PGIM FIXED INCOME

ESG ENGAGEMENT POLICY

ENGAGING WITH ISSUERS

As an active, bottom-up, fixed income asset manager, PGIM Fixed Income views ESG engagement as an important tool in our investment process. Through constructive and ongoing dialogue with issuers, we believe that ESG engagements can enable us to achieve better investment and, where applicable, ESG outcomes for our clients.

FOCUS

Our ESG engagement efforts are rooted in our fiduciary duty towards our clients. As such, our ESG engagements focus on issuers where we believe that an engagement will be additive to our investment process. The objective of our engagements will be specific to each issuer and focused on issues that are material to the issuer from an ESG credit risk/opportunities and/or ESG impact perspective.

A core tenet of our engagement philosophy is that we should not pursue engagements that are likely to harm the value of our clients' positions in the issuer. While we cannot know with certainty what the effect of an engagement will be in advance, we prioritise engagements and objectives that our analysts believe (based on their knowledge of the issuer and its industry) will preserve or improve the value of our positions in the issuer and avoid those that they believe will conflict with this intention.

Our engagements are focussed on issuers of debt and include listed and unlisted companies as well as securitised products, municipals, and sovereigns.

PRIORITISATION

As one of the world's largest fixed income managers, investing in several thousand issuers across most industries and asset classes, our engagements with issuers are prioritised on the basis of factors such as the materiality of the ESG topic(s) on the issuer, our relative value view of the issuer, and how receptive we view the issuer to be to engagement.

Additionally, we may consider other factors that aid in our prioritisation, such as specific themes, controversies, specific events including change to regulation, M&A, or other issues that may arise.

APPROACH

Our approach to engagement is rooted in constructive dialogue with our issuers, collaboration internally between fundamental research analysts, economists and ESG specialists, and quality engagements over quantity.

Given that our engagement activities are directly linked to our investment research and decisions, our strong preference is for one-on-one direct engagements as this allows us to represent our own viewpoint and enables us to speak candidly when highlighting our ESG concerns to company management, policymakers, arranging banks, sponsors, NGOs or any other stakeholder. We do not employ third parties to conduct engagements.

We believe constructive dialogue should be informative and meaningful for both parties. This means that while dialogue will often entail our analysts probing management on the relevant, material ESG issues and assessing the issuer's plans to address them, we also believe in sharing information such as pointing out to issuers our assessment of credit material ESG risks as well as the impacts that their policies, practices or products have on the environment and society. Where applicable, we discuss the implications these considerations may have for their funding costs and future market demand for any new issuance of bonds.

To enable this constructive ESG dialogue, we encourage close collaboration between our team of fundamental research analysts, economists and ESG specialists throughout the engagement process. Such collaboration allows for knowledge sharing between teams and enables us to think holistically of the ESG objectives and risk-return implications of an engagement. Given that we see ESG engagements as a part of our investment process, we see great value in this collaboration across teams.

As we believe that engagements should be highly relevant to our investment process and also provide valuable insights to the issuers we engage with, our approach to engagements emphasizes quality over quantity. This means that our focus is on fewer but more substantive engagements, where the objective is centered on one or two in-depth questions or recommendations.

Through in-depth and nuanced discussions on our ESG concerns, we may make issuers aware of how our concerns factor into our investment decision, gain a better understanding of what the issuer is doing to address our concerns, and discuss industry best practices. Such dialogues are likely to enrich our investment analysis while at the same time provide useful insights to issuers into how they compare to industry peers and how markets perceive their ESG initiatives. Our ESG Impact Ratings offer additional tangibility and context to the conversations, as they allow our analysts to show issuers how we rate them on ESG impacts, while also providing the rationale and factors behind the ratings.

We believe that by asking informed questions, raising our concerns and sharing industry best practice, we can positively influence issuer ESG practices over the long-term. While we find that it is usually difficult to attribute changes made by an issuer to a single investor or engagement, we believe that issuers hearing the same concerns from multiple investors on the same ESG points can lead to change and contribute to long-term value creation. As a result, we believe that it is our responsibility to contribute to such dialogue, even if we may not be able to claim full credit for the outcomes.

