



# **Policies for integration of sustainability risks into our investment process and consideration of principal adverse environmental and social impacts**

**(Entity-Level disclosure ref: SFDR Article 3 and Article 4)**

**January 2023**



# I. Sustainability Risk Integration in Our Investment Process

## Introduction

Sustainability is increasingly important in corporate management. Corporate value may be severely damaged by inappropriate responses to environmental and social issues. As a responsible institutional investor, we believe that integration of sustainability risks into our investment management processes is essential in fulfilling long-term management responsibilities. We identify and assess these risks appropriately and utilize them in our investment decisions.

Sustainability risks areas are broad, ranging from potential issues/topics to those that are already reflected into financial information and to those that are highly probable. The risks evolve due to changes in the external environment and market participants. The impact from sustainability risks on investment performance in financial and other products varies to some extent depending on nature of the business. We seek to identify highly material sustainability issues for each industry and reflect them in our overall investment activities such as ESG evaluation, engagement and the exercise of voting rights.

At Sumitomo Mitsui DS Asset Management Company, Limited (hereafter “SMDAM”), members of our Responsible Investment Section take a lead in establishing a ‘sustainability risk consideration system’ which provides consistency and continuity within our firm through giving support to our portfolio management teams in integrating ESG evaluation into their investment processes based on the investment philosophy of each investment product. We have developed a framework to effectively analyze and identify potential business risks and opportunities which may affect corporate value of our investee companies. The framework for sustainability risk consideration is as follows:

## 1. Overview

### (1) Important view points on sustainable/ESG investment

- Not being too excessively bound by uniform formal standards, we will perform our activities with an eye toward goals and an emphasis on practical effectiveness.
- Based on our understanding of risks and opportunities of investee companies and the realities of individual companies, we will encourage the investees companies to promote their issues and to make effective information disclosure.



## (2) Our Philosophy and Basic Policies on Sustainable/ESG Investment

- We set forth our sustainability initiatives (including ESG elements) in our Management Philosophy, Investment Philosophy, Principles of Fiduciary Duties and Sustainability, and Basic Policy on ESG Investment, with the aim of providing high-quality investment performance while contributing to the realization of a sustainable society.

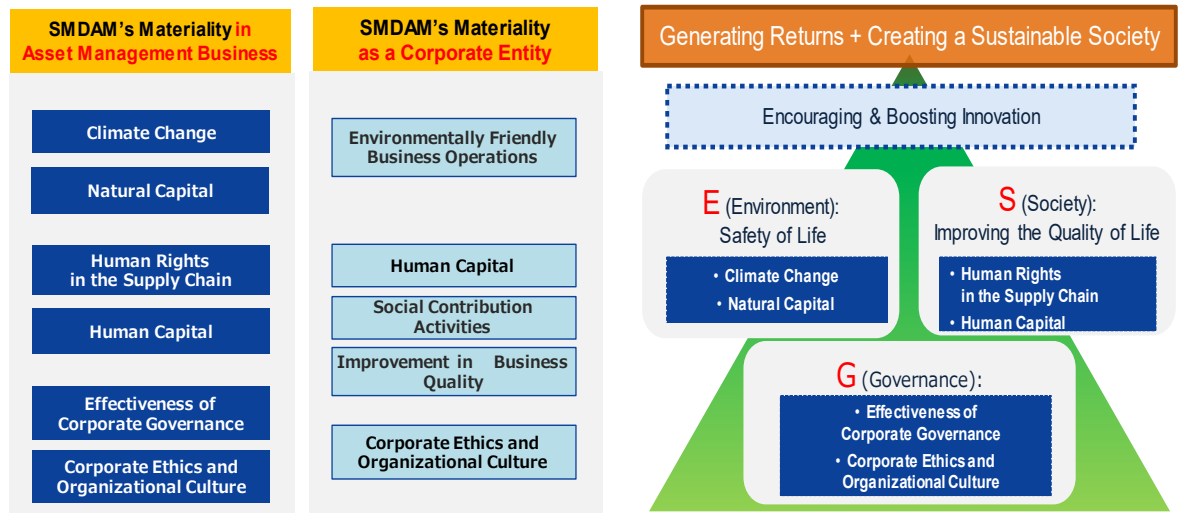
<p style="text-align: center;"><b>Management philosophy</b></p> <p>Through the implementation of the Code of Conduct (Value) by each employee, we will respond quickly to changes in the business environment, including macroeconomic and technological innovations, and contribute to the <b>improvement of Quality of Life</b> to all the stakeholders.</p>	<p style="text-align: center;"><b>Investment Philosophy (Preface)</b></p> <p>As a group of asset management professionals, we aim for stable return over the medium to long term by providing best-in-class investment performance that respond to changes in the market environment, incorporate new management skill and <b>take sustainability into account</b>.</p>
<p style="text-align: center;"><b>Principles of Fiduciary Duties and Sustainability</b></p> <p><b>Principle 1</b> We will fulfill our management responsibilities as a responsible institutional investor.</p> <p><b>Principle 2</b> We will strive to <b>materialize a sustainable society</b> through our asset management business.</p> <p><b>Principle 3</b> We, as a corporate citizen, will engage in activities to <b>pass on an affluent society and the global environment to the next generation</b>.</p> <p><b>Principle 4</b> We will train and educate human resources to contribute to the QOL of our clients, the society and our employees.</p>	<p style="text-align: center;"><b>Basic Policy on ESG Investment</b></p> <ol style="list-style-type: none"> <li>1. Taking account of the investment philosophy and investment horizon of each investment product, SMDAM incorporates analysis and evaluation of ESG and other non-financial information into its investment process, and considers them in investment decisions and active ownership. Principal adverse impacts (PAIs) of corporate activities on environment and society are also taken into consideration.</li> <li>2. SMDAM aims to contribute to enhance the value of investee companies through engagement by communicating the investor's point of view, sharing ESG issues to be solved for the medium to long term value enhancement, and encouraging appropriate actions by investee companies.</li> <li>3. SMDAM exercises its voting rights in consideration of ESG theme related engagement.</li> <li>4. SMDAM strives to improve the overall effectiveness of ESG investments by signing or participating in ESG-related initiatives such as the PRI, and will work to collaborate with other institutional investors as necessary.</li> <li>5. SMDAM collects information on ESG investments, including domestic/overseas laws/regulations, trends in ESG product needs of customers and beneficiaries, and the activities of other asset managers, in order to promote effective ESG integration. SMDAM also strives to disclose appropriate information to protect the rights of customers and beneficiaries.</li> </ol>

