



Hiroki Aida "Minna nakayoshi"

Sustainability Report 2022-2023



Sumitomo Mitsui DS Asset Management

Our Mission & Vision

Towards The Best Asset Management Firm For Your Better Quality of Life

We, as professionals, focus on:

- Delivering best-in-class investment performance while maintaining the highest standards of fiduciary responsibility to our clients,
- Contributing to a diversified and sustainable society through our investment activities.

To these ends, we commit ourselves to:

- Aiming for collective growth, based on a respectful understanding of all stakeholders,
- Creating a flexible working environment that allows all employees to reach their full potential.

Our Values

Sincerity

Customers' interest first

We act in fair and responsive manner by placing customers' interest as our values to become their most trusted partner.

Agility

Time - strategic resources

We address issues in a time-conscious manner to deliver new products and services to our customers earlier than peers.

Challenge

Confront the status quo

We challenge norms by exploring extraordinary products, services and processes in pursuit of the highest standard of investment management services.

Passion

Strive for an extra basis point

We dedicate ourselves to improve investment performance and business efficiency across all business areas.

Teamwork

Tackle conflict head-on in pursuit of value

We embrace diversity of views and ideas, and make collective efforts to achieve what cannot be done by one person alone.

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Editorial Policy

This “Sustainability Report 2022-2023” provides detailed explanations of our vision for a sustainable society, as well as the initiatives of our officers and employees to achieve that vision. Specifically, we have endeavored to use examples to communicate our approach and progress concerning various ESG themes in a way that is easy to understand, centered around our materiality (key management issues), as announced in April 2022.



Sustainability Report 2022-2023 Editorial Team

CEO Message

Striving to Contribute Further to Sustainability


This year's report is our third Sustainability Report since 2020. Of course, our corporate philosophy and the Principles of Fiduciary Duties and Sustainability, which we introduce in every report, have not changed, but the information in the report has changed in line with megatrends surrounding asset management companies over the past three years. In the first report in 2020, Sumitomo Mitsui DS Asset Management ("SMDAM") provided information about our management and investment policies, ESG evaluations, and our own ESG progress. Next, in the 2021 report, we focused on sustainable investment and examples of practicing engagement. Then, in April 2022, we identified our materiality (key management issue) to serve as a foundation for all our efforts as we work to achieve a more sustainable society. In this report, we provide information on the status of these activities, so I ask stakeholders to read it .

Taking into account the characteristics of the investment management business, our materiality categories consist of "Materiality for Investment Management" and "Materiality for Business Operation." We have identified material issues in the following three areas for each of these materiality categories: "Environment issues: Safety of Life," "Social issues: Improving Quality of Life," and "Governance." We intend to take advantage of the opportunity provided by this identification of materiality to engage in more specific activities centered on "contributing to achieving a sustainable society" in the future.

Stewardship activities, consisting of engagement and the exercise of voting rights, are two pillars of our contribution to sustainability in investment management operations. Across all industries, in Japan and overseas, sustainability initiative have already become a key component of each company's management strategy. Based on these changes, in our engagement activities, we are practicing dialogue that goes deeper than before with investee companies, etc., particularly in relation to materiality themes. At the same time, we exercise voting rights in ways that contribute to enhancing corporate value, based on the outcomes of our engagement activities. In both cases, our aim is to create added value for both investee companies and our clients, and it is essential that we make continuous improvements to that end.

For this report, young employees, who will be responsible for the future of our company, spoke about "sustainability" and our "vision." This is the "Young Employees Roundtable Discussion," which was a particular area of focus for our editorial team. The employees of investment management companies experience job satisfaction when investors, their clients, gain returns, i.e., the value of their assets appreciates, and when SMDAM's profits itself are aligned on the same trajectory. As a CEO, I intend to make SMDAM into a company that meets the expectations of young employees such as these.

As interest in sustainability finance has also grown in Japan, people have become aware of the role that investment management operations play in the investment chain and the fact that we contribute to achieving a sustainable society. We will continue our activities to ensure that more citizens of Japan can participate in the investment chain through asset formation.

A full-length portrait of Takashi Saruta, an elderly man with white hair, wearing a dark grey pinstriped suit, a light-colored striped shirt, and a patterned tie. He is standing in a modern office environment with large windows and light-colored walls. His hands are clasped in front of him.

Representative Director,
President and CEO

Takashi Saruta

Contribution to a Sustainable Society Through Initiatives for our Materialities

To enable us to contribute more to achieving a sustainable society, we identified our materialities and announced the details of related initiatives in April 2022.

Information about “Our Materiality” on our website is available on our website here <https://www.smd-am.co.jp/english/corporate/vision/fiduciary/01/>



When identifying our materiality, we conducted internal questionnaires and consulted external experts, in order to reflect the viewpoints of wide range of stakeholders. Based on the results of these surveys, division heads, who oversee the management of our company, engaged in focused discussions on four occasions to determine our materialities from among numerous ESG issues that came up from the perspectives of both management and governance.

Taking into account the characteristics of the investment management business, our materiality categories consist of “Materiality for Investment Management” and “Materiality for Business Operation.” We have identified material issues in the following three areas for both of these categories: “Environment issues: Safety of Life,” “Social issues: Improving Quality of Life,” and “Governance.”

We have expressed our view of society as a single “organism” using the image of a double helix of DNA on the page on the right. Each material issue that we have identified is an essential element to ensure that society is healthy and sustainable. Based on this approach, in our investment management operations, we will engage in “activities with true value for stakeholders” that prioritize substance over criteria for appearance’s sake, while at the same time focusing on developing human resources and creating a better corporate culture, in addition to our recent activities aimed at contributing to a better quality of life for society, our clients, and our employees, as a single company.

Materiality for Investment Management

Environmental Issues: Safety of Life		Social Challenges: Improving Quality of Life		Enhanced governance and better disclosure	
<p>Climate Change</p>  <p>We will work to reduce GHG emissions across the supply chain</p>	<p>Natural Capital</p>  <p>We will work to promote a circular economy and reduce environmental impact by cutting food loss</p>	<p>Human rights in supply chains</p>  <p>We will work to appropriately manage human rights risks through due diligence related to human rights</p>	<p>Human capital</p>  <p>We will implement human resource strategies that are consistent with management strategy and work to create an attractive workplace environment</p>	<p>Effectiveness of corporate governance</p>  <p>We will work to ensure the diversity of the Board of Directors and implement measures to enhance corporate value</p>	<p>Business Ethics and Corporate Culture</p>  <p>We will foster corporate ethics and our corporate culture, and ensure thorough compliance with laws and regulations and risk management</p>

Materiality for Business Operation

Environmental Issues: Safety of Life	Social Challenges: Improving Quality of Life			Enhanced governance and better disclosure
<p>Environmentally-Friendly Business Management</p>  <p>We will endeavor to reduce energy usage and our impact on the environment by revising our operations</p>	<p>Human capital</p>  <p>We will eradicate discrimination and harassment, enhance the workplace environment, and develop human resources</p>	<p>Social Contribution Activities</p>  <p>We will contribute to solving environmental and social issues through donations and volunteer activities</p>	<p>Improvement of business quality</p>  <p>We will utilize digital technology to revise and improve our operational processes</p>	<p>Business Ethics and Corporate Culture</p>  <p>We will aim to be an organization where all employees are conscious of being professionals, have an appetite to contribute to society, and maintain a spirit of taking on new challenges</p>



Environmentally-Friendly Business Management

Enhancing the quality of operations

Human capital

Natural Capital

Human rights in supply chains

Effectiveness of corporate governance

Climate Change

Business Ethics and Corporate Culture

Social Contribution Activities

What Sort of Company Do We Want SMDAM to Be In 2050? What Do We Want to Do to Achieve That Vision?

We held a roundtable discussion for young employees of SMDAM in their 20s and early 30s. The participants spoke about SMDAM's "sustainability" and "vision" through the lens of questions conscious of "the year 2050."



Ryo Yashima

Fund Manager,
JP Fixed Income Group,
Investment Department

Yoshiko Hara

Assistant Manager,
Disclosure Department

Haruka Matsuzaka

Fund Manager,
Multi-Asset Group,
Investment Department

Akane Kumagai

Analyst, Responsible
Investment Section

Hiroki Fukaya

Manager,
Global Investment
Management Department

Q How do you feel about recent changes among our clients and within our company?

Hara

Last year, the EU enacted the Sustainable Finance Disclosure Regulation (SFDR), but investment management companies in the EU and US have created many funds that comply with the SFDR, even while no clear criteria have been indicated for what is classified as sustainable. At the time, I thought of the SFDR like a game of poker played by the EU and US, and felt disappointed that, while SMDAM was simply and honestly engaging in ESG integration, we were a "company that could not take part in the money game." When I saw the recent measures to address greenwashing by authorities in the EU and US and the increasingly sophisticated ESG criteria of our clients overseas, however, I realized that "sustainability is real, and not a game." Some people remain skeptical, but as time has progressed, I feel that sustainability criteria have advanced and there has been a definite spread of these ideas.



Kumagai

The idea of sustainability has steadily spread in recent times, and I certainly think this is a change that deserves attention.

Fukaya

I feel there has been progress in implementing ESG-conscious operations across our company as a whole, and at the same time, each employee's awareness of ESG has also increased. As ESG investment gains popularity, one key issue for investment management companies is how we should address problems such as greenwashing. In my department, the Global Investment Management Department, we perform operations such as monitoring and due diligence for funds managed by external managers. First, I am endeavoring to develop a good understanding of external managers' ESG initiatives, and then share this information with related departments within SMDAM, to enable us to appropriately disclose information to our clients.

Kumagai

The importance of external sourcing is increasing for our company. Your words gave me a good understanding of your mindset when engaging in your work, Hiroki.

Q What sort of company do you imagine SMDAM will be in 2050?

Matsuzaka

In Ray Kurzweil's book, *The Singularity Is Near: When Humans Transcend Biology*, he predicts that AI may exceed human intelligence by 2045. In the investment management industry, there may come a time when operations related to investment management, etc.,

are entrusted entirely to AI, which is unlikely to make human errors. When that happens, our advantage as humans will be the “peace of mind and trust that comes from being responded to by a human.” I think we will probably transform into a company that uses the trust of our clients that we have developed to date as fuel to contribute to comprehensively enhancing clients’ quality of life.

Kumagai I also think that reexamining our strengths and what sort of company we want to become in the future will contribute to our mission and objectives.

Yashima Although there have been ups and downs in the progression of ESG as a trend, it is expected that it will become even more widely accepted around the world, as well as Japan, of course. Given this trend, I imagine that SMDAM will become a company that consistently performs well as a major Japanese investment management company, while also focusing more on ESG and properly fulfilling our social responsibility. In order to become such a company, and from the perspective of diversity, of course, it will be important that we are an organization where young and mid-level employees are able to discuss various different opinions.

Kumagai Instead of leaning toward a top-down style of management, it can be expected that we will be able to mitigate risk as a company and become a more resilient organization if we have an environment where employees are each able to express and discuss independent opinions as professionals.

Q Based on the questions thus far, what do you think about the future, such as things you want to try ahead of the year 2050, things you want to change, or things that SMDAM can do?

Matsuzaka I hope that people with various different backgrounds will participate in this industry. Additionally, partly because of the recent start of financial education in high schools, I think a day may soon come when asset formation through investment is more common. To ensure that we do not miss such trends, I think it is important that the investment management industry as a whole works together to implement measures across the industry. Some people think there is an inherent danger in investment, so as an industry, I would like for us to communicate to people that the reality is different.



Kumagai I think such trends are spreading, so I certainly hope that action is taken across the industry as a whole.

Fukaya One of Our Values is “Teamwork: Tackle conflict head-on in pursuit of value.” Previously, in a coastal clean-up project that I was personally involved in, I learned that serious environmental problems were occurring in a setting close to me, and really felt that it was important that many people tackled these issues with a sense of ownership. I feel we must learn about what sort of problems are occurring now and, based on this understanding, think about what we can do and

move to action. I think that, in my operations too, I would like to work hard to establish funds that can contribute to ESG, which are an attractive option for clients.

Kumagai It is extremely important that we have a sense of ownership. Our clients have various needs, but if we can offer each of them good products, I feel it will be a strength for us as an investment management company.

Yashima There are also signs that ESG investment is spreading at pension funds both in Japan and overseas. The Government Pension Investment Fund (GPIF) is also promoting investment that takes ESG into consideration, based on one of its investment principles, which states that the “sustainable growth of investee companies and the capital market as a whole are vital in enhancing long-term investment returns.” People’s expectations of investment management companies are also increasing, and I think we must focus on ensuring we are able to exceed those expectations. In addition, these developments mainly affect equities at present, but there are also ongoing discussions concerning green government bonds in relation to investment in bonds, the area in which I work. I think we must also closely follow information related to these developments.



Kumagai In order to win the trust of our clients, it is important that they learn our competitive strengths after comparing SMDAM with competitors. For example, we have accumulated a track record of engagement related to bonds. I think that if we can leverage these steady efforts to achieve visible results, it may be an opportunity for our company.

Hara While environmental problems and social issues related to ESG are an area of focus, there are also companies investing in new industries, where there are many uncertainties, such as space development. Taken to an extreme, we could perhaps even consider it sustainable to “discard the environment on earth and escape into space.” There is significant uncertainty related to developments both on earth and in space, and I think we currently do not know what is truly “sustainable.” Uncertainties, however, are precisely what leads to new solutions. I think our work is to identify the feasibility of new solutions, support their development, and find the correct answer for sustainability.

Kumagai Amid these uncertainties, I think it is vital that we turn our attention to future profits, and I think the ways in which each individual can act will be an important perspective for sustainability. I hope SMDAM can become a company where employees are able to engage in serious discussion with a sense of ownership and continue to offer new solutions, not just for our clients, but for financial markets as a whole.

Achievements Related to the Principles of Fiduciary Duties and Sustainability

We have formulated the “Principles of Fiduciary Duties and Sustainability” as our basic policy for general corporate activities that are in line with our corporate philosophy, in which Principles 1 and 2 set forth our duties as an investment management firm, and Principles 3 and 4 set forth our duties as a corporate citizen. We will contribute to achieving a sustainable society by putting these principles into practice.

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

- In order to provide the maximum benefit to our clients, we will exert ourselves to cultivate investment professionals who will play a central role in the investment management business, and work to enhance capabilities of investment management, trading operation and risk management through utilizing state of the art IT technologies and domestic and overseas networks.
- We will incorporate ESG factors into the investment process, and take a progressive approach to stewardship activities including engagement and exercising voting rights in order to encourage companies to enhance their sustainability and eventually contribute to augmentation of the company’s enterprise value over the medium- to long-term.
- We will develop and provide the most suitable products and services such as long-term investment products to accumulate assets by identifying the true needs of clients. We will also provide timely information on the investment products using IT technology.
- We will not only establish a rigid corporate governance structure that ensures the appropriate management of conflicts of interest and independence of management, but also endeavor to disclose risks and commissions with a high level of transparency.
- We will strive to maintain our soundness as a company and reinforce our crisis management system to be prepared for various contingencies.

FY2021 Achievements

- We launched pilot funds in strategic fields, expanded research coverage in Asia, enhanced systems for overnight trading, etc.
- We developed a proprietary AI engine, and began utilizing it for selecting shares when investing in domestic equities, etc.
- We launched the “Be Active.” service brand with the aim of ensuring that individual investors feel more closely connected to investment management.

Policies for the future

- We will formulate a business plan from a medium- to long-term perspective, including the expansion of our network in Asia.
- We will enhance operational efficiency through the use of IT tools, including utilizing AI and RPA in research operations, etc., and creating databases from various types of information.
- We will conduct sustainability training, with the aim of enhancing officers’ and employees’ understanding of environmental and social issues and increasing their sense of ownership.
- Under the “Be Active.” brand, we will share useful information and provide services to enable individual investors to continue to form assets over a long period of time.

Principle 2 We will strive to help build a sustainable society through our investment management business

- We recognize the significance and essentials of asset accumulation for individual investors in an aging society with fewer children. Therefore, we will engage in investor education for a wide range of generations to raise the awareness for related issues and to improve financial literacy.
- We will work to resolve environmental issues, such as climate change, and social issues, such as human rights through our original stewardship activities and by participating in initiatives in Japan and overseas.
- We will strengthen our efforts to develop and provide products that focus on the sustainability of society.

FY2021 Achievements

- We participated in online classes related to career development for high school students, held in collaboration with the Sumitomo Mitsui Banking Corporation Group.
- In July 2021, we sent letters to approximately 150 major companies in Japan requesting measures to address climate change and the enhancement of information disclosure, and began related engagement activities. Through the end of March 2022, we engaged in dialogue concerning climate change on a total of 244 occasions, mainly with these companies.
- In March 2022, we joined the Net Zero Asset Managers Initiative, an initiative by global investment management companies that aim to achieve net zero greenhouse gas emissions by 2050.

