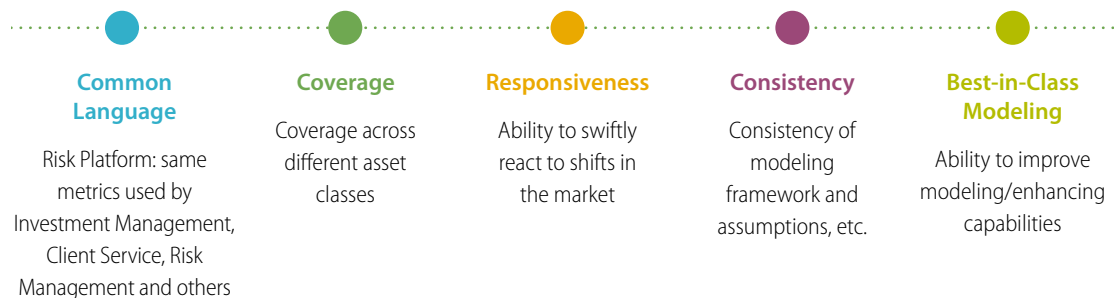
The types and importance of the ESG factors that the Firm's research analysts study depend on the asset class, sector and individual issuer. Research analysts are critical in defining these for each issuer they cover, and in thereafter providing investment rationales to portfolio managers for consideration. The primary responsibility of a 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 team's views within the context of each mandate's guidelines and risk tolerance.

Risk Management

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 considerations, to name a few, that should form part of an issuer's assessment. Therefore, the Firm's research analysts have designed ESG frameworks that identify material E, S and G risks across sovereigns, various credit sectors and securitised fixed-income asset classes.

As part of the Firm's robust risk management process, Western Asset has developed a proprietary methodology to conduct climate stress tests on client portfolios. These climate stress tests are designed to understand and estimate the impact of climate-related risks in a variety of scenarios. The Western Asset Risk Management & Quantitative Solutions Department 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



Collaborative Engagement and Investor Initiatives

While Western Asset has been a member of the PRI since 2016, the Firm continually evaluates collaboration with initiatives in which it feels it can have a meaningful involvement and impact. To this end, Western Asset became a founding member of the UN PRI Sovereign Working Group and UN PRI Sub-sovereign Debt Advisory Committee, and also joined as supporters of TCFD, TPI, CA100+ and the ASCOR Project during the Reporting Year.

People

Western Asset takes a team-based approach to its investment process, combining expertise from its portfolio managers, research analysts, traders and risk managers. The ESG efforts of the Firm are supplemented by a group of ESG experts. Western Asset appointed a Global Head of ESG Investments in 2018, and added an ESG Research Analyst in 2019 and a dedicated ESG Product Specialist in 2021 to support research and engagement, thought leadership, product development and stakeholder engagement. During the Reporting Year, Western Asset has sought to consolidate its existing resources and determine where there are additional opportunities to grow the ESG Team. In 2022, the Firm created a position for a designated Sustainability Risk Manager.

Culture

Western Asset is committed to being the premier fixed-income investment management firm in the world. Trust, Honesty, Integrity, Teamwork, Diversity, Mutual Respect and Personal Responsibility are our core values. Continuously shared and applied throughout the Firm, our values enrich and enhance our efforts to excel for our clients, our people and our organisation.

These core values apply to all employees and are integral to the Firm's success. All employees are expected to adhere to and apply these values in their day-to-day work and in their interactions with others. Throughout the Firm, we strive to maintain a culture in which each employee feels a sense of belonging and is empowered to contribute to their full potential.

As part of our values-driven culture, and to enhance overall business performance, the Firm upholds Diversity as a core value and views it as fundamental to our business. We keep this in mind during the human resources recruiting process as it pertains to attracting and retaining top talent, as well as serving our clients through the most effective business solutions. The Firm's business has inherently been infused with an appreciation for different countries, cultures, markets and people. Western Asset invests in markets across the globe, which requires a daily engagement with issuers, brokers and service providers with many different traditions. The Firm's global business model, weaving together a team-based approach with multiple offices located around the world, requires day-to-day engagement among staff in different locations. Recruiting from the regions surrounding the Firm's offices leads to a diversity of staff far greater than would be the case if the Firm operated out of one office in one location. The Firm's global client base likewise requires day-to-day interactions with clients from different backgrounds and cultures. These realities provide a strong foundation for the proactive measures the Firm takes to find ways to better allow employees to be fully involved and contribute.

Diversity, Equity and Inclusion

Our Philosophy

Western Asset is committed to serving the best interests of its clients by achieving excellence in its investment management services. The Firm believes Diversity, Equity and Inclusion (DEI) principles are essential to providing superior client service, which is why the principles of DEI are embedded across the Firm.

DEI is vital on many counts. In terms of the Firm's critical competitive advantages, DEI ensures we are able to recruit, hire and retain long-term the absolute best talent and incisive minds, creating a team of diverse, world-class investment and client-support professionals to maintain the highest level of investment services for the benefit of its clients.

Our Approach






Western Asset's comprehensive approach to DEI globally, and to affirmative action in the United States, provides that all applicants and employees be recruited, trained, promoted, retained and compensated strictly on the basis of qualifications for the role and treated equally in these and all aspects of the employment relationship. The Firm remains committed to ensuring equitable pay practices across global offices. Further, Western Asset's commitment to DEI extends to partnerships with clients, vendors and the global communities it serves.

In January 2021, the Firm formed the Western Asset Diversity, Equity and Inclusion Committee (DEI Committee), which comprises 13 senior colleagues from four of our eight global offices. The DEI Committee is tasked with developing and implementing a comprehensive DEI Programme connected to 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 and the Firm adopted a comprehensive formal framework to help ensure that our global DEI goals and priorities—and clarifying them—continue into the future and perpetually. 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.

A summary of Western Asset's eleven-point DEI Programme is shown below:

DEI Global Framework Summary

How Will Western Asset Generate DEI change?		
Establish a DEI Function	Hire Dedicated DEI Headcount	Allocate a Budget for DEI
 Recruiting	<ol style="list-style-type: none"> 1. Broaden our diversity recruitment outreach programme. Focus our energy on establishing three key strategic DEI partnerships and develop an internal "Recruitment Ambassador" programme. 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. 3. Enhance the interview process by increasing the diversity of interviewers; providing bias training for hiring managers and interviewers; and standardizing a portion of interviewer questions. 	
 Training & Development	<ol style="list-style-type: none"> 4. Improve our current internship programme. Programme enhancements may include establishing returnships, junior analyst positions and rotational programmes. 5. Provide diversity-focused training on topics such as microaggressions, inclusion, belonging, cultural awareness and unconscious bias. 6. Develop mentorship, sponsorship and development planning programmes (currently in development within the UNITE employee resource group). 	
 Accountability, Metrics & Reporting	<ol style="list-style-type: none"> 7. Modify incentive structures to encourage policy adoption (contingent upon clear articulation of the Firm's DEI goals and training). 8. Implement procedures and systems to track and monitor progress. Adjust our strategy as needed. 	
 Communications	<ol style="list-style-type: none"> 9. Communicate DEI progress internally and externally to facilitate transparency and common understanding of the Firm's DEI goals. 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. 	
 DEI	<ol style="list-style-type: none"> 11. Develop a globally integrated DEI policy based on the requirements of each local office. 	

Source: Western Asset. As of 30 Aug 22

Western Asset's approach to DEI has the full support of the Firm's CEO, who serves as the Executive Sponsor for the DEI Committee. The Firm's Executive Committee provides the executive leadership and vision that inform our overall DEI agenda and that help synchronise Western Asset's DEI goals with the Corporate Social Responsibility goals of its parent company, Franklin Templeton.

Employee Resource Groups at Western Asset

Western Asset views employee resource groups (ERGs) as a critical component of its DEI strategy that will ensure progress and accelerate impact. The Firm encourages, supports and promotes the creation, establishment and growth of ERGs globally as a way of enhancing Western Asset's diversity recruitment efforts as well as accelerating the impact of diversity and inclusion within the Firm. To date, nearly 46% of Western Asset's staff have voluntarily joined at least one ERG, proving the importance and wide appeal of these groups. The Firm supports the following ERGs spanning a variety of shared interests and perspectives:

46%
of staff belong
to at least one
ERG

- **Asian Pacific Islanders for Engagement and Excellence:** APEX seeks to celebrate and support Asian-Pacific Islander cultures within Western Asset by embracing differences and promoting professional and personal development.
- **Black Heritage Network:** BHN aims to facilitate the professional development of Black employees by providing an educational forum, creating connections and promoting an inclusive environment at Western Asset.
- **Latinos for Engagement, Advancement and Development:** LEAD seeks 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 Western Asset's mission.
- **Pride:** Pride seeks to provide a forum for education and awareness supporting the professional growth of LGBTQIA+ (lesbian, gay, bisexual, transgender, queer and questioning, intersex and asexual/aromantic/agender) individuals by fostering a safe environment within Western Asset for staff to be authentic in the workplace.
- **Unify, Network, Inspire, Teach and Empower:** UNITE seeks to unify, provide a network and space to inspire, an environment to teach, and a way to empower women within Western Asset.

Western Asset's ERGs provide support by fostering an inclusive and safe working environment, and creating opportunities for employees to develop both personally and professionally. Through ERGs, the Firm encourages employees to engage in open, authentic and global conversations around diversity and inclusion, to learn productively about the diversity that the Firm involves, to demonstrate the spirit of ally-ship towards their colleagues, and to develop a collaborative sense of community as Western Asset continues on its DEI journey. To demonstrate the Firm's steadfast commitment to this part of its DEI strategy, each ERG is assigned a dedicated sponsor from the Executive Team. The Executive 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.



Training and Development Opportunities Around Diversity

All Western Asset professionals and staff are required to maintain their core competencies through internal training, professional reading and attendance at industry-related functions. Internal programmes, which make up a majority of the training that employees receive, are designed not only for assimilation into the Firm and the employee's job functions, but also for career and employee development. Specifically, for diversity training the Firm provides:

- 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 at Western Asset, is leveraged to provide a wide range of trainings around diversity, discrimination and harassment, appropriate workplace behaviour, performance management, communication and collaboration. At present, there are over 25 courses on inclusion and over 30 courses on diversity. Additionally, in 2022 the Firm initiated a new video series called "All In", featuring leadership at Western Asset, designed to empower leaders across the organisation to model inclusive behaviours in meetings and build more inclusiveness into our culture.
- DEI training and workshops on topics such as psychological safety and unconscious bias.

In addition to the internal programmes, Western Asset supports and encourages its employees to further develop their potential through external educational, training and development opportunities. The Firm stands behind its commitment to education by subsidizing the costs associated with approved classes and related business expenses.

Environmental Initiatives in Western Asset's Global Offices

Much like the Firm's core values, another area in which Western Asset's staff around the world are united is 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, convert to renewable sources of energy, implement more sustainable processes, and enhance the well-being of our employees.

Some highlights of the progress made during the Reporting Year:

London










- 100% of the energy used in the office is renewable
- The London office reduced the amount of electricity (kWh) used over the following timeframe:
 - 1 July 2020 – 30 June 2021: 542442.29
 - 1 July 2021 – 30 June 2022: 269815.58
 - Reduction of 272606.71 kWh

Melbourne

- Results from 2021 Building Report
 - 5.1 Star National Australian Built Environment Rating System (NABERS) Energy weighted average rating (up from 4.7 Star NABERS Energy weighted average rating in 2020)
 - 4.6 Star NABERS Water weighted average rating (up from 3.6 Star NABERS Water weighted average rating in 2020)
 - 39% reduction in water consumption
 - 32% waste diverted from landfill
 - 34% reduction in emissions

Tokyo

- 100% of the energy that is used in the building is renewable
- The Tokyo office is a part of the Environment Committee of the Shin-Marunouchi building
- 10th year of participating in “Eco Turn Delivery System”, in which all the stationery is delivered in plastics boxes. The plastic boxes are collected after delivery for reuse.
- PET Bottle Caps Project: The Tokyo office has been collecting thrown away PET bottle caps to donate to the Japan Committee Vaccines for the World's Children. Caps are converted to recycled materials and sold, with the proceeds going towards vaccines to children in developing countries.

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 22

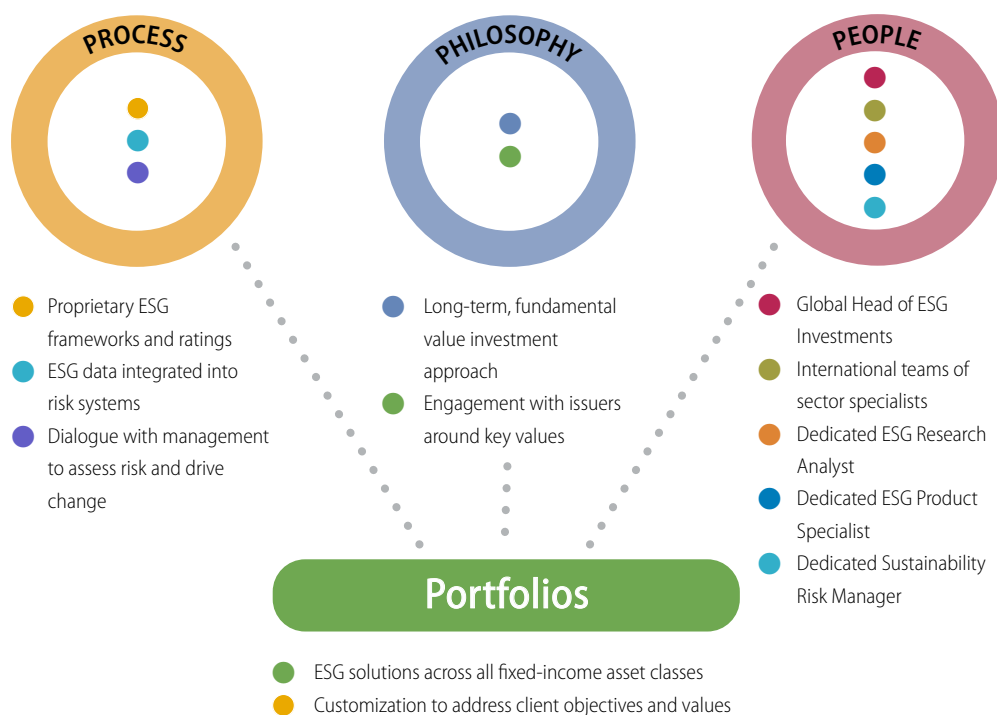


“Signatories’ governance, resources and incentives support stewardship.”

UK Stewardship Code 2022

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

As a long-term, fundamental fixed-income investor, Western Asset believes that ESG considerations as well as engagement are key to delivering value for its clients. As such, ESG is integrated throughout the Firm and its broader operations.



“Western Asset has committed itself to actively enhancing the Firm’s infrastructure for responsible investing, and it did so this past year in a number of ways. Among the improvements upon which we are pleased to report are: 1. Our implementation of a leading third-party research management system to support our research and engagement processes; 2. The increase in the breadth and incorporation of climate and other ESG data and metrics into our compliance and risk systems, and 3. Upgrades to our proprietary models for analysing the impact of climate change on investment portfolios. While we are proud of these achievements, we recognise that our work is far from ‘complete.’ As stewards for our clients’ capital, we have a duty and are profoundly motivated to continue investing in and enhancing our stewardship platform in the years ahead.”

–Michael B. Zelouf, CFA, Director of London Operations

Oversight

Stewardship and ESG governance at Western Asset start with the ESG Strategic Steering Committee (ESGSSC), which is responsible for the coordination of the Firm's ESG efforts and planning. The ESGSSC is further supported by additional ESG committees that focus on both investment and operational matters. Additionally, as ESG is integrated in both the Firm's investment and business operations, it benefits from the Operations Committee as well as local management committees' oversight. Each office maintains a local Management Committee that focuses on business health and strategy related to that office. The Firm also maintains a global Operations Committee that brings together senior managers across the Firm to address operational challenges, strategies and initiatives. While these committees are not ESG-specific, they address ESG from a variety of viewpoints to ensure comprehensive oversight.