(As at 1 January 2023)

## (3) SMDAM's Materiality (Key issues to be addressed)

- Using materiality as a starting point, we internally and externally present our vision on what a sustainable society should be like and our initiatives we are taking for its realization.
- As an asset management company, we conduct investment activities that are truly valuable to our stakeholders, with an emphasis on material substance rather than on a pro forma standard criteria.
- We analyze impacts on the corporate value of investee companies from two perspectives:
  - (a) Suppressing/Deterring negative impacts on the society (aspect of risks) and
  - (b) Creating positive impacts (aspect of opportunities)

## Our Materiality in asset management business

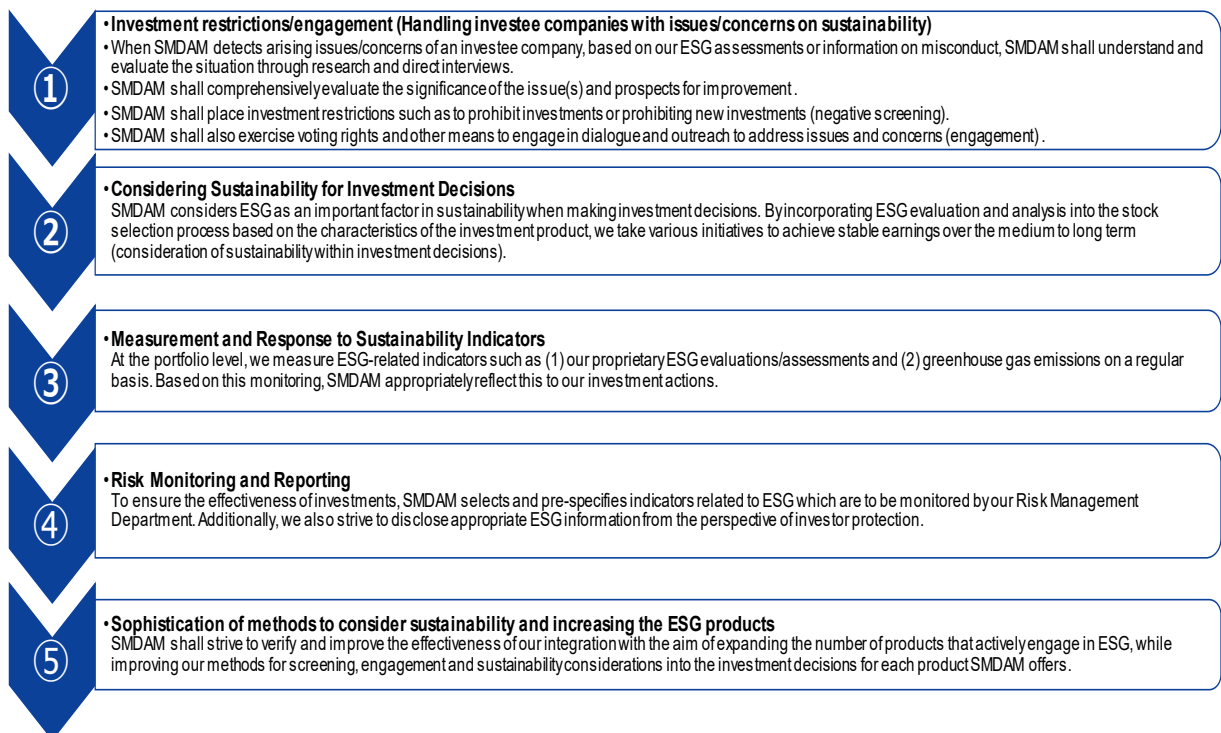


(As at 1 January 2023)

### (4) Integration of sustainability/ESG into our investment process

- In accordance with our “Basic Policy on ESG Investments”, all active fund managers at SMDAM are generally\* required to consider ESG aspects, which is an important factor of the sustainability for the companies in which we invest.

(\* ) Based on practical difficulties, there are exceptions to this stance (e.g. passive investments and products which have short positions). These products may be exempted. The following chart shows a typical flow of the integration process.



## 2. Policy on Corporate's Business Conditions Tracking and Engagement

- We emphasize the importance of investment research as a source of added value. Analysts and fund managers gather a range of information to understand the current conditions and prospects of investee companies.
- Not limited to general dialogue with investee companies on corporate policies, financial conditions, management strategies, etc., efforts are made for a deeper understanding on the status of the investee companies in relation to promoting their sustainable growth, increase their corporate value, or to avoid impairments/damage.
- We shall collect, evaluate, and analyze not only financial information but also information related to sustainability, including information on environmental, social, and governance (ESG) matters. This is reflected in our investment processes according to the specific investment philosophy for each product.
- The policy of incorporating a sustainability assessment and analysis into our investment processes is not limited to Japanese-domestic stocks. It is applicable to various investment assets such as REITs, foreign/non-Japanese stocks and Japanese-domestic and foreign/non-Japanese bonds.
- We shall engage by considering the global operating environment, status of all industries, specific industries, or individual issues with investee companies to (1) develop and implement appropriate strategies & visions and (2) to promote disclosure from a medium-to-long-term perspective.
- We shall enhance efficient investments and develop appropriate financial and capital structure strategies, shareholders' (or investors') return policies based on the cost of capital, and enhance information disclosure.
- ESG issues related to (a) exercising proxy voting rights, (b) raising awareness of emerging climate change risks, and (3) the penetration of SDGs (Sustainable Development Goals) that impact sustainability, shall be all subjects to engagement activities.

## 3. Policy on Exercise of Voting Rights

- We shall exercise our voting rights for the purpose of enhancing value of investee companies or avoiding damage to them for the benefit of our customers and ultimate beneficiaries.
- Recognizing that our stance exercising our voting rights are important with impact on the investee company's management and causes change in the value of investee companies, we shall exercise our voting rights in order to prevent investee company management from harming shareholder interests and motivate management to efficiently and effectively use resources to generate maximum value.
- Understanding that the most important criteria for judging the exercise of voting rights is to contribute to the interests of our customers and ultimate beneficiaries of our funds and to enhance the corporate value of the investee companies or avoid damage, our voting decisions shall be

made in accordance with the actual conditions of the investee company based on constructive dialogue with them and other investment considerations.