Policies for the future

- We will focus on financial education activities to communicate the importance of asset formation from an early stage in life.
- We will endeavor to make engagement that adds value for investee companies possible, particularly in relation to Materiality for Investment Management.
- We will build a framework for operations and management to enable us to appropriately operate ESG/sustainability-related funds and disclose appropriate information that does not cause misunderstanding among clients.

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

- We will participate in CSR activities such as revitalizing communities and providing social welfare support.
- We will carry out environmentally conscious business management, such as reducing greenhouse gas emissions and plastic waste.

FY2021 Achievements

- In June 2021, we established “The QOL Donation Fund (the “QOL Fund”),” which is automatically deducted from employees’ salaries.
- We engage in activities to enhance the understanding of officers and employees of SMDAM in relation to sustainability, including holding in-house seminars, jointly holding events, and participating in volunteer activities, through collaboration with organizations supported by the QOL Fund.
- We formulated a “Human Rights Policy” and “Sustainable Procurement Policy” in order to strengthen initiatives related to respect for human rights and consideration for the environment.

Policies for the future

- We will focus on activities based on participation by employees, centered on the QOL Fund.

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

- We will put in place an environment where employees with variety of values can fully demonstrate their abilities and promote diversity, especially the active participation of women.
- We will provide a variety of career support programs so that all employees regardless of ages or assignments can take pride in their work and obtain professional expertise and insight required.

FY2021 Achievements

- In April 2021, we introduced a fully flexible work system as part of efforts to create an environment that enables employees to select flexible workstyles that suit their respective lifestyles.
- In order to support the active participation of women, we held female managers’ community meetings, and we are also focusing on the development of management candidates through dispatch to the Japan Institute for Women’s Empowerment & Diversity Management, etc.

Policies for the future

- We will endeavor to maintain systems to enable employees to work flexibly in ways suited to their life stage and various circumstances, while also improving our workplace environment to ensure that employees remain healthy and maintain an appropriate work-life balance while working.
- We will clarify the image of human resources that we want, and aim to provide systematic educational opportunities.

Please refer to our website for details.

<https://www.smd-am.co.jp/english/corporate/vision/fiduciary/>



Disclosure Based on TCFD recommendations

SMDAM announced its support for the Task Force on Climate-related Financial Disclosures (TCFD) in December 2019. As an investment management firm, we will analyze the impact of climate change on investee companies, both risks and opportunities, and try to translate such an analysis into high-quality investment returns to clients over the long term. At the same time, through engagement we will contribute to realize a sustainable society by supporting the innovations and transitions of investee companies aimed at reducing greenhouse gases (GHG).

I. Basic Concept

1 Governance

1 Supervision by the Board of Directors

Our corporate philosophy and “the Principles of Fiduciary Duties and Sustainability”, which serve as the basic policy for our corporate activities, clearly state our intention, as an investment management firm and as a corporate citizen, to contribute to build a sustainable society. Therefore, sustainability initiatives, including for climate change, are positioned as the most important task of management.

Basic policies and action plans at the company level are developed through an established process in which the policies and plans are fully considered by the Sustainability Promotion Subcommittee at the practical level and by the Management Meeting, which is attended by the CEO and executive officers, and then approved by the Board of Directors.

In addition, the Board of Directors receives reports related to the progress of implementation plans twice a year, and performs monitoring to ensure that operations are being executed appropriately.

In addition, the Board of Directors also engages in lively discussions concerning matters such as ESG integration in investment processes, the status of stewardship activities, and sustainability-conscious business management, while Outside Directors with abundant knowledge provide advice to the management team.

2 Role of Management Team

In formulating company-wide policies and actions plans pertaining to climate change and other sustainability-related issues, the officer in charge of the Corporate Strategy Department leads associated discussions while coordinating with related internal departments. Those policies and plans are deliberated at Management Meetings attended by the CEO and Executive Officers and by other meeting bodies, after which they are approved by the CEO or the Board of Directors depending on their level of importance. The policies and plans are implemented under the responsibility of the CEO. Meanwhile, the Responsible Investment Officer, the pertinent officers in charge in the Investment Management Division and those in charge in the Corporate Division respectively demonstrate leadership in the areas of stewardship activities, asset management operations and risks and opportunities of SMDAM proper, and handle individual risks and opportunities with speed.

2 Strategy

1 Climate Change Risks and Opportunities

We recognize the following as risks and opportunities caused by climate change.

Risks

- A decline in assets under management due to stock prices falling worldwide as a result of economic losses caused by global warming
- A deterioration in relative investment performance due to SMDAM investee companies being negatively impacted by the transition to a carbon-free economy
- An increase in reputational risk due to our investment activities being regarded as inappropriate from the standpoint of the reduction of greenhouse gas (GHG) emissions and our investment products being considered a form of so-called greenwashing
- An increase in costs resulting from factors such as accommodating tighter regulations on climate change-related disclosure in Japan and overseas and procuring renewable energy in order to reduce our own GHG emissions

Opportunities

- An increase in new investment opportunities that include companies with innovative technologies that will contribute to the transition to a carbon-free economy and companies that can be expected to grow through a transformation of their business model
- An improvement in relative investment performance through enhancing our capacity for research and analysis of non-financial information such as endeavors to address the issue of climate change
- Expanded business opportunities from greater investor needs for investment products themed after solving or adapting to the issue of climate change

2 Impact on Business and Strategy

Investment

- We at SMDAM manage all of our active investment products while taking sustainability into consideration. Based on the increasing importance in recent years of such non-financial information, including that on climate change, we are working to further improve investment performance by conducting qualitative and quantitative research and analysis on the impact of non-financial information on stock and bond prices. Additionally, we support the practical application of innovations that will help smoothen the transition to a carbon-free economy and solve the issue of climate change through engagement in the form of dialogue with investee companies and the exercise of voting rights in our capacity as a responsible institutional investor.

Product Development

- We work to develop and provide investment products that accommodate shifts in customer needs. These include investment with sustainability integrated into the investment process in a consistent fashion and products intended to improve sustainability.

Operations

- With a target of effectively zero GHG emissions by SMDAM (Scope 1 & 2) by 2030, we are working to bring down our energy consumption through such measures as promoting efficient office use, procuring renewable energy, and promoting paperless operations. We also established a sustainability procurement policy in July 2021 and are working to reduce GHG emissions in our supply chain (Scope 3).

③ Impact on Finance

One study* has found that if outdoor temperatures were to rise by 2°C as of the year 2100, global GDP per capita in 2100 will be 15-20% lower than that it would be if temperatures remained unchanged from the first decade of this century. This is envisioned to have a negative impact on our profits through the decline in the market capitalization of global stock markets that would ensue. Conversely, on an individual sector and company level, there may conceivably be cases of performance growth through lifestyle shifts and technological innovations. We will work to keep any negative impact on finance to a minimum by ascertaining and investing in sectors and companies where growth can be expected in our capacity as an asset management firm whose forte is active investment. (The results of scenario analysis are indicated under “III.2. Analysis of Portfolio Transition Risks and Physical Risks” on p. 13.

At the same time, given that we are an asset management firm, we do not own production facilities that emit GHGs, and as such are not anticipating any major transition risks that would accompany operation. Additionally, we operate our businesses out of relatively small-sized offices that we maintain in major cities in Japan and overseas, and as such are not anticipating any major physical risks that would accompany climate change. Carbon offsetting, which is considered necessary to achieve effectively zero GHG emissions by 2030, is a factor that will increase costs. However, it is believed that any impact will be kept to minute levels.

*Overview of the IPCC's Special Report on Global Warming of 1.5°C (July 2019), Ministry of the Environment

③ Risk Management

① Climate Change Risk Evaluation

We assess climate change risks of investee companies using proprietary ESG evaluations and assign scores based on those companies' relative performance within their same sector. The issue of climate change is also one of our priority ESG themes. We practice engagement primarily with sectors that have high GHG emission levels and with companies that have considerable room to improve their ESG scores. Meanwhile, for our leading investment products, we measure climate change risks in portfolio units, verify measurement values for our entire portfolio as well as those for the investee companies that comprise it, and utilize them in investment decisions pertaining to stock selections. For information on the conformance of our portfolio with the Paris Agreement, please see “III.3. Analysis of Conformance of Portfolio with Paris Agreement” on p. 14.

② Management of Climate Change Risks

In cases where climate change risk metrics are included in the investment guidelines of specific products, the Investment Management Division autonomously manages them just as it does other constraints. In addition, the Risk Management Department monitors the status of compliance and issues requests to the Investment Management Division to take the necessary actions or decide on a policy to deal with situations in which thresholds are closely approached or encroached.

II. Progress in Immediate Term

In March 2022, SMDAM became a member of the Net Zero Asset Managers Initiative (NZAMI) for asset management firms aiming to realize a society with net-zero GHG emissions. We plan on disclosing our near-term targets as of 2030 on our website in the course of FY2022.

Our Board of Directors adequately monitored executive actions and also supplied advice upon SMDAM's joining of NZAMI so that our response to climate change risks would translate into benefits for our stakeholders (our customers, shareholders and employees as well as greater society).

In October 2021, we established a department to promote sustainability across the company in the form of the Sustainability Promotion Office. Every month, we hold Sustainability Promotion Subcommittee meetings intended to promote the execution of sustainability-related operations that include the management of SMDAM's climate change risks.

In FY2021, we conducted about 700 instances of exclusive engagements related to climate change and other environmental aspects across the globe. In those, we held dialogues largely to encourage high-quality information disclosure based on superior case examples of disclosure. Additionally, as a form of CDP collective engagement, we led efforts to encourage five Japanese corporations to acquire a CDP score.

Disclosure Based on TCFD recommendations

III. Status of Portfolio

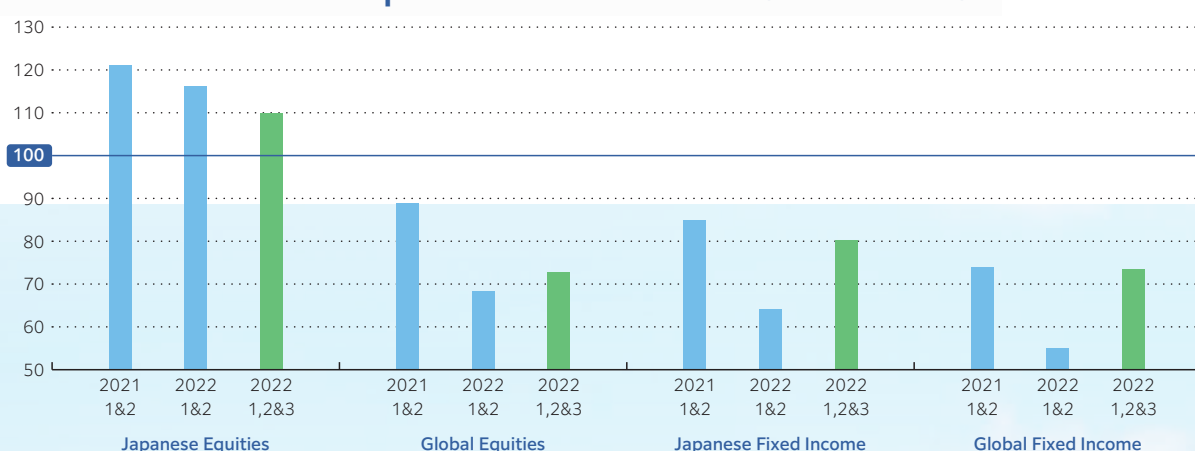
1 GHG Emissions in Portfolio

We performed a comparative analysis between SMDAM portfolio that we manage in-house or consign to external parties and benchmarks for carbon footprint, or GHG emissions per million USD of portfolio value as of the end of March 2022. SMDAM portfolio consists of four asset classes, namely Japanese Equities, Global Equities, Japanese Fixed Income and Global Fixed Income

*2: Externally-consigned fixed income excludes FOF and listed investment trusts. Global and Japanese fixed income exclude government bonds and government institution-related bonds.

A look at our carbon footprint (Scopes 1, 2 & 3) as of March 2022 shows that while results for Japanese equities exceeded benchmarks, results for other asset classes fell below them. Japanese equities were impacted by the overweighting of materials and industrials with both high value and carbon footprint.

Our Portfolio and Carbon Footprint for Each Asset Class (Benchmark=100)



Source of data: MSCI*3 used for 2022. Sustainalytics used for 2021.

Benchmarks: TOPIX used for Japanese equities. MSCI KOKUSAI used for global equities. Nomura BPI (corporate bonds) used for Japanese fixed income. Bloomberg Global Aggregate Ex-Japan (corporate bonds) used for global fixed income. Benchmarks were applied to portfolios managed by SMDAM as of March 2022. Global and Japanese fixed income exclude government bonds and government institution-related bonds.

Portfolio emissions = $\sum [\text{GHG emissions of issuers} \times (\text{Market value of portfolio holdings}) \div \{(\text{Issuer market cap}) + (\text{Total issuer interest-bearing debt})\}]$

Carbon footprint = GHG emissions per million USD of portfolio value = Portfolio GHG emissions \div Portfolio value

Changes from previous year

We expanded the scope of aggregated assets to newly include external consignees (excluding FOF and listed investment trusts). Scope 3 was also made a new target for GHG emissions.

*3: For details, please see the disclaimer on p. 54.

While various means of contributing to the realization of carbon neutrality by the year 2050 exist, our policy will be to focus on engagement while making divestment an option based on the philosophies of "Just Transition" and "Leave No One Behind" under SDGs. We are insistent in our requests to investee companies that they proactively conform with a decarbonized society, meaning that they reduce GHG emissions while simultaneously promote the creation of value as those who will usher in the green revolution.

2 Analysis of Transition Risks and Physical Risks in Portfolio

Using the "CVar" analysis tool supplied by MSCI, we performed an analysis of the transition and physical risks in our portfolio. For the purpose of that analysis, in addition to the most difficult scenario of halting the rise in average outdoor temperatures until the year 2100 to 1.5°C, we used scenarios in which that rise was 2.0°C and 3.0°C. The purpose of this scenario analysis is to quantitatively ascertain the latent damage to our portfolio caused by climate change stress. More so than extracting accurate forecast figures, it is designed to enable us to draw up a future image of a scenario in which we subject our portfolio to stress without taking sufficient action.

Transition risks	Policy risks	... An increase in costs pertaining to GHG emitted by investee companies over the period between now and roughly 15 years in the future
	Technological opportunities	... Growth in profit through contributions associated with the transition to a low-carbon society, such as the cultivation of new markets and the absorption of GHG
Physical risks		... Costs resulting from the impairment of noncurrent assets and suspension of business activities due to natural disasters such as typhoons and floods

Latent Damage to Value of Portfolio by Temperature Rise Scenario/Asset Class (As of March 2022)



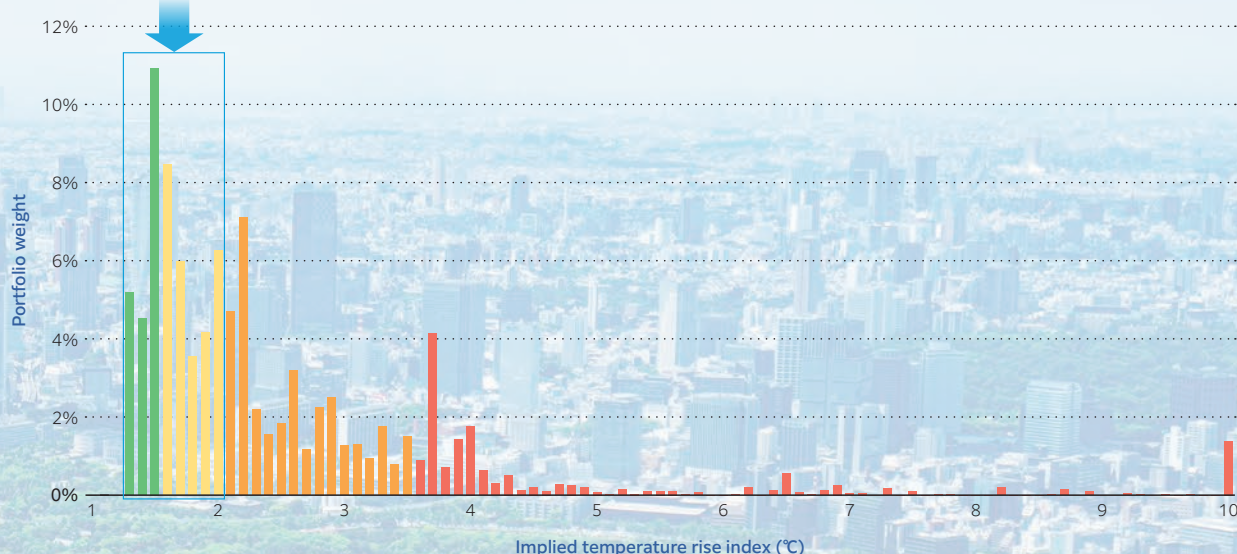
The results of this analysis indicate that transition risks (policy risks plus technological opportunities) in our portfolio are extremely limited. Conversely, physical risks to our Japanese equities and fixed income, which account for a large percentage of our portfolio, are high. Based on these results, we will engage in dialogue with high-risk investee companies so that they adequately deal with latent risk as we aim to lower the risks in our portfolio.