ESG Strategic Steering Committee (ESGSSC)

Western Asset formed the ESGSSC in 2020 to advance and monitor the Firm's global ESG platform and initiatives, including those related to climate change. The ESGSSC, co-chaired by Ms. Bonnie Wongtrakool and Mr. Brishni Mukhopadhyay, includes ESG thought leaders from various departments spanning the investment desks, business heads, heads of risk, and regulatory and compliance teams across the globe to allow for a well-rounded discussion on key ESG themes and trends, and the implications that these may have on the Firm. The ESGSSC debates key themes shaping the industry and how to align the Firm's response to regulatory obligations, client needs and operational initiatives. The ESGSSC also ensures that Western Asset's Executive Committee is informed of ESG developments and business needs. Meetings are held on a monthly basis and a broad variety of topics ranging from key developments, investments, sales and client requirements, and risk- and regulatory-related issues are discussed. Members within the committee have different reporting lines which offer independent perspective to allow for a more thorough discussion of issues.

ESG Strategic Steering Committee

<div>Brishni Mukhopadhyay, CFA</div> <div>(Reports to Michael Zelouf, CFA, Head of London Operations)</div> <div>Co-Chairperson</div> <div>Product Management</div>		<div>Bonnie Wongtrakool, CFA</div> <div>(Reports to Michael Buchanan, CFA, Deputy CIO)</div> <div>Co-Chairperson</div> <div>Investment Management</div>	
ESG Committee Members			
<div>Roberto Apelfeld, PhD</div> <div>Risk Management</div>	<div>Mariam Bahmane</div> <div>Investment Management</div>	<div>Ryan Brist, CFA</div> <div>Investment Management</div>	<div>Michael Dale</div> <div>Client Service, Asia/Pacific</div>
<div>Courtney Hoffmann</div> <div>Regulatory Affairs & Compliance – US</div>	<div>Ian Justice</div> <div>Investment Management</div>	<div>Ahmet Kocagil, PhD</div> <div>Risk Management</div>	<div>Dennis McNamara, CFA</div> <div>Investment Management</div>
<div>Jelena Petrovic</div> <div>Regulatory Affairs & Compliance – UK</div>	<div>Sean Rogan</div> <div>Investment Management</div>	<div>Annabel Rudebeck</div> <div>Investment Management</div>	<div>Damon Shinnick, CFA</div> <div>Investment Management</div>
	<div>Susan Signori</div> <div>Client Service, US</div>	<div>Michael Zelouf, CFA</div> <div>Client Service, UK/Europe/ME</div>	

ESG Cross-Mandate Task Force

In 2022, the Firm established an ESG Cross-Mandate Task Force to better align the investment process and ensure consistency of approach to sub-asset classes within fixed-income. The Task Force brings together key sector heads from across the investment team to discuss ESG-related issues as they impact each fixed-income sector. The Task

Force meets on a monthly basis and is charged with maintaining a 'red list' and a 'watch list' of issuers that require increased monitoring and engagement, and that, in some cases, may recommend exclusion of certain issuers. The Task Force comprises Mr. Michael C. Buchanan, Deputy CIO, the heads of various investment desks, senior research analysts and portfolio managers, as well as Ms. Wongtrakool, Ms. Bahmane and Mr. Mukhopadhyay. With respect to ESG investing, the treatment and assessment of issuers from an ESG perspective may impact strategies in different ways. For instance, how dedicated emerging market portfolios should allocate to sovereign issuers with elevated concerns compared to strategies benchmarked against the Bloomberg Global Aggregate index may differ in terms of corporate names this includes discussions on specific issuers and whether these should exist in sustainable portfolios. Although the approach to holding issuers within each of these strategies may differ subtly, the ESG Cross-Mandate Task Force aligns the thought process and ensures the consistency of approach.

Sustainability Risk Team

The Sustainability Risk Team comprises the heads of risk team globally, Mr. Roberto Apelfeld, Manager of Pacific Rim Portfolio Risk & Head of Client Solutions, Mr. Paulo Caricati, EMEA & LATAM Head of Risk Management and Sustainability Risk Manager, Ms. Tania Labastida Garcia, Sustainability Risk Manager, Ms. Marjan Zahedi, Portfolio Risk Manager, in addition to Ms. Wongtrakool, Ms. Bahmane and Mr. Mukhopadhyay. The team meets on a weekly basis 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 on portfolio allocation and risk tolerances based on decarbonisation targets, to mention a few. Members of the risk team report into Mr. Ahmet Kocagil, Chief Risk Officer.

ESG Sovereigns Working Group

The ESG Sovereigns Working Group seeks to assess material indicators that affect sovereign ESG ratings ranging from environmental factors such as cyclical and structural aspects of climate change, the impact of social factors such as health and human capital, equity, inclusion and demographics, and governance considerations such as macro-policies, institutional strength, government effectiveness, security and property rights, structural policies on trade, finance and business regulations to mention a few. This working group meets bi-monthly and includes sovereign research analysts covering developed markets, emerging Asia and emerging LATAM along with members of the ESG Team.

ESG Infrastructure Working Group

Western Asset believes that a robust operational infrastructure is important to manage portfolios effectively, especially in regard to incorporating ESG considerations. The group seeks to facilitate cross-functional coordination, clarify roles and responsibilities in relation to ESG matters, identify operational areas of risk and matters that need to be escalated to the ESGSSC, and to support the evolution of Western Asset's ESG programme. The group meets quarterly. The working group involves team leaders and subject matter experts who ultimately report into the Executive Committee.

Additionally, several members of the ESG Infrastructure Working Group representing IT and system infrastructure have separate bi-weekly meetings with members of the ESG Team. Issues discussed range from the preparedness of IT infrastructure, data availability and building out links between systems to allow for a seamless ESG platform. Recent conversations have involved using VerityRMS, the Firm's research management system (which houses research) for ESG research and engagements. More specifically, considerations ranged from how the information can best be uploaded into VerityRMS, disseminated to relevant stakeholders and monitored by compliance teams to conduct checks on the sustainable aspects of portfolios.

In addition to the formal committees outlined above, the Legal and Compliance, Portfolio Risk and Enterprise Risk & Assurance departments play a key role in the Firm's ESG efforts. These departments provide additional elements of ESG governance by being involved in various ESG-related implementation projects, including those related to

research system development, regulatory change and client-driven initiatives that implicate ESG guideline and risk monitoring. This involvement seeks to ensure that Western Asset has the appropriate controls, oversight and escalation points for its ESG framework, which is evolving on a continual basis. Furthermore, ESG specialists also work closely with the Firm's internal IT team to perpetually develop systems to support ESG research integration, portfolio construction, risk management and client reporting capabilities.

Ultimately, the Firm holistically integrates ESG in its operations, allowing for close partnership on ESG initiatives. Western Asset's chosen approach is a result of the Firm's fundamental belief that ESG considerations are key in delivering superior results in fixed-income solutions.

Implementation and Integration

In order to implement and integrate stewardship into the Firm's daily activities, Western Asset has adopted a comprehensive approach involving both resources and systems that support these efforts. By investing in both people and technology, the Firm believes it can best address the stewardship needs of its clients as outlined below.

Resourcing of Stewardship Initiatives

While many Western Asset employees have knowledge of and are involved in ESG investing efforts, several key staff at the Firm are focused on ESG investing as subject matter experts from investment management, client services and product management perspectives. These individuals' functions are integrated into the Firm's day-to-day operations and have substantial visibility and organisational support.

Western Asset has a dedicated Global Head of ESG Investments, Ms. Bonnie Wongtrakool, who oversees, implements and manages the Firm's cross-sector ESG strategies, capabilities, analysis, research and engagement across the Firm. She is supported by a full-time ESG Research Analyst, Ms. Mariam Bahmane and ESG Product Specialist, Mr. Brishni Mukhopadhyay. Ms. Wongtrakool reports directly to the Deputy Chief Investment Officer, Mr. Michael Buchanan. Mr. Mukhopadhyay reports to the Head of London Operations, Mr. Michael Zelouf. Mr. Mukhopadhyay is strategically positioned in the Firm's London office based on increasing regulatory requirements and client demand. Mr. Mukhopadhyay ultimately serves as a steward for our clients' ESG integration needs. Ms. Tania Labastida Garcia was hired in May 2022 as the Firm's first Sustainability Risk Manager. 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.

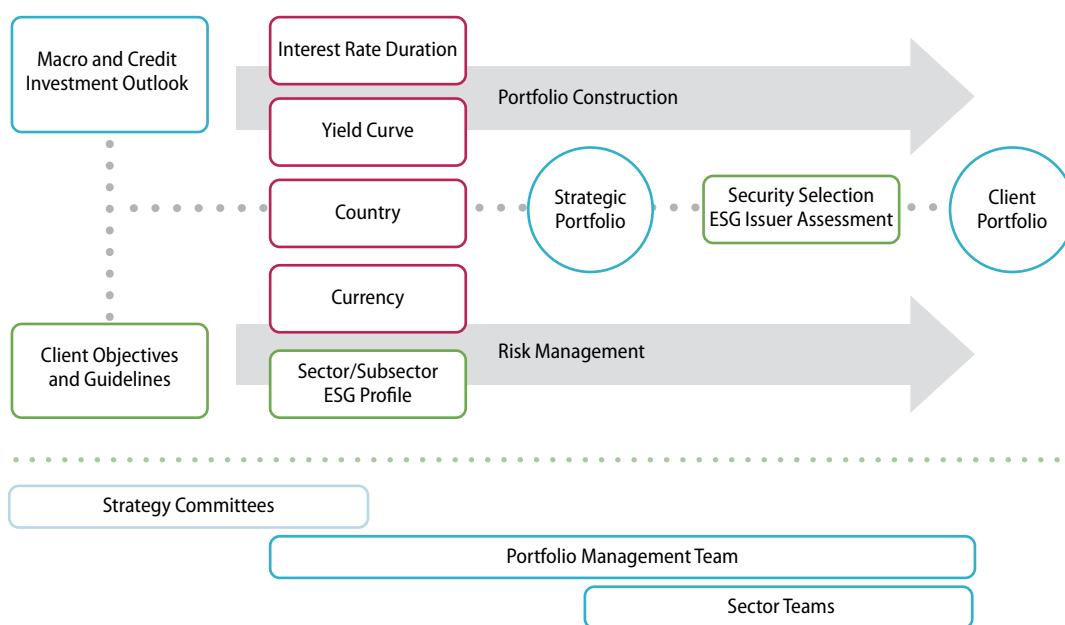
Western Asset's team-based approach to investment management allows for all of the Firm's investment professionals to leverage the collective experience and judgement of the entire investment team as part of the Firm's responsible investing initiatives. Investment professionals, with both sector and 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 team's views within the context of each mandate's guidelines and risk tolerance.

All of 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 specifically look at the impact of ESG factors on individual issuers, which is taken into consideration in formulating the credit and risk profile of the investment. Western Asset's policy is that the research analysts document all new corporate bond purchases (and annually for existing issuers) 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 ESG considerations can often have a material impact on valuations. We believe 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 ESG factors when constructing portfolios, rather than having a separate ESG team that focuses solely on ESG investing. This structure is consistent with our philosophy that ESG considerations affect valuations and should be integrated by everyone when making investment decisions, as opposed to having a siloed team perform this function.

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



The Global Head of ESG Investments, together with the ESG Research Analyst and ESG Product Specialist, works with the Firm's research analysts across its international offices to advance its credit and sovereign ESG analysis and ensure that ESG analysis is applied consistently.

ESG Specialty Research and Engagement



Bonnie Wongtrakool, CFA
Global Head of ESG
Investments/Portfolio Manager

Ms. Wongtrakool leads the Firm's ESG research, engagement, strategies and portfolios, which express Western Asset's ESG capabilities across a wide range of fixed-income mandates. She is a member of the Firm's US Broad Strategy Committee. Ms. Wongtrakool joined the firm in 2003 and graduated Phi Beta Kappa and *magna cum laude* with a Bachelor of Arts in Economics from Harvard College, where she received the Detur Prize and was awarded the John Harvard Scholarship for academic distinction. She subsequently received a law degree, *cum laude*, from Harvard Law School, and is a member (inactive) of the Massachusetts State Bar. Ms. Wongtrakool is also a CFA® charterholder.



Mariam Bahmane
ESG Research Analyst

Ms. Bahmane works in partnership with the Firm's sector research teams to augment the Firm's initiatives in the ESG space. She holds two degrees from Swarthmore College: a Bachelor of Science in Engineering, and a Bachelor of Arts in Economics. During her time there, she was selected to be a D.E. Shaw Nexus Fellow, Karim Abdel-Motal Scholar, Richard Rubin Scholar, and Redefine Her Street Finance Fellow. Ms. Bahmane has also held a Fellowship in Design Thinking from the Hasso Plattner Institute of Design at Stanford University and is an alumna of the Girls Who Invest programme, which includes Western Asset among its corporate sponsors.



Brishni Mukhopadhyay, CFA
ESG Product Specialist

Brishni Mukhopadhyay is a Product Specialist focused on Sustainable Investment and ESG. Prior to joining the Firm in 2021, Brishni was a Sustainable Investment and ESG Product Specialist with Lazard Asset Management. He also worked within Client Strategy at J.P. Morgan Asset Management from 2014 to 2020 and was a member of the Sustainable Investment Leadership Team. He holds a Master of Science in Operations Research (Finance) from Columbia University and a Master of Engineering in Mechanical Engineering from the University of Sheffield. He is a CFA® charterholder and chairs the CFA Institute's ESG Advisory Panel. Brishni is also a part time tutor on Sustainable Finance at the University of Cambridge's Institute for Sustainable Leadership (CISL).

Investment in Technology as part of Resources in Stewardship

As part of the Firm's commitment to robust infrastructure to address the stewardship requirements for clients, Western Asset has invested in VerityRMS. With this new system, research analysts can engage with issuers and log these engagements directly into the tool. Details such as the date and theme of the engagement are captured, as are notes, potential next steps, outcomes, impact on ESG characteristics and investment decisions, where material.

Unlike equities, bond engagements typically do not rely on third-party proxy voting service providers. We believe that given their deep expertise covering individual issuers and sectors, our research analysts are best suited to conduct engagement and to assess best practices and key trends.

Remuneration

The compensation philosophy and process at Western Asset are deeply grounded in the Firm's mission and core values. In compensation matters, as in all aspects of the Firm's business, Western Asset takes a highly integrated global approach and strives to emphasise the Firm's 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 its clients' interests. In line with this approach, the Firm's investment professional incentive programme is structured to reward the entire Investment 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. Compensations are 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. For example, annual reviews for research analysts consider the extent to which the research analyst is carrying out an appropriate level of ongoing analysis and engagement and whether they are taking a full risk profile of an issuer into consideration as part of the research process, including any material ESG risk and opportunities factors. As part of efforts to better structure this assessment for research analysts, a scorecard was developed to be utilised on a going forward basis.

Employee Training and Client Education

The Firm believes that regular formal and informal learning opportunities across Western Asset's departments are essential to responsible investing integration and delivering value for our clients. As part of the Firm's ongoing efforts to advance its ESG capabilities, its dedicated ESG professionals conduct internal training sessions for the Investment 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. Training is utilised extensively to ensure that Western Asset's staff are clear on their role in ESG integration, including regulatory and client obligations.

Examples of Western Asset's continued internal ESG training include:

- Weekly presentations by the Firm's research analysts including the incorporation of ESG factors into their coverage universe.
- Monthly ESGSSC meetings with Investment Team heads and business leaders across offices, including training and updates on a variety of ESG themes in order to facilitate training and transfer knowledge between teams and offices.
- Monthly ESG Cross-Mandate Task Force meetings with various Investment Team heads on a variety of ESG issues and the implications of these on portfolios.
- Ongoing consultation between the ESG and Investment teams in global offices to enhance regional ESG research and engagement frameworks and processes.
- Weekly meetings by the Sustainability Risk Team to discuss methodologies and models for assessment of sustainability risk.
- Ad hoc meetings by the ESG Sovereigns Working Group to discuss key themes affecting sovereign issuers.
- Ad hoc meetings between members of the ESG Team and other internal stakeholders to discuss the identification and valuation of material ESG risks and opportunities as well as portfolio construction built on ESG considerations.
- SFDR training for the Investment Team to ensure it is fully aligned with the expectations of SFDR and the regulatory considerations around Principal Adverse Impacts for Article 8 funds.
- Quarterly meetings by the ESG Infrastructure Working Group to discuss ESG-related themes that span across the Regulatory, Compliance, Legal, Operations and Technology teams.
- Training sessions conducted by the ESG team for Client Service & Marketing groups 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 its clients.
- Firm sponsorship for employees to earn the CFA Institute's Certificate in ESG Investing.