- Believing that sound company management and increasing value of the investee companies requires not only respects for legal compliance but also through cooperative relationships with stakeholders other than shareholders, such as consumers, business partners, local communities, and society in general, we take the view that investee company misconduct related to social credit/reputation is highly likely to damage corporate value in both short and long term. We take a strict stance against disgraceful acts which are related to social credit/reputation when exercising our voting rights.
- Main viewpoints on our voting decisions:
  - (a) Perspectives on outcome accountability verification
    - Corporate earnings performance, capital efficiency such as Return of Equity (ROE), shareholders (or unitholder) return, Total Shareholders Return (TSR)
    - Eligibility of directors (attendance rate at board of directors' meetings, etc.)
    - Responsibility for acts relating to social credit/reputation
  - (b) Perspectives on future corporate value enhancement or damage avoidance
    - Design of internal governance system, composition of board of directors (Ratio of outside directors, diversity, etc.), and accounting auditor
    - Eligibility of directors (Independence of outside directors, Number of concurrent positions and others)
    - Remuneration system (Incentive to contribute to future value improvement or damage avoidance for the company)
    - Business strategy, financial and capital strategies, and medium-to-long term strategies related to non-financial factors including ESG strategy

## 4. Policy on Investment Exclusion/Restrictions

At SMDAM, the Executive Officer in charge of the Responsible Investment Section determines investment constraints based on our "Rules on managing Unsuitable Investee Companies", when an investment is inappropriate from an ESG perspective. This rule excludes companies which do not meet the requirement of "good governance practices" in terms of the SFDR definition (sound business operation) from our investment universe.

## Types of Investment Exclusion

The following types of investments are currently excluded from our investment:

- A) Companies which committed misconduct from an ESG perspective
- B) Companies that provide inappropriate products and services from an ESG perspective
- C) Companies identified through norm-based negative screening
- D) Product level investment exclusions (that are applied based on the product characteristics, and specific investment guidelines provided by clients)

## Norm-based Negative Screening and Investment Exclusion

- We shall designate the investment candidates which meet the quantitative criteria of both (1) and (2) in the following table subject to our qualitative judgment as shown in (3) in the table which may deem investment candidate as "inappropriate for investment from an ESG perspective" and therefore subject to investment exclusion.

### Negative Screening and Investment Exclusion Criteria

Viewpoints for Entity-Level Exclusion	External Database to Use	Threshold Criteria
(1) International norm-based exclusion	Sustainalytics Global Standards <b>Screening</b>	Non-compliant
(2) Materiality	Sustainalytics <b>Controversy</b> Rating	Category 5
(3) Qualitative judgement (by each Investment Group)	Qualitative discussions by Executive Officer (Investment Department)	Idiosyncratic circumstances
(4) Decision by Executive Officer in charge of the Responsible Investment Section	Decision by Executive Officer (Responsible Investment Section)	Comprehensive judgement

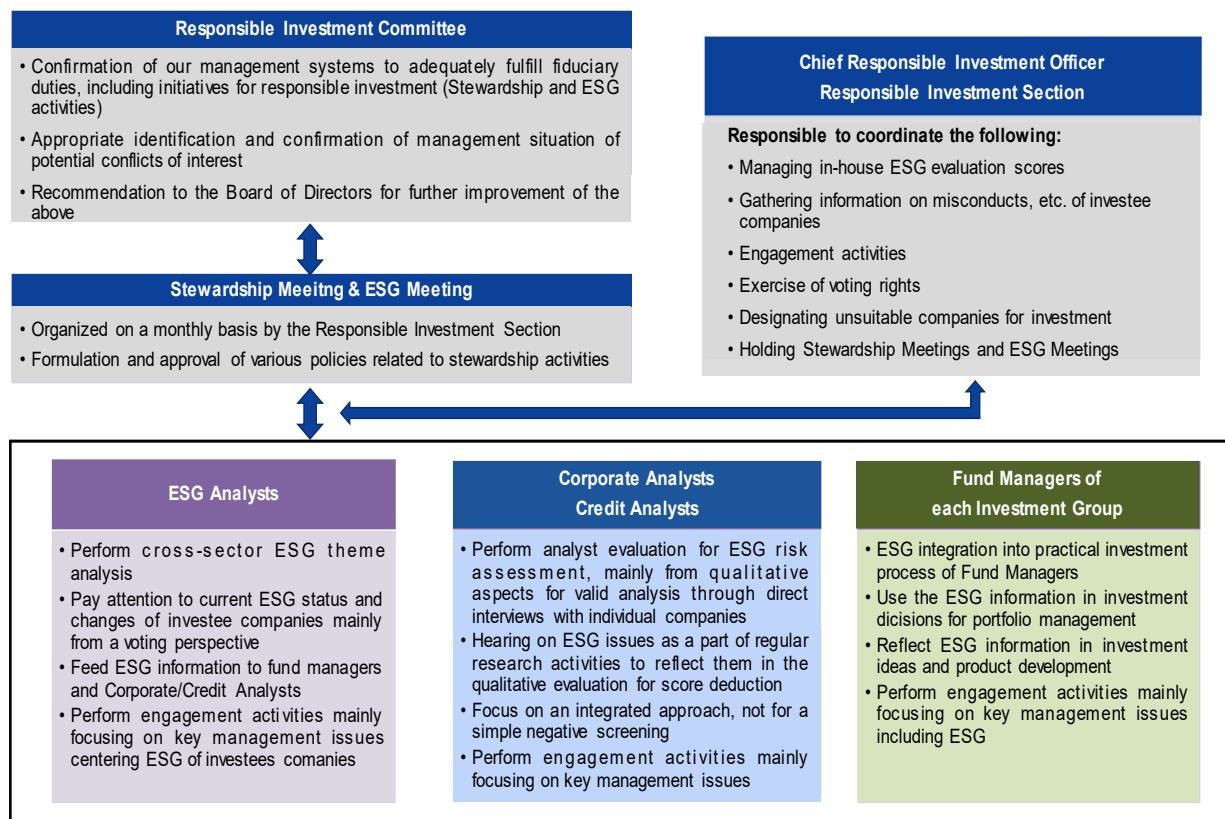
(As at 1 January 2023)

- Following deliberations at the Stewardship Meetings/ESG Meetings, the Executive Officer in charge of the Responsible Investment Section determines investment constraints.