3 Analysis of Conformance of Portfolio with Paris Agreement

For the implied temperature rise index, we indicate conformant climate change target estimates in “°C” units based largely on the GHG emission targets that our investee companies have committed to. We have arrived at the result that 49% of our portfolio will be conformant with the 2°C scenario under the Paris Agreement in the future. On the other hand, investee companies that will not be conformant with the Paris Agreement at all under existing plans (the area indicated by the red line graph) constitute 16% of our portfolio. To lower climate change risks in our portfolio, adequate risk management for those investee companies will be of the essence.

Distribution of Implied Temperature Rise Index (As of March 2022)

Conformant with Paris Agreement (2°C)



For information on the status of our portfolio (FY2021), please see our website.
<https://www.smd-am.co.jp/english/corporate/vision/fiduciary/03/>



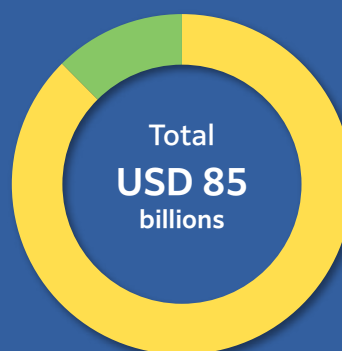
Progress in Sustainable Investment Management

Stewardship Activities

Assets under Management (As of March 31, 2022)
Figures shown in US dollars are conversions from Japanese yen based amounts, at USD/JPY 121.375.

Institutional accounts

■ Domestic	USD 74 billions
Discretionary Accounts (Pension Funds)	USD 29 billions
Discretionary Accounts (Others)	USD 4 billions
Investment Advisory Accounts	USD 42 billions
■ Overseas	USD 11 billions



Investment trusts

■ Publicly Offered Funds	USD 54 billions
■ Privately Placed Funds	USD 32 billions



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Message from the Head of Investment Management Division and Responsible Investment Officer

Junichi Sakaguchi

Responsible Investment Officer

Shingo Imai

Director and Senior Managing Executive Officer,
Head of Investment Management Division

As a responsible institutional investor, SMDAM provides high-quality asset management services to its customers while simultaneously engaging in stewardship activities directed at investee companies. In the past year, alongside endeavoring to deepen ESG integration and sophisticate management methods in individual management strategies, we have steadily accelerated initiatives for that purpose across the whole company, including identifying materiality (priority challenges in management).

We will continue to aggressively tackle sustainable investment with a view to realizing our vision of "becoming the very best asset management firm that contributes to people's QOL."

Consideration and Implementation of Materiality in Asset Management

Shingo Imai, Director and Senior Managing Executive Officer, Head of Investment Management Division

Over time, SMDAM has readied itself to practice sustainable investment through means such as establishing its Principles of Fiduciary Duties and Sustainability, expressly stating its "consideration of sustainability" in its investment philosophy, and introducing a sustainability-related product certification system. Under the "materiality" that we identified in April 2022, we positioned the following six items as our materiality in asset management operations: climate change, natural capital, human rights in supply chains, human capital, the effectiveness of corporate governance, and corporate ethics/organizational culture. For the item of climate change, we became a member of the Net Zero Asset Managers Initiative (NZAMI) for asset management firms aiming to achieve essentially zero GHG emissions by the year 2050. While the road to realizing a decarbonized society is a long one, we will take proactive action in our capacity as an asset management firm. Going forward, we will materialize initiatives for this materiality and put it in practice in engagement and the exercise of voting rights.

Meanwhile, we also experienced some highly positive outcomes with ESG integration and the sophistication of investment management. As a platform for our Investment Management Division as a whole, we tackled the likes of providing GHG emission projections by our Corporate Research Group, expanding coverage of our ESG evaluations and engagement to include Japanese SMEs and non-Japanese corporations, commencing the screening of international model screenings, and actively taking part in collective engagement. With regard to individual investment management strategies, in addition to pursuing more effective ESG integration methods, we are working to enhance our lineup of investment management products that are focused on impact investment, Asia GX, infrastructure debt, and other aspects of sustainability. Some case examples of theory and actual business being gradually fused together also arose. These include joint research on the relationship between ESG score and credit spread and the application of natural language processing to the management of Japanese securities. Going forward, we intend to leverage this knowledge of ours in pushing forward with the development of new products that meet customer needs alongside the sophistication of our existing products.

Moving towards Sustainable Investment that Prioritizes Substance

Junichi Sakaguchi, Responsible Investment Officer

The key to sustainable investment at SMDAM is the act of using engagement to decide whether the ESG initiatives conducted by our investee companies are substantial in nature. It should be possible to count on companies that link ESG to their main business and offer the kind of products and services that address social and environmental issues based on a formidable governance structure to yield a positive impact over time from a financial angle. In other words, it is crucial to ascertain whether or not non-financial information, that on ESG included, will tie into future financial information. There is no shortage of corporations who stick to superficial action from beginning to end and make their proactive ESG endeavors an excuse for sluggish business performance. This is where the discerning eye of investors is tested.

In exercising voting rights as well, rather than mechanically applying numerical standards set forth in guidelines, our policy is to reflect information and analytical results obtained through engagement in the determination of that exercise while factoring in the individual circumstance of investee companies as much as possible.

SMDAM will continue working to elevate the quality of its sustainable investment in order to strike a balance between obtaining investment returns and realizing a sustainable society.

Investment Research Platform (As of April 1, 2022)

Number of investment professionals:

276

Average years of industry experience:

Approx. **16.0**

Number of CFA/CIIA:

91

Basic Policies on Engagement



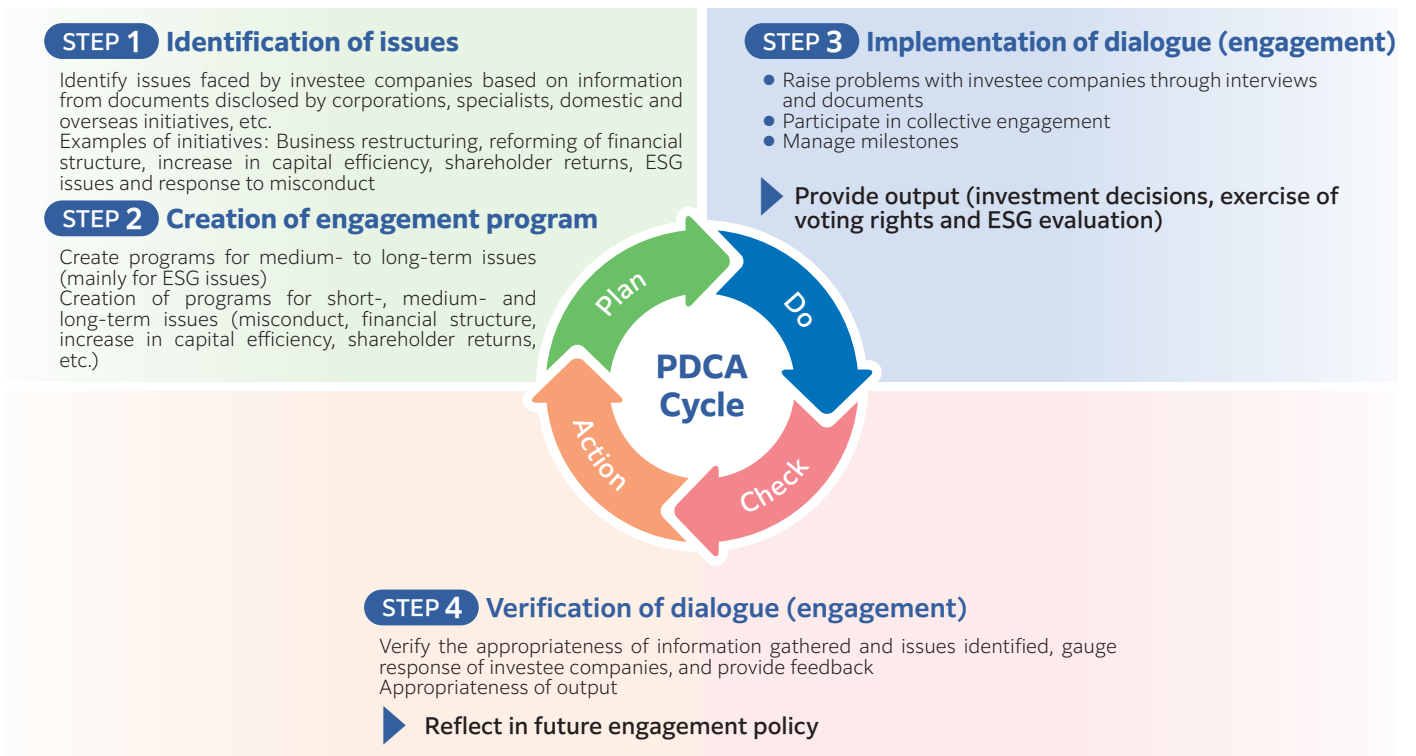
Through engagement, SMDAM encourages its investee companies to take action with sustainability in mind. Engaging in multilateral discussions with the management team of those companies yields the promise of enhanced corporate value or the mitigation of damage, and leads to delivering high-quality returns to customers and final beneficiaries.

Based largely on environmental shifts across the globe and demands pertaining to Sustainable Development Goals (SDGs), we are aggressively tackling engagement themed after ESG challenges. Our engagement efforts, which are mainly directed towards the priority sectors and target companies set forth for each materiality of ours, are genuinely valuable from the perspective of our stakeholders and prioritize substance as well as external standards.

Basic Policies on Engagement

- 1 The Company will conduct engagement with investee companies to fulfill its fiduciary responsibilities to customers and final beneficiaries as well as to contribute to the sound development of Japan’s capital markets and economic expansion by playing an instrumental role in the virtuous cycle of the investment chain, thereby achieving its social mission as a responsible institutional investor.
- 2 The Company will work to improve the value of or mitigate damage to investee companies and other entities by encouraging them to develop and implement an appropriate medium- to long-term business strategy and vision based on medium- to long-term issues in the industry as a whole, a specific sector, or an individual company as well as to disclose information.
- 3 The Company will conduct engagement based on the perspective of improving environmental and social sustainability while taking the type of assets it invests in, the characteristics of and legal framework in countries and regions, and other conditions into consideration. In addition, the Company will conduct engagement pertaining to Japanese equities, J-REIT included, based on the perspectives of challenges related to the exercise of voting rights and the improvement of the capital efficiency of investee companies.
- 4 The Company will also take part in collective engagement under appropriate conditions if collaborating with other institutional investors is believed to be effective upon holding a dialogue with investee companies.

Image Representation of Engagement Cycle





Climate Change

Environmental issues such as climate change, environmental destruction and the loss of biodiversity constitute a crisis that is right before our eyes. Reducing emissions of GHG, which are said to be the cause of climate change, is a particularly pressing issue. Responsible institutional investors are being called upon to do their part for the transition to a decarbonized society.

Awareness Surrounding Climate Change and Direction We Should Aim For

The key point for us where climate change is concerned is the achievement of essentially zero GHG emissions by the year 2050, a goal adopted by the Japanese government that international society is also tackling with a shared sense of crisis. As a responsible institutional investor, we likely have the ability to support actions calling for reductions of emissions to suppliers and other members of our entire value chain, not just to individual investee companies. At the same time, it is of utmost importance that we promote the shift from the use of fossil fuels to renewable energy, the introduction of hydrogen energy, CCUS (Carbon Dioxide Capture, Utilization and Storage), and other innovations. We also believe that together with reducing GHG emissions, preserving forest and marine environments to elevate their ability to absorb CO2 and seeing to it that each of us individually revisits our own lifestyles are of equal importance.

Our Progress

As a supporter of the Paris Agreement, which encompasses globally-shared long-term goals concerning climate change, as well as initiatives by the Japanese government and international society aimed at achieving essentially zero GHG emissions by 2050, SMDAM joined the Net Zero Asset Managers Initiative (NZAMI) by global asset management firms aiming to realize the same targets.

Our policy is to encourage investee companies to pursue actions, such as acquiring Science Based Targets (SBT) certification, which is granted to corporations and other entities with long-term plans that conform to the levels required under the Paris Agreement, and improving their CDP climate change score while retaining the option of divesting sectors and corporations with high levels of GHG emissions. We will also aggressively take part in collective engagement organized under initiatives within and outside Japan even more than before. Additionally, we project GHG emissions by investee companies covered by our analysts and utilize those projections as an element of our investment decisions.

Case Example : Company A, a Wholesale Business-Related Company

STEP 1 Identification of issues

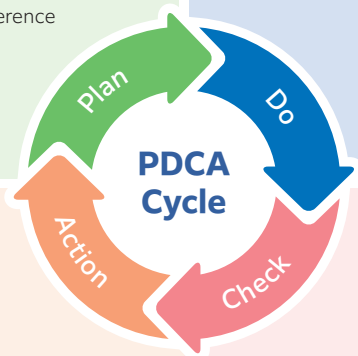
Formulate more advanced climate change countermeasures

STEP 2 Creation of engagement program

- (1) Evaluate current climate change countermeasures and analyze issues
- (2) Extract the best practices that will serve as a reference from case examples at other companies

STEP 3 Implementation of dialogue (engagement)

While the target of essentially zero GHG emissions by 2050 is commendable, the nature of near-term targets for 2030 remains vague. As investors, we convey the messaging that formulating near-term targets in as much detail as possible will lead to the improvement of corporate value.



STEP 4 Verification of dialogue (engagement)

As companies have suggested a certain level of understanding and early response relative to our messaging, our policy will be to gradually confirm progress through holding dialogue on an ongoing basis.

Natural Capital



Futoshi Saito

Senior Analyst, Responsible Investment Section

Natural capital refers to the stock of forests, rivers, seas, air, soil and other natural assets. It is a key form of capital that makes up the foundation of our socioeconomic activities as humans. The destruction of those natural assets and the loss of biodiversity that accompanies it have resulted in concern over natural capital to grow rapidly over time.

Awareness Surrounding Natural Capital and Direction We Should Aim For

Our investee companies form a widespread value chain that ranges from agriculture, forestry, fisheries, mining and other primary industries to retail, services and other tertiary industries. Natural capital is connected to that entire value chain. In particular, improving the sustainability of society as a whole and mitigating the burden on the environment through a circular economy are extremely crucial elements in passing a fertile global environment on to the next generation. A vital key to this will be putting a stop to the likes of the destruction of forests and contamination of the seas and air that are taking place against the backdrop of increased demand for food resulting from worldwide population growth and shifts in modes of living and increased water consumption that have accompanied industrialization, and managing them appropriately as we move forward. Additionally, the role of forests and the seas as GHG absorption sources is also of the essence. We believe that the adequate management of natural capital will link to contributions to the resolution of the issue of climate change.

Our Progress

Through engagement with its investee companies, SMDAM contributes to the improvement of the environmental preservation and continuity of biodiversity, water resources, forests, the seas and so forth as well as to the effective utilization and circular economy of natural capital as a whole. Issues such as lower crop yields accompanying climate change, food shortages and safety assurance for food in line with population growth, ecological destruction accompanying the cultivation of agricultural land, excessive pesticides and the continuity of aquatic resource are closely connected with the element of a sound human lifestyle in the form of food. We should proactively cover these issues in our engagement efforts. Also, similar to the TCFD for climate change, the Taskforce on Nature-related Financial Disclosures (TNFD) has been established for natural capital as a vehicle for facilitating the establishment of rules for the disclosure of associated information. While closely monitoring such trends, we encourage our investee companies to endeavor to enhance the disclosure of information pertaining to natural capital.