Western Asset also presents at global industry conferences and events to help educate investors on ESG integration and topical ESG-related issues. Examples from this Reporting Period include:

- Panellist, "Climate Change: Understanding and Managing the Climate Change Risks and Opportunities in Multi-asset Class Portfolios", MSCI Americas Institutional Investor Conference.
- Panellist, "ESG Has Integrated, What's Next?", FTIS Symposium.
- Presented to the NeuGroup ESG Working Group (cross-industry association of CFOs and Treasuries) on Green Bonds.
- Panellist, "Responsible Investment through an ESG Lens", Evergreen Webinar (Australia).
- Panellist, "Financial Services Initiatives to Achieve Net Zero Targets by 2050", Economist Climate Risk North America 2022 Conference.
- Interviewed Harvard Business School Professor Robert Kaplan on "Climate Change Investment: Is ESG Accounting Correct?", Brandeis Business of Climate Change 2022 Conference.
- Presented to MGM leadership at the MGM Executive Education Sustainability Summit.
- Panellist, "Accounting for Carbon", CFA Los Angeles Society PORTFOLIO conference.
- Panellist, "The Increasing Importance of Natural Capital for Financial Sector", Australian Institute of Superannuation Trustees.

Also during the period, Mr. Mukhopadhyay was 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.

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 responsible 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. As a result of the ongoing efforts to deepen and strengthen the stewardship programme at Western Asset, engagements increased by 34% during the period, new ESG investment strategies were offered to clients and investors, and ESG



"As responsible fiduciaries, we have a duty to preserve and grow our clients' capital, which we seek to achieve through our long-term fundamental value approach. At Western Asset, we view ESG as table stakes, because we believe it can impact the long-term risk-adjusted returns that we produce for our clients."

—Michael Buchanan, CFA, Deputy Chief Investment Officer

AUM increased by 4%. The Firm's governance structure was enhanced by the establishment of the ESG Infrastructure Working Group. Importantly, the Firm's stewardship efforts were recognised by Western Asset becoming a signatory to the UK Stewardship Code.

Western Asset believes that the efforts outlined around governance structures and processes above demonstrate our ability to engage multiple stakeholders to consider various facets of ESG integration holistically. Western Asset believes that ESG integration is a dynamic and evolving area, and that having representation from multiple channels allows us to discuss and debate the implications from all angles to offer credible solutions to our clients. Western Asset is continuously working to deepen its resources in the area of ESG to support increasing regulatory and client demand in this area.



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

UK Stewardship Code 2022

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

Western Asset operates as an investment manager. As a fiduciary to its clients, Western Asset provides services in the best interests of its clients. For legal, regulatory and business reasons, the Firm is and always has been focused on identifying and addressing potential conflicts of interest. Towards that end, 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 strives to identify, prevent, manage and disclose effectively, wherever necessary, any significant conflicts of interest. Western Asset’s [Statement of 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’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 take steps to identify and address actual and potential conflicts that could arise through its role as investment manager. In addition, these potential conflicts are monitored, managed and controlled on an ongoing basis. Not all potential conflicts are actual or material 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, detention methods and controls, as well as dedicated policies for each conflict of interest. Generally, Western Asset’s business does not materially 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 requested 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, and
- Outside business activities.

Western Asset also considers any circumstances of which the Firm is aware that may give rise to a conflict arising 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 business.

Western Asset takes measures to reinforce and strengthen its “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 tailored as needs evolve and delivered by Legal and Compliance staff rather than a generic outside 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 debate key issues related to stewardship and its implementation. Members of the ESG Cross-Mandate Task Force and ESG Strategic Steering Committee, among 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 the consequent implications is necessary to arrive at a nuanced decision that reflects our clients’ best interests.

Examples 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 its 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 similarly situated account is treated 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 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 manages a

range of global aggregate bond portfolios under a strategy known as Global Core Plus. One mandate with the Global Core Plus strategy is for a large institutional investor with specific sustainable guidelines. Western Asset identified two sovereign issuers that we believed would not align with the client's ethos around responsible investing despite the guidelines permitting such an investment. Once this potential conflict was identified, the client was consulted to evaluate the alignment of these sovereign issuers with the implicit responsible investing beliefs underlying their mandate. Based on the discussions, the client agreed with Western Asset's approach of excluding the two sovereign issuers. While the specific mandate ultimately did not invest in these two sovereign issuers, the Firm invests in these sovereigns in other Global Core Plus mandates based on the issuers' ESG risk more broadly and risk-adjusted returns expected for these issuers. 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.

Examples of Conflicts of Interest: Affiliations

When Western Asset makes trading decisions for its clients, it is obliged to make those decisions on the merits of its 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. Its 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 its 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.

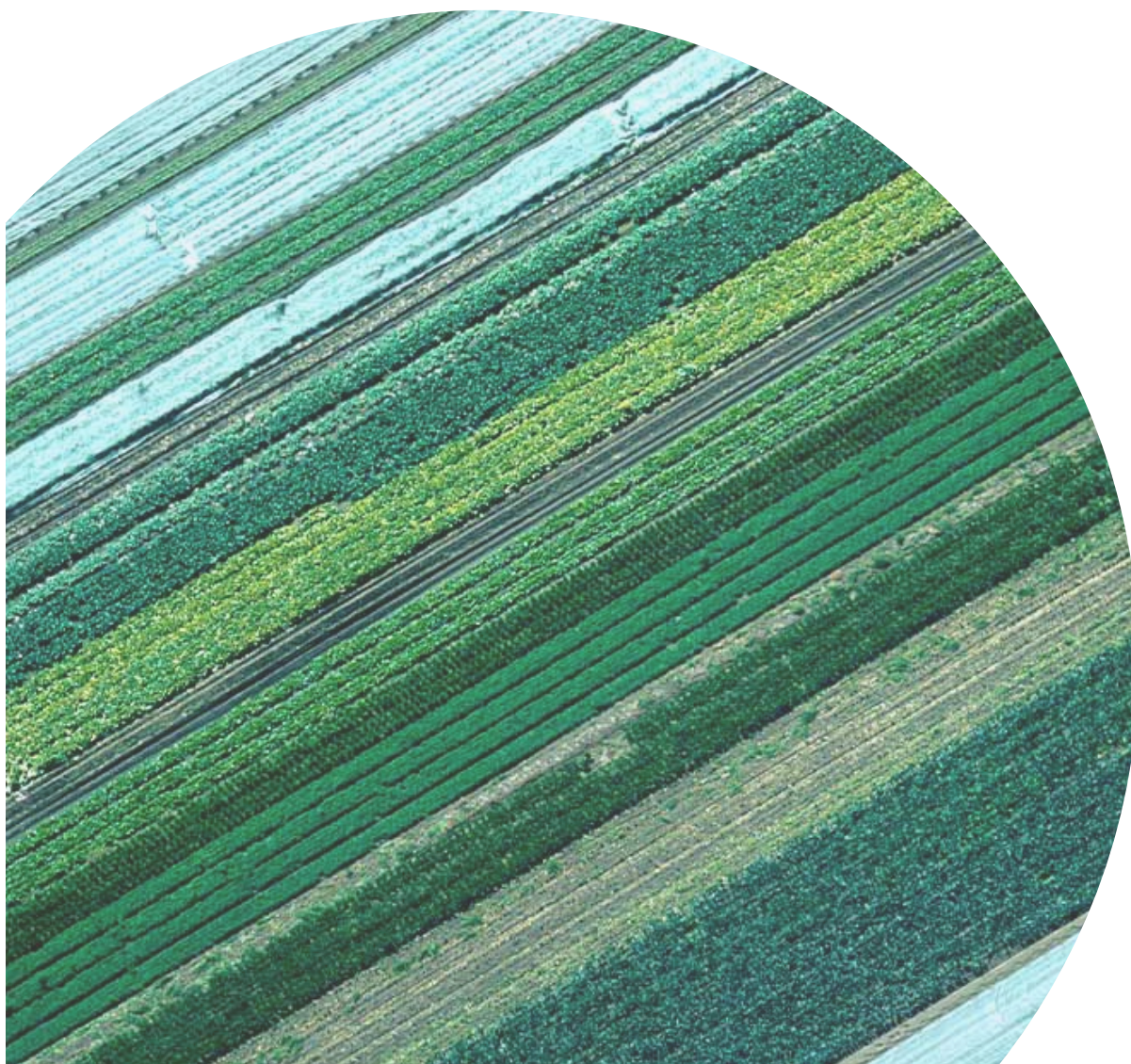
Examples of Conflicts of Interest: Personal Trading

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 utilise My Compliance Technology (MCT). The system contains employees' personal brokerage accounts and data-feeds with trading activities. MCT 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 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.”

UK Stewardship Code 2022



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

At Western Asset, we believe that the core of our mission is to deliver superior long-term investment results to our clients while adhering to our high standards of personal and corporate accountability. Therefore, Western Asset serves as a contributing and active participant in working groups on a broad universe of globally relevant investment, regulatory and ESG topics, with an aim to promote efficient investing, responsible corporate governance, sustainable development and market stability in the interest of our clients, ourselves and our world. The Firm participates in the development of standards and initiatives where we believe our contributions will make an impact. Our risk management framework encompasses identifying and mitigating the investment, corporate, environmental, regulatory and social risks that endanger our complex landscape.

Independent Yet Collaborative Risk Management

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 limits underperformance if the future does not unfold as expected.

To do this effectively, very strong communication amongst risk managers and portfolio managers is essential. Maintaining independence between Western Asset’s Risk Management & Quantitative Solutions department and its Investment Management department provides an important counterbalance. The Firm places substantial emphasis on this collaborative approach. This collaboration is supported by robust systems and processes results in an integrated risk management platform within the Firm’s global team environment.

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, every proprietary investment research framework (more than 50 developed by the Firm) identifies and assesses financially material E, S and G risks. Based on the research, research analysts provide an ESG score that we believe is reflective of the underlying ESG risk.

Identifying and Acting Upon Climate Risk & Decarbonisation

Increasingly, financial regulators recognise climate change as a systemic risk that has the potential to disrupt financial markets, affect investment returns and have a negative impact on the broader economy. During the Reporting Year, Western Asset notes the Department for Work and Pension’s concerns stemming from climate change as a systematic financial risk and one that needs to be integrated into various investment considerations.

Western Asset understands that there are various types of risks posed by climate change, whether they be physical (droughts, floods, wildfires and hurricanes) or transitional (as when transitioning to a low carbon economy). The results of these risks materialising would entail:

1. The transition process to a lower carbon society that will involve costs, taxes, policy changes, prohibitions, subsidies, gainers and losers, corporate losses and defaults, sovereign fiscal difficulties, credit downgrades, political tensions, etc.

2. Chronic (physical) effects of higher temperature such as rising sea level, floods, droughts, migration, political tensions, as well as an increase on corporate and national capital stock and revenues of climate (physical) events (wildfires, floods, storms, etc).

To evaluate and address these risks, Western Asset's Risk Management & Quantitative Solutions department has established a dedicated Sustainability Risk Research group. This team focuses on applying quantitative tools, including the Firm's proprietary 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. During the Reporting Year, the Risk Management & Quantitative Solutions Department has fine-tuned its climate risk assessment model further for measuring transition risks from climate change and developed its own model for measuring physical risks from climate change.

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. The climate risk stress test 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. The Sustainability Risk Research Group owns the models for the carbon optimiser and climate risk stress tests and monitors for their efficiency and future development.

For clients interested in portfolios with carbon-based targets, Western Asset suggests a dual-track approach to decarbonisation: 1) A portfolio optimised to significantly reduce its initial carbon footprint and related ESG risks (e.g., thermal coal production), and 2) An ongoing strategy of portfolio maintenance and issuer engagement to further reduce carbon footprint over time. Given Western Asset's expectations of increasing scrutiny and costs associated with carbon emissions, the Firm believes that initial portfolio construction is key in reaching global decarbonisation goals.

Earlier in 2022, an institutional investor awarded Western Asset with a mandate that sought to achieve a reduction in the portfolio WACI of at least 40% relative to the benchmark. Western Asset had used its carbon optimiser to construct a model portfolio and shared it with the client to help them align their portfolio with their climate target.

In a separate scenario, Western Asset engaged with a client to determine whether its decarbonisation objectives were relevant for their portfolio. The client's mandate already had a WACI that was around 50% below the benchmark. The client was looking for a further reduction, which in our analysis, would have resulted in high concentration risks in specific sectors and issuers, and would thereby run contrary to diversification of climate risk and achievement of the client's risk and return targets. As part of our stewardship efforts, Western Asset engaged with the client to help them get a better understanding of the potential implications of additional WACI reductions. The client, having reviewed our assessment, understood the implications of an aggressive decarbonisation trajectory and agreed to move the mandate to a more gradual decarbonisation path that was more aligned with the investment universe and the client's risk and return objectives.

Stewardship duties entail working with clients to help them understand the interplay of climate risks and financial risks, how these vary across different investment universes, and clients' responsible investment beliefs, along with their specific risk and return objectives. When evaluating climate risk, one has to understand the implications on the investment universe such as the data availability for Scope 1, 2 and 3 emissions and how these vary across sover-

eigns, investment-grade credit and high-yield credit. Certain fixed-income asset classes such as securitised fixed-income do not currently have an industry standard on decarbonisation stemming from lack of data.

Western Asset seeks to understand the nuances that such dynamics between climate risks and a well-functioning financial market have, 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 joined the CA100+ in the Reporting Year. Western Asset has also been a supporter of TCFD and TPI since 2019. Additionally, Western Asset joined 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.

Climate Change Related Engagements

Engagement Case Study—Airline Company

Western Asset has been engaging with an airline company over the past few years. The Science Based Target Initiative (SBTi) had just formalised a Below 2 Degrees decarbonisation pathway for the airlines sector. We had inquired whether the company would be willing to build buy-in internally from the company and executive team to formulate a robust decarbonisation strategy in line with SBTi guidance. We also asked the company to develop an action plan that would enable its emissions to reduce accordingly in practice.

► **Outcome:** We have been in touch with the issuer as they were reaching out to investors to explain their decarbonisation strategy. The company was willing to commit to set science-based targets, in line with SBTi recommendations. To formalise their commitment prior to their approval of their decarbonisation plan from SBTi, the issuer committed to publish their medium-term target in their ESG report that same year and committed to update their GHG reduction progress on a yearly basis. Specific to the decarbonisation strategy, the company was adamant that real GHG reduction hinges on sustainable aviation fuel (SAF). The economics of SAF are not advantageous; SAF cost is multiples of conventional jet fuel due to limited SAF supply, infrastructure and incentives. We have been requesting that the company share with the investment industry their demand for SAF; the issuer followed up with closing purchase agreements at appropriate prices for SAF. In addition, they announced that they have been advocating policymakers to formalise incentives for SAF markets. The issuer added that they will consider publishing a climate alignment lobbying report.

Engagement Case Study—Packaging Company

Western Asset engaged with a plastics packaging company to commit to increase circular plastics content of their plastic packaging by 2030, in line with circular economy objectives.

► **Outcome:** In November 2021, the company announced their new target: 30% circular plastics use across its fast-moving consumer goods packaging by 2030. They also set sustainable packaging goals to achieve 100% reusable, recyclable or compostable fast-moving consumer packaging by 2025, in line with the Ellen MacArthur Foundation's New Plastics Economy vision. The company explained that they run monthly meetings to monitor progress towards their circularity goals. They also organise educational trainings for relevant stakeholders on these KPIs.