#### <Types of constraints>

- 1) Setting Company-wide investment constraints: Sales instruction, Prohibition of Purchase, etc.
- 2) Setting Investment constraints over all active investment products under management
- 3) Designated hold (Pending decision for the case where available information for making an appropriate decision is insufficient)

## 5. Organizational Framework of Sustainable/ESG Investment Promotion



(As at 1 January 2023)

## 6. Sustainable Product Certification Panel

- Our company clearly states in its investment philosophy that it considers sustainability factors in all active products, and at the same time, conducts sustainable product classification of each product according to our own classification system.
- The certification as a sustainable product is made by the Chief of the Responsible Investment Section based on deliberations at our Sustainable Product Certification Panel.
- The Sustainable Product Certification Panel is chaired by the Chief of the Responsible Investment Section, and its members consist of representatives from investment, product, risk management, disclosure and other departments.
- At the Sustainable Product Certification Panel, we discuss how to monitor and disclose information in addition to considering sustainability in our investment management operations.
- Prior to submission of an application to obtain an approval as an SFDR Article 8 or Article 9 product from the European regulators, in-house certification is required for product eligibility as an Article 8 or Article 9 fund.



- In light of the recent growing social demand for promoting sustainability, as well as amplification of our ESG-related data, the current certification criteria will be periodically reviewed with the aim to advance the level of sustainability consideration.

### Requirement to internally certify as an SFDR Article 8 eligible product

“SFDR Article 8 eligible”	Requirement condition
Requirement 1	The product (fund/investment strategy) shall promote sustainability while sustainable investment is not included in its investment objectives.
Requirement 2 (1)	“Good governance practice” is secured.
Requirement 2 (2)	“Do not significantly harm” is secured.
Requirement 3	Sustainability risk is considered.
Requirement 4	Principal Adverse Impacts (PAIs) are considered.

(Note) The product should also comply with other SFDR requirements for necessary disclosure. SFDR stands for the European Union's Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088) which has been effective from March 2021.

(As at 1 January 2023)

## 7. Specifying Materiality Themes at a Firm level

SMDAM aims to become the best asset management company in contributing to “Quality of Life” in its management philosophy, and perform stewardship activities towards its investee companies as a responsible institutional investor playing a role in the investment chain, as well as providing quality asset management services to its clients.

In order to accelerate these initiatives and contribute more than ever to the realization of a sustainable society, we have identified "materiality themes" as key management topics. In consideration of the characteristics of the asset management business, the materiality themes in our company are classified as "Materiality in Asset Management Business" and "Materiality as a Corporate Entity", and furthermore, especially important is the key materiality themes in three areas of ESG, "Environmental Issues: Safety of Life," "Social Issues: Improving Quality of Life," and "Governance issues".

In identifying the key materiality themes, our executive management engaged in a series of discussions based on the opinions of a wide range of stakeholders, including employees, outside experts, customers and rating agencies, and identified the following key materiality themes in environmental, social and governance issues out of a wide range of challenging issues.

## **(1) Materiality in our asset management business**

For "Materiality in asset management business" we identified six particularly important themes from two perspectives of "importance in achieving a sustainable society" and "importance in long-term investment performance."

- Climate change
- Natural capital
- Human rights in the supply chain
- Human capital
- Effectiveness of corporate governance
- Corporate ethics and organizational culture

These materiality themes are reflected in our own ESG evaluation, and we shall conduct engagement activities that are truly valuable for our stakeholders, focusing not only on pro forma evaluation standard but on substance, primarily targeting the priority sectors and target companies specified for each theme. In addition, when exercising voting rights, we shall encourage investee companies to fully disclose ESG information, and if the disclosure is insufficient and management of the companies has no intention of making efforts for any improvement, we shall oppose to the agenda of electing such directors at our voting exercise.

## **(2) Materiality as a corporate entity**

In the area of "Materiality as a corporate entity", we have identified five particularly important themes as depicted below from the perspectives of "importance to realize a sustainable society" and "importance in our company's business operations." We will work to develop human resources and create a sound organizational culture with a medium-to-long term perspective in addition to our current activities that contribute to improving the Quality of Life of society, customers, and employees.

- Environmentally friendly business operations
- Human capital
- Social contribution activities
- Business quality improvement
- Corporate ethics and organizational culture

As described above, SMDAM is committed to perform a comprehensive approach to the business operations in consideration of sustainability.

## 8. ESG Evaluation Framework

ESG factors generally encompass a wide range of fields and their impacts on our investment decisions shall vary depending on the characteristics of each business. Therefore, we identify specific sustainability issues with high-materiality for each sector and reflect these to our engagement themes and ESG evaluation standards. Within this identification process we also refer to the views and thoughts set by the ESG rating agencies such as the GRI (Global Reporting Initiative) and the Sustainability Accounting Standards Board (SASB) and ideas of each ESG rating agency.

### ESG evaluation of individual companies etc.

We have developed the following multiple ESG rating scoring systems internally, in order to establish an easy-to-use evaluation method that considers the asset class, type of investee company, availability of ESG data and materiality.

In order to collect a broader range of ESG information, where ESG information is difficult to obtain, we use complimentary and relevant ESG data from external ESG vendors and use this to perform comprehensive analysis covering multiple aspects of the ESG characteristics for each fund's portfolio.

Evaluation items and evaluation weights of each item are determined primarily by our Responsible Investment Section. The items and weightings from our own proprietary evaluation are periodically reviewed to ensure the effectiveness of the evaluation method.

#### (a) Proprietary ESG evaluation scores

##### ■ SMDAM ESG Score (Comprehensive)

- Primarily used for ESG evaluation of Japanese stocks and corporate bond issuers (mainly large-cap companies)
- Granted to the names that are continuously and comprehensively covered by our in-house sector analysts and/or credit analysts
- Composed of Basic Evaluation (by the ESG Analysts in Responsible Investment Section) and Analyst Evaluation (by the Sector Analysts of our Corporate Research Group and Credit Analysts in Bond Investment Group) with extensive evaluation items for each aspect of E (Environment), S (Social) and G (Governance)
- A proven comprehensive ESG score since 2009

##### ■ SMDAM ESG Score (Core)

- Primarily for evaluating Japanese companies (mainly small & mid-cap companies) that do not have continuous coverage by the Sector Analysts, Credit Analysts, etc.
- Also consists of a Basic Evaluation and an Analyst Evaluation with a focus on especially important selected evaluation items, and reflecting the principal adverse impacts (PAIs) on environment and society

- The Analyst Evaluation is provided by sector analysts, relevant portfolio managers and ESG Analysts at the Responsible Investment Section

#### ■ **SMDAM ESG Score (Info)**

- Calculated by extrapolating our own ESG score in addition to external ESG scores provided by third-party ESG rating agencies with extensive coverage in their database.
- Mainly used to calculate average ESG scores of fully-covered entire portfolios and comparing them with benchmarks

#### ■ **SMDAM ESG Score (Global)**

- Primarily assesses non-Japanese investee companies covered by our Sector Analysts, Credit Analysts, etc. This score is also granted to domestic investee companies, etc., if necessary.
- Consists of a Basic Evaluation and Analyst Evaluation, with the analyst evaluation considering the materiality of each sector and evaluating on selected key assessment items.