Case Example 2: Company B, a Real Estate Business-Related Company

STEP 1 Identification of issues

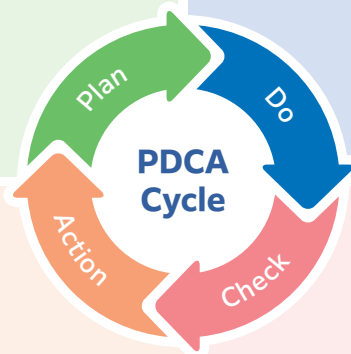
Enhance disclosure of information related to water resources

STEP 2 Creation of engagement program

- (1) Evaluate current natural capital-related measures and analyze issues
- (2) Analyze risks in entire value chain

STEP 3 Implementation of dialogue (engagement)

We convey messaging to encourage the disclosure of information related to areas such as real estate development-related stress on water resources and stress on water sources in our entire value chain, building materials included



STEP 4 Verification of dialogue (engagement)

- We have elicited a certain level of understanding from companies. The implementation of management in line applicable rules on managing water resources, including those from overseas, etc., and the execution of proposals to business partners, including those for water-saving facilities, have been announced.
- Conversely, there were some areas that could not be fully grasped across the entire value chain and some companies inclined to prioritize risk management for climate change and biodiversity due to business circumstances. Policy of Ongoing Watching

Human Rights in Supply Chains and Human Capital



Keiko Akuto

Senior Analyst, Responsible Investment Section

With human rights issues in supply chains becoming increasingly prominent in Japan and overseas, corporations are being called on to take preventive measures addressing business and human rights. Meanwhile, the importance of the intangible assets that account for part of corporate value, particularly human capital, is growing. Endeavors for drawing out the value of those assets to the maximum extent are indispensable.

Awareness Surrounding Human Rights in Supply chains and Human Capital and Direction We Should Aim For

- Human Rights** There are fears that the increasing prominence of forced labor and other human rights issues in supply chains will result in the likes of damage to brand value and a deterioration in business performance caused by boycotts. In Japan as well, the government formulated the “Action Plan for Business and Human Rights (2020-2025)” in October 2020, and in the proposed guidelines publicly released by the Ministry of Economy, Trade and Industry this August, specific procedures for the implementation of human rights due diligence by corporations were indicated. Currently, there are still a large number of corporations that are unable to perform sufficient human rights due diligence due to personnel and budget constraints. We believe that conducting fact-finding surveys on human rights risk in our organization and supply chain and implementing measures to remedy any problems should they be present as soon as possible leads to the circumvention of unforeseen risk and sustained growth.
- Human capital** The acquisition and development of capable human resources considerably affects the competitiveness of a corporation. Additionally, given the growing fluidity of labor markets, the improvement of workplace environments and boosting engagement so that employees with diverse values can individually manifest their capability regardless of their gender, nationality or other aspects can also be called a priority management challenge.

Our Initiatives

- Human Rights** In October 2021, SMDAM established its Human Rights Policy for the purpose of organizing its view on respecting human rights and making more comprehensive efforts in that area. Based on this policy, we encourage our investee companies to adequately manage and cope with human rights risk at their organization and in their supply chain. We also cooperate with external parties to participate in human rights-related initiatives and other efforts to ascertain trends both within and outside Japan in a timely manner.
- Human capital** SMDAM encourages its investee companies to tackle the recruitment and development of employees based on a human resource strategy that conforms with their medium- to long-term management strategy and the creation of workplace environments where employees can fully demonstrate their ability in order to improve corporate value.

For information on SMDAM’s human rights policy, please go here.
<https://www.smd-am.co.jp/english/corporate/vision/fiduciary/02/>



Case Example 3: Company C, A Food-Related Company

STEP 1 Identification of issues

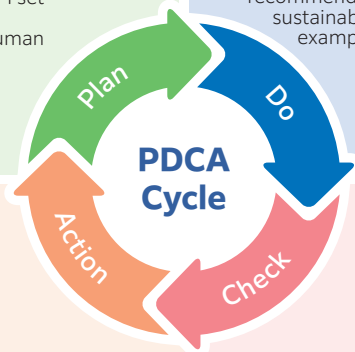
We enhanced the disclosure of the status of implementation of human rights due diligence conducted on primary raw material suppliers

STEP 2 Creation of engagement program

- (1) We verified progress relative the human rights KPI set for each primary raw material
- (2) We shared issues in the implementation of human rights due diligence

STEP 3 Implementation of dialogue (engagement)

We verified the progress of the fact-finding survey conducted on primary suppliers and actions taken towards business partners that were found to have issues with human rights
 As the company was of the opinion that “the sustainability of food will be difficult unless the situation is transformed into one in which consumers accept the price being passed on to them,” we recommended that stakeholder understanding with respect to sustainable procurement had to be obtained while illustrating examples of initiatives at other companies



STEP 4 Verification of dialogue (engagement)

- We obtained the following comment from the company: “We recognize the need to reinforce the disclosure of information in order to elicit understanding from stakeholders”
- Policy of Ongoing Progress-Watching

Effectiveness of Governance and Corporate Culture

Osamu Koide

Principal, Responsible Investment Section



In the Japanese equities market, a large number of stocks are discounted due to issues with the disclosure of information. SMDAM believes that it can help such corporations improve their corporate value by engaging in constructive dialogue with those corporations to encourage them to disclose information.

Awareness Surrounding Effectiveness of Governance and Direction We Should Aim for

Price/earnings ratios and other valuation indicators in the Japanese equities market have stalled at relatively low levels. To elevate these indicators to levels on par with other principal countries, enhancing the awareness of managers with respect to corporate value and the establishment of a governance framework to encourage risk-taking needed for medium- to long-term growth are imperative. The considerable presence of stocks discounted by the market due to issues with the disclosure of information can also be considered a distinguishing characteristic of the Japanese equities market.

We feel that we can help corporations in such a situation analyze the associated causes from an objective angle and facilitate the improvement of their corporate value through constructive dialogue. Our view is that the enhancement of the disclosure of information directly ties into the improvement of corporate value, and that the rotation of CFOs and other members of top management provides favorable opportunities for effective engagement. Additionally, our rule of thumb is that in many cases, accelerated change takes place one to two years after key members of management rotate. Conducting engagement during that period proves to be effective.

Preparing integrated reports is a shortcut to being favorably valued in the market

We have highlighted the need to prepare integrated reports to a variety of companies, including Company D featured in the below case example. We encourage companies to start by issuing such reports even if they are just serviceable ones. A perfect report does not be produced from the outset. Gradually improving on reports while engaging in repeated discussions with a variety of stakeholders is enough.

Additionally, a characteristic of integrated reports is that they are not legally stipulated, which means they can be prepared with a high degree of freedom. Examples of this are the reports issued by companies like NISSIN FOODS HOLDINGS CO., LTD. who bring their individuality right to the forefront, resulting in reports that compel people to read them just by looking at the cover. We feel that these are fascinating initiatives. These reports contain a wealth of content, yet are packed with fun ideas to sustain reader interest. Readers tend to perceive non-financial information as being difficult and hard to tackle somehow. That is why ideas to attract the reader are an essential first ingredient. These reports surely serve as a reference for personnel in charge of IR as well. The role of outside directors is vital in boosting the effectiveness of governance. As of this fiscal year, SMDAM has been proactively engaging in dialogue with outside directors with a particular focus on corporations with considerable room to improve their ESG evaluations. Heightened awareness of issuers has enabled us to secure appointments at a pace that has considerably exceeded our expectations, a situation that we are most pleased with. We explain to outside directors that the disclosure of information, particularly the preparation of integrated reports, is the fastest shortcut to boosting valuations by external evaluation institutions. Our hope is that outside directors will highlight that need to key members of management who do not sufficiently understand it.

Case Example 4: Company D, a chemicals manufacturer-related company

STEP 1 Identification of issues

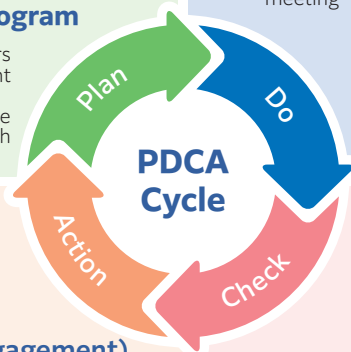
We determined that the company had issues with its stance towards the disclosure of information, and that said stance was a considerable factor behind the discounting of the stock price. However, the company took on its current president framework in June 2018, and is taking a more proactive stance towards the disclosure of information, albeit gradually.

STEP 2 Creation of engagement program

- (1) We facilitated the elimination of discount factors by encouraging the top members of management to hold briefings on main businesses
- (2) We discussed topics such as the need to prepare integrated reports and problematic areas with parent-subsidary listings

STEP 3 Implementation of dialogue (engagement)

- We verified through preliminary discussions with our sector analysts that the holding of briefings on main businesses would lead to the elimination of discount factors
- However, they are of the opinion that it is difficult due to the high degree of dependence on specific customers. We subsequently conveyed our messaging at a president's meeting



STEP 4 Verification of dialogue (engagement)

The company's stance towards the disclosure of information has gradually become more proactive after it took on the current president framework. We will adopt a policy of continuing our dialogue with the company while keeping an eye on elements such as the content of integrated reports and progress in capital allocation and issues with parent-subsidary listings.

- The company held a briefing on its main businesses approx. three months after we conveyed our messaging. Sales-side coverage also increased, the degree of market attention on the company rose, and the discount factors were eliminated to a certain degree, resulting in improved corporate value
- We confirmed the company's forward-looking stance towards preparing integrated reports as well

Business Ethics and Corporate Culture

Misconduct that pertains to social trust exerts a negative impact on corporate value. Where some misconduct is conducted intentionally, other is rooted in elements of corporate culture, such as a lack of business ethics or open communication. We need to penetrate the challenge this poses in our capacity as an institutional investor.

Awareness Surrounding Business Ethics and Corporate Culture and Direction We Should Aim For

From inspection fraud to disguised quality, there has been no end to misconduct by Japanese corporations. The insular constitution of those corporations has been cited as one of the causes of that. Additionally, our business environment in recent times, which has been changing at a dizzying pace, requires that change to be accommodated swiftly and flexibly. For corporations to keep such misconduct in check and take advantage of the changes that environmental shifts bring, in addition to aspects of hard infrastructure such as governance structure and rules, approaching aspects of soft infrastructure in the form of employee ethics and corporate culture is of the utmost importance.

Our Initiatives

Amid misconduct that concerns social trust, there are numerous cases where the presence of long-standing habits (including rampant aimless behavior stemming from “habits”) and corporate culture (including limited openness in communication in the organization, a lack of interest in others due to a vertical hierarchy and an atmosphere based on a top-down chain of command where people cannot say what they want) is evident. In more worse cases, organizations are unable to effectively self-cleanse, requiring them to rely on pressure from the outside.

Our policy at SMDAM is to do our part as a responsible institutional investor by conducting engagement aimed investee companies where misconduct has occurred so that we can put negative impact in check while identifying opportunities for rebuilding those companies’ corporate culture into one with open communication whose employees are able to manifest their creativity. Additionally, we research methods of incorporating business ethics, corporate culture and other forms of soft infrastructure into ESG evaluations unique to SMDAM at a greater level than before as we work to improve the effectiveness of those evaluations.

Case Example: Company E, A Securities and Commodity Futures Trading Business-Related Company

STEP 1 Identification of issues

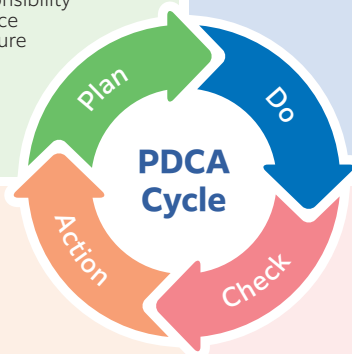
We determined that challenges rooted in the company’s governance and business culture are present after misconduct that significantly impacts corporate value took place

STEP 2 Creation of engagement program

- (1) We investigated the causes, clarified where responsibility lies and verified measures to prevent reoccurrence
- (2) We confirmed the connection with business culture

STEP 3 Implementation of dialogue (engagement)

- We inquired whether there were any challenges with business culture, past cases included, after performing STEP 2-(1)
- We received a response from the company that it formulated reform policy, etc. for the sophistication of its management framework and business culture based on the advice of external consultants



STEP 4 Verification of dialogue (engagement)

Our policy will be to continue engagement while monitoring the effects of governance reinforcement based on the misconduct in question and progress in corporate climate reforms while keeping a close eye for the time being on whether a similar situation will reoccur

Participation in Global Initiatives

To fulfill our stewardship responsibilities as a responsible institutional investor, we have become a signatory to and accepted various global initiatives, starting with the U.N. Principles for Responsible Investment (PRI). We work cooperatively with investors within and outside Japan and conduct engagement with our investee companies.

U.N. Principles for Responsible Investment (PRI)

The PRI, which are incorporated by institutional investors in their asset management process after they form a grasp of ESG challenges, constitute principles whose purpose is to improve long-term investment effects for the sake of customers and final beneficiaries. They were publicly released by then-U.S. Secretary-General Kofi Annan in April 2006. SMDAM became a signatory to them in March 2010.

Signatory of:



Principles for Financial Action towards a Sustainable Society (commonly known as Principles for Financial Actions for the 21st Century)

The Principles for Financial Actions for the 21st Century are principles established in October 2011 based on the recommendations of the Central Environmental Council of the Ministry of the Environment as action guidelines for financial institutions willing to fulfill responsibilities and roles necessary to form a sustainable society. We joined in December 2017.



Japan Stewardship Initiative (JSI)

The JSI was established in November 2019 as a cross-industry organization that resolves issues pertaining to the actual business portion of stewardship activities by institutional investors. It engages in activities that contribute to the deepening and sophistication of stewardship activities such as the operation of reporting (smart) formats for communication between asset management firms and asset owners and the holding of seminars and study sessions. We have been a member of the JSI since its establishment.



ESG Disclosure Study Group

The ESG Disclosure Study Group is a forum where investors and corporations come together to explore effective and efficient information-disclosure frameworks and promote mutual understanding among stakeholders for the purpose of "creating a mechanism that realizes the sustainable development of Society keeping with the long term value creation of Companies themselves." SMDAM also makes proactive remarks on the disclosure of information on ESG that is beneficial to both investors and corporations. We joined this group in October 2020.



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

The TCFD was established in April 2015 by the Financial Stability Board (FSB) at the request of the G20 for the purpose of examining how the disclosure of information on climate change and the pertinent response of financial institutions should be conducted. We declared our support for the TCFD in December 2019.



CDP

CDP is a UK-based non-governmental organization (NGO) that runs a global disclosure platform for investors, companies, states, regions and cities with which they can manage their own environmental impact. Since the establishment of its predecessor, the Carbon Disclosure Project, in 2000, the organization has been sending out questionnaires on areas such as climate change, water, forests and supply chains and disclosing pertinent information to institutional investors. We became a signatory to CDP in June 2021.



Climate Action 100+ (CA100+)

The CA100+ is a collective engagement program which identifies and conducts engagements with over 100 global companies that release large amounts of GHG emissions in order to meet the targets under the Paris Agreement. This program is to be implemented over five years from December 2017. It asks for the reduction of GHG emissions, monitoring of climate change-related risks and opportunities, and improvement of environmental information disclosure in line with the TCFD from the standpoint of asset management. We became a signatory in February 2020.



Net Zero Asset Managers Initiative (NZAMI)

NZAMI got off the ground in December 2022 as an initiative by global asset management firms aiming to realize essentially zero GHG emissions by 2050. Member firms are asked for their commitment to endeavors that include setting interim targets for 2030, forming investment products for achieving essentially zero emissions, conducting engagement, and disclosing information based on the TCFD on an annual basis. We became a member of NZAMI in March 2022.

30% Club Japan Investor Group

The 30% Club, which was founded in the UK in 2010, is a global campaign aimed at an increase of the proportion of women on seats in companies' important decision-making bodies, including the board of directors. Its Japanese body, 30% Club Japan, went into action in May 2019. The Investor Group, one of its working groups, aims to share the importance of gender diversity with the management team of investee companies and to exercise influence in achieving that diversity. We joined in December 2019.



ACGA (Asian Corporate Governance Association)

ACGA is a non-profit organization mainly based in Hong Kong that was established in 1999 with the objective of working to improve corporate governance in Asian markets based on the idea that corporate governance is an indispensable element for the long-term growth of the Asian economy and capital markets. We became a signatory in 2007.



Case Examples of SMDAM Activities under Initiatives

30% Club Japan Investor Group

The objective of 30% Club Japan, of which SMDAM is a part, is to increase the ratio of female executives (directors and corporate auditors) at the top 100 TOPIX companies to 30% by the year 2030. We believe that discussing measures to resolve gender-related issues through constructive dialogue with our investee companies is effective, and as such conduct activities that include: (1) Gathering and sharing best practices for engagement, (2) Communicating information on the importance of gender diversity in important decision-making bodies, including the board of directors (Thought Leadership Report and other white papers) and (3) Enhancing awareness.

In addition to proactively participating in activities as a member of subgroups for (1) and (2) above, we assist with the smooth operation of initiatives in the capacity of a secretariat.

CA100+

As a supporter of collective engagement, we attend member report meetings arranged for before and after dialogues as forums to share information on the implementation of engagement. We will seek to proactively contribute to improving the corporate value of investee companies as a lead investor that will directly take part in dialogue for any new collaborative engagement in the future, including initiatives other than the CA100+.