Having already surpassed their prior target to reduce Scope 3 emissions by 5% some four years in advance, the issuer added a Scope 3 commitment in May 2022 to complement their plastic circularity targets. Their target entails reducing Scope 3 emissions by 25% by 2025 and was approved by the SBTi. The company had already surpassed

their initial goal of reducing their emissions by 8% by 2020. The packager plans to achieve this goal by switching from oil to natural gas, electrify their crackers and produce plastic that is more lightweight (less resin used), more recycled (versus virgin resin) and more bio-based (versus virgin resin).

Identifying and Acting Upon Geopolitical Risk and Cybersecurity

In today's digitally connected world, we are all vulnerable to cybersecurity risks, as demonstrated by cyberattacks on multiple companies in recent years. Furthermore, geopolitical risks highlights that cybersecurity is a systemic risk. In recognition of that, Western Asset has been engaging with multiple firms across various sectors to assess their preparedness to withstand cyber-attacks. The Firm believes that it is only best practice to share and consult with others in an effort to strengthen our own cybersecurity infrastructure and governance program.

Cybersecurity Related Engagements

Engagement Case Study—Pharma Company

In response to a historical data privacy leak, the Firm decided to investigate the strength of cybersecurity governance, audits and software patchwork management of a large pharma issuer.

► **Outcome:** We asked the company to confirm whether all employees go through cybersecurity training, whether the Board of Directors oversees cybersecurity and how often cybersecurity audits occur. The issuer indicated that they conduct internal and external cybersecurity audits and reports are circulated to senior management. The Firm will follow up on the frequency of these audits and board oversight.

To address software patchwork management, we learnt the company has a global vulnerability management programme. Based on our review, their security and data privacy appear to be in line with peers.

Engagement Case Study—Telecommunications Company

Given the critical nature of the telecommunications sector and risk exposure to data privacy leaks, we engaged twice with a major telecommunications issuer over the reporting period on their alignment with best cybersecurity practices.

► **Outcome:** The company laid out their social engineering safeguards including regular employee trainings and technical safeguard so that staff cannot access customer account data or other sensitive info unless proper credentials are provided by the seeker. The issuer explained that they have policies to ensure thorough patch and vulnerability management, for both manufacturer software updates and open-source software tools.

The company confirmed they bring in external auditors to perform penetration tests. The latter are circulated to the appropriate level of management, depending on the nature of the findings. They conduct internal audits and other tests at least annually. The company's internal audit generally brings in an outside, independent firm to assess the maturity level of their alignment with the current (version 1.1) NIST Cyber Security Framework (CSF). They confirmed their cybersecurity programme is aligned to the current (version 1.1) CSF, published in April of 2018. The framework is voluntary guidance, based on existing standards, guidelines and practices for organizations to better manage and reduce cybersecurity risk.

When asked what they do to make consumers comfortable with the security and privacy of their data, the company mentioned they are transparent with their consumers and provide them controls to manage the privacy and security of their data as well as educate them on helpful practices and available protections for their accounts (i.e., scam shield tools, optional family controls).

Promoting a Well-Functioning Financial System

As a leading global fixed-income manager, Western Asset regularly engages with its trading counterparties, bond syndicate teams at investment banks and regulators to help promote a well-functioning market. These include the development of new instruments in the fixed-income markets such as “green bonds” and “sustainability-linked bonds.” In the wake of the global financial crisis of 2008, Western Asset collaborated with other market participants including the CFA Institute in identifying some of the factors that precipitated the crisis, and discussed practical ways of mitigating them for the future. Western Asset also responded to Financial Conduct Authority (FCA) questions and surveys on market liquidity and functioning of money market funds.

Effectiveness in Promoting Well-Functioning Markets

In its efforts to effectively advance responsible investing, Western Asset regularly assesses opportunities to participate in industry groups and initiatives. Certain initiatives are not currently well aligned with the Firm as a fixed-income investment specialist, while others have proven to be a strong forum for collaboration. The Firm has been active in the following areas over the reporting period:

UN PRI Working Sub-Group on SFDR & EU Taxonomy. Western Asset joined as an active participant of a sub-group of the UN PRI’s Sovereign Debt Advisory Committee (SDAC) to review potential implications of SFDR and the Taxonomy regulations for sovereign debt markets. This work has included multiple rounds of feedback to the European Supervisory Authorities highlighting concerns—or flagging areas of necessary clarification—to help ensure these regulations do not unexpectedly or negatively impact sovereign debt markets. This work has also highlighted areas of needed engagement with sovereign issuers and multilaterals to push for greater disclosure on climate and social dimensions of government budgets.

Institute of International Finance Principles Consultative Working Group. The purpose of this group has been to review and 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 and for recent developments across sovereign debt markets. As a full-time and active member of the Group, Western Asset’s efforts culminated in a revised set of Principles for Stable Flows and Fair Debt Restructuring.

Institute of International Finance Committee on Sovereign Risk Management (CSRM). The CSRM 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 CSRM, 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. In 2021 and 2022 Western Asset worked as a member of several restructuring credit committees, which have been documented under Principle 12. Western Asset played a particularly important role, and contributed to meaningfully improving terms through active engagement with the issuer, other creditors, legal and financial advisors. This is very much an intensive process of engagement and negotiation.

IPREO Steering Committee. IPREO is owned by IHS Markit and is one of two platforms in the market that enable primary deals to be brought to the market (investment-grade, high-yield and rates). Western Asset sits on their 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. The Firm continues to work closely with IPREO to help expand the information they are looking to provide per deal to make it more useful for the buy-side user, i.e., showing secondary curves for that issuer, etc. (Chatham House rules apply).

TradeWeb. This is one of the bigger electronic platforms (and an approved multi-lateral trading facility) with which the Firm is engaged; we have the aim of improving Request for Quotes (RFQs) for the buy-side as a whole. The Firm recently worked closely with TradeWeb to add more functionalities to its portfolio trading segment to allow for multi-currency trading (including choosing your base currency), the ability for the user to upload their own reference prices for bonds and for their analytics to provide a bid/offer comparison versus these uploaded levels in addition to their TradeWeb composite. The Firm also works on a regular basis with TradeWeb to improve RFQs on the rates side.

MarketAxess. Western Asset worked closely with MarketAxess on the development of its own portfolio trading platform, which lacked certain analytics and currently cannot perform multi-currency trading. The Firm encouraged MarketAxess to further develop their portfolio trading segment in order to provide the buy-side with an alternative robust choice to TradeWeb.

Bank for International Settlements (BIS). Western Asset participated in the central banks' workshop for liquidity in fixed-income markets at the Bank of England, where the sterling buy-side and central banks convene (via BIS) to discuss factors that may affect secondary liquidity in the sterling market and any potential roadblocks we see in the future.

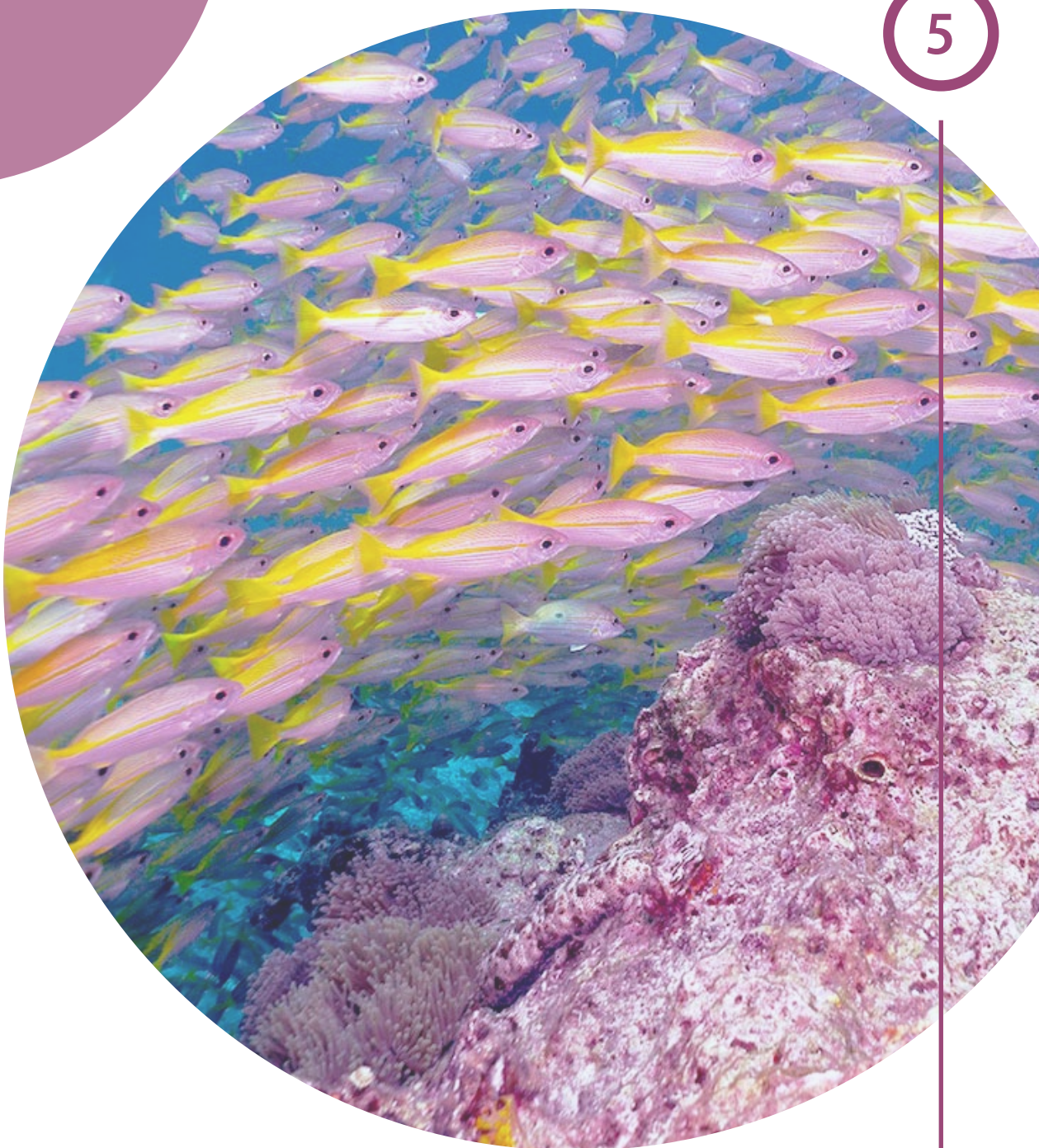
Association for Financial Markets in Europe (AFME). Western Asset participates in regular, small buy-side credit roundtables for investment-grade credit, where we discuss the future of electronic trading and potential liquidity problems.

CFA Institute. Mr. Brishni Mukhopadhyay, Western Asset's 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.



"ESG at Western Asset is truly a global effort, powered by collaboration among teams located across all of our offices. Likewise, sustainable investing is flourishing worldwide, as investor belief in ESG as a tool to identify value and mitigate risk continues to grow."

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



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

UK Stewardship Code 2022

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Western Asset’s approach to ESG and stewardship is outlined in the Firm’s ESG policies, which encapsulate the Firm’s approach to engagement, processes for taking into consideration ESG matters in investment decision-making, application of exclusion lists as well as SFDR-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, committee and working group oversight, as well as through a comprehensive network of controls. Through the reports the Firm provides, clients are able to measure the effectiveness of the ESG programme on their mandates.

Review of Western Asset’s ESG Policies

Western Asset has a long-standing compliance framework that ensures the Firm’s policies and procedures, as well as controls, are reviewed at least once annually, or as a result of material events. The Firm’s ESG framework is supervised by the Firm’s Chief Investment Officer, Head of Global Credit, Global Head of ESG Investments, Chief Risk Officer and Director of Global Client Service & Marketing. Western Asset continuously evaluates its ESG integration process to mitigate ESG risks and improve the robustness of the Firm’s investment and engagement process.

Changes to the ESG-related policies must be made by a collective effort of various subject matter experts, including the ESG Team, investment professionals, portfolio risk managers, as well as Legal and Compliance staff. Each group is charged with staying informed of the changes to industry practices and regulations, and ensuring that Western Asset’s ESG programme evolves in line with these changes.

PRI Assessment of Western Asset’s ESG Integration

As a PRI signatory, Western Asset is required to publicly report on its responsible investment activity annually through the UN PRI Reporting Framework. Western Asset’s 2020 Public Transparency Report is available on the PRI website: <https://www.unpri.org/signatory-directory/western-asset-management-company/1966.article>.

In its 2020 PRI signatory assessment, Western Asset received an “A” across all categories: higher than the median in the Sovereign/Supranational/Agency, Corporate Non-Financials, Financials and Securitised fixed-income categories and at the median in Strategy & Governance.

During the 2021 reporting cycle, PRI incorporated changes in its assessment methodology, shifting to numerical gradation based on one to five stars, away from the alphabetical one that had been used historically. Consequently, the signatory assessment for 2021 was not released until after the 30 June 2022 reporting period.

The Global Head of ESG Investments is charged with ensuring that Western Asset complies with its obligations on an ongoing basis as the PRI signatory.

ESG Team Oversight

At Western Asset, the ESG Team includes ESG specialists: The Global Head of ESG Investments, the ESG Research Analyst and ESG Product Specialist who are supported by the Sustainability Risk Manager. The ESG Team, collectively and on an ongoing basis, reviews the Firm’s approach to ESG investing through their interaction with portfolio managers and research analysts. This interaction allows the ESG Team to identify which processes require changes or enhancements. In addition, through involvement with industry groups and initiatives, the ESG Team is able to identify new trends and

requirements that need to be integrated into the Firm's ESG Framework. The Global Head of ESG Investments may also interact directly with the Firm's senior management to discuss resource requirements.

Internal ESG Committees and Working Groups

Various internal ESG working groups and committees such as the ESGSSC, ESG Cross-Mandate Task Force, Sustainability Risk Team, ESG Sovereigns Working Group and ESG Infrastructure Working Group collaborate in close concert with each other to allow for an inclusive exchange of ideas and best practices in the arena of responsible investing. Separately, the Firm's Global Regulatory Developments Working Group monitors for ESG regulatory changes, ensuring that any such developments are considered as part of the ongoing monitoring process. Equally important, these committees and working groups provide valuable oversight over the Firm's ESG programme and are able to assess its effectiveness. These forums allow for the debate and monitoring of investment processes, identify areas ripe for innovation and adaptation to meet regulatory and client requirements. They also allow members to be aware of the multiple facets of responsible investing stemming from data needs, investment decisions, client requirements, operational support, regulatory implications and future alignment to mention a few key facets.

Compliance Oversight of ESG Processes

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 Legal and Compliance 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 in 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 are able to 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. The Regulatory Affairs group is responsible for the execution of the Firm's Compliance Monitoring Programme, which is currently being enhanced to carry out dedicated ESG integration monitoring that will seek to ensure that the Firm's practices relating to ESG are appropriate and effective.

Portfolio Compliance

The Portfolio Compliance Team has a three-level approach to controlling the investment environment. The first level of controls is the Start Up and Integration Team (SUIT) which spearheads the negotiation and coding of guidelines. Guideline rules are coded into the Firm's proprietary monitoring system known as Compliance Service. This system is designed to address all client guidelines, including ESG-related parameters.

Second, the Portfolio Compliance Team conducts ongoing monitoring which evaluates trades and accounts, on both a pre-and post-trade basis. Portfolio 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. ESG investing fits within the broader framework for all guidelines in client accounts.

Third, Portfolio Compliance professionals also work 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. In turn, this analysis allows clients to make well informed decisions in order to transition their mandates to responsible investments, where they desire to do so.