#### ■ **SMDAM ESG Score (REIT)**

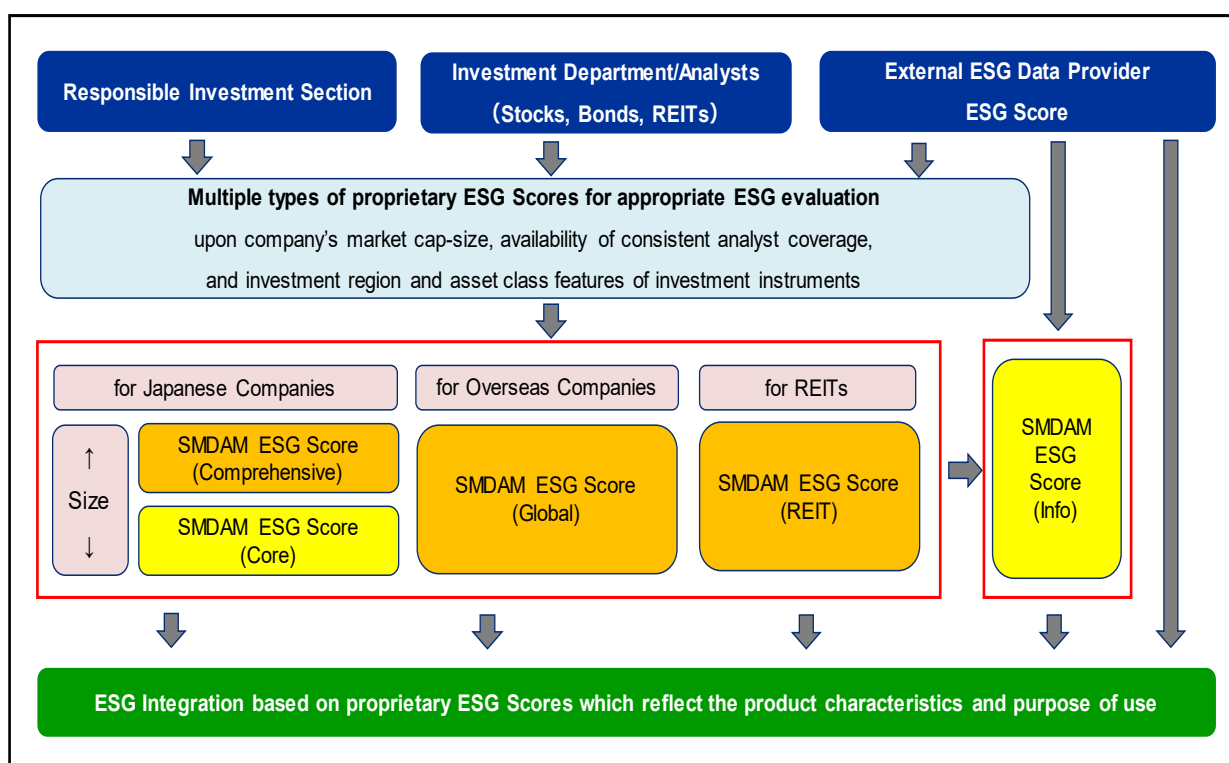
- REIT specialized rating systems for Japanese and foreign REITs assessed by specialized analysts.
- Governance Score is SMDAM's unique evaluation item that considers the laws and regulations as well as REIT product system in each country.
- Environmental and social aspects are evaluated by our professional REIT analysts based on GRESB, an ESG index specific to real estates and REITs, as well as on the evaluation criteria of the Task Force on Climate-related Financial Disclosures (TCFD).

### **(b) External databases used for ESG evaluation**

- Sustainalytics ESG Risk Rating
- Sustainalytics Carbon Risk Rating
- Sustainalytics Global Standard Screening
- Sustainalytics Country Risk rating
- Sustainalytics PAI (Principal Adverse Impact) Solutions
- CSRHUB
- RepRisk Rating
- GRESB (Global ESG Benchmark for Real Assets)

(As at 1 January 2023)

## (2) Leveraging proprietary ESG evaluation in our ESG evaluation Framework



(As at 1 January 2023)

## 9. ESG Data Provider Evaluation & Working Group

- As there are difference in methodology, number of companies covered, frequency of data updates, and data transparency among ESG evaluation and data providers (ESG data providers), we use multiple ESG data providers depending on the purpose of use.
- In addition, we confirm quality of the providers, having discussions with them on appropriateness of their methodology etc., as necessary, including after adoption of the providers.
- To verify the validity and reliability of external ESG data, we established the ESG Data Provider Evaluation and Working Group. The Responsible Investment Section leads the working group in conducting a multifaceted evaluation of each provider by collecting opinions from various relevant departments such as Investment, Investment Development, Investment Planning, Risk Management, Information Technology and Client Disclosure.

## 10. Collaborative Engagement and Initiatives

To ensure our company, as a responsible investor, can appropriately fulfill its stewardship responsibilities, we have signed and endorsed a variety of domestic and global initiatives and are co-working with other investors. In order to solve global issues and realize a sustainable society, it is essential for various organizations to work together without barriers. We actively participate in a number of key initiatives and conduct collaborative engagement to improve effectiveness of all of our ESG investments.

In addition, for companies that have violated international norms and standards, we encourage them to take appropriate management actions and measures to prevent further recurrence. We do this through engagement and dialogue including through collaborations with other professional organizations especially in case of non-Japanese companies.

### (1) Collaborative engagement

- When engaging with counterparties and setting themes for dialogue, we use a collaborative engagement model if we believe that collaborating with other institutional investors is more effective in improving or avoiding damage to the corporate value of investee companies.

In accordance with our policy of collaborative engagement, we will seek the common interest of investors by communicating our company's views and seek understanding from other participants while respecting the views of other companies.

- Institutional Investors Collective Engagement Forum (IICEF) shall focus on topics that contribute to the common interests of shareholders, centering on corporate governance issues such as cross-shareholdings, parent-child listings, and the formulation of materiality that will enhance corporate value.
- We have adopted Sustainalytics as an engagement partner, mainly focusing on foreign companies, and carry out outsourced engagement and collaborative engagement.