TCFD Consortium, ESG Disclosure Study Group and Japan Stewardship Initiative (JSI)

Through the TCFD Consortium and ESG Disclosure Study Group, we proactively take part in roundtables and workshops and share investor perspectives pertaining to the disclosure of information and other areas. Additionally, through the JSI, we also contribute to the smooth operation of that initiative as a member of its steering committee.

Exercise of Voting Rights

We endeavor to decide the most ideal exercise of voting rights for improving the corporate value of our investee companies

Akane Kumagai

Analyst, Responsible Investment Section



In order to improve the corporate value of and mitigate damage to our investee companies, we exercise voting rights in accordance with guidelines unique to our organization. In actually exercising those rights, rather than superficially deciding how we will vote, we seek out the decisions that are more ideal from the perspectives of the sound development of our investee companies and the improvement of their corporate value while taking the results of our engagement into consideration in some cases.

We established unique guidelines from the dual perspectives of responsibility for results and the improvement of future value

Exercising voting rights to convey to management the voice of shareholders at general meeting of shareholders, the highest decision-making body of a stock company, is an activity that directly ties into the interests of our customers and final beneficiaries. As trustees, we are mindful to exercise voting rights in the manner most ideal for improving the corporate value of our investee companies. As a general rule, we opt to exercise our voting rights via instruction for all proposals rather than submit blank votes.

In our criteria for the exercise of voting rights, we emphasize the below perspectives for the purpose of promoting stronger governance at investee companies and contributing to improvement of their corporate value.

Perspective 1 Perspectives regarding verification of responsibility for results

Evaluating management responsibility for actions pertaining to corporate performance and social trust

Perspective 2 Perspectives regarding improvement of future value or mitigation of damage

Evaluating impact on future corporate value, including organ design and officer composition following general meetings of shareholders, ideal nature of executive compensation, future business strategy, finance and capital strategy, and medium- to long-term strategy pertaining to sustainability

Based on these perspectives, we regularly review our guidelines while taking ESG issues as well as revision of Corporate Governance Code and Stewardship Code into consideration. In our January 2022 revision, we newly added elements such as criteria for total shareholder return (TSR), criteria pertaining to the diversity of the board of directors, and criteria for evaluating management strategy related to climate change, human rights, and other sustainability issues.

Newly introduced criteria related to TSR to encourage fostering of shareholder perspective at investee companies

In addition to its preexisting criteria, such as that for ROE and business performance, SMDAM introduced criteria related to TSR. More specifically, we will look into opposing proposals for appointing directors in cases where the TSR for the past three years is significantly underperforming compared to the TOPIX with dividend and average TSR in the same sector. As a result, in addition to asking director candidates at investee companies to be answerable for trends in stock prices, we anticipate a shift in behavior towards that which is mindful of a shareholder perspective. Recently, there has been an increasing trend among corporations to employ TSR as a KPI for executive compensation based on the idea of further emphasizing a shareholder perspective.

Aiming to sophisticate stewardship by incorporating environmental and social standpoints

Up to now, our guidelines emphasized governance. To fulfill sufficient responsibility for stewardship, we added sustainability elements that address the environment, society and other areas to our guidelines for the exercise of voting rights. One of the criteria we added is that of addressing diversity in the composition of the board of directors and other organs. We will look into opposing cases where diversity in gender, nationality and so forth cannot be confirmed. Under another criteria regarding sustainability, we will look into opposing cases where insufficient information on management strategy pertaining to the environment and society, including strategy addressing climate change, human capital and intellectual property, is being disclosed, and the will for or orientation towards improvement cannot be confirmed even through dialogue.

Aiming to make decisions on the exercise of voting rights that contribute more to the improvement of corporate value

Upon exercising voting rights, we base our decision on the external environment and individual circumstances that the corporation is in and the state of its endeavors for improvement as ascertained through interviews and engagement. For that reason, we administer our guidelines with flexibility. For example, at corporations such as those that are in a phase of aggressive investment for the sake of their medium- to long-term growth, we occasionally allow encroachments on our guidelines after forming an understanding of the actual situation at and operating environment of those corporations. We also flexibly administered quantitative criteria such as business performance and ROE in the critical situation recently posed by the spreading of COVID-19.

Case Study

Here, we will introduce case examples of how we flexibly administer our guidelines for the exercise of voting rights and strictly manage conflicts of interest.

Case Examples in Which Our Guidelines Were Encroached But We Gave Our Support after Taking Nature of Dialogue and Actual Situation at Corporation into Consideration

Classification of proposal	Criteria encroached	Reason for decision
Appointment and dismissal of directors	TSR criteria	We decided that it was appropriate to allow the encroachment given the likelihood that selective trends in the market have strongly influenced the high stock price levels of three years ago.
	ROE criteria	We flexibly applied this criteria after taking the impact of the spreading of COVID-19 on the department store business into consideration.
	Dividend criteria	In consideration of factors such as the dividend capacity of the corporation in question, we allowed the decision to not distribute dividends from the standpoint of ongoing concern.
	Cross-shareholdings	Having positively evaluated the corporation adopting a reduction target of under 20%, the ideal ratio to net assets under our guidelines, we gave our support.
Appropriation of retained earnings	Dividend criteria	While dividend criteria were not met, having positively evaluated the announcement of dividend targets in the immediate term and the gradual enhancement of shareholder returns, we gave our support.

Case Examples of Shareholder Proposals that We Supported

We carefully examine the content of shareholder proposals and consider supporting shareholder proposals in cases where we determine they would improve the corporate value of or mitigate the damage to investee companies.

Classification of proposal	Description of proposal and reason for our decision
Executive compensation	Changes to Articles of Incorporation pertaining to individual disclosures of executive compensation We gave our support due to the proposed content encouraging the stronger disclosure of information and improved transparency.
Proposal related to Articles of Incorporation	Amendment of Articles of Incorporation regarding disclosure of cost of shareholder's equity Having determined that the proposal encourages the stronger disclosure of information and will contribute to the improvement of corporate value, we gave our support. Proposal pertaining to disclosure of information related to climate change Having determined that the content contained in the Articles of Incorporation would not constrain the businesses of the corporation in question and that such reinforcement of the disclosure of information would contribute to shareholders' common interest, we gave our support.
Appropriation of retained earnings	Proposal to distribute additional dividends in addition to company proposal We gave our support due to the company having sufficient payment capacity and not indicating any measures that would contribute to shareholder interests in place of returns to shareholders and to the improvement of corporate value.
Other proposals related to capital policies	Proposal pertaining to acquisition of treasury stock We gave our support due to the determination that the proposal would link to the improvement of corporate value.

Case Example of Proposals that Became Target for Management of Conflicts of Interest

We strictly manage conflicts of interest in the exercise of voting rights with respect to our shareholder companies, including our largest shareholder Sumitomo Mitsui Financial Group, in order to keep our customers and other third parties from incurring any disadvantage. Our principle in this regard is to give our support only in cases where our unique guidelines and recommendations by external advisory bodies for the exercise of voting rights are all for support.

8316 Sumitomo Mitsui Financial Group

Proposals	Decision
① Appropriation of retained earnings	We gave our support.
② Proposals related to Articles of Incorporation	We gave our support.
③ Appointment and dismissal of directors	We opposed certain internal directors due to encroachment on criteria for cross-shareholdings and issues related to market manipulation at subsidiary SMBC Nikko Securities. We opposed certain outside directors from the standpoint of independence.
④ Shareholder proposals: Proposals related to Articles of Incorporation	We gave our support due to the proposed content calling for the formulation and disclosure of business plans that include medium- to long-term targets in conformance with the Paris Agreement not placing constraints on our business and contributing to the reinforcement of the disclosure of information related to climate change.
⑤ Shareholder proposals: Proposals related to Articles of Incorporation	We opposed the proposed content calling for lending, etc. consistent with the essentially zero emission scenario by the International Energy Agency (IEA) in consideration of the risk that it will limit corporate operation even though we recognize the importance of lending based on reliable scenarios.

Basic Policy on the Exercise of Voting Rights

https://www.smd-am.co.jp/english/corporate/responsible_investment/voting/



Results of exercise of voting right for Japanese equities

https://www.smd-am.co.jp/english/corporate/responsible_investment/voting/report/



Progress in Sustainable Investment Management

Initiatives to Enhance ESG Integration and Asset Management Capabilities

SMDAM is continuously tackling the sophistication of asset management for the purpose of acquiring investment returns over the long term. Simultaneously, we are endeavoring to push forward with ESG integration (the incorporation of ESG elements into the asset management process) based on ingenuity by our investment team as well as enhance infrastructure shared across our company, including our ESG research framework and ESG evaluations.

Engagement Activities (FY2021)

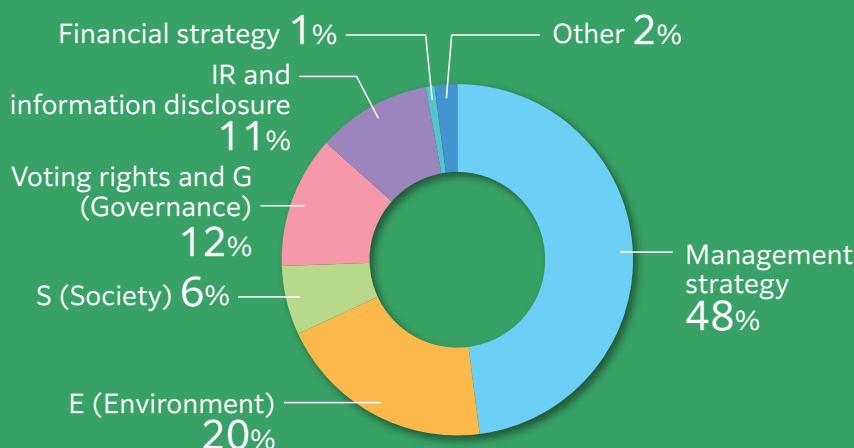
Exclusive engagements

2,725

Executive officers or higher

70%

Ratio of dialogue themes in engagement activities



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Use of proprietary AI engine in Domestic Equity Investment

Daisuke Nishida

Investment Development Group,
Investment Department
Manager

Kazuhiro Bena

JP Equity Value +a Group,
Investment Department
Senior Fund Manager

Keiya Furukawa

JP Equity Value +a Group,
Investment Department
Fund Manager

Through the development of a SMDAM-original AI engine and its application to a Japanese equities fund, we tackled the sophistication of investment methods.

The Value +a Group in the Investment Department commenced the application of an original AI engine developed in-house by that department's Investment Development Group to the management of Japanese equity funds. In this system, AI instructed in fund manager knowledge in advance analyzes text from corporations' summaries of financial results and assigns scores to stocks. The scores assigned go up in accordance to the degree of expectation that the corporation's performance will improve in the medium term. Moreover, fund managers refer to this score given to summaries of financial results (AI score) upon choosing stocks.

Advantage of AI developed in-house

The first noteworthy advantage that internalizing our AI engine has given us is a newfound ease with relearning and other updates. This has enabled us to handle the likes of newly-appearing vocabulary and vocabulary that appears with low frequency in a timely manner. Another important advantage is technological innovativeness. Through the incorporation of the latest natural language processing technology, aspects such as context comprehension and evaluations of low-frequency vocabulary, which presented numerous challenges in the area of natural language processing, improved.

Additionally, we have been utilizing an approach that combines pattern search learning and active learning, the result of joint research with external specialized institutions. This has enabled us to extract stable AI performance using limited instructor data. In turn, we now have a system in place that allows us to implement a full cycle that runs from learning to scoring and utilization through AI based on limited personnel and data resources.

Trials and tribulations

In developing the AI engine, we re-applied our past joint research results with external specialized institutions to actual business. Because of that, the personnel in charge of development had to unpack a complexly-intertwined program to understand it and revise it so it could hold up under system operation. This proved to be highly difficult. Meanwhile, fund managers also took their time to carefully handle areas such as the selection of over 100 items of financial results summary data to instruct the AI in and the

indication of items within those summaries that should particularly be reflected in scores. We are also continuing our daily efforts to explore how we can utilize AI scores to contribute to efficiency and performance.

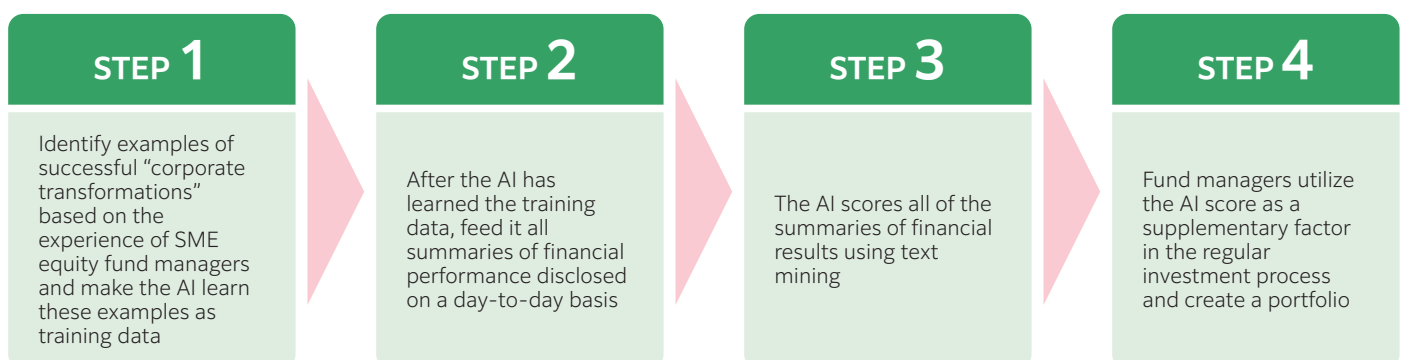
Unearthing blue-chip companies and grasping signs of changes

Scores for individual stocks calculated using the AI engine are applied to the SME domain, which has a particularly large number of stocks. By referring to AI scores in addition to carrying out conventional stock selection processes, fund managers can avoid losing sight of attractive companies amid the wide range of listed stocks. To give specific examples, we conduct research while according preference to stocks with a relatively high AI score and those that show improvement, and work to ensure that we do not overlook "hidden blue-chip companies" and "signs of changes in companies."

Future development

In equity investment, if we can teach AI the stock picking expertise of veteran fund managers and have teams utilize the AI, it will be easy to transfer expertise to successor fund managers. That is to say, if we do a good job of incorporating AI, we may be able not just to enhance performance, but also to contribute to reducing "key person discount." Additionally, we also think that by developing our AI in-house, we will be able to prevent the "creation of a black box," which tends to happen when using another company's AI engine. We also expect this to be able to contribute to "making our investment methods more sophisticated" and fulfilling our "accountability to clients."

Stock identification process utilizing AI (artificial intelligence)



Joint Research with the Japan Center for Economic Research

Empirical Analysis Related to Bond Markets and ESG

Kei-Ichiro Inaba, Ph.D. Former Chief Forecaster, Japan Center for Economic Research

Joined the Bank of Japan in 1998. In 2008, he obtained a PhD (in economics) from the University of London, and since July 2022, he has served as specially appointed professor at Hitotsubashi University Business School, School of International Corporate Strategy (ICS). He is a member of the editorial board of the monthly magazine "Tokei" (Japan Statistical Association), and has published many articles in peer-reviewed journals.



As part of collaborative efforts between industry and academia, between March 2021 and June 2022, we performed joint research concerning empirical analysis related to bond markets (credit markets) and ESG, together with the Japan Center for Economic Research (JCER), a public interest incorporated association. Jun Fukushima of the Investment Planning Department and Responsible Investment Section, who was the facilitator of this research, spoke with Kei-Ichiro Inaba, Chief Forecaster at JCER (at the time), who was involved in the joint research, and Yuji Hatakeyama, Senior Credit Analyst in the Investment Department and Responsible Investment Section of SMDAM, about the significance and implications of this research.

Joint research background and objectives

Fukushiro Thank you for giving us your time today. First, what was the background that led to you suggesting joint research to SMDAM?

Inaba ESG management is a modern way of demonstrating CSR. In the stakeholder view, originating in business studies, considerations for E and S issues enhance corporate value. On the other hand, in the shareholder view, originating in economics, such considerations have the risk of destroying corporate value. The considerations may be private consumption and overinvestment. Consideration for G issues is desirable under either view, although the impact pathway differs.

Under the former view, good governance is useful for "promoting desirable acts" by managers. Under the latter view, good governance is useful for "suppressing improper acts" by managers.

Exploring the ways in which ratings for each aspect of considering E, S, and G issues are related to price formation for securities is also a way of testing the stakeholder view and the shareholder view. A major institutional investor such as your company, SMDAM, has access to data on ESG ratings, and I also thought you would be interested in such analysis. Additionally, I also heard that credit analysts were participating in ESG evaluation, and I thought I could learn a lot from exchanging information and opinions with credit investment practitioners.