Transparent and Detailed Reporting

Western Asset believes in transparent and detailed reporting as part of disclosure and alignment to a client's requirements. The Firm has developed a comprehensive reporting suite that allow us to measure the portfolio's alignment on key sustainability indicators. Western Asset can customise reporting to accommodate specific client needs. In addition to monitoring and reporting on economic performance and portfolio risk, Western Asset is also able to monitor and report on the following upon request:

- The ESG score and carbon intensity 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 rating 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
- Investments in labelled thematic bonds (e.g., green, social, sustainable and sustainability-linked bonds)

Case Study—Global Regulatory Developments Working Group

The Global Regulatory Developments Working Group—chaired by Western Asset's General Counsel and comprised of senior members of the Legal and Compliance Department, Enterprise Risk Management, Regulatory Reporting Team, Client Service and Information Technology (IT)—meets monthly to discuss regulatory developments impacting the Firm, including ESG regulatory changes. The Group has been formed to ensure that any regulatory changes are identified, and appropriately assessed, that resources are dedicated to implementation, and that ultimately the

Firm reaches compliance with the relevant regulation in a timely and effective way. Through this forum, the Firm assesses the impact of various ESG regulatory changes including SFDR, EU Taxonomy Regulation, UK TCFD, and proposed SEC ESG Disclosure Rules, amongst others, all of which featured extensively during the Reporting Year.

► **Outcome:** The group's discussions highlighted certain areas where the impact of the aforementioned regulations was more significant including IT, reporting, research and compliance. As a result, additional regulatory assessment tools were developed such as ESG Regulatory and Undertaking Impact Grid highlighting impact analysis and IT system development monitor. The most significant outcome of the work done by the group during the Reporting Year was approval and adoption of VerityRMS, the Firm's research system. Finally, the General Counsel with direct reporting line to the Firm's Chief Operating Officer who is also a member of the Firm's Executive Committee, gained valuable insight and was able to escalate key issues, such as allocation of resources, IT development and client reporting needs.



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

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Understanding Clients’ Needs

Our goal at Western Asset is to have our 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, and to work toward a shared future. Western Asset prides itself on our ability to provide customised investment solutions for our clients, including ESG solutions. We believe that this tailored approach has allowed us to be a valued partner for our clients. Western Asset puts its clients first in everything we do. Western Asset listens, understands and seeks to help its clients succeed. By meeting or exceeding clients’ expectations, Western Asset believes its success will follow.

Dedicated Client Service Is a Hallmark of Western Asset

We believe our primary responsibility to clients is to provide our extensive investment expertise to help them identify investment strategies that will best meet their specific needs. To complement that effort, we provide an exemplary level of client service and assign 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 client’s investments.

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.” Western Asset is most grateful for the trust that our clients have placed in us.

Understanding Client’s Specific ESG Needs

Since 1986, Western Asset has been managing portfolios subject to varying forms of SRI guidelines for clients around the world. The Firm also has experience managing to guidelines with explicit ESG requirements (e.g., environmental tilt, positive screening, SRI, etc.). Western Asset works with each of its clients during the onboarding process to customise investment guidelines that suit the specific aims and objectives of each mandate. A few examples of how we have helped our clients understand the implications of ESG integration 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

This requires continuous engagement with clients to assess whether what is being implemented from an ESG perspective meets their expectations, and to escalate where there may be potential mismatches between ESG expectations and risk-return targets.

Importantly, the Firm also discusses with our clients how we expect to achieve those goals. In addition, in our efforts to detail precisely how we aim to achieve these goals, the Firm works with clients to set appropriate investment hori-

zons—which are generally long-term in nature—and, as a result, we describe how we can plan to meet responsible investing targets that align with their specific timelines.

To support those conversations and to help our clients transition to more responsible investing strategies, including ESG strategies, Western Asset has developed a range of tools as outlined below.

Frequency of Client Communications

	Update	Characteristics
Reporting and ESG Analytical Tools		
Principal Adverse Impact (PAI) Tool	New	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.
TCFD Tool	New	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.
ESG Sovereign CO2 Intensity Impact	New	The report enables attribution analysis of the drivers of emissions intensity within the sovereign asset class.
ESG Portfolio Report	Enhanced	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.
ESG Analysis Tool	New	The report enables comparison of the ESG performance of a portfolio to another and over time.
ESG Research Coverage Tool	New	The tool enables the Firm to monitor the coverage of Western Asset's proprietary ESG research and engagements.
ESG Research Tools		
Verity RMS	New	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	New	The report alerts research analysts of ESG downgrades and upgrades for their issuer coverage.
MSCI Controversy Severity Report	New	The report alerts research analysts of severe and very severe controversies.
MSCI ESG Report	New	The report aims to integrate and disseminate MSCI ESG research to research analysts and portfolio managers.
MSCI Industry Report	New	The report circulates third-party sectorial ESG frameworks to research analysts.
ESG Issuer Tear Sheet	Enhanced	The report enables issuer analysis of its ESG performance versus its peers.

True to our client-centric philosophy, Western Asset works 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), the Firm engages with all types of clients, some may have additional communication needs. The type and nature of communication with clients 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 4,400 client interactions.

Western Asset's Responsible Investment Solutions

While Western Asset considers ESG factors and risks in its investment solutions broadly, the Firm has also developed a variety of best-in-class ESG strategies for clients with more specific responsible investment objectives. For example, the Firm currently offers a range of ESG solutions across various strategies, such as the flagship US ESG Core Plus, Sustainable Macro Opportunities, Global Aggregate ESG, Short Duration Blue Chip and Global Sustainable Corporate strategies. The newest offering is the US Investment Grade ESG strategy.

To enhance Western Asset's product offering, the Firm has launched new investment vehicles and continues to transition more of its fund offerings in compliance with the EU SFDR Article 8 requirements. These efforts are supported by Western Asset's parent, Franklin Resources, Inc. Western Asset's range of ESG labelled funds align with sustainable themes such as seeking carbon reduction based on WACI, SDG alignment and SRI Exclusion and minimum portfolio ESG ratings where relevant.

Additional ESG solutions in our UCITS fund range that are expected to be available to investors in the near future include:

- Global Multi-Strategy
- US Corporate Bond
- US Core Bond
- US High Yield
- Global Core Plus Bond
- UK Investment Grade Credit
- Global High Yield
- US Core Plus Bond

These best-in-class strategies apply an enhanced focus on sustainability factors above and beyond the ESG integration utilised in existing mandates.

Using a robust, actionable, and transparent approach, we partner with our clients to meet their responsible investing, stewardship and fixed-income investment objectives. We will continue to enhance and augment our ESG resources and platform, which integrate material ESG considerations across our strategies, and to work with our clients to offer robust and rigorously constructed sustainable fixed-income solutions consistent with clients' responsible and sustainable investing beliefs, and as well as their investment return objectives and risk tolerances.

Customisation of ESG Investment Solutions

In addition to providing ESG investment vehicles, Western Asset also supports customised segregated mandate solutions for its clients.

During the Reporting Year the Firm had over 800 ESG-related discussions with clients and prospects. In these discussions, the Firm's investment team, client service professionals and the 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, which may over time result in an increasing number of segregated mandates transitioning to customised ESG solutions.

In Western Asset's ongoing efforts to advance the integration of ESG into the portfolio management process and address the evolving needs of its global clients, the Firm will continue to develop ESG solutions.

Case Study—New ESG Mandate

Western Asset recently worked with a large European institutional client that had a decarbonisation mandate to reduce emissions by at least 40% compared to the benchmark. Western Asset developed a carbon optimiser that allows the Firm to identify issuers with lower WACI or GHG emissions in lieu of those with higher emissions while maintaining other risk characteristics such as duration, yield and sector exposure. The carbon optimiser tool allows Western Asset to be overweight in issuers with low carbon intensity while underweighting those with high carbon intensity. This tool certainly proved to be helpful to model portfolios to assess the impact of decarbonised strategies.

► **Outcome:** The Firm was able to demonstrate portfolio implications from an investment risk perspective while meeting the decarbonisation requirements of the client. The client viewed the investment and climate implications of the portfolio and were pleased with Western Asset's efforts and awarded the mandate to the Firm.

Client Reporting

Western Asset can customise reporting to accommodate specific client needs. In addition to reviewing investment results and portfolio risk, Western Asset is also able to monitor and report on the following upon request:

- The ESG score and carbon intensity 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 rating 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
- Issuers with environmental targets
- Investments in labelled thematic bonds (e.g., green, social, sustainable and sustainability-linked bonds)

Engagement Summary Reports

As part of engagement reporting, Western Asset also includes 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. When setting timelines for engagement on specific topics, Western Asset believes in setting credible timelines to meet the clients' expectation and match up 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 issuers' valuations that may affect clients' portfolios.

Unlike equity managers, fixed-income managers cannot cast proxy votes on a quarterly basis to demonstrate alignment with client requirements around responsible investing. However, the Firm can engage on a regular basis to monitor progress.

Specific to climate, Western Asset provides clients with mandate specific reports which include data on the WACI, which is the recommended metric by TCFD. Also disclosed 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.

Publications

As part of our commitment to share our research and to educate our clients, Western Asset publishes thought pieces to showcase our thinking. We believe that this allows us to help our clients understand the implications of incorporating ESG considerations, how ESG considerations can impact valuations and future trends. Our growing library now includes:

ESG-Focused White Papers:

- [Integrating Natural Capital into Investment Decisions](#)
- [Portfolio Risk and Climate Change: Transition Risks in Credit Portfolios](#)
- [An ESG Guide for Asset Owners](#)
- [ESG and Bond Portfolio Performance](#)
- [An ESG Perspective on the Automotive Industry](#)
- [ESG Sovereign Case Study in Indonesia](#)
- [ESG Investing in Sovereigns](#)
- [Western Asset's Approach to ESG](#)
- [ESG Essentials](#)

ESG-Focused Blog Posts:

- [ESG Assessment of Securitized Products](#)
- [Gender Equality in Asset Management Benefits Everyone](#)
- [Assessing Climate Risk in Client 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](#)
- [How Can Investors in Sovereign Debt Help Address the Climate Crisis](#)

Outcome

During the Reporting Year, Western Asset's teams have worked towards development of new tools and systems to support the ever growing demands on responsible investing. In Western Asset's ongoing efforts to advance the integration of ESG into the portfolio management process and address the evolving needs of its global clients, the Firm will continue to work with its clients to develop solutions as well as customise segregated mandates that address their ESG and financial objectives. For example, Western Asset has worked 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 its clients' ESG advancement intentions, while informing them of unintended consequences and help them to optimise portfolios.

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



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

UK Stewardship Code 2022

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Given its alignment with Western Asset’s long-term fundamental value philosophy, ESG assessment is an important tenet of the Firm’s investment process and is incorporated across all fixed-income strategies that the Firm manages. ESG research is integrated into the Firm’s comprehensive credit research process by the research analysts who analyse ESG factors in conjunction with traditional metrics. Western Asset believes that ESG factors can affect the creditworthiness of fixed-income issuers and therefore impact the performance of fixed-income investment portfolios. These factors are wholly consistent with the Firm’s long-term, fundamental value-oriented investment philosophy.

The types and importance of the ESG factors analysed by the Firm’s research analysts depend on the asset class, sector and individual issuer. The dialogue between research analysts and the issuers’ management team is a key component in its evaluation of these factors.

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.

Western Asset’s engagement approach is based on the principles of the UN Global Compact (UNGC). Material issues such as physical and transition effects of climate risk and environmental management, diversity and development of talent, labour rights, human rights, supply-chain management, product safety and security, transparency in reporting, governance and corporate management are some of the issues that are considered within our ESG analysis framework.

Western Asset also works with issuers to help them understand the importance of addressing key ESG concerns. We encourage issuers to set targets, and where targets have been set, we work closely with them to understand whether these are credible. Where targets are not credible, we seek to help issuers design a credible pathway that aligns with ESG best practices.

Western Asset believes that issuers with superior ESG practices have a lower cost of debt, favourable future bond spreads and tend to experience lower drawdowns during periods of market stress. Conversely, issuers that are deemed to be lower in ESG quality tend to have higher risk affecting their future ability to meet debt obligations and must compensate investors with a higher premium. Poor-quality ESG issuers are also more likely to be adversely affected by developments such as legal sanctions, the introduction of new regulations, or shifts in consumer sentiment. It is therefore imperative that issuers and asset managers understand, measure and allocate strategically to mitigate these risks while seeking to benefit from opportunities that ESG megatrends may usher in.

As long-term, value-oriented investors, the Firm seeks compensation in wider spreads from issuers that lag their peers in ESG practices. Conversely, we generally favour issuers whose ESG profiles we believe will improve but whose spreads overcompensate for historical deficiencies.

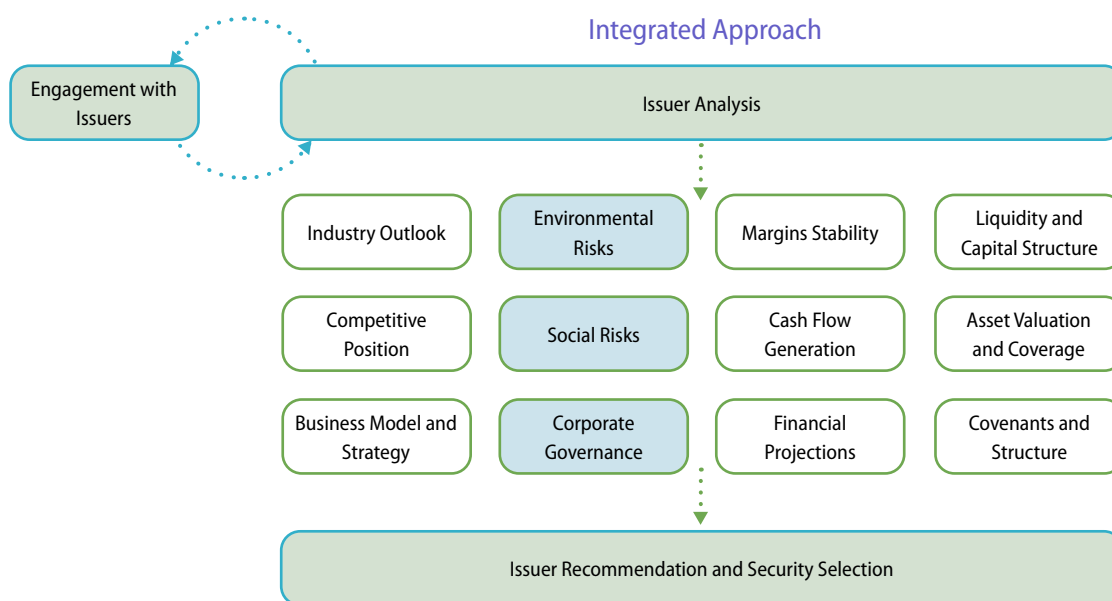
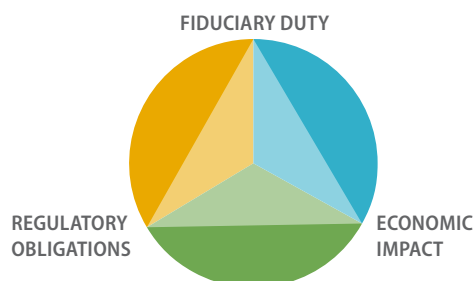
Western Asset's Integrated Approach

The illustration below depicts our approach to integrating ESG considerations into our research process which is not a siloed approach. It combines our proprietary ESG analysis, with inputs gleaned from engagement, alongside traditional financial metrics. Western Asset adopts an integrated approach to ESG considerations by materially embedding it into our analysis of issuers.

The Benefits of an ESG Integrated Approach

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.

