NOMURA

Connecting Markets East & West

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Overview

Environmental, Social, and Governance-focused investing is proving to be one of the most significant portfolio management themes of the 2020s. Asset owners, gatekeepers, and retail investors are seeking to capitalize on emerging ESG investment opportunities and avoid what appear to be increasingly unsustainable risks. Furthermore, institutional investors across the world are taking a stand to ensure that their investment portfolios align with their organizational values. NCRAM is committed to responsible practices in investing the assets our clients have entrusted to us, and we are dedicated to helping our clients meet their ESG goals.

NCRAM has a long history of integrating ESG analysis into our high yield bond investment process, and we have worked to steadily improve the rigor and oversight of this integration. We signed the UN PRI in 2013, formalizing our commitment to incorporate ESG issues into investment analysis and decision-making. NCRAM also signed on to the Task Force on Climate-Related Financial Disclosures (TCFD) in 2021, demonstrating our intent to both require transparency from bond issuers and provide transparency to our investors. We established an ESG Committee, chaired by our CEO and staffed by investment, product development, legal, and compliance personnel, to provide strategic direction on ESG matters. NCRAM launched an ESG-centric high yield strategy in 2018 for separate accounts that is built using our proprietary ESG scores. In 2021, we announced our intention to manage the Global Sustainable High Yield strategy, targeting both an attractive financial return and positive sustainability outcomes.

ESG High Yield Strategies

Many institutional investors globally are demanding a deeper commitment to sustainability in their portfolios, and they are looking for investment managers to target specific ESG exposures and outcomes. As transparency related to bond issuers' ESG risks has improved and new opportunities to help our clients meet their financial and sustainability goals have emerged, NCRAM has developed a variety of solutions for our clients.

NCRAM runs several ESG-focused separately managed accounts that we designed with clients based on their unique requirements, and we are well-positioned to work with SMA investors to incorporate custom ESG-related objectives in their portfolios. We believe our proprietary ESG scores are an excellent starting point for sustainability-oriented strategies, and we can apply other factor- and industry-based exclusions to clients' SMAs.

With regard to commingled fund solutions, NCRAM has announced that it intends to sub-advise the Global Sustainable High Yield Bond Fund (GSHY) in Nomura Asset Management's Irish-domiciled UCITS fund range. GSHY is classified as an Article 9 product under the European Union's Sustainable Finance Disclosure Regulation (SFDR).

ESG Integration Investment Strategies

For all NCRAM strategies, regardless of whether a mandate articulates specific ESG objectives, sustainability analysis is an important part of the mosaic of factors that our analysts and portfolio managers contemplate when making investment decisions. ESG considerations impact both credit analysis and portfolio construction. For example, when assessing sustainability risk, NCRAM considers the potential implications of an ESG event or exposure at the issuer, sector, and portfolio levels. NCRAM believes responsible investment requires that systematic risk factors such as climate change must be integrated with the fundamental credit research that underpins our time-tested "Strong Horse" investment philosophy. Thus, NCRAM incorporates ESG analysis in all portfolios we manage.

ESG Analysis and Proprietary ESG Scores

NCRAM's investment process is driven by rigorous credit analysis. Our sector-specialist team of analysts research prospective investments, assessing an issuer's commercial and financial risks and opportunities, and the structure of a proposed bond deal. The evaluation also considers issuers' sustainability strengths and weaknesses. NCRAM's analysts are responsible for the holistic review of a credit, from both economic and ESG perspectives; we do not delegate sustainability research to analysts outside of our high yield investment team. Our analysis of ESG factors is based on both direct communication with the issuer as well as secondary sources of information, including public filings, financial news, and third party research.

Sustainability research points of emphasis include:

- Environmental: emissions, effluents, energy efficiency
- Social: labor practices, diversity, stakeholder relations
- Governance: board composition, ESG transparency, creditor relations

This sustainability analysis drives the proprietary NCRAM ESG Score that our analysts apply to an issuer. The scoring process is based on the analyst's professional expertise, not an algorithm or quantitative model. Information from outside vendors is used as an input, but NCRAM analysts make the final determination. Our ESG Committee helps guide the analysts when calibrating the degree of risk to attach to a given matter, and to normalize scores across sectors.

We primarily evaluate issuers on an absolute basis using a 1-8 scale (with 1 being the best). Issuers are assigned a score based on a two-pronged approach. First, we assess the level of financial impact ESG risks are expected to have on the company. Second, analysts consider the issuer's level of disclosure and/or engagement regarding significant ESG factors, as well as its management team's articulated plan to address or mitigate ESG risks. The scale measures risk on an absolute basis, but sector-relative scores can also be calculated, based on client preference.

NCRAM's ESG scoring rubric is detailed in Figure 1, overleaf.

Risk Exposure	Numerical Score	Description (Absolute Scores 1-8)
Negligible	1	Company has negligible risk exposure to ESG/sustainability risks. ESG/sustainability risks are not expected to have a negative impact on the value of the business in the near term.
Low	2	Company has exposure to ESG/sustainability risks, but risks are expected to have a non-material negative impact on the value of the business in the foreseeable future. Disclosure of and engagement with ESG/sustainability issues is significant within the company's governance structure.
	3	Company has exposure to ESG/sustainability risks, but risks are expected to have a non-material negative impact on the value of the business in the foreseeable future. The company may or may not engage on ESG/sustainability issues.
Medium	4	Company has exposure to ESG/sustainability risks that are expected to have a material negative impact on the value of the business in the foreseeable future. However, ESG/sustainability disclosure is good, and management has a tangible plan to address material ESG/sustainability concerns.
	5	Company has exposure to ESG/sustainability risks that are expected to have a material negative impact on the value of the business in the foreseeable future. The company may or may not engage on ESG/sustainability issues.
High	6	Company has significant exposure to ESG/sustainability risks due to high exposure to multiple ESG/sustainability issues that are expected to have a significant negative impact on the value of the business in the foreseeable future. ESG/sustainability disclosure is improving, and management is progressing towards addressing ESG/sustainability concerns.
	7	Company has significant exposure to ESG/sustainability risks due to high exposure to multiple ESG/sustainability issues that are expected to have a significant negative impact on the value of the business in the foreseeable future. ESG disclosure is limited or nonexistent, and management has a limited plan or no plan to address ESG/sustainability concerns.
Severe	8	Issuer has severe ESG/sustainability risks (fraud, bribery, criminal activities, human rights violations, etc.) or appears on a client's ESG exclusion list.

ESG's Impact on Portfolio Construction

NCRAM credit analysts are responsible for identifying and understanding an issuer's material ESG risks and integrating this information into financial models and research reports. Portfolio managers and analysts judge whether a company's relevant ESG strengths and weaknesses are priced into market yields and spreads. Existing positions are monitored by the credit analyst and formally reassessed during periodic reviews among portfolio managers and the analyst. Should we determine that an issuer's practices may not reflect NCRAM's ESG principles, the investment will be reevaluated. Note that where possible, NCRAM plans to implement holding restrictions impacting issuers that we believe pose the most severe ESG risks or are engaged in harmful business activities.

At the broader portfolio level, NCRAM portfolio managers review and assess aggregate ESG exposures on an absolute basis and relative to the benchmark. NCRAM can furnish reporting to clients summarizing key sustainability exposures and qualitative examples of our ESG implementation.

Issuer Engagement

NCRAM believes that engagement helps our investment team better understand an issuer's commitment to integrating sustainability objectives into business strategy and the potential financial ramifications of ESG risks going forward. Engagement also grants NCRAM a platform from which we can advocate for better disclosure and support an issuer's efforts to improve its ESG practices. As a leading global high yield bond manager, NCRAM is able to secure 1-on-1 meetings with management teams of many of the issuers that we hold in our portfolios. Our analysts can also interact with management teams through conferences, investment road shows, and regular company calls. These events enable us to frequently communicate with company management regarding factors with potential credit impact, including ESG matters.

If we consider an investment to pose material ESG, financial, or other risks, our analysts would generally engage in a conversation with members of the issuer's management team to share our concerns. As bondholders, we have some limits on our ability to influence an issuer's operations and governance. However, we can add our voice to those of other investment managers pushing for positive change, and we can attempt to motivate issuers by reevaluating our investment decisions and our participation in new issues. NCRAM may sell certain holdings if it is unsatisfied with the ESG risks of an issuer as compared to its industry peers and credit fundamentals.

NCRAM Governance and Oversight

NCRAM has established an ESG Committee chaired by our CEO & CIO, with membership including representatives from NCRAM's investment and product development teams, as well as our compliance and legal departments. The committee is responsible for designing and implementing NCRAM's ESG policies and procedures, monitoring market trends, and ensuring compliance with applicable regulations. Committee members interface with organizations such as UN PRI and other industry groups and forums, as well as other Nomura Group companies.

The ESG Committee reflects its findings back to the broader investment team, and provides training to all investment personnel at least annually, based on material from both industry groups and internal sources. NCRAM's ESG Policy is reviewed as necessary, but at a minimum annually.

Key Takeaways

- NCRAM maintains high yield bond management capabilities developed to capture ESG-related investment opportunities and meet clients' evolving sustainability goals
- NCRAM's analysts and portfolio managers assess both the economic and ESG strengths and risks of prospective investments
- The Global Sustainable High Yield strategy seeks to deliver both attractive financial returns and positive sustainability outcomes

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An investment in high yield instruments involves special considerations and certain risks, including risk of default and price volatility, and such securities are regarded as being predominantly speculative as to the issuer's ability to make payments of principal and interest.

NCRAM uses certain processes when determining the ESG strengths and weaknesses of issuers. Different ESG processes may achieve different results. NCRAM's overall ESG determinations with regard to issuers may change over time. NCRAM's ESG determinations may not conform to a client's ESG determinations. NCRAM has no firm-wide exclusion list and may purchase or hold securities from issuers which may be considered to have low ESG ratings and/or substantial ESG risk (unless limitations are stipulated in client guidelines). Low ESG determinations do not automatically result in an exclusion or sell decision (unless exclusions are stipulated in client guidelines).

A copy of NCRAM's Code of Ethics and its Part 2A of Form ADV, are available upon request by contacting NCRAM's Chief Compliance Officer via e-mail at Compliance@nomura-asset.com or via postal mail request at Nomura Corporate Research and Asset Management Inc., Worldwide Plaza, 309 West 49th Street, Compliance Department, 19th Floor, Attn: Chief Compliance Officer, New York, NY 10019-7316.

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The portfolio may participate in new issuances of securities (New Issues), and a portion of the portfolio's returns consequently may be attributable to its investment in New Issues. The market value of New Issues may fluctuate considerably due to factors such as the absence of a prior public market, unseasoned trading, and the limited availability for trading and limited information about the issuer. When a portfolio's asset base is small, New Issues may have a magnified impact on the portfolio's performance. As a portfolio's assets grow, it is probable that the effect of the portfolio's investment in New Issues on its total returns may not be as significant, which could reduce the portfolio's performance. There is no guarantee that the availability or economic attractiveness of New Issues will be consistent from year to year.