Hatakeyama In recent years, even in the area of bonds, we have received an increasing number of questions from many clients concerning the relationship with ESG performance, particularly from pension funds. We anticipated that, if we were able to benefit from academic expertise, it could contribute significantly to making our sustainable investment more advanced, so we took on the challenge of joint research.

Fukushiro Why did you focus on the relationship between ESG and credit markets?

Inaba Because it was a niche area in terms of academic research. Researchers overseas have pioneered empirical analysis of the relationship between the level of achievement of CSR or ESG and securities prices. Plus, the main area of analysis was equity markets. There was relatively little research concerning credit markets. In my review of the literature, there was one example of prior research analyzing the ESG ratings of Japanese companies and the spreads on their corporate bonds against government bonds. It is known, however, that market liquidity and price discovery ability is lower for corporate bonds than CDSs. CDS premiums are a better indicator of credit risk premiums than spreads on corporate bonds. There is prior research analyzing the relationship of CDS premiums with E for European companies. Under these circumstances, I believed that analyzing the relationship between CDS premiums and ESG ratings for Japanese companies would offer an academic contribution that fills a niche in the literature.

Results of joint research

Fukushiro Recently, JCER has released a discussion paper titled "ESG Management and Credit Risk Premia: Evidence from Credit Default Swaps for Japan's Major Companies."(Note 1)

Could you tell us about the facts identified in this paper?

Inaba We used ESG ratings from Sustainalytics. Overall, we noticed that the Stakeholder Influence Capacity (SIC) of major companies in Japan is insufficient. SIC refers to the "ability to leading expanding good

relationships with stakeholders to increasing corporate value in the future,” and it is a concept that can combine the two views mentioned earlier. According to basic estimates (March 2018 to March 2021), E ratings were not related to CDS premiums. This result is not consistent with the stakeholder view. A high S rating was associated with a wider CDS premium. This is consistent with the shareholder view. A higher G rating was associated with a smaller CDS premium, which is consistent with both views. Furthermore, just because there was a higher G rating, it did not follow that E and S caused the premium to be any smaller. This suggests that major Japanese companies’ improving G unlikely helped the companies align their considerations for E and S issues with increasing their corporate value. Nevertheless, in fiscal 2021, when the COVID-19 pandemic struck, a significant interaction was discovered between E and G ratings, and between S and G ratings. It appears that there have been developments in relation to SIC recently.

Fukashiro From a practical perspective too, it was meaningful that we were able to summarize the relationship between E, S, and G ratings and credit risk premiums through empirical research.

Hatakeyama We succeeded in obtaining empirical proof of the effectiveness of “ESG analysis” in day-to-day credit research and investment in bonds. In bond markets, the status of issuers’ governance (G) is prioritized and paid attention to as part of assessments of creditworthiness, but the results of our test, which show that the E and S measures of Japanese companies are not evaluated positively, are in line with the intuition of investment practitioners. Furthermore, I think the fact that these results show academically that the “SIC of Japanese companies is still developing” is very valuable for SMDAM as we promote ESG investment.

Fukashiro That’s right. From the perspective of fiduciary responsibility toward the ultimate beneficiaries too, I feel the greatest lesson from this research was that we recognized the necessity of further “engagement” to promote ESG management at investee companies in Japan.

Hatakeyama At SMDAM, we intend to continue to value the concept of SIC, and we want to consider specific ways to perform engagement that ensures the SIC of each issuer.

Joint research implications and recommendations for the asset investment industry

Fukashiro Dr. Inaba, do you have any recommendations for SMDAM or the asset investment industry?

Inaba I spoke about the fact the SIC of companies in Japan appears to have been growing recently. I think that as time passes and analysis is performed over a longer sample period, it will become clear whether this is right or wrong. In order for analysis to prove that the SIC “has grown” in the future, the efforts of companies themselves will be necessary, along with appropriate engagement from institutional investors. Within a finance-theoretic framework, if the price of a company’s securities is driven upward despite the fact that we cannot expect SIC growth, it can be viewed as mispricing amid an ESG management and investment boom.

That being said, it can be still justified. End investors may derive happiness from “non-monetary returns,” i.e., the positive E and S impact. This has something in common with the “hometown spirit” seen in mini local government bonds. It may be meaningful for ESG investment funds to ascertain and introduce the “non-monetary returns” of the ESG activities of investee companies in investment reports, to provide the end investors with this type of satisfaction.

Fukashiro At SMDAM, we intend to fully satisfy our responsibility as a responsible institutional investor, to a greater extent than ever before, while referring to the results of this research and the knowledge of Mr. Inaba. Thank you for your time today.



Jun Fukashiro

Investment Planning Department and
Responsible Investment Section
Principal

Yuji Hatakeyama

Credit Research Group,
Investment Department and
Responsible Investment Section
Senior Credit Analyst

Kei-Ichiro Inaba, Ph.D.

Specially Appointed Professor,
Hitotsubashi University Business School,
School of International Corporate Strategy (ICS)
Former Chief Forecaster,
Japan Center for Economic Research

(Note 1) “ESG Management and Credit Risk Premia: Evidence from Credit Default Swaps for Japan’s Major Companies”



Enhancements to In-house ESG Evaluations and Expansion of Coverage

In 2009, we began “ESG evaluations*” covering a wide range of ESG factors, particularly in relation to major companies in Japan subject to research by our analysts. Subsequently, reflecting differences in asset classes, company size, etc., we developed “ESG evaluations (Global)” for global companies and “ESG evaluations (Core)” for small and medium-sized enterprises (SMEs), and we utilize these evaluations in respective investment decisions and engagement.

Global companies

Materiality prioritized by ESG evaluations (Global), and beyond

Noriko Miyoshi

Chief Investment Officer, Global Fixed Income Group, Investment Department



SMDAM’s ESG evaluations (Global) are a framework in which we evaluate ESG along two axes: “basic evaluation,” which covers a wide range of non-financial information, and “analyst evaluation,” which focuses on areas that we consider important.

Basic evaluation: covering a wide range of non-financial information

This evaluation indicates an absolute level of ESG risk that is comparable across industries and countries/regions, by quantifying financial materiality utilizing scores granted by external ESG rating institutions.

Furthermore, we work to reduce bias and increase objectivity by using signals from a wide range of sources, including alternative data and NGOs, as inputs and using multiple ESG rating institutions.

Analyst evaluation: focus on areas that SMDAM considers important

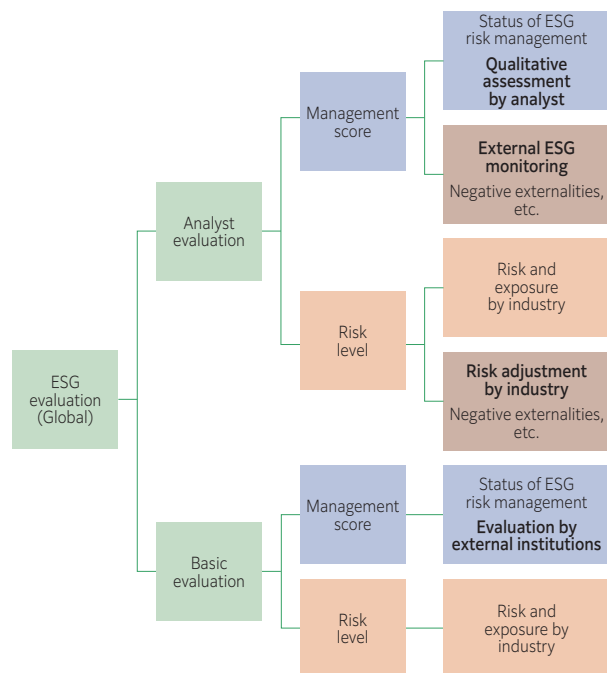
With regard to analyst evaluations, we believe that “qualitative assessments by analysts” conducted in cooperation with research staff for foreign equities and bonds are our most important source of added value. We investigate risks and opportunities related to important ESG evaluation items, taking into consideration materiality (key management issues) for each industry, and evaluate not just whether there is disclosure, but also the actual state of initiatives. We also adjust our evaluations for the possibility of future improvement based on dialogue.

Additionally, one notable feature is the fact that we use rules to apply considerations that go beyond the framework of general ESG evaluations, such as negative externalities and reputational risk .

Use in overseas credit investment and future issues

In overseas credit investment, we have utilized ESG evaluations (Global) as part of the process for assessing the creditworthiness of individual bonds since 2021. When selecting bonds, we analyze ESG from a multi-faceted perspective, including differences between the basic evaluation and the analyst evaluation and comparison with industry peers, and reflect this information in internal indicators for assessing creditworthiness, such as internal ratings. The Investment Policy Committee receives monthly reports concerning any issuers that have very low ESG scores, and considers whether such issuers should be excluded from the scope of investment.

In addition to sustainability risk, many investors share the issue of how to quantitatively evaluate the Principal Adverse Impacts (PAIs) of the business activities of investee companies, etc., on the environment and society. There is still no consensus on evaluation methodologies and data, but we do not use that as an excuse. We will continue endeavoring to make our investment methods more sophisticated to enable us to meet the expectations of our clients and society, while reflecting the results of trial and error and our engagement efforts.



* Current ESG evaluation (Comprehensive): Sustainability Report 2021 (page 31) [sustainability_report_2021_c05.pdf \(smd-am.co.jp\)](https://www.smd-am.co.jp/sustainability_report_2021_c05.pdf)



Small and Medium-sized Enterprises

Aiming to create shared
global universal “criteria”

Tadao Kimura

Head of Corporate Value Group,
Investment Department

Masanori Mizuno

Investment Department and
Responsible Investment Section
Principal

Taisuke Yamagata

Corporate Value Group,
Investment Department
Senior Fund Manager



We spoke about developments to date and the future outlook with Tadao Kimura, Head of the Corporate Value Group in the Investment Department, which utilizes in-house ESG evaluations (Core) in investment decisions, and Taisuke Yamagata, Fund Manager in the same group, as well as Masanori Mizuno, Principal in the Investment Department and Responsible Investment Section, who supported these evaluations from development to introduction.

Q What were the reasons for the development of in-house ESG evaluations (Core)?

Kimura Previously, we had invested by measuring corporate value with common “criteria” that were not swayed by the current state of the economy or market psychology, but we aim to create “criteria” that also reflect an ESG scale. This contributes to “visualizing” investment decisions that we “think about comprehensively in our heads.” We also hope to ensure that these “criteria” meet global expectations, such as the SFDR in Europe, partly because we have many overseas clients.

Mizuno There was an issue in general ESG evaluations whereby there was little data for SMEs and evaluations tended to be swayed by whether or not there was disclosure. Then, we developed ESG evaluations (Core), in which Fund Managers themselves give scores, in collaboration with the Responsible Investment Section.

Q Are there any instances of judgment being divided within the group? It seems that in general, there would be concerns about objectivity.

Yamagata ESG scores for the same types of companies are sometimes quite different. It appears this means that even if a comprehensive assessment gives similar results, there are clear differences in our views if we quantitatively extract the ESG component.

Mizuno We could say this means the accuracy of our corporate analysis has increased. Maybe this is because we can identify underlying risks?

Yamagata When assessing corporate value, we use models that determine the level of risk and adjust the cost of capital. Accordingly, ESG factors, which are highly material, are already considered as part of our comprehensive assessment, and we are actually rarely ever surprised by new risks.

Mizuno Our ESG evaluations are a kind of true ESG integration, where all we are doing is extracting and systematizing information that was contained within comprehensive investment decisions.

Yamagata Initially, myself and others were concerned that evaluations would lean toward being favorable because we were already investing. In fact, I truly felt that bad scores were also being fairly given. This is likely because, in our evaluations, we have come to the conclusion that even taking into consideration issues

related to ESG, the assets are still an attractive investment.

Q On the other hand, what is the relationship with market evaluations?

Yamagata I noticed that in cases when there was a divergence between the market’s evaluation and my own feeling, some component could be explained from an ESG perspective. If ESG perspectives become more commonplace in capital markets in the future, perhaps they will be further reflected in share prices.

Kimura There is a restaurant company that, for some reason, the market has never valued highly, despite the fact that this company expends great effort thinking about its customers. When we tried actually giving it a score, however, we found that the company had a low awareness of stakeholders other than customers, which provided a satisfying explanation.

Q Do you also use these evaluations in engagement?

Yamagata Many of our investment targets are SME equities, which means there is significant room for growth in relation to ESG measures. I hope that SMDAM can grow together with companies as we ourselves test new ESG evaluations.

Kimura I have been investing in SME equities for over 20 years, but recently it feels like we are no longer “interviewing” companies. Companies also want to hear the opinions of investors, so we are mutually engaged in natural communication aimed at enhancing corporate value. Then, there are also the ESG scores that we ourselves have granted companies, and we are specific and clear about why this is important and how we consider individual circumstances, so there is different level of passion. We cannot say the same about scores that have been “received” from analysts and external institutions.

Q Is there any resistance to interfering with the basis of investment?

Kimura Investors alone cannot create a mechanism for reflecting ESG scores in models, so in the constantly expanding domain of ESG, it is important that evaluations perform the role of a filter, saying “it would be a good idea to look at this,” from the perspective of a fund manager. We must also update our “criteria.” I hope we can rely on your support to ensure this system remains “sustainable.”

Enhancements to ESG Evaluations for APAC REITs and Response to the SFDR

Evaluating global REITs based on global standards

Etsuro Akiyama
REIT Group Head,
Investment Department

Sumitomo Mitsui DS Asset
Management (Singapore) Pte. Ltd.

Junnosuke Shinkawa Chief Analyst
Tomoya Nose REIT Analyst

We have continuously revised and improved our ESG evaluation systems in line with changes in the management environment surrounding REITs. We are performing evaluations in line with global standards and contributing to enhancing the value of REITs through engagement.

Globally comparable ESG evaluation system

Over the past few years, the global economy has suffered major impacts from frequent natural disasters caused by climate change and COVID-19, the first global pandemic since the Spanish flu. Meanwhile, social issues such as growing inequality, social division, human rights, gender, and refugees have attracted attention around the world, and the invasion of Ukraine by Russia has shaken the core of international order.

In 2018, when interest in corporate governance increased, we began ESG evaluations in the J-REIT market, with the aim of establishing proprietary ESG research methods. In the following year, 2019, we expanded the scope of our ESG evaluations to cover the Asia and Oceania regions. To date, we have utilized ESG evaluations as one perspective for evaluating REITs to invest in, and we have also them as a method for engagement when conducting individual interviews with REITs and exercising voting rights.

Since we began ESG evaluations, there has been a rapid increase in people's awareness of the environment and human rights, and there has been progress in the development of information disclosure rules, such as the Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainable Finance Disclosure Regulation (SFDR). On the other hand, lockdowns in cities and the suspension of economic activities due to COVID-19 resulted in demands being imposed upon REITs, such as rent reductions and exemptions for tenants. The management environment surrounding E (Environment) and S (Society) for REITs has changed unceasingly in this way.

Based on these circumstances, in fiscal 2021, we decided it was necessary to revise our framework for ESG research. REIT analysts at our local subsidiary in Singapore took the lead and worked as one team with the REIT Group in our head office in Tokyo to expand the regions where we applied these evaluations and revise our methods for evaluating E (Environment) and S (Society).

Efforts toward further improvements and engagement

There have been continuous changes in the environment surrounding ESG at REITs, including rapid changes in the international energy situation as a result of the invasion of Ukraine by Russia that began in February 2022, and the revisions that we made in the previous fiscal year do not represent our end goal. In order for SMDAM to appropriately understand REITs' measures to achieve a sustainable society, it is vital that we continuously endeavor to improve our ESG evaluations. Through REIT ESG evaluations and engagement that utilizes this data, we will contribute to enhancing the value of REITs in which we invest or are considering investment.