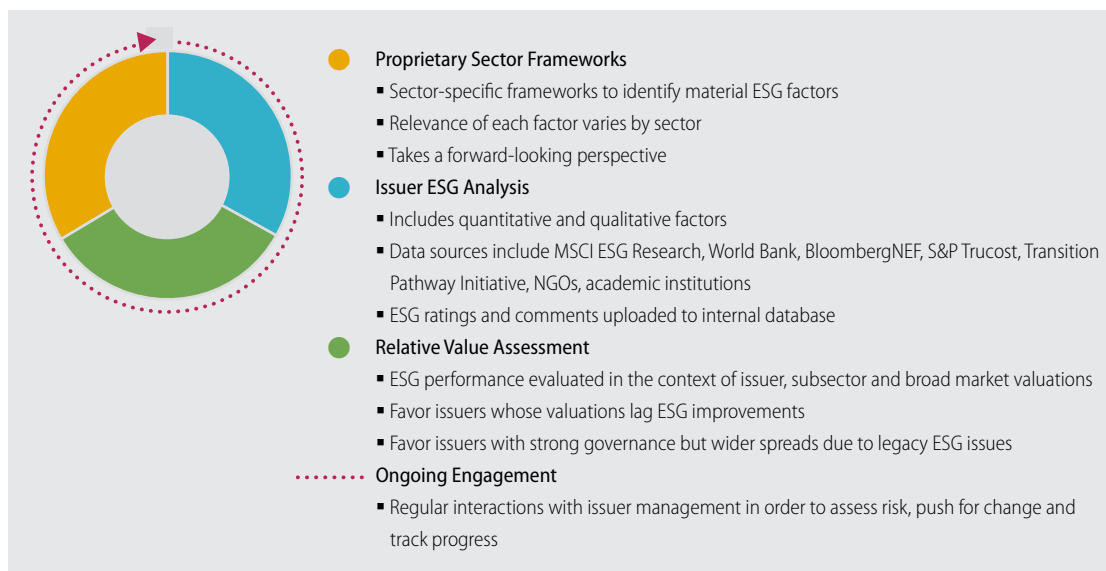
Engaging with borrowers on the need for accurate and consistent disclosure of ESG risk exposures, seeing how well they are managed and being clear has direct influence on their borrowing costs, can create a positive feedback loop of better disclosure and ESG risk management, improved their financial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



While Western Asset has incorporated ESG analysis into its investment process for a long time, in recent years the Firm has strengthened its commitment to ESG by formalising research frameworks, integrating ESG data into portfolio risk reports and compliance systems, and dedicating additional resources.

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 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 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. Western Asset's policy is that research analysts document, for new corporate bond purchases (and on an annual basis for existing issuers), 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. The Firm seeks to identify issuers with improving but undervalued ESG profiles and, perhaps most importantly, avoid issuers with deteriorating or overvalued ESG profiles. The Firm believes that its 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, management practices to mention some considerations.

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 broad sustainable themes as depicted in the illustration below.

UN Sustainable Development Goals



Portfolio Construction

Western Asset's portfolio managers build on the rigorous ESG research conducted by our research analysts, construct the portfolio 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 its clients, and as a result first and foremost follows the investment guidelines set out by each client. Western Asset's 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 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, Western Asset will collaborate with a client to come up with a solution that fulfills 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 financially 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 understand and measure the impact of climate related risks in a variety of scenarios. Western Asset applies 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 & Quantitative Solutions 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.

Service Providers

Western Asset engages with service providers to enhance existing and new ESG methodologies and to provide direction for the creation of robust and useful ESG solutions to aid in decision-making.

Engagement Case Study—Engaging with an ESG Data Service Provider on Their ESG Sovereign Climate Value at Risk (VaR) Solution

Western Asset attended a consultation with an ESG data service provider to provide feedback on their ESG Sovereign Climate Solution. Western Asset welcomed the use of The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) scenarios in their solution but reiterated that the use of 30-year-out inflation forecasts in its model led to uncertainties. We also noted that the methodological approach only applied to local government bonds but not to external sovereign issues, which did not touch any of investors' external sovereign exposure. We also found that the solution could not be sufficiently mapped to emerging markets. The ESG Service Provider decided to officially launch their solution with little consideration for our feedback. That said, the Firm welcomes opportunities to cross-pollinate and brainstorm thoughtful and robust frameworks with ESG service providers.

Engagement Case Study—Engaging with Credit Agencies on ESG Ratings and ESG-labelled Bonds' Solutions

The Firm has engaged with a number of credit agencies in order to provide insight on ESG toolkit gaps that investors face when managing ESG enhanced mandates for their clients. Western Asset has provided credit agencies with feedback on their prototypes and solutions. Over the course of the reporting period, the Firm provided feedback on a variety of ESG research and ESG labelled bond tools developed by credit agencies.

"Signatories monitor and hold to account managers and/or service providers."

UK Stewardship Code 2022



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

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

Oversight of Third-Party Relationships

At Western Asset, our approach to the oversight of ESG data service providers rests on the well-established third-party oversight framework we have established. 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 financial health of the vendor. Western Asset also benefits from a broad vendor management programme run by its Enterprise Risk/Assurance Group, which includes a Vendor Management Committee 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 vendor or service provider utilised by Western Asset.

Engaging with Data Providers to Improve Data Quality

Before commencing any engagement, Western Asset works with third-party agencies to understand their views and rationale around ESG considerations where relevant. We are also aware that third parties revise their assessment and we seek to understand the rationale where such revisions are not fully explained.

Engagement Case Study—Engaging with Data Provider on the Accuracy and Quality of Their Data

The Firm's Municipal Bond investment 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 bonds. In this case, the team found inconsistencies between its assessment of use of proceeds and that of a service provider. The investment team escalated the issue to Western Asset's 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 four bonds and were able to justify their assessment for the remaining bonds. The data provider was able to rectify the erroneous ESG labelled bond tags in their data feed and platform.

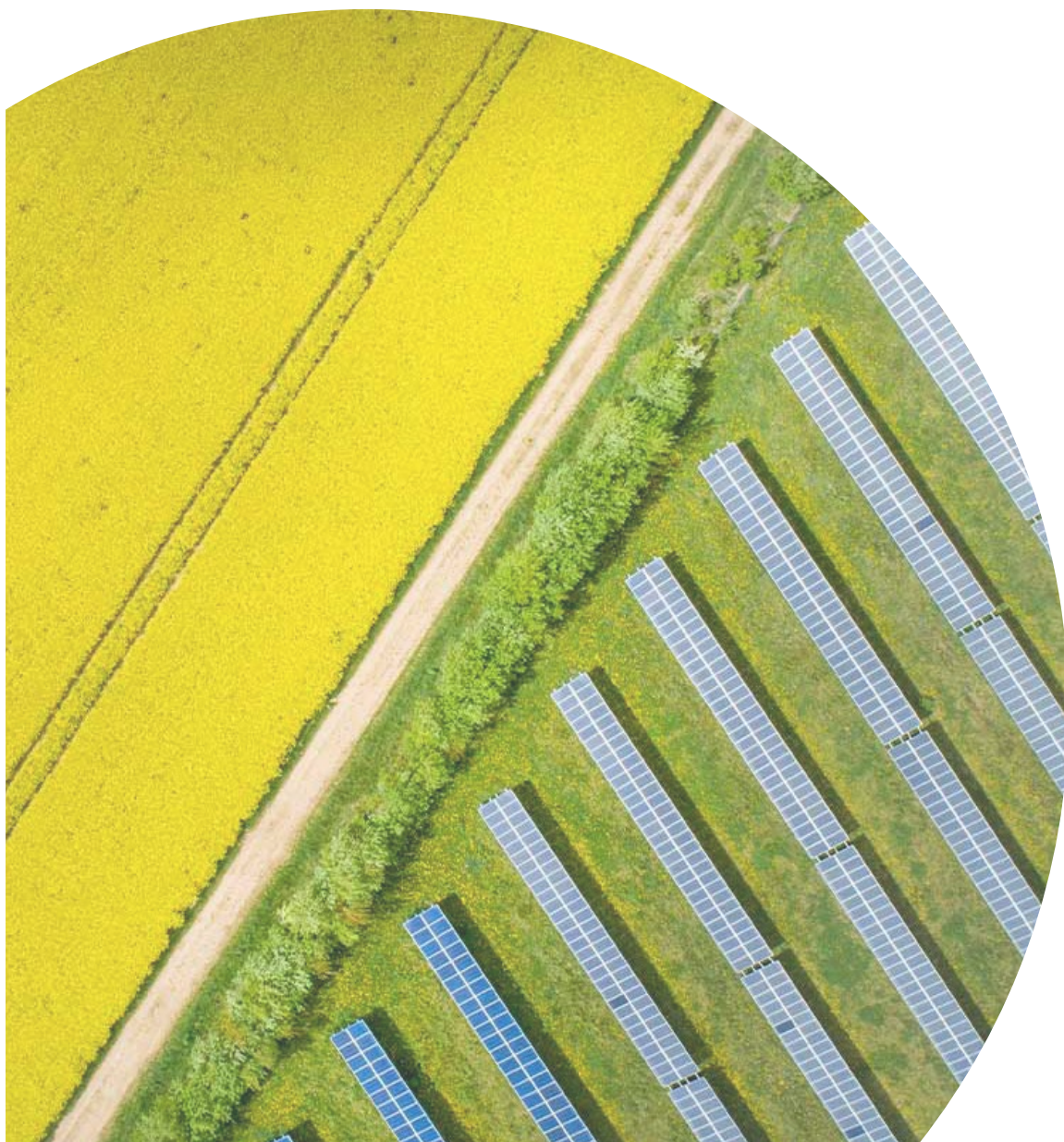


"Over the past year, an increasing number of our clients have embraced the need to integrate ESG considerations and to align their portfolios with their own principles of responsible investing. We are delighted to help them assess the implications of incorporating ESG into their portfolios through an ongoing discussion of qualitative considerations and quantitative analyses. It has been a privilege for us to partner with our clients on this very important journey."

– Annabel Rudebeck, Western Asset Head of Non-US Credit

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

UK Stewardship Code 2022



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

Western Asset’s Engagement Philosophy

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.

Western Asset explores a wide range of investment opportunities, encompassing many private as well as public issuers. The dialogue between its research analysts and issuers’ management is a key component in its evaluation of these opportunities. Engagement with management allows Western Asset’s research analysts to obtain additional perspective on ESG concerns that are inadequately addressed by existing policies and disclosures. In some cases, particularly with privately held issuers, the Firm’s research analysts serve to increase awareness of the importance of ESG considerations through their conversations with management.

When deciding upon issues to engage, Western Asset is guided by its Engagement Policy, which is based on the principles of UNGC. These include themes such as:

- Climate risk and environmental management
- Diversity and development of talent
- Human rights and supply chain management
- Product safety and security
- Transparency in reporting
- Governance and corporate management

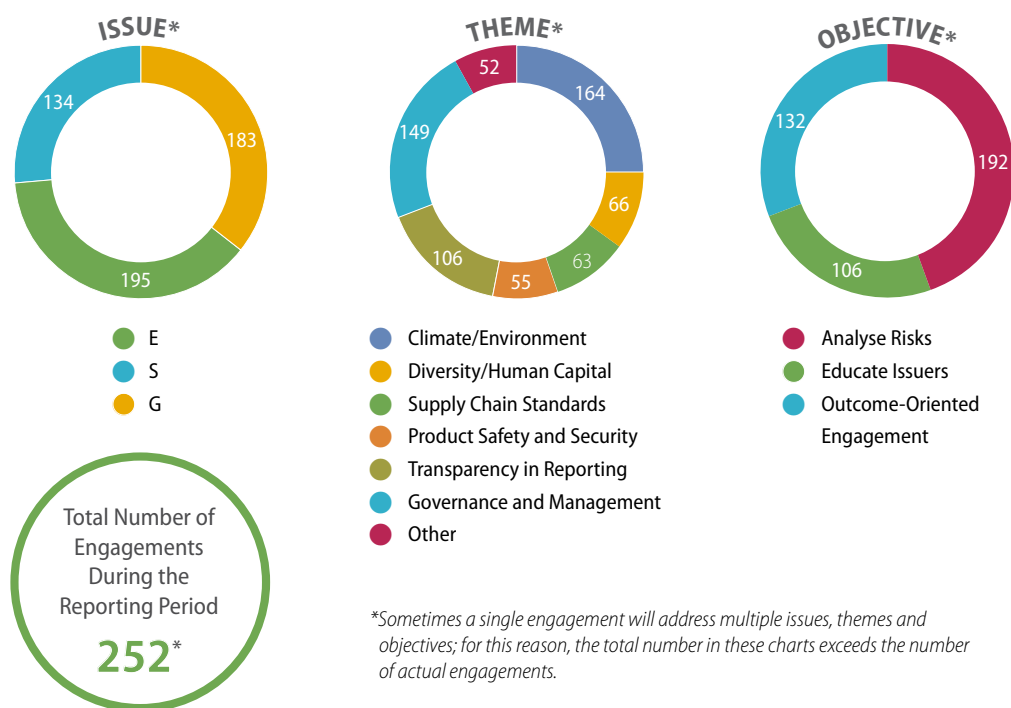
Engagement can also depend upon how critical an ESG factor might be, based on new information or news that emerges about a particular issuer. This is important as it allows us to understand an issuer’s ability to assess the importance of ESG issues, then incorporate it into their assessment.

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

Ultimately, as long-term, value-oriented fixed-income investors, Western Asset seeks compensation in wider spreads from issuers that lag their peers in ESG practices. Conversely, the Firm generally favours issuers whose ESG profiles it believes will improve but whose spreads overcompensate for historical deficiencies. By reinforcing the linkage between ESG practices and the cost of capital in our meetings with issuer management, we push issuers to improve their behaviour around material issues.

Western Asset’s ESG policies are publicly available on our [website](#).

Breakdown of Western Asset's Engagements During the Reporting Period



Western Asset's Engagement Process

Western Asset's engagement process is aligned with the principles of the UNGC. 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. The 10 principles of the UN Global Compact are derived from the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

Engagement activities are led primarily by the sector research analysts and conducted in partnership with the ESG Team. Engagement is performed at a variety of touchpoints: around primary issuance, earnings reports, investor conferences, and ad hoc. The Firm begins an engagement by asking issuers to respond to questions and suggestions, and to elaborate on their plans to disclose and integrate sustainability into their business strategy.

As part of our engagements, Western Asset's research analysts have access to senior executives of firms that include but are not restricted to 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 and tracked to assess appropriate progress by issuers on material issues. The timeframe for resolution of issues 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. Engagements that do not produce expected results by issuers can result in reduction in exposure or divestment.

Western Asset seeks to achieve the following objectives through issuer engagement around these themes:



Engagement Resources and Data

ESG considerations are fully integrated into Western Asset's research, investment process and risk management. Western Asset's research analysts are responsible for providing fundamental analysis at the industry and issuer levels, and opining on industry and issuer risk/reward characteristics by incorporating material ESG considerations, amongst others. Portfolio managers rely on proprietary ESG research conducted by our research analysts to support their investment decisions. Given research analysts' experience in covering issuers, we believe that they are in the best position to assess the impact of material E, S and G considerations on an issuer, utilising one of more than 50 sector proprietary frameworks. The proprietary research may be complemented with data from third-party sources.

The internal ESG research frameworks utilised by research analysts incorporate data from sources such as MSCI, the World Bank, non-governmental organisations, academic institutions, the Carbon Disclosure Project (CDP), BloombergNEF, S&P Trucost, ISS, the Science Based Target Initiative, and the Transition Pathway Initiative. In contrast to third-party ESG data providers, Western Asset's research analysts take a forward-looking approach to an issuer's ESG performance, consider qualitative as well as quantitative factors, and view issuers from a holistic perspective of related subsectors. The Firm believes this results in a more meaningful assessment of an issuer's ESG profile. Additionally, Western Asset's proprietary, independent ESG research process enables it to consider investment opportunities outside of the universe of issuers rated by third-party vendors, whose coverage omits many of the issuers that Western Asset analyses in the high-yield and emerging market sectors.

We believe that research analysts are best positioned to engage on these ESG considerations with management to help issuers understand the importance of addressing ESG concerns and then based on the engagement incorporate material information into valuations. Research analysts 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. Western Asset's policy is that research analysts document, for new corporate bond purchases (and on an annual basis for existing issuers), 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. The Firm seeks to identify issuers with improving but undervalued ESG profiles and avoid issuers with deteriorating or overvalued ESG profiles. The Firm believes that its 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. This analysis is then shared with the portfolio managers, who are ultimately responsible for holistically considering all investment risks as well as client guideline requirements prior to making an investment decision.

Engagement Case Study—Thermal Coal Exposure Reduction

Western Asset has engaged with a large metals and mining issuer on their exposure to thermal coal for two years—at the time, the issuer-owned thermal coal assets in Mozambique. We expressed our concerns around the stranded asset risk embedded in thermal coal given its potent GHG emissions profile. We also discussed Just Transition considerations and the socioeconomic role the company has in the region. We invited the issuer to manage stranded asset risk carefully to the downside while considering the impact on the livelihood and sustainability of the workforce and local communities. Over our initial engagement meetings, the issuer expressed that thermal coal-related emissions represent a minor fraction of their total carbon footprint. They confirmed they have short- and medium-term goals that are aligned with the Below 2 Degrees climate scenario. When asked about progress about stranded asset risk, they revealed that a thermal coal asset reduction would involve governmental negotiations.

► **Outcome:** Over the following year, we learned that the company bought additional shares from a main shareholder to simplify the ownership structure of their coal assets, an important step towards an eventual divestment from thermal coal. We received confirmation that they are looking for a responsible partner that will take over their thermal coal operations and honour their socioeconomic commitments to the region. A year later, the company confirmed to us that they sold their thermal coal asset. This concluded our two-year long engagement with the issuer.

Engagement Case Study—Greenwashing Risk Management Related to ESG-labelled Bonds

The Firm participated in an issuer's green bond roadshow. In order to assess the quality of their green bond framework, we aimed to evaluate 1) Management and tracking of use of proceeds; and 2) Process to avoid 'Doing No Significant Harm' (DNSH) to other sustainability objectives, among others.

We asked them how they ensure that any freed-up capital from financing their green project portfolio is not allocated to brown activities. The company walked us through the enhancements they made to their existing internal tracking system. This system is governed by a green bond committee that includes the finance, operations, sustainability and legal team representatives. Any allocation goes through committee approval and will follow the green allocation framework which was approved by their second-party opinion, Sustainalytics.

We also asked the company to walk us through the processes they have in place to avoid financing a green project that does significant harm to other environmental objectives. The issuer illustrated their process with one of their portfolio's green project: a water osmosis project that will not only improve their water recycling performance but will also reduce GHG emissions from water treatment. They also have mechanisms in place to avoid harming social objectives, including their ISO-certified Health & Safety accreditation programme.

► **Outcome:** As a result of a constructive view on the fundamentals and the green bond framework, the Firm bought the green bond.

Engagement Case Study—Controversy Risk Assessment of Under-reporting Methane Emissions

Scientists at a space research institute alleged that a metals and mining issuer had underestimated and under-reported its methane emissions from one of their Australian mines by a scale of thirty times. Western Asset contacted the company to assess the controversy and verify the allegations.

The issuer raised a number of concerns around the researchers' claims. First, the third-party speculated that hot spots captured by their satellites were a result of gas pre-draining; that said, the company does not conduct pre-drainage nor flaring in its mine. They believe scientists likely confused land and vegetation clearing activity in the mine for flaring signals. The company added that the scientists estimated the mine's 2020 coal production incorrectly in their report. They also cast doubt over their annual estimation extrapolation factors; satellites are likely to capture hot

spots at a snapshot in time but the third-party may have made assumptions to project those hot spots into yearly methane emissions. The company added they met the scientists prior to the report's publication; however, they claimed the scientists responded with low engagement and transparency.

In response to the company's narrative, we inquired how their methane measurements stacked up against best practices. The company explained that their measurement processes were aligned with Australian regulations. Underground, they were using a combination of real-time, continuous (i.e., sampling every 20 to 30 minutes) and manual sampling over 100 locations. They conduct clean energy regulatory audits and calibration monthly to every three months, aligning with ISO standards. That said, measuring emissions is more challenging in an open cut mine. Because of the exposed nature of the mine, fugitive emissions are dispersed and unable to be measured from discreet points. Their open cut methane reported emissions were in fact estimates; they were extrapolating site-specific emissions factors and/or using research-based regional emission factors as advised by the Australian government. We confirmed there were not widely-agreed upon methane measurement best standards for open pits.

In addition, we inquired whether their reported methane emissions were audited. The company confirmed they conduct independent voluntary audits to their methane disclosures annually.

We also investigated whether the company could do better with respect to methane abatement. The company said they were abating 70% of their methane emissions, which they were using for power generation. They clarified that Australia mandates a minimum of 44% methane emissions, so they were abating a considerable amount of methane over regulated levels. The company added that their investments in methane abatement technologies follow a cost abatement curve, which they revisit on an annual basis. They did not forecast abatement opportunities given current abatement costs in the immediate term. However, they were planning to close three coal mines in Australia by 2023 and expected methane emissions reductions as a result.

► **Outcome:** The issuer supported their case with evidence, post-allegations. We note no additional related allegations on this topic. This standalone allegation was an opportunity for the Firm to evaluate the quality of methane risk management of the issuer.

We took this engagement as an opportunity to request additional climate disclosures on the issuer's climate strategy to meet their Net Zero commitment by mid-century. We flagged to the issuer that they received fewer shareholder votes on their climate action plan this year. The company let us know that they will work on improving the transparency of their multi-year decarbonisation progress and climate strategy.

This engagement gave us the comfort to continue to hold the company across various mandates.

Engagement Case Study— Paper and Pulp Producer's Management of Biodiversity Controversies

Western Asset engaged with a paper and pulp producer to assess biodiversity risk exposure, and had asked them to comply with the latest biodiversity-related disclosure standards, as well as to formulate a long-term decarbonisation strategy.

After engaging with the issuer, we gained more comfort on the quality of their biodiversity risk management. For instance, the company conducts biodiversity impact assessment prior to settling in a new area and reports on potential adverse impact by state. During our meeting, we inquired about their use of glyphosate and were pleased to learn that they added more laboratories to develop nature-based herbicides/pesticides. In 2020, they produced 49 million natural pest enemies, resulting in over R\$14 million in net cost avoided in the 2019/2020 period, while also limiting the impact of glyphosate on biodiversity and public health. Furthermore, the company dedicates 40% of their land for conservation purposes, higher than Brazil's legislation standards, which acts as an ecological corridor and a natural buffer that reduces risks of plague on their eucalyptus plantation.

We also asked how they measure their impact on biodiversity. While they currently work with NGOs and academic institutions to monitor their biodiversity risk and impact exposure, they sit in the Task Force on Nature-Related Financial Disclosures, a leading ESG standard-setting body, to develop and standardise nature-related risk and impact KPIs.

► **Outcome:** Based on our engagement, the company welcomed our suggestion on familiarising themselves with the disclosures required of companies under the EU SFDR and in particular those around PAI indicators on biodiversity metrics. The company understood our position that investors depend on qualitative and quantitative data disclosures, and alignment would be beneficial in this respect.

In addition, we noted that while they have medium-term GHG reduction targets that align with the 1.5 degrees scenario, they have not yet set a long-term net zero target. The issuer explained that they are working with the SBTi to set up a decarbonisation methodology for the paper and pulp industry before doing so. In addition to the SBTi, the company sits on the GHG protocol land-use committee to advise on proper carbon accounting for land use.

Example of Engagement Journey in VerityRMS for an Issuer

Engagements with issuers can be a journey and entail multiple points of interaction from identification to monitoring, follow-ups and escalation where relevant. All engagements summarised above are logged into Verity RMS. This allows us to better evaluate progress made, if any, potential impediments to progress, tangible outcomes, escalations where necessary, and relevant follow-ups where necessary. An illustration of the engagement journey for an issuer is shown below.



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

UK Stewardship Code 2022



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Western Asset participates in well-established groups that are aligned with our priorities around ESG to ensure maximum impact from its collaborations with peers, asset owners and issuers. As an example, the Firm is a member of CA100+, the largest stakeholder engagement group which includes asset managers and asset owners focused on improving climate change governance of the world's largest corporate greenhouse gas emitters.

Western Asset has been involved in several collaborative initiatives that seek to shape standards around stewardship.

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, the Firm became a signatory and participant in CA100+.
- 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
 - Signatory of CA100+

Collaborative Engagement Initiative #1—UN PRI Plastics Engagement Group

In this collaborative engagement group, Western Asset engaged with issuers to progress towards the New Plastics Economy Global Commitment, as established by the Ellen MacArthur Foundation in collaboration with the United Nations Environmental Programme (UNEP). These include: 1) Eliminating problematic or unnecessary plastic by 2025;

2) Moving away from single use plastic where relevant by 2025; 3) Ensuring 100% of plastic packaging is reusable, recyclable, or compostable by 2025; 4) Working towards a higher bar of post-consumer recycled content across all plastic packaging post 2023, and 5) Reporting annually on progress.

► **Outcome:**

1. One issuer committed to tighten up its targets for the use of sustainable materials in 2021. They also started disclosing their plastic performance using the SASB standard. The company has also set new science-based targets for the reduction of CO2 emissions, including Scope 3 emissions. The issuer committed to include ESG performance in executive compensation; they are currently establishing the climate KPIs to link to remuneration. Finally, the company committed to publicly support the development of a UN convention to tackle plastic pollution.
2. Another issuer committed to set targets on the percentage of recyclable products, the percentage of use of recycled material in their portfolio, and the percentage of used products to be collected and recovered by the end of 2022. In addition, they hope to set science-based targets for the reduction of Scope 3 CO2 emissions by the end of fiscal year 2022.
3. The third issuer created a new brand that encompasses all its sustainable products. The brand aims to produce 2 million tons of polymers annually from recycled or renewable materials by 2030, at the latest. The company also published more ambitious GHG reduction targets at the end of 2021; they are currently working on a Scope 3 target. They also established a sustainability report in line with SASB standards. Last, the company committed to link their sustainability targets to remuneration schemes.

Collaborative Engagement Initiative #2—CA100+

In 2021, Western Asset became a signatory and participant of CA100+. Our role as a collaborating investor involved contributing insights, identifying engagement questions and leading specific sections of company meetings. Issues covered include: 1) Asking investee companies to implement strong climate governance with direct board oversight of climate change risk and opportunities; 2) Acting to reduce GHG emissions in line with Paris Agreement goals, including setting science-based targets, and 3) Improving disclosures to be in line with TCFD recommendations. As part of this collaborative effort, Western Asset engaged with our largest airline holdings during the reporting period.

► **Outcome:** All the companies we engaged with committed to set decarbonisation targets aligned with the SBTi. A few were able to have their decarbonisation plan approved by SBTi while the plans of other companies are pending the organisations' review. All companies committed to increase the share of SAF out of their jet fuel. SAF supply and infrastructure is at a nascent stage at the moment with non-negligible price premiums versus conventional jet fuel. We are working with the airlines sector on engaging the different players of SAF supply chain to increase supply at appropriate price levels while optimising other sustainability and land-use considerations for the fuel.

Engagement Case Study— CA100+

Over the past 12 months, Western Asset engaged with an airline issuer three times while holding an overweight exposure to the company. Western Asset engaged on: 1) Their ownership of an oil and gas refinery business; 2) Their ambition to decarbonise in line with Paris Agreement Goals, and 3) Their appetite to signal demand for SAF.

The issuer set a net-zero GHG emissions reduction target, but Western Asset noticed that it did not include its refinery segment in the target's scope. In our first engagement meeting, Western Asset asked what their long-term

plans were vis-à-vis their refinery segment. In addition, Western Asset asked them to clarify their decarbonisation plan. The company's CEO disclosed that the Board of Directors reviews their assets every five years to determine their alignment with the company's strategic goals. The refinery business is currently under review and if the asset is not considered core to the business, the company will consider all options, including potential divestment or carving it out, while adding outside investors. We also asked the issuer to indicate demand for SAF; SAF has the potential to decrease GHG emissions by 80% versus conventional jet fuel. The CEO further pointed out that SAF is not a viable solution given price differentials versus conventional jet fuel. At this point, the CEO indicated that fleet renewal is the main lever to operationalise their net-zero GHG reduction target.

Western Asset escalated the engagement with the company by joining the collaborative engagement group, CA100+. We decided to focus on: 1) Their decarbonisation pathway; 2) Capex alignment with their climate strategy, and 3) Commitment to SAF. We achieved traction on all three objectives. First, the issuer committed to set a science-based target and already sent their decarbonisation plan to SBTi. Given SBTi's long backlog, the company was still waiting for approval by the SBTi. Second, they announced that they strengthened their SAF commitment by signing up to the first mover coalition, a public-private partnership out of COP26, where they commit to source at least 5% of their jet fuel needs by high quality SAF (i.e., SAF that achieves at least 85% less GHG emissions versus conventional fuel) by 2030. This target is conditional to SAF availability and feasibility. The company also set a target to source 10% of their jet fuel from SAF by 2030. This ensures that half of their SAF commitment would come from feedstock that achieves the lowest lifecycle GHG emissions. Western Asset also learned that they completed offtake agreements with four SAF providers; these agreements are not locked in current SAF prices. Finally, Western Asset asked the issuer to clarify how they plan to align Capex with achieving decarbonisation goals. The company mentioned they would make this information available in their spring report. We added that we expect them to work on disclosing Capex alignment with decarbonisation in their SEC 10K reports as well, not just their sustainability report. Western Asset will keep monitoring the issuer's progress on its commitments and will keep engaging with the issuer in the context of CA100+.

Engagement Case Study— ASCOR Project

In 2021, Western Asset became a supporter of the ASCOR Project, representing the Firm's parent Franklin Resources, Inc., to identify and assess potential indicators to measure sovereign climate mitigation and adaptation policies and funding needs for mitigation and adaptation. At this juncture, as part of this collaborative initiative, Western Asset's role is to assess a selection of economy-wide and sectoral mitigation and adaptation policies to identify the most relevant indicators for assessing potential transition and physical risks. These indicators will allow investors to assess a country's progress towards the goal of Net Zero. Once specific metrics are identified, the working group will seek to quantify countries' transition and physical-related funding needs, which will also help investors assess the level of funding required and to identify investment opportunities.

► **Outcome:** Despite Net Zero commitments pronounced by several countries, very few currently have credible policies in place to meet these commitments. Although the work is at a nascent stage currently, Western Asset believes that the identification and quantification of metrics will allow for increased monitoring, transparency and the ability to hold sovereigns to account, ultimately leading to better outcomes with respect to Net Zero commitments.



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

UK Stewardship Code 2022

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Although bondholders possess very different legal rights than shareholders, Western Asset believes it can impact issuer ESG practices given its role in determining issuers' cost of debt capital. As long-term, value-oriented investors, the Firm seeks compensation in wider spreads from issuers that lag their peers in ESG practices. Conversely, the Firm generally favours issuers whose ESG profiles we believe will improve but whose spreads overcompensate for historical deficiencies. Western Asset can escalate issues internally with issuers and ultimately reduce exposures to issuers where there is no constructive response. Western Asset manages client accounts against guidelines, and/or benchmarks, which may limit our ability to apply ESG considerations.

Western Asset believes that successful engagement takes significant time and effort. The Firm begins an engagement by asking issuers to respond to questions and suggestions and to elaborate on their plans to disclose and integrate sustainability into their business strategy. The Firm then aims to intensify focus by tracking issuer progress on improvements and initiatives. Western Asset currently tracks 'next steps' to each engagement activity in an engagement report. If an engagement with management regarding a material matter is unsuccessful, the Firm may decide to divest exposure to that issuer. Where an engagement has not resulted in the desired outcome, research analysts may escalate it internally within meetings with the Western Asset ESG Team to debate the materiality of the issue and what the appropriate next steps are. These could include further engagement to help the issuer understand the criticality of the underlying issue and the risks posed. Escalation may lead to continued engagement or divestment depending on the severity and imminence of the underlying ESG concern.

Escalation through the ESG Cross-Mandate Task Force

Western Asset has formed an ESG Cross-Mandate Task Force that explicitly functions as a central escalation point for identified ESG issues in relation to specific issuers. The ESG Cross-Mandate Task Force comprises of senior members of the investment team, including the Deputy CIO and the Head of ESG Team.

An ESG issue can be escalated to the ESG Cross-Mandate Task Force by ESG specialists, portfolio managers, research analysts, product specialists or client service executives (in the instance that an issue should be raised by a client). Issuers that are escalated are likely to either exhibit high ESG risk, suffer from severe controversies or those which have not demonstrated sufficient progress after engagements. Once escalated, the issuer is debated by the ESG Cross-Mandate Task Force. Based on the outcome of the discussion, the issuer is placed in one of the two categories below:

1. **ESG Red List:** Represents issuers which must be sold from sustainable labelled mandates. While a portfolio manager for a particular mandate has discretion, documentation is needed justifying the portfolio manager's view, leading to additional discussions at the level of the ESG Cross-Mandate Task Force.
2. **ESG Watch List:** Represents issuers where portfolio managers have discretion on whether to sell issuer from their mandates, but are not required to do so.