#### Collaborative Engagement Initiative

Name	Overview
Institutional Investors Collective Engagement Forum (IICEF)	A general incorporated association established for the purpose of supporting constructive "purposeful dialogue" (collaborative engagement) with companies by domestic institutional investors (mainly passive management investors) in collaboration to contribute to appropriate stewardship activities of institutional investors.
Climate Action 100+	A global initiative of institutional investors to engage in constructive dialogue with companies with significant influence in solving global environmental problems (currently focusing on 167 companies) on topics such as information disclosure and efforts to reduce greenhouse gas emissions.
SBT Collaborative Engagement 2021 by CDP	Collaborative engagement in which CDP signatories can participate. Letters will be sent to 1800 companies (including 170 Japanese companies) in the 2021 edition. Selection of target companies to encourage the setting of Science Based Targets (SBT), sending of letters to companies, preparation of reports on results are in a lump sum carried out by CDP.

(as of 1 January 2023)

## (2) Leveraging Global Initiatives

### (a) Purpose of our participation in Global Initiatives

We actively express our support and commitment to global environmental initiatives and international frameworks such as the Paris Agreement and the Convention on Biological Diversity. Through our participation in the initiatives in Japan and abroad, we anticipate changes in global conditions, accumulate ESG-related knowledge and use it in investment activities, supporting the efforts of the companies we invest in to realize a sustainable society.

### (b) Leveraging the Global Initiatives we are participating with

Our Responsible Investment Section promotes the activities of the Global Initiative and gathers relevant information by participating in conferences and other events in addition to reporting on our company's activities.

- **Principles for Responsible Investment (“PRI”)**

Information gathering through participation in their conferences, etc.

- **Asian Corporate Governance Association (“ACGA”)**

Collecting relevant information by attending their conferences, etc. with a policy on participating in their collaborative engagement

- **Financial Action Principle for the 21st Century toward Creating a Sustainable Society (“Principles for Financial Action for the 21st Century”)**

Collecting information by submitting our activity reports and attending conferences

- **30% Club Japan Investor Group**

Functioning as a secretariat of the administration. Collecting information by submitting our activity reports and attending conferences to share best practices and effectively use them in our own company activities.

- **Task Force on Climate-related Financial Disclosures (“TCFD”) and TCFD Consortium**

Information collection through participation in their conferences, etc.

- **Climate Action 100+**

Participating in 2 out of 10 collaborative engagement target companies in Japan. The initiative receives regular reports in a conference from a representative asset management firm that is in charge of direct engagement with the companies and we express our opinions at the conference. “Net-Zero Corporate Benchmark” is used in our climate change engagement activities.

- **CDP**

Gathering their useful information by attending their conferences, etc. and participating in the “SBT Cooperative Engagement” for a science based approach.

- **Net Zero Asset Managers Initiative (“NZAMI”)**

We announced our commitment to the carbon neutrality goals with the initiative.

## II. Consideration of Principal Adverse Impacts (“PAIs”) on environment and society

### (Introduction)

#### Policy, Procedures, and descriptions on our PAIs consideration

The Mission & Vision of Sumitomo Mitsui DS Asset Management Company, Limited includes;

- We, as investment professionals and as a corporate citizen, focus on contributing to a diversified and sustainable society through asset management business.
- We commit ourselves to aiming for a collective growth, based on a respectful understanding of our all stakeholders.

We believe it is our responsibility to consider and mitigate, through appropriate due diligence, the Principal Adverse Impacts (“PAIs”) of investment decisions on sustainability factors (\*) alongside the relevant financial and sustainability risks, making appropriate disclosures, taking due account of our business size, the nature and scale of our activities and the types of financial products we make available.

\* It includes the concept defined under the European Sustainable Finance Regulation (“SFDR”) which has a broad and evolving definition. The PAIs in the SFDR regime, are principal adverse impacts of our business operations and investment decisions on sustainability factors; environmental, social and employee issues, respect for human rights, anti-corruption and anti-bribery issues. They are typically and partly observed with, but not limited to the indicators defined under SFDR, in SMDAM’s understanding.

Based on our conception, we have identified a set of materialities as key management issues, consisting of “Materiality in asset management business” and “Materiality as a corporate entity”, both taking into account the characteristics of our asset management business.

We are committed to improve the QOL (Quality of Life) of our clients with our investment management products and services, and of stakeholders through our good governance practices including reduction of GHG (Greenhouse Gas) emissions, sustainable procurement, and human rights due diligence based on our own Human Rights Policy.

The consideration of sustainability factors in the investment decision - making processes and engagement activities can realize benefits beyond financial markets, enhancing the stability of the natural environment and society as the foundations of the real economy, which in turn contribute to increasing the resilience of the real economy and the stability of the financial system, ultimately impacting on the risk - return of financial products.

It is therefore essential for us to consider PAIs of investee companies, in order to deliver quality investment returns to our clients over the long term.

All professionals in our investment teams consider the PAIs throughout comprehensive investment actions at least within the scope of single materiality, alongside the relevant financial risks and relevant sustainability risks. While we embrace dynamic materiality to focus on information material or likely to be material, some strategies adopt double materiality depending on their philosophy and product design. For



sustainable investments, this means to ensure the investments do not significantly harm to any environmental or social objectives.

“PAI Due Diligence” \* is the essential foundational process across all of our investment products, to be systematically carried out throughout the entire life-cycle of investment operations, which is an on-going, proactive and reactive, and process-oriented activity of firm-wide stewardship activities with active ownership.

\* The PAI Due Diligence is aligned with our “*Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises*”

The “PAI Due Diligence” process for our comprehensive investment activities, consists of the following 6 elements to be further elaborated below;

- 1) Policy Framework
- 2) Identification and Prioritization of Actual/Potential Adverse Impacts
- 3) Consideration of PAIs in Investment Processes
- 4) Engagement and Escalation
- 5) Collaborative Engagement and References to International Standards
- 6) Monitoring and Disclosure/Reporting

## 1. Policy Framework

In our "Management Philosophy" and "Principles of Fiduciary Duties and Sustainability", which are the basic policies of our corporate activities, we declare that we will contribute to improving the "Quality of Life" of our clients, investee companies, and society as a whole. In addition, in order that each executive and employee can more effectively put these principles into practice in their daily work, we established a Human Rights Policy and a Sustainable Procurement Policy in 2021, and we have identified “Materiality in asset management business” and “Materiality as a corporate entity” in 2022.

In the asset management business, in the "Basic Policy on ESG Investment", we consider the impacts of environmental and social sustainability on investee companies (sustainability risk) and the principal adverse impacts (PAIs) of investee company activities on the environment and society. Laws, regulations, and international norms regarding sustainable investment continue to evolve. Based on global trends, we will periodically review the appropriateness of the policy and flexibly review it if necessary.