[Overview of revisions to ESG research]

1 Expansion of target regions

Expand the scope of ESG evaluations from the previous Asia and Oceania regions, including Japan, to Europe and America, and make global comparisons of REITs' ESG measures possible (REITs covered: 200+ to 300+)

2 Revisions to evaluations related to the environment and society

Incorporate global standards such as the TCFD and SFDR into SMDAM's ESG evaluation systems

① Use the TCFD recommendations in our evaluation system for E (Environment)

- Examine the status of disclosure in line with management concepts and award a score according to the level of completeness
- Award a score depending on the level of progress and commitment toward greenhouse gas (GHG) reduction targets
- Based on the score, propose processes for REITs to set GHG reduction targets and suggest improvements to sustainability strategy

② Award scores in the S (Society) field using standards in line with global standards

- Provide data concerning the percentage of female directors at industry peers and in the region, and suggest improvements to diversity
- From a humanitarian viewpoint, introduce evaluation standards based on whether properties held by office REITs and industrial REITs accept companies involved in the manufacture of inhumane weapons as tenants
- Reflect REITs' special social initiatives in the COVID-19 pandemic in scores

Sovereign ESG Integration

Setsuko Yamashita

Macro Research Group,
Investment Department
Senior Economist

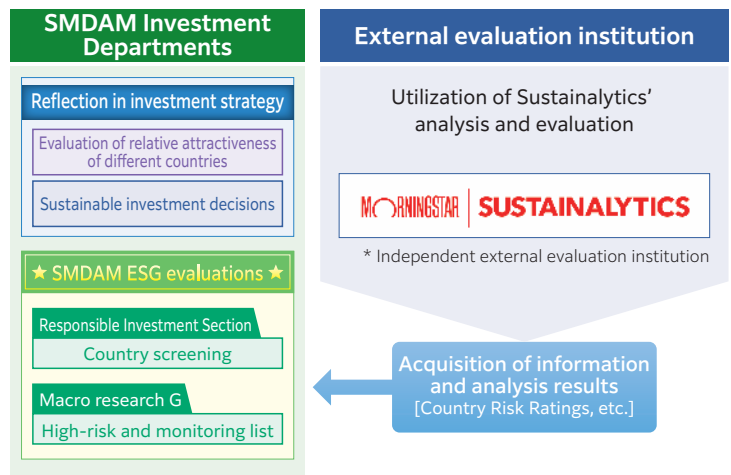
Kei Katayama

Global Fixed Income Group,
Investment Department
Senior Fund Manager

In bond investment, there are discontinuous changes in the prices of bonds when events occur that call into question the viability of the issuer, regardless of whether it is a company or country. In particular, in relation to sovereign bonds, there are a wide variety of non-financial risks, and we believe that objective evaluation standards are necessary to avoid losses on portfolios and generate good returns.

Utilization of external ESG scores in investment decisions and risk management for investment in sovereigns

At SMDAM, we utilize Sustainalytics' Country Risk Ratings as external ESG scores. Sustainalytics is a leading ESG evaluation institution that conducts negative screening based on macroeconomic research and measures and monitors risk for each portfolio. Specifically, we regularly create monitoring lists that identify high-risk countries based on the Country Risk Ratings. Our economists make judgments concerning the viability (sustainability) of countries on the list, taking the impact of ESG factors into consideration, and report the results to investment-related departments. Based on this information, the fund managers in charge formulate investment strategy policies. Additionally, employees responsible for risk management measure weights, durations, average ESG scores weighted for market value compared with benchmarks, etc., for bonds on the list for each fund, and a system is in place under which fund managers in charge receive warnings when they hold excessive amounts of the bonds of countries with significant ESG risk.



Responding to market changes through collaboration among teams, using ESG scores as a common language

In active investment in foreign bonds, in which we invest in the government bonds of countries around the world, in addition to ESG risk evaluations for individual countries, we have also begun utilizing external ESG scores when evaluating the relative attractiveness of countries for investment, from the current fiscal year. Specifically, we have added proprietary ESG scoring items, which reflect Country Risk Ratings and changes in them, to the existing items used by fund managers when evaluating the relative attractiveness of different countries, such as economic fundamentals, supply and demand factors, risk factors, and relative yield evaluations. These evaluations of the relative attractiveness of different countries are used as one factor for making investment decisions concerning the selection of countries for investment, interest rate and currency strategies, and allocation to different countries.

When assessing the sovereign risk of major countries, it has become common practice among investors to consider not just macroeconomic research, but also ESG factors for each country, namely E (measures targeting the environment), S (free and fair social systems), and G (stable government). We think that regularly identifying changes in the external ESG scores of countries where we invest and the relationship with bond markets in each country and region will become increasingly important in global government bond investment.

In the future, we intend to continue offering sovereign bond investment products able to address changes in global markets to a wide variety of investors, by working with in-house economists, fund managers, and the Responsible Investment Section to regularly update our methods for evaluating and analyzing ESG factors.

Image of "relative attractiveness evaluations of bonds for different countries"

We have added "ESG scores" to the evaluation items for relative attractiveness evaluations of different countries in active investment in foreign bonds. These scores are evaluated using five levels based on the Country Risk Ratings, with weights determined taking into consideration the impact of the markets of each country.

Market	Fiscal policy		Growth		Prices		Financial policy		Relative value		Risk preference		Risks		ESG Score		General Score	Order
	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight	Weight			
US	-1.8	5%	-1.0	10%	-1.0	20%	-2.0	20%	-2.5	10%	2.0	10%	2.0	15%	0.0	10%	-0.54	3
UK	-1.6	5%	0.0	10%	0.0	25%	-1.0	20%	-1.0	10%	1.0	10%	0.0	10%	1.0	10%	-0.18	2
Germany	1.0	5%	0.0	10%	-1.0	25%	-1.0	20%	-2.0	5%	1.0	5%	1.0	15%	1.0	15%	-0.15	1

* 1. There is a wide range of countries actually subject to analysis. *2. There are grounds for analysis for each item

-Impact Investment- Enhancing Corporate “Ability to Create Social Value”

Ayako Watanabe

JP Equity Value +a Group,
Investment Department
Senior Fund Manager

In 2020, we launched an impact investment strategy, based on the idea of “solving social issues using corporate assets and services.” We identify and invest in companies growing sustainably through businesses that create social value.

Identifying companies growing sustainably

Over the past two years, the surrounding environment has undergone significant change, including the spread of COVID-19 and a military conflict in Europe. Over the past two years, companies have also listened to rising calls for harmony with society and the environment, reviewed the structure of their businesses, and worked to introduce better technologies and services. We invest in companies that can continue to grow sustainably over the long term by presenting solutions to social issues in accordance with changes in the competitive environment.

What do we look at?

Impact investment starts from identifying impact businesses that can create social value. Then, we evaluate consistency with long-term impacts and themes, namely “enhancement of quality of life” and “reduction of environmental impact,” as well as the originality and competitive superiority of businesses, and the ability of leaders to implement strategy.

Based on this evaluation, we analyze the “ability to create social value,” which forms the basis of future prospects for impact businesses and the evaluation of corporate value. Of these, we particularly focus on investment in human capital, which is the foundation of competitiveness. Why is the “proportion of female managers” important? Is it sufficient just to increase the proportion? We explore the possibility of sustainable corporate growth by debating the “expectation effect” of increasing the number of female managers and the “impact on impact businesses and corporate value.”



Case study: importance of dialogue with companies

In order to increase the possibility of achieving impact and monitor processes aimed at creating impact and progress toward that goal, we prioritize regular dialogue with senior management and other key people. Dialogue is based on a framework for logical analysis, namely “inputs (investment of management resources),” “outputs (products and services created by business activities),” and “impact (effects on stakeholders and long-term effects on Earth and society).”

Here is an example from an electronic device manufacturer. In the fiscal year ended March 2021, net sales from “products that contribute to reducing CO2 emissions in society,” which is an output, were less than 20% of total net sales, which was insufficient from the perspective of the “importance of impact businesses” investment criteria. However, it felt as though there was something wrong with this figure, as shipments of power semiconductors for electric vehicles (EVs) and sales of products related to conserving energy and renewable energy were both good. When we confirmed this point in dialogue, it became clear that the statistics, which were based on industry standards, did not include major products that were driving growth, and the disclosure thus differed from reality. The contribution to reducing CO2 from the contributing products (impact) should also have been higher than the disclosed level, and we could also expect that if the company executed the capital investment on an unprecedented scale that it planned (input), there would be an even greater increase in outputs and impact. Accordingly, we judged that these factors would contribute to an increase in the long-term evaluation.



Planning to create impact reports

We think companies with an impact, i.e. those that create positive environmental and social change, have a strong possibility of achieving sales and profit growth that exceeds the market average over the medium and long term. We collaborate with the analysts from the Corporate Research Group and the Responsible Investment Section to identify such companies and continue our approach of investing in companies about which we have a particularly strong conviction.

We are preparing to be able to deliver impact reports that visualize the impact of each investee company to beneficiaries. Impact investment has just finally begun to grow in Japan, but please look forward to great progress in this area in the future.

-Infrastructure Debt Fund- Addressing Financing Needs of Infrastructure Projects

Aoi Yokota
Alternative Investment Department
Fund Manager

Haruhiko Takamoto
Alternative Investment Department
General Manager

Nobuhisa Fukumi
Alternative Investment Department
Senior Fund Manager

The International Energy Agency (IEA) estimates that annual investment of four to five trillion dollars in clean energy, including renewable energy, will be required to achieve net-zero emissions by 2050. Infrastructure debt offers one solution to address the need for funding of this enormous sum.

What is the Infrastructure Debt Fund?

The Infrastructure Debt Funds managed by SMDAM invest funds in project finance for essential infrastructure projects for society and the economy. Project finance refers to a method of financing where financing is provided to a specific project, and income from the project is used as the primary source of funds for repayment. Project finance is used to raise funds for projects around the world, and it is applied across a wide range of fields.

Investment in Rapidly Expanding Field of Clean Energy

With risks related to climate change attracting increasing attention in recent years, the move to introduce renewable energy as a measure for controlling CO₂ emissions has spread. According to the IEA's "World Energy Investment 2022," investment in clean energy, including renewable energy, grew by only around 2% year-on-year over the first five years after the Paris Agreement was adopted in 2015, but it has grown rapidly, by 12% year-on-year since 2020.

ESG Perspective

SMDAM's Infrastructure Debt Funds are particularly active in investing in renewable energy projects, such as overseas solar power plants and wind power plants, and we have also established standards in their investment guidelines to the effect that they "will not invest in coal-fired power plants." In our view, these measures are particularly meaningful in terms of environmental (E) and social (S) ESG factors.

Furthermore, in terms of due diligence, investment decision-making, and post-investment monitoring processes, in addition to financial data, we also analyze non-financial data from each ESG perspective. In this way, we confirm whether there is any negative impact on the environment or society.

As one example of ESG analysis, from the perspective of "E," we check whether there is any negative impact on the environment from major fuels and the status of acquisition of permissions and licenses related to the environment; from the perspective of "S," we check whether there are any movements opposing projects by local communities, residents, etc.; and from the perspective of "G," we check the level of information disclosure about the project, etc.

In the future, we expect to continue contributing to the development of global infrastructure projects and the limiting of CO₂ through investment in renewable energy projects, via investments from our Infrastructure Debt Funds, and we will continue working to have a positive impact on the environment and society.

Examples of Evaluation Items for Each ESG Factor

Environment	Social	Governance
<ul style="list-style-type: none"> Content of environmental Due Diligence reports Whether or not there is a negative environmental impact from major fuels Status of acquisition of permissions and licenses related to the environment for investment projects Whether or not there are any violations of laws and regulations related to the environment where investment projects are located Whether or not there are any contractual measures for rectification in the event of environmental violations, etc. 	<ul style="list-style-type: none"> Whether or not there is any opposition from local communities, residents, etc. Level of social contribution to local communities Job creation and contribution to labor relations Consistency with policies where investment projects are located 	<ul style="list-style-type: none"> Level of project information disclosure Whether or not there are provisions related to information disclosure in financing contracts



Stock Selection for Asia GX Strategy

Sumitomo Mitsui DS Asset Management (Hong Kong) Limited
Shintaro Aizawa Senior Portfolio Manager
Jain Tushar Portfolio Manager
Stanley Tang Senior Portfolio Manager

SMDAM’s “Asia GX Fund” invests in carefully selected companies working to achieve their own GX (green transformation), companies with the technology and expertise to accelerate GX, and companies using proprietary technology to support GX around the world.

Issues and Opportunities in Asia

Identifying changes is important when selecting investments. In a period of major transition as society moves toward carbon neutrality and the achievement of a circular society, it is fair to say that it is more important for us to identify the future vision of companies than their current state. Accordingly, we believe that our ability to identify the appetite and capacity of companies to promote GX will be key.

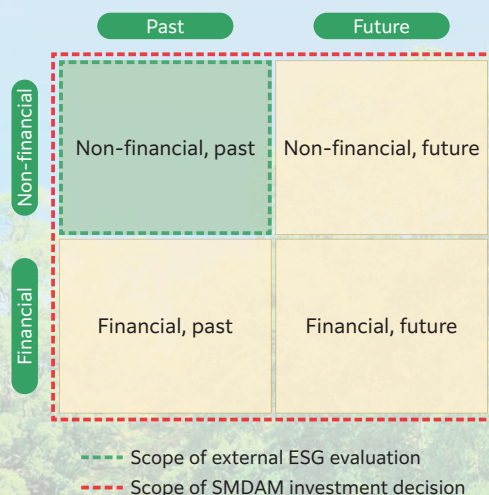
In particular, in Asia, we are directly facing an extremely important but difficult challenge, namely reducing environmental impact while also maintaining a stance of prioritizing growth to make society as a whole more affluent. In order to balance both factors, governments, companies, and individuals must all undergo their own transformations from their respective positions. We believe that in fact, these major issues offer a chance for companies in Asia that have deep regional knowledge, and that there is significant potential for growth for companies that succeed in transforming themselves and solve social issues.

Reasons for Investing in Companies with Low ESG Scores

Reliance Industries Ltd. has the largest market capitalization in India, and operates a wide range of businesses across various industries, including oil refineries, petrochemicals, retail, and telecommunications. The company is a representative example of a company in Asia that is working to achieve and accelerate GX, as described above. Reliance Industries supports the core of economic growth in India, but Sustainalytics, a global ESG evaluation institution, has given it a harsh ESG rating of 37.0 (high risk), from the perspective of so-called global standards. In particular, the evaluation of carbon risk under the E (Environment) category is extremely poor, mainly because of the oil refining and petrochemical businesses, which have a high environmental impact. In other words, these businesses, which act as a foundation for economic growth in India, are considered to be a major burden from the perspective of environmental problems.

Certainly, the lower-than-average rating cannot be denied based on Reliance Industries’ current form, but our approach differs. We think the company is not just promoting its own GX, but will also have a major positive impact on the creation of a decarbonized society and circular society in India through its own transformation.

This is because we have judged that Reliance Industries’ ambitious target of “becoming Net Carbon Zero by 2035” is not simply an empty promise. In November 2021, when we engaged in dialogue with the management of Reliance Industries, we confirmed their commitment to their business strategy of achieving net carbon zero through major investments across key areas (solar cells and panel manufacturing, wind and solar power generation, manufacturing of cells for energy storage systems, etc.). In fact, subsequently, the company revealed that it would be investing and expanding its businesses in sectors related to GX, including a rapid succession of announcements related to strategic partnerships with REC Solar, a solar panel manufacturer in Norway; Sterling & Wilson Solar, a solar power generation EPC business operator in India; and the Abu Dhabi National Oil Company, in order to develop green hydrogen. In its annual report for fiscal 2022, Reliance Industries also emphasized the fact that green energy will be a priority area over the next 5 to 15 years, and indicated that it invested 750 million US dollars that fiscal year. Taking into consideration the company’s appetite for GX and its sound financial position, we decided that it is poised to become a leader in green energy investment in India, the country with the second largest population in the world. We value external scores, but in our view, they are an “evaluation of a company at the current point in time,” and it is vital that we adopt a forward-looking perspective from the viewpoint of long-term investment. We will refine our unique perspective based on our own resources, and contribute to creating added value at investee companies through the accurate selection of investments and dialogue.



ESG Integration in Global Equity Strategy

Sumitomo Mitsui DS Asset Management (UK) Limited

Haruka Inada

Senior Portfolio Manager



We prioritize ESG integration in the investment process. The reason is because we believe that no matter how outstanding a company's business performance appears to be, it is "not sustainable" if it is built on the sacrifice of something else.

ESG Integration as Our Natural Stance

In global equity investment, we have maintained a stance of identifying and investing from a long-term perspective in companies that have long-term, structural growth drivers, and that are capable of maintaining growth at a level that exceeds the economic cycle. When making long-term investments in companies, of course we value financial factors, such as sales and profits, but we also pay attention to non-financial factors, such as the impact of a company's business activities on the global environment, coexistence with society, and governance systems. In that sense, it is fair to say that we have been promoting ESG integration even since before there was a focus on ESG investment, and our investment style is highly compatible with sustainability analysis.

I feel strongly that, based on my experience of investment operations to date, companies that maintain long-term growth do not just exhibit good business performance, but have also often used pioneering measures to build systems to make growth sustainable. Paying attention to non-financial factors often provides a satisfying explanation for why companies that appear to have achieved similar levels of sales and profits have differing valuations (market valuations).

Awareness to Anticipate Changes in Sustainability Trends is Key

Looking at the trend of prioritizing sustainability in recent years, corporate measures consist of two parts: engaging in new actions, such as "setting a target to achieve net zero GHG emissions and implementing countermeasures," and disclosure to make clear the actions already being taken for sustainable business management. In order to identify whether the growth of investee companies is sustainable, as investors, we must properly evaluate investee companies' ongoing measures targeting key environmental and social issues, not just in new key focus areas such as "net zero."