Once a meaningful engagement has taken place, an assessment of the engagement is recorded internally. These recordings facilitate monitoring of our ESG-related interactions with issuers, provide helpful insights to our investment process and are used to inform clients of our ESG engagement efforts. We then track the issuer’s progress on the ESG issues we raise and reflect this in our ESG Impact Ratings and fundamental credit ratings (where ESG risks are integrated), both of which must be updated at least annually, or more frequently as events warrant.

ESCALATION

When an issuer is not addressing its most material ESG concerns, regardless of whether we determine this through engagement or our research, we believe that the most effective method of escalation is to reduce our holdings of the issuer's debt with the expectation that this will, over time, impact the issuer's cost of capital.

Given that we generally do not have equity ownership rights, we are not able to use proxy voting, which is one of the primary escalation mechanisms available to equity holders. As a leading fixed income asset manager, we do, however, still have effective mechanisms available to us. Unlike equity, debt matures, requiring issuers to raise new debt regularly. As a result, our decision to invest in an issuer can affect its cost of capital in a way an equity investor cannot. To this end, our divestment in the secondary market may contribute to widening an issuer's market spreads, which in turn can also impact the future cost of capital, when the issuer comes back to market with a new issue. Even if we do not currently hold an issuer, our views, as one of the largest global active fixed income managers, can be impactful if the issuer intends to issue future debt. On the back of these considerations, we see our decision to buy, divest or not invest as our most effective instrument of escalation, especially if it is done in combination with direct feedback to the issuer regarding our investment decision.

The primary example of this is with respect to our ESG Impact Ratings. Investments in our ESG strategies are informed and guided by our ESG Impact Ratings. Our research analysts assign issuers under their coverage an ESG Impact Rating, which assesses the issuer's impact on the environment and society. Should our analysts conclude that the issuer isn't adequately addressing its most material impacts or making progress the way it was expected to, the analyst would generally downgrade the ESG Impact Rating. These downgrades are meaningful because, depending on the resulting ESG Impact Rating, it can trigger us to reduce or even exit the position in our ESG strategies. It should be noted, though, that even if we divest an issuer, we may continue to engage with them as they continue to issue new debt.

ENGAGEMENT WITH POLICYMAKERS AND REGULATORS

As a large, global asset manager, PGIM Fixed Income is affected by regulation in many jurisdictions, both where this applies to issuers and investors. And in recent years, there has been rapid growth in regulation worldwide that is specifically ESG-related. Where proposals for such regulation are particularly relevant to PGIM Fixed Income, we actively engage with policymakers, either directly or via collaboration with other PGIM businesses at the PGIM level (and, at times, via our trade association partners). This is mostly achieved through responses to open regulatory consultations, such as the SEC's proposals on climate disclosures and ESG fund disclosures. It may also involve consultations with standard setters, such as on the ISSB's proposed sustainability disclosure standards. We also engage with policymakers on proposals that may negatively impact our investments to make sure they understand the implications of their actions on both the economy and our investors.

ENGAGEMENT WITH INDUSTRY ORGANISATIONS

We are a member of a number of trade associations and industry initiatives and are committed to providing feedback to policy consultations or technical input into regulatory process that materially impact us or our investments. The selected list of our current memberships and collaborative initiatives related to ESG topics is below:

Directly as PGIM Fixed Income

1. Signatory to the UN Principles for Responsible Investment (UN PRI) (Securitised Products Advisory Committee)
2. Signatory to the Financial Reporting Council's UK Stewardship Code
3. Partnership for Carbon Accounting Financials (PCAF)
4. Climate Bonds Initiative
5. Center for Real Estate Finance Council (CREFC) (Sustainability Steering Committee, Transparency Subcommittee)
6. European Leveraged Finance Association (ELFA) (ESG Committee)
7. Structured Finance Association (SFA) (Auto ABS Working Group, CMBS Working Group, ESG Task Force Steering Committee, Structured Finance Disclosure Framework Working Group)
8. Loan Syndications and Trading Association (LSTA)
9. Association for Financial Markets in Europe (AFME)
10. Loan Market Association (LMA)

Indirectly via PGIM, Inc

1. Ceres Investor Network
2. International Financial Reporting Standards (IFRS) Sustainability Alliance
3. The Council of Institutional Investors (CII)
4. The Institutional Investors Group on Climate Change (IIGCC)

NOTICE: IMPORTANT INFORMATION

Source(s) of data (unless otherwise noted): PGIM Fixed Income, as of 5 July 2024.

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