**Management philosophy**

Through the implementation of the Code of Conduct (Value) by each employee, we will respond quickly to changes in the business environment, including macroeconomic and technological innovations, and contribute to the **improvement of Quality of Life** to all the stakeholders.

**Investment Philosophy (Preface)**

As a group of asset management professionals, we aim for stable return over the medium to long term by providing best-in-class investment performance that respond to changes in the market environment, incorporate new management skill and **take sustainability into account**.

**Principles of Fiduciary Duties and Sustainability**

**Principle 1**  
We will fulfill our management responsibilities as a responsible institutional investor.

**Principle 2**  
We will strive to **materialize a sustainable society** through our asset management business.

**Principle 3**  
We, as a corporate citizen, will engage in activities to **pass on an affluent society and the global environment to the next generation**.

**Principle 4**  
We will train and educate human resources to contribute to the QOL of our clients, the society and our employees.

**Basic Policy on ESG Investment**

1. Taking account of the investment philosophy and investment horizon of each investment product, SMDAM incorporates analysis and evaluation of ESG and other non-financial information into its investment process, and considers them in investment decisions and active ownership. Principal adverse impacts (PAIs) of corporate activities on environment and society are also taken into consideration.
2. SMDAM aims to contribute to enhance the value of investee companies through engagement by communicating the investor's point of view, sharing ESG issues to be solved for the medium to long term value enhancement, and encouraging appropriate actions by investee companies.
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(As at 1 January 2023)

(Restated)

## 2. Identification and Prioritization of Actual/Potential PAIs

As “Materiality in Asset Management Business”, the following six materiality themes with particularly significant impacts have been identified from the perspectives of “importance for realization of a sustainable society” and “importance in long-term investment performance”.

With focuses on sectors and entities more relevant to the materiality themes, we undertake due diligence to identify, prevent and mitigate sustainability risks and negative impacts in our portfolios, leveraging to influence investees companies causing principal adverse impacts through our constructive dialogues for engagement as well as investment actions.

- Climate Change
- Natural Capital
- Human Rights in Supply Chain
- Human Capital
- Effectiveness of Corporate Governance
- Business Ethics and Corporate Culture

We have prioritized and identified the below-listed PAI indicators (including 16 mandatory items and 6 additional important items we selected from voluntary indicators the SFDR stipulates) in consideration of the regulation, their relations to our key materiality themes as well as practical

availability and credibility of the data), while we consider PAIs comprehensively beyond the proposed indicators and the explicit scope under SFDR. These key PAI indicators will be periodically reviewed and authorised at the firm-wide Stewardship/ESG Meeting, and shall be constantly monitored and periodically disclosed.

### **“Materiality in asset management business” and relevant PAI indicators**

<b>Key Materiality</b>	<b>Rationales of Materiality</b>	<b>PAI Indicators</b>
Climate Change	<p>Climate change issues are common risks a wide range of industries are exposed to, and have been one of the most critical focuses in the global society, triggered by the Paris Agreement.</p> <p>Governments around the world have been taking environmental actions; introduction and deliberation of environmental regulations and carbon tax, and subsidies for products of reduced environmental impact, etc.</p> <p>Climate change countermeasures have been one of the most important management issues for businesses.</p>	M1, M2, M3, M4, M5, M6, E4
Natural Capital	<p>Natural capital - water, air, soil, minerals, and biodiversity - is a fundamental and principal factor of economic activities.</p> <p>Its existence has been occasionally taken for granted, but it is now pointed out that human economic activities are consuming it at a rate that makes it impossible to reproduce.</p> <p>In light of this situation, given such circumstances, we believe that mitigating the burden on natural capital will lead to corporate sustainability.</p>	M7, M8, M9, E6
Human Rights in Supply Chain	<p>Globalization has brought rapid economic development, whereas the adverse impacts of corporate activities on human rights have raised serious concerns.</p> <p>The human rights issues have recently drawn increasing attention, particularly in Europe and the U.S., with initiatives to legislate human rights due diligence, and also in Japan, with the formulation of a guideline and action plan on "business and human rights" as a part of humanitarian diplomacy.</p> <p>Once a company's human rights issues are exposed, reputation may be damaged with the risk of boycotts of the company's products and services.</p>	S4, S9
Human Capital	<p>We believe that human capital is the foundation underpinning corporate operations. Continuous retention and attraction of excellent management executives and human resources is a key for the sound management issue.</p> <p>Diversity is another essential managerial issue in terms of sources of innovation, risk management from various perspectives, and talent sourcing.</p>	M12, M13
Effectiveness of Corporate Governance	<p>Establishment of effective corporate governance is positioned as the cornerstone of sound enterprise management.</p> <p>Corporate governance is a business management system that, we believe, leads to increased corporate value over the long term, yet its dysfunction may entail serious misconduct risks.</p> <p>Equipment of an effective corporate governance system enables corporates to maintain stable operations over the</p>	M10, M11

	long term, and helps to control conflicts of interest between shareholders and the company management. Furthermore, its establishment is also tightly linked to the promotion of “E (Environment)” and “S (Social)” characteristics.	
Business Ethics and Corporate Culture	Business Ethics and Corporate Culture are forged by the founder, successive executives, and daily activities of the employees. Robust Ethics and Corporate Culture are shared within the organization over time, and serve as the source of its competitive edge and function as governance. In contrast, weak ones may result in negative consequence, such as a lack of compliance awareness or an attitude of “Play things safe”.	M14, S6, S15

(As at 1 January 2023)

## PAI indicators specially considered in our PAI analysis

Investee	Mandatory /Additional	Theme	PAI Indicator	PAI Name (Adverse Sustainable Indicator)
Corporate	Mandatory	Climate and other environment-related indicators	M1	GHG emissions
			M2	Carbon footprint
			M3	GHG intensity of investee companies
			M4	Exposure to companies active in the fossil fuel sector
			M5	Share of non-renewable energy consumption and production
			M6	Energy consumption intensity per high impact climate sector
			M7	Activities negatively affecting biodiversity-sensitive areas
			M8	Emissions to water
			M9	Hazardous waste and radioactive waste ratio
	Additional	Social and employee, respect for human rights, anti corruption and anti bribery matters	M10	Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises
			M11	Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises
			M12	Unadjusted gender pay gap
			M13	Board gender diversity
			M14	Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)
Sovereign & Supranational	Mandatory	Climate and other environment-related indicators	E4	Investing in companies without carbon emission reduction initiatives
			E6	Water usage and recycling
			S4	Lack of a supplier code of conduct
		Social and employee, respect for human rights, anti corruption and anti bribery matters	S6	Insufficient whistleblower protection
			S9	Lack of a human rights policy
			S15	Lack of anti-corruption and anti-bribery policies
Sovereign & Supranational	Mandatory	Climate and other environment-related indicators	M15	GHG intensity
		Social and employee, respect for human rights, anti corruption and anti bribery matters	M16	Investee countries subject to social violations

(Footnote) Above-shown PAI indicators are 16 mandatory indicators (M) and 6 voluntary indicators we additionally selected on materiality following the SFDR.

(as at 1 January 2023)

### 3. Consideration of PAIs in Investment Processes

#### (1) Norm-based Negative Screening

A fundamental step of our PAI Due Diligence is the firm-wide screening of potential violations against international standards including UN Global Compact and OECD Guidelines for Multinational Enterprises. For investment exclusion, we shall designate the entities as "inappropriate for investment from an ESG perspective", if they meet the quantitative criteria of both (1) and (2) in the following table and do not have any idiosyncratic issues to be taken into consideration in our qualitative judgment as shown in (3).

#### Negative Screening and Investment Exclusion Criteria

Viewpoints for Entity-Level Exclusion	External Database to Use	Threshold Criteria
(1) International norm-based exclusion	Sustainalytics Global Standards <b>Screening</b>	Non-compliant
(2) Materiality	Sustainalytics <b>Controversy</b> Rating	Category 5
(3) Qualitative judgement (by each Investment Group)	Qualitative discussions by Executive Officer (Investment Department)	Idiosyncratic circumstances
(4) Decision by Executive Officer in charge of the Responsible Investment Section	Decision by Executive Officer (Responsible Investment Section)	Comprehensive judgement

(As at 1 January 2023)

(Restated)

#### (2) Consideration of PAI Indicators

PAI indicators listed under the SFDR are prudently considered in stock selection, portfolio-level monitoring, and dialogue with investee companies.

Believing it can ultimately impact on the risk - return profile of financial instruments, all of our actively-managed products consider PAIs, i.e. negative externalities, in addition to financial and sustainability risks to the extent material and permitted by relevant laws, regulations and mandates.

As a company causing significant negative impacts on environment and/or society may result in its corporate value destruction in the future potentially triggered by regulatory penalties and/or reputational damages, we seek for its prompt rectification through our engagement activities in order to avoid such risk.

#### (3) Continuous PAI updating for process-oriented activity

We will update on a continual basis sustainability risks and PAIs of investee companies in our portfolios through exclusive or collaborative engagement with other institutional investors, and communication with stakeholders including relevant NGOs.

Systematically and across the organizations, the observations of sustainability risks and PAIs are shared in the forms of analyst reports and ESG scores, to support our investment decisions.

## **4. Engagement and Escalation**

### **(1) Engagement Policy**

We have engaged and will engage in constructive dialogue with investee companies to contribute to their medium-to-long term sustainable growth and improvement in their corporate value or, alternatively, to help mitigate damage to them, encouraging their formulation, execution, and information disclosure of appropriate business strategies/visions in consideration of sustainability-related issues.

If, despite our repeated engagement, no improvement is seen in investee company sustainability issues, including those that have a significant negative impact on environment and society, or if there are undesirable actions affecting social credibility with no respect to stakeholder relationship, we will take a strict stance when exercising voting rights on the companies.

The matter may be further escalated to firm-wide investment exclusion/restriction in case of critically significant situations where no improvement is observed. Such matters will be decided by the Executive Officer in charge of the Responsible Investment Section, based on our “Rules on Managing Unsuitable Investee Companies”. (Escalation)

### **(2) Engagement on Climate Change**

In March 2022, we became a signatory of the Net Zero Asset Managers Initiative, a global initiative of asset managers aiming to achieve net-zero GHG emissions by 2050.

To this end, we will encourage investee companies to obtain SBT (Science Based Targets) certification, which is granted to companies with long-term plans consistent with requirements of the Paris Agreement, and will urge them to improve their CDP climate change scores, while considering investment exclusion as an option, focusing on sectors with high GHG emissions. Meanwhile, we will participate even more actively than we did in the past in collaborative engagements organized by domestic and global initiatives.

## **5. Collaborative Engagement and References to International Standards**

We have signed and endorsed a variety of domestic and global initiatives and are participating in collaborative engagement to co-work with other institutional investors, etc., which helps us to improve effectiveness and efficiency of our engagement activities.

For more details, please refer to Part I - 10. Collaborative Engagement and Initiatives (page 13).

## 6. Monitoring and Disclosure/Reporting

### (1) Monitoring of PAIs

We focus on and will disclose the following PAIs in the format of the weighted average of the portfolio, both at an entity-level and a product-level. In addition to the Mandatory indicators, 6 “Opt-in” additional indicators are selected in line with SMDAM’s key Materiality and according to data availability.

We shall make reasonable efforts to obtain the required data directly or through third parties (data providers). Where this is not possible, we shall make a best estimate.

Separately from the consideration of financial material sustainability risks, the investment team considers Principal Adverse Impacts of its investment decisions in stock selection. The PAIs do not constitute binding investment limits for a portfolio’s composition of a financial product.

By identifying investee companies with poor PAI indicators, it enables us to continue dialogue and engage with them to improve their corporate sustainability while continuing to hold their stocks in our portfolios. These activities are essential in realizing a sustainable society.

### (2) Reporting and Disclosure

For funds and discretionary accounts under our management subject to the SFDR, we will disclose and report the mandatory items related to the PAIs on our company’s website, in pre-contractual disclosure documents (such as fund prospectuses), and periodic disclosure reports pursuant to the regulations and relevant guidelines.

In addition, regardless of the scope of entity or a fund’s domicile covered by the SFDR, we will periodically disclose PAI indicators that we consider important, including mandatory items, for ourselves (entire company) in addition to each fund/account.

Further information will be available at:

[Responsible Investment | Sumitomo Mitsui DS Asset Management \(smd-am.co.jp\)](https://www.smd-am.co.jp)

and

[Sustainability Related Disclosures – Sumitomo Mitsui DS Asset Management \(smd-am.co.uk\)](https://www.smd-am.co.uk)

#### **Sumitomo Mitsui DS Asset Management Company, Limited**

Registration Number: The Director of Kanto Local Finance Bureau (KINSHO) No.399

Member of: Japan Investment Advisors Association

The Investment Trusts Association, Japan

Type II Financial Instruments Firms Association, Japan