Additionally, ESG investment is not based on any universal model, and instead changes in line with the demands of society. For example, at one time, there was a tendency to consider it correct to cut investment in companies related to fossil fuels such as coal and oil, from the perspective of promoting decarbonization. Now, however, the view is spreading that simply withdrawing investment funds (divestment) will not solve the problem, and in fact, "it will be effective to work closely with companies to promote a transition toward decarbonization through dialogue." We are not restricted by fixed ideas, and instead consistently maintain a humble stance as we attempt to anticipate new trends in advance based on social changes and corporate measures.

Our Aim Through ESG Integration

In the Global Equity Group, we use ESG factors as inputs for our decisions at each stage of the investment process, from the selection of candidate companies for inclusion in portfolios, to evaluation of growth opportunities and risks for individual companies, quantitative corporate value analysis, and even evaluation of the characteristics of the portfolios we create. In exactly the same way as sales and profit outlooks, etc., we integrate ESG into our investment process as a key factor. In interviews with the management teams of investee companies, we also engage in dialogue concerning ESG-related opportunities and risk together with discussions of growth strategy."

As part of our proprietary ESG evaluation,* we perform multi-faceted analysis, and may even invest in companies with low external ESG evaluations. In recent years, investments in a natural gas and infrastructure company in Australia, a rare earth-related company in the US, and others fall under this category. The reason for such investments is because, through dialogue with companies, we develop an understanding of the context in which a company was deemed to have a high level of risk in external ESG evaluations, and if we deem that "the actual level of risk is not high" or "there is a strong possibility that the level of risk will decline," we think it will contribute to a return through appreciation in the share price when the market's view of the shares changes.

The purpose of ESG integration is primarily to contribute to better returns, but it is a huge benefit for us as investors if we are able to contribute to achieving a better society through positive changes at investee companies.

* Refer to page 31 for information on our ESG evaluation (Global).

Sustainable Product Certification Standards

In September 2022, we revised our “Sustainable Product Certification Standards” based on increasing expectations placed on investment management companies and discussions concerning information disclosure worldwide. At the same time, we have also built a comprehensive framework for operations and management to ensure the quality of these products as investment products.

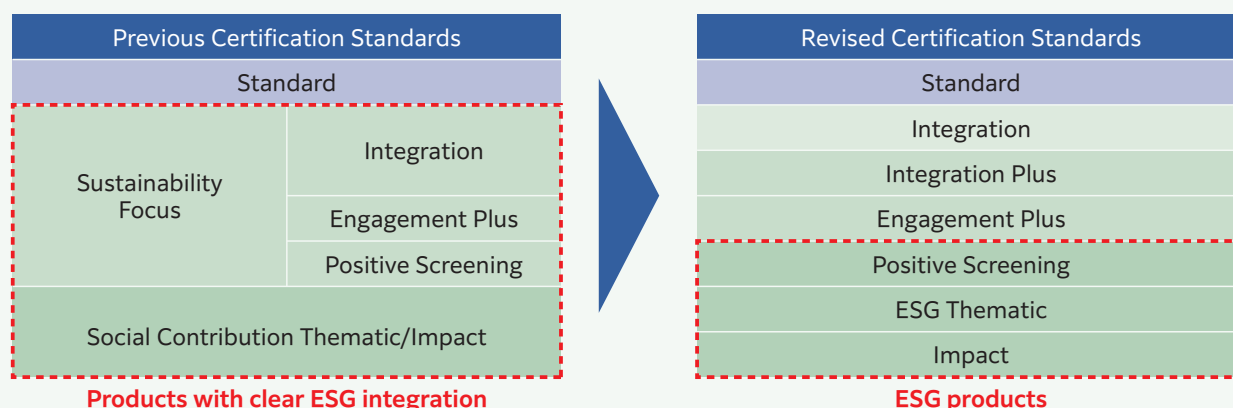
< Background to Revisions to Certification Standards >

In March 2020, we clarified our consideration for sustainability factors in all active investment products in our “Investment Philosophy,” and at the same time, we began classifying types of sustainable products based on our proprietary certification standards. Simultaneously, we were taking on a new challenge through the act itself of adding this “consideration” of companies’ measures to tackle environmental problems and social issues to our investment process alongside financial information such as profitability and capital efficiency.

Two and a half years have passed since that time, during which there have been major changes in expectations and the environment surrounding global sustainable investment. There have been rising calls for investment management companies such as SMDAM to contribute to sustainability, and now consideration of such factors is already a matter of course, with the depth of this consideration instead being questioned. In addition to such changes in the environment, the expansion in the range of asset classes covered by our ESG evaluation and the diversification of investment methods in line with the enhancement of usable external ESG data both contributed to these revisions to our certification standards.

< Overview of New Certification Standards >

Our previous standards were focused on the “methods” by which we considered sustainability factors, but in our new standards, we have also added the perspective of the “importance of sustainability factors in investment decisions.” We have created a new classification of “Integration Plus” to cover products that were included in the previous “integration” for which sustainability factors are clearly and specifically incorporated in the investment process as a key source of excess returns. Furthermore, previously, we defined products other than standard as “products with clear ESG integration,” but with these recent revisions, we have now defined “Positive Screening,” “ESG Thematic,” and “Impact” products as “ESG products.” The investment balance of “ESG products” (non-consolidated basis) was 557.9 billion yen as of March 31, 2022 (Note).



Standard	Stewardship activities and negative screening are applied across all companies
Integration	Sustainability is taken into consideration, and ESG evaluations are incorporated into processes related to investment decisions
Integration Plus	Sustainability is positioned as a key source of excess returns and ESG evaluations are utilized in a quantitative and systematic manner
Engagement Plus	Persons responsible for investment actively engage in dialogue related to ESG themes that will contribute to enhancing corporate value
Positive Screening	Specific quantitative screening standards for investment in companies with excellent ESG factors, etc., are incorporated
ESG Thematic	Specific sustainability issues and themes are set and companies that contribute to those issues and themes, etc., are considered for investment
Impact	In addition to investment returns, investee companies, etc., are also selected for their contribution to solving sustainability issues

(Note) The balance of “products with clear ESG integration” as of March 31, 2021, based on the previous standards, was 5,999.3 billion yen.

Operations and Management Framework for Sustainable Products



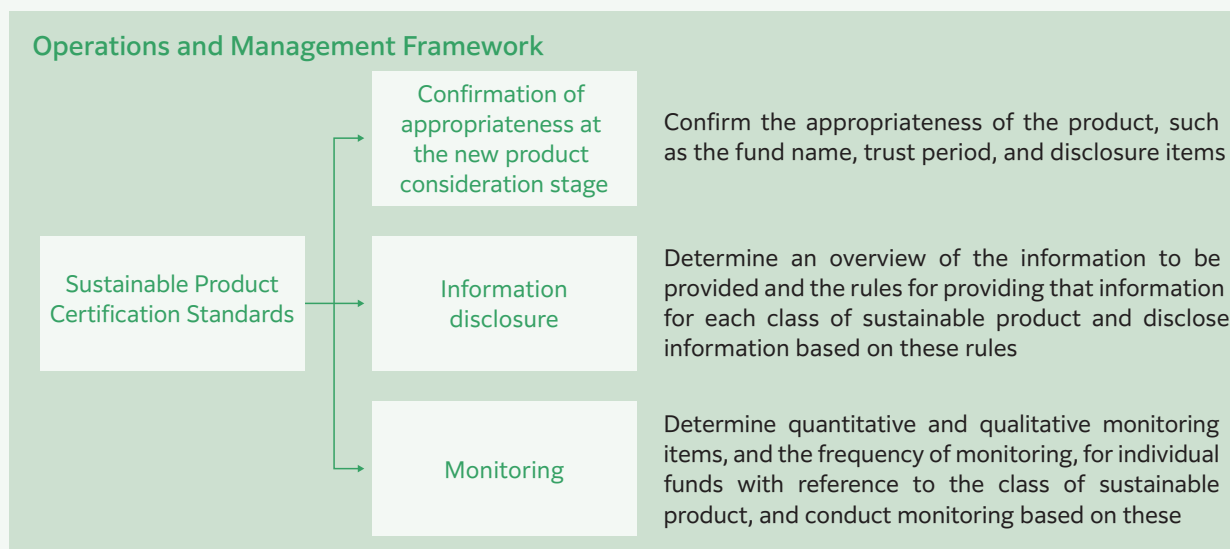
Hideki Kawanabe

General Manager, Responsible Investment Section

We used the revisions to our Sustainable Product Certification Standards as an opportunity to discuss the ideal state of operations and management, from the consideration of new products to information disclosure, monitoring, and other processes, from the perspective of strengthening the governance of these products, and began creating a comprehensive framework.

By putting into practice the operations and management framework described below, we monitor to make sure there are no inconsistencies between actual investment and classifications based on certification standards, and we also take steps to enhance information disclosure to ensure that it is easy for fund beneficiaries and clients to understand.

At present, there are discussions in Japan and overseas concerning the creation of systems and disclosure rules related to the ideal state of sustainable investment, and clients' expectations of investment management companies are also constantly changing. Based on this point, SMDAM works on a daily basis to enhance the information disclosure of investee companies and make investment more sophisticated utilizing ESG data. In addition to reviews of individual certified products, we also conduct reviews of the certification standards themselves every year and revise them as necessary.



Our aim is to balance the realization of a sustainable society and investment returns at a high level, and we work to implement more effective ESG integration and engagement that creates added value. At the same time, we will also focus more on measures aimed at maintaining and enhancing the quality of our products, including the enhancement of information disclosure.

Enhancement of Climate Change Analysis

Contributing to Enhancing Investment Decisions
By Sharing Knowledge and Forecasting
Greenhouse Gas Emissions

Shunpei Yoshimura

Assistant Manager, Corporate Research Group, Investment Department*

* At the time of writing. Currently assigned to the Engagement Investment Dept., Investment Department.

In the Corporate Research Group, which dynamically covers a wide range of ESG issues, we have been particularly focusing on research related to the environment since the previous fiscal year. In this report, we provide information concerning the “Cross-sector Analyst Study Group” and “Greenhouse Gas (GHG) Emissions Forecasts for 2030.”

Identifying Investment Opportunities Through a Cross-sector Study Group

The Corporate Research Group promotes knowledge-sharing by holding study groups related to ESG, where each analyst shares information concerning positive examples of ESG measures in the sectors they oversee and the status of technical innovation, etc. Behind this effort lies the increasing importance of understanding megatrends across industries, as new business opportunities appear amid the increasing global trend toward decarbonization.

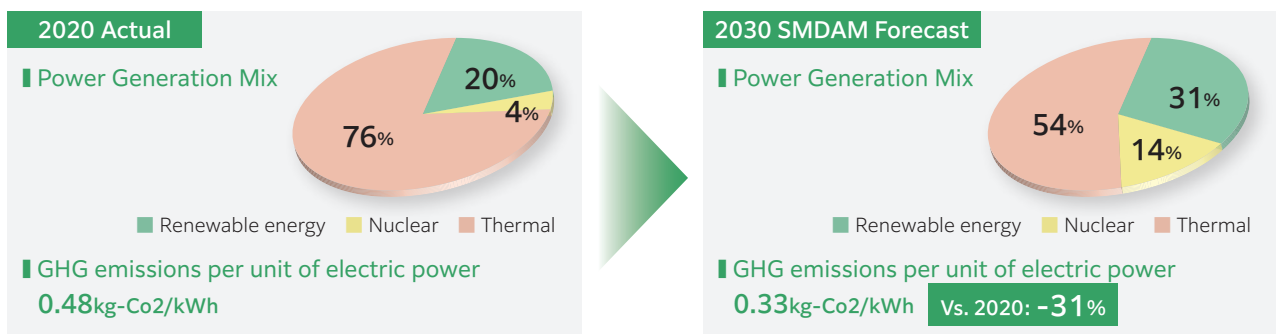
For example, it is expected that as renewable energy, which is unstable in terms of the amount generated, accounts for a growing share of electric power, we will see full-fledged “aggregation businesses” to match power demand and supply, along with the spread of storage batteries, etc. When analysts overseeing the electric power sector share information about investment by electric power companies aimed at achieving carbon neutrality, it contributes to the identification of investment opportunities by other analysts. Conversely, when other analysts share information about the level of maturity of related technologies with analysts overseeing the electric power sector, it enables the electric power analyst to enhance the accuracy of analysis of the feasibility of the achievement of carbon neutrality by electric power companies and future electric power costs.

Effective Engagement Based on Forecasts of Environmental Costs

The aim of GHG emissions forecasts by analysts is to enhance investment decisions by visualizing future environmental costs that will impact corporate performance over the medium and long term, and, furthermore, to enhance the effectiveness of engagement. Specifically, we provide fund managers with information on amounts of GHG emissions multiplied by expected carbon taxes as the “potential future environmental costs.” Considering environmental costs also facilitates advanced dialogue in engagement with companies. Additionally, we can also gain an understanding of companies’ risk management systems by providing information about forecast environmental costs and communicating our concerns. For companies with insufficient information disclosure, we work to encourage disclosure in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).

Analysts with deep knowledge of technical trends in the companies and sectors they cover forecast GHG emissions based on information disclosed by companies, such as integrated reports, and interviews with companies. These forecasts are based on the “2030 power generation mix.” This information is useful not just for forecasts of GHG emissions, but is also utilized for evaluating companies’ emissions reduction targets. It is expected that GHG emissions per unit of electric power consumption will decline through 2030 as the proportion of thermal power generation in the mix declines when nuclear power comes back online and renewable energy spreads. In other words, if the amount of electric power used by a company does not change, GHG emissions will fall even if companies do not make any effort. Accordingly, we can assess the ambitiousness of companies’ emissions reduction targets by evaluating them without this effect.

ESG analysis appears partly qualitative, but these factors contribute to forecasts of the future business environment and analysis of companies’ competitive superiority, so they are closely related to medium- to long-term corporate performance, i.e. quantitative calculations of corporate value. In the Corporate Research Group, we will endeavor to boost investment performance by enhancing ESG research, and therefore fulfill our fiduciary responsibility.



Source: Prepared by SMDAM based on Ministry of Economy, Trade and Industry data for actual results (including some estimates)

Collaboration with Nikko Global Wrap



From image bottom left
Quantitative Analyst, Nikko Global Wrap
Quantitative Analyst, Nikko Global Wrap
Senior Quantitative Analyst, Investment Development Group, Investment Department

Takuya Kitabayashi
Yohei Kondo
Masaya Furusho
Noriyasu Nakagawa

From image top left
Senior Fund Manager, Multi-Asset Group, Investment Department
Fund Manager, Multi-Asset Group, Investment Department

Mitsuru Hayakawa
Ryuta Henmi
Ami Saito

In order to strengthen our quantitative multi-asset investment capabilities, in 2022, we aggregated our model development and management functions within subsidiary Nikko Global Wrap (Nikko GW). With this measure, we will further advance collaborative relationships within the SMDAM Group.

Q What was the objective of this aggregation?

Previously, Nikko GW and the Investment Development Group in the Investment Department of SMDAM each possessed similar functions for quantitative multi-asset investment model development and management operations, meaning that these operations were duplicated within the group. In order for both companies to share expertise related to the details of models and their development process, we held regular meetings and created opportunities for discussion, but we did not achieve an effective integration of our expertise. So, we have now aggregated development and management functions within Nikko GW, with the objective of ensuring the effective communication of ideas and further strengthening our development capabilities.

Q How is the division of roles related to quantitative multi-asset investment following the aggregation of functions?

Nikko GW develops and manages models. Within SMDAM, the Investment Development Group in the Investment Department oversees functions related to due diligence for models and the arrangement of development, while the Multi-Asset Group of the same department oversees the creation of products, investment by actual funds, business promotion, etc.

Q How do you exchange information?

Nikko GW, the Investment Development Group, and the

Multi-Asset Group each participate in meetings to confirm and discuss the status of model development and other measures, thereby exchanging information as before. Models and funds are developed with a sense of unity through the participation of members of Nikko GW and the Investment Development Group in weekly meetings of the Multi-Asset Group, as well as day-to-day communication among the relevant employees.

Q What can you tell us about the exchange of human resources?

One employee from SMDAM had already been loaned to the Asset Allocation Team, which develops models in Nikko GW. We used the opportunity provided by this aggregation to add two new members from the Investment Development Group, meaning that of the total of 11 members of the Asset Allocation Team, three are loaned from SMDAM.

Q What is the future outlook?

In quantitative multi-asset investment, there is significant scope to develop advanced investment methods, such as the utilization of alternative data. As the importance of multi-asset investment increases, we will promote this collaboration with Nikko GW, including the aggregation of functions, and thereby accelerate the process of making our investment operations more sