ISSUER ENGAGEMENT IS CRUCIAL TO THE FUTURE OF SUSTAINABLE INVESTING

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We believe that ESG investing is not only about partnering with issuers who already demonstrate a deeply integrated approach to ESG, but also about engaging with those who wish to move forward with their ESG initiatives. We believe that successful engagement can reduce credit risk, unlock value and influence positive impact.

How can bondholders engage?

For many companies, establishing an ongoing dialogue with their investors has historically been related to equity holdings. That said, we have found that as significant lenders of capital, <u>fixed income investors</u> with sufficient scale and scope can exert meaningful influence over issuers' ESG risk management and disclosure. In 2017 alone, PIMCO analysts and portfolio managers conducted more than 4,000 calls and in-person meetings with issuers' senior management, typically addressing ESG issues among other financial matters.

Engagement enables us to evaluate how each issuer will address risk factors going forward, as well as the company's direction and aspirations. Along with fostering meaningful change among issuers and industries, as always we are acting on our clients' behalf by identifying issuers whose performance we believe is likely to significantly improve – or deteriorate – over time.

PIMCO's engagement protocol for ESG strategies

Within PIMCO's ESG strategies, a dedicated engagement specialist identifies and engages with issuers who have the potential and willingness to improve ESG-related practices. In 2017 we launched our ESG engagement protocol to 120 corporate issuers, and of these, 83 companies – almost 70% – provided detailed input to our ESG engagement.

We base our engagement on four pillars:

- **Corporate culture and conduct**: We expect companies to demonstrate a commitment to implementing high-quality governance, including business ethics and oversight of key environmental and social practices.

- **Risk management:** We look for evidence that internal control of environmental and social risks is sufficient to ensure sound stewardship of the company's assets. This varies by industry and includes product risks, supply chain management and regulatory risk (e.g., driven by the low carbon transition).

- **Positive impact:** We engage with issuers to encourage them to align business strategy and revenues to the UN's <u>Sustainable Development Goals (SDGs)</u>. The SDGs provide a common language and reporting framework for investors and businesses to accelerate focus, accountability and impact.

- **Transparency and red flags:** We examine ESG disclosures, which should be a relevant and timely representation of material issues to investors and other stakeholders. We also undertake a quality check on policies to ensure they reflect business practices.

UN Sustainable Development Goals: measuring impact

Since their publication in 2015, the <u>SDGs</u> have taken on a significant role in mobilizing action and cooperation by governments, companies and the financial community in advancing sustainable development.

In 2017, PIMCO undertook a targeted engagement effort to encourage issuers to assess and disclose the SDGs that are most relevant to their business. Many issuers are mapping the 17 goals to their business activity, and some have identified priority SDGs where they can have the greatest impact.

Ultimately, we want to have the ability to quantify and compare the contribution of each company to the achievement of the SDGs. We also want to communicate the impact of our clients' investments in ESG strategies, and can only do this if issuers measure the wider impact of their products and services on society and the environment. This will enable investors to build portfolios that better match their financial and impact goals.