Issuers on the ESG Red and Watch Lists require further engagement to determine progress made against ESG concerns identified and escalated.

Escalation Case Study – Mining Issuer Human Rights Controversy

Based on internal escalation, a mining issuer was assessed by the ESG Cross-Mandate Task Force. The issuer is being investigated in the country it is headquartered in, following alleged violations of an Indigenous community's environmental and social rights, based on operations from a mine operating in a separate country. Concerns were raised around the adverse health effects of the Indigenous community stemming from chemicals found in the air, water mismanagement and high noise levels. Although the mining issuer claims adherence to local regulations, these regulations were deemed to be less stringent compared to the World Health Organisation (WHO) standards.

► **Outcome:** Once escalated, the ESG Cross-Mandate Task Force debated the specific concerns with respect to the issuer and recommended the issuer be placed on the ESG Red List. This resulted in a divestment, where held, from sustainable labelled mandates. Western Asset will keep engaging with the issuer to make a judgment on whether the issuer has made progress in mitigating the ESG risks identified.

► **Continued Engagement:** As part of this escalation, the Firm's research analysts engaged with the issuer further. The issuer has responded to Western Asset's queries, stating that the claims of water mismanagement are erroneous highlighting how in some instances, partial modifications made to local creeks can be viewed as examples of ecological innovation. While acknowledging that open-pit mining produces a certain level of emissions and particulate matter in the air, the company highlighted how regional background conditions that includes both natural and anthropogenic factors such as marine aerosols, desert sands, open unvegetated/dust-producing areas, and forest fires can result in higher emissions in the local area. The specific mine under focus measures these regional background conditions at recording stations located upwind from its operations (meaning that these stations do not record emissions from its operations) to understand how they are impacting air quality. The combination of these conditions has sometimes caused air quality readings that are above WHO guidelines. There was no comment received on noise decibel levels. Western Asset was also informed of the following steps undertaken by the issuer in an agreement signed on 27 May 2022 between the relevant mine and indigenous community, with the presence of representatives from the local Governor's and Mayor's Offices and the Ministry of Mines, which agreed to create an employment committee to deliver seven key areas:

1. **Employment:** The mine will look for employment opportunities for the community. During 2Q22, 79 people from an Indigenous community were hired by contracting companies and 57 currently continue to be employed. This was a 65% increase on 1Q22.
2. **Education:** The mine will undertake maintenance to the local school, classrooms and bathrooms, in addition to other maintenance that will be carried out by the local Mayor's office.
3. **Health:** The mine will carry out improvements to the fences of the local health centre in Media Luna to enhance its security by providing the material required; contracting of works will be done by the local hospital.
4. **Childhood Programmes:** The mine will build two early childhood attention centres over a five-year period to enhance services in the two local communities.
5. **Water:** Over 300 water tanks, 1,000 litres each, have been distributed to families of the affected Indigenous community to enhance water storage capacity. The local Mayor's office committed to the delivery of one additional water tanker per week.
6. **Housing:** The mine will support the construction of 13 houses for the Indigenous community's traditional authorities. The houses will be built by community members to promote employment opportunities.
7. **Humanitarian Aid:** The mine will deliver 500 food baskets for Media Luna families affected by COVID-19.

While Western Asset notes the points highlighted in the agreement above, the Firm will continue engaging to seek clarity on the progress to mitigate the highlighted concerns, as well as to understand the findings of the court case to determine the appropriate next steps.

Differences From an Investment Perspective Based on Client Mandate and the Engagement Type

It is common for a client of Western Asset to have mandates with different strategies managed by the Firm. One of the Firm's clients has two separately managed accounts with Western Asset – one of which is a mandate with an explicit sustainable investment objective while the other mandate does not have any specific sustainability objectives. Based on the engagement with the mining company described above, Western Asset decided to divest from the issuer in the sustainable labelled mandate, based on the client's guidelines and general expectations from that account. On the other hand, for the non-sustainable labelled mandate, Western Asset highlighted our concerns and consulted with the client on the next steps. Based on our assessment and discussions, the client agreed that the issuer should continue to be held in the non-sustainable mandate as long as progress could be monitored versus the concerns flagged.

Examples of Escalations Were Partial or Unsuccessful

While Western Asset has been successful in engagement with issuers through escalation to highlight our concerns, there have been instances where the Firm has had partial success or has been unsuccessful, despite best efforts. Illustrated below are a couple of examples where despite escalations, the issuer has not fully addressed our concerns.

Engagement Case Study—Petrochemical Issuer

Western Asset asked a petrochemical company to incorporate their recycled plastic content target with executive pay to signal accountability and credibility. After an initial engagement with the issuer's Sustainability Team, the request was escalated to the Board of Directors and its compensation committee. The issuer explained they will not be able to add the circular content Key Performance Indicator (KPI) to their executive compensation scheme during the next fiscal year. However, in response to our ask, they promised to add their Scope 1 and 2 targets to their executive pay scheme given that they have a robust system to measure and track their performance to this KPI. We clarified that linking pay to a sustainable KPI related to their products will send a stronger message. However, the issuer clarified that auditing, monitoring, and measurement mechanisms are not ready for recycled content and they do not want to overcommit and under-deliver.

► **Outcome:** Western Asset noted progress made with additional KPIs and reporting that the company has implemented post engagement by the Firm. While Western Asset believes the issuer is able to monitor and measure progress, we believe that the issuer is still likely to benefit from the linkage of plastic content to executive compensation particularly in light of the demands for a circular economy and its overall impact on the environment. Although the initial escalation to the issuer highlighting our concerns proved unsuccessful, Western Asset seeks to continue engagement with the issuer to seek to address our concerns in the next fiscal year.

Engagement Case Study—Metals and Mining Company

Western Asset asked a metals and mining issuer if it could explore joining the Initiative for Responsible Mining Assurance (IRMA); the latter emerged as a best standard on responsible mining for the investor community. Its standards are the most detailed and inclusive to civil society.

The company mentioned that they considered IRMA, but found it was too prescriptive on how they should achieve certain outcomes. They also thought their auditing process is burdensome and impractical, taking 60 days to complete an audit per site. They communicated this feedback to IRMA and they hope IRMA will come back with a more practical process. The issuer also noted that IRMA does not consider energy companies so they would not be able to audit their coal mines.

The issuer stated that they are part of International Council on Mining and Metals (ICMM). ICMM conducts independent audits at all their sites for human rights, including Health and Safety, among others. They also conduct third-party impact assessment at their high-risk mines on a yearly basis. Summary results of their audits are disclosed with additional disclosures in the pipeline.

► **Outcome:** While Western Asset does acknowledge the issuer's concerns around how comprehensive IRMA standards are, given the level of detail and inclusivity with respect to civil society, the issuer may benefit from aligning with these standards. Additionally, while Western Asset applauds the issuer for conducting third-party impact assessment, it may be less relevant to the business.

While the initial escalation to the issuer highlighting our concerns proved unsuccessful, Western Asset seeks to continue engagement with the issuer to address our concerns.

“Signatories actively exercise their rights and responsibilities.”

UK Stewardship Code 2022



“Signatories actively exercise their rights and responsibilities.”

Different asset classes provide different mechanisms and avenues for asset managers to engage with issuers. As Western Asset is primarily a fixed-income manager, Western Asset engages with issuers through direct communication with senior management where issues are discussed and expectations set. In addition, Western Asset may be in a position, on a rare occasion, 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.

Proxy Voting

Western Asset is primarily a fixed-income manager where proxy voting is uncommon. When 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 15 proxy voting opportunities, which limits the Firm’s ability to make an impact through this channel.

If the voting rights have not been reserved by the plan fiduciary, it is Western Asset’s policy to vote solely in the interests of plan participants and beneficiaries and for the exclusive purpose of providing economic benefits to them.

All Western Asset-voted proxies are logged when received, and the materials are then distributed to the appropriate portfolio manager(s) or research analyst(s) to make the recommendation for the specific vote. Upon receipt of these recommendations, a member of Western Asset’s Compliance Department will log the rationale, and vote the proxy as per the recommendations, in accordance with the Firm’s Proxy Policy and Procedures. Depending on the best interest of each individual client, Western Asset may vote the same proxy differently for different clients.

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 generally-considered material ESG risks. 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 the Firm’s fiduciary duties to its 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 will be considered on a case-by-case basis. Constructive proposals that seek to advance the health of the issuer and the prospect for risk-adjusted returns to Western Assets clients are viewed more favourably than proposals that advance a single issue or limit the ability of management to meet its operating objectives.

Covenant Negotiations

Western Asset carries out extensive analysis of issuers in which it invests on behalf of our clients. Negotiations predominantly occur for new issues; however, this may occur where there are bond restructurings as well. The research analyst will first raise concerns internally and where there is interest to participate in the new issue, will take steps to raise concerns in covenants with the issuer. Where negotiations are not successful, Western Asset is unlikely to participate in the new issue as a result. This approach ensures that the Firm selects more viable issuers, preventing costly workouts and negotiations of covenants.

Western Asset carries out extensive analysis of issuers in which it invests on behalf of our clients. As part of the Firm's stewardship responsibilities to its clients, 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.

Covenant negotiations may occur for new bond issues as well as where there are balance-sheet or liability-management events that could result in bonds restructuring from their original terms. 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 judgement 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 there was a drop of 79% in new high yield issues over the previous year. This has limited Western Asset's ability to engage through covenant negotiations, highlighting certain structural issues within fixed-income markets with respect to the tool-set for engagement with issuers to improve sustainability, social impact and governance.

Debt Restructuring

Western Asset views debt restructurings, whether in developed or emerging markets, as an unavoidable part of managing credit assets, which represent a significant portion of our AUM. 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.

At Western Asset, bond trading at distressed prices does not automatically trigger a sale unless instructed by the client. Rather, 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, Western Asset assigns additional resources to review the credit and ensure clients' interests are protected.

Involvement in Creditors Committee

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. Can Western Asset influence the proceedings? Can the Firm add value? Is this in Western Asset's portfolios' best interests? Would it protect client portfolio 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 upon the range of values and the corresponding upside potential, the Investment 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 its 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 its 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 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 a reasonable 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 be focused on current opportunities in the market rather than being consumed by the legal complexities of a workout. Western Asset's dedicated distressed analyst is supported by the Firm's Legal and Compliance Department as well as outside legal counsel that the Firm may retain.

NDA Negotiation Case Study— Global Aerospace and Defense Supplier

Western Asset looked to participate in a new issue of a global aerospace and defence supplier. In order to participate in the deal, Western Asset had to sign a Non-Disclosure Agreement (NDA). Upon further review of the NDA, the research analyst noted that if one affiliate in a group participates in a deal, all other affiliates would be restricted on the name. This approach was found to be too prohibitive as it would limit the ability of Western Asset affiliates to work independently and work through different market segments to invest and engage with the company.

► **Outcome:** Despite Western Asset raising the issue of the NDA clause which broadly restricts participation of an affiliate group, the company was unwilling to make changes to the NDA. As a result, Western Asset did not participate in the new issue.

New Issue Covenant Negotiation Case Study – Energy Company

During the summer of 2021, in what was a difficult period for companies to access debt capital, Western Asset participated in a small working group of high-yield bond institutions taken 'private' for several weeks in order to negotiate a new issue covenant package ahead of a formal public marketing process and launch of the bond transaction. As part of the small investor group, Western Asset worked collectively with the underwriting investment bank, as well as met individually with the company on multiple occasions to better understand their needs, structure and negotiate covenants that would lead to the company successfully refinancing an upcoming bond maturity. The deal structure and new issue pricing was enhanced as a result, with bespoke covenants negotiated around dividend capacity, anti-layering limitations, leverage limitations, and reporting requirements.

► **Outcome:** Due to the substantially enhanced covenants and structure of the new bond issue, Western Asset elected to participate in the final public launching of the bond issue. Despite our concerns about overall weak high yield market conditions during late summer 2021, we believed the improved covenant structure would be relatively unique and attractive to the market. We also believed that the enhanced covenant package afforded bondholders better downside protection than existing comparable bonds. Since issuance approximately one year ago, the bonds have strongly outperformed both the high yield market as well as the high yield energy subsector. We believe this outperformance is largely driven by the differentiated covenant package and structure negotiated prior to the public launch of the bond deal.

Debt Restructuring Engagements

Throughout the past year, Western Asset has participated in a number of debt restructurings resulting in better outcomes for our clients. Some examples:

- **Mezzanine Whole Loan Secured by Large Retail Property:** Western Asset directly and actively engaged with the issuer as well as with the other lenders in the capital stack to seek a mutual resolution of the defaulted debt on the project, including sourcing additional capital, requiring the issue to commit to additional collateral and equity, and devising a plan for restructuring of the debt. The negotiations are ongoing.
- **Securitized CMBS First Mortgage Collateralised by a Regional Mall:** Issuer declined to service the debt during 2020 cash flow shortfalls and turned over the collateral. Working through the CMBS servicer, Western Asset directed a foreclosure of the note and oversaw appointment of a property management and leasing team. Following a transition period, launch of a new business plan and full marketing process, the property was sold resulting in a full principal recovery.
- **First Mortgage Whole Loan Secured by a Full-service Hotel:** Issuer defaulted at loan maturity and declined to satisfy the debt through a refinancing or sale of the property. In order to protect client capital Western Asset engaged legal counsel and attempted to negotiate a resolution with the issuer. When no satisfactory options were presented, the issuer twice filed bankruptcy to stymie a resolution. Western Asset navigated both court processes and ultimately prevailed, obtaining a dismissal of the bankruptcies, allowing for a foreclosure on the property. Following foreclosure, the property was sold via a brokered marketing process and returned more than the original principal.
- **CMBS First Mortgage Secured by Portfolio of Regional Malls:** Originally owned by a global investment manager, junior unsecured debt was defaulted in 2020 following cash flow challenges and a downgrade. Through the servicer, Western Asset directed a replacement of the sponsor with new ownership and management. The new owners contributed additional capital to carry operating shortfalls and pay down the outstanding debt in addition to a restriction on any distributions/dividends to ownership during the remaining loan term. As an inducement to the new investment, Western Asset provided an extension of the loan to provide time to pay down and pay off the debt. The loan was then reinstated and is now performing.

Conclusion

In this second Stewardship Report, our goal is to demonstrate extensive investment and development of our ESG infrastructure, governance and product offerings over the Reporting Year, which resulted in ever greater engagement with our clients around their responsible investing goals as well as with the issuers in which we invest on behalf of our clients. This commitment to support our clients is underpinned by our mission, which includes putting our clients first in everything we do and builds upon our Firm's core values of Trust, Honesty, Integrity, Teamwork, Diversity, Mutual Respect and Personal Responsibility.

From the infrastructure perspective, we have implemented a robust research system supporting all of our investment research and engagement efforts, integrated more ESG data into our trading, risk and compliance systems, made enhancements to our WISER risk system (including a carbon optimiser tool) and developed a broad range of reporting tools to both support investment decision-making as well as to provide tangible information to our clients. From the governance perspective, we have formalised a number of ESG-focused groups including the ESG Cross-Mandate Task Force, ESG Infrastructure Working Group and Sustainability Risk Team. This has provided for better integration of ESG across Western Asset's business operations and added to the robustness of oversight and controls. Finally, we are now providing an expanded set of ESG investment solutions to our clients to support their varied investment needs and views of responsible investing.

In addition to these developments, Western Asset has continued to engage with industry groups to drive changes that we believe will have a positive and lasting impact. We have also engaged with more issuers than before and demonstrated our stewardship through debt restructurings. We continue to be committed to looking for additional avenues where our stewardship can play a role within fixed-income markets.

We hope this Stewardship Report demonstrates our deep commitment and achievements related to stewardship and ESG advancement at Western Asset. As we look toward the shared future, we are proud to see a continuation of the transparency and accountability to our clients that has been years in the making, and to be a signatory to the UK Stewardship Code 2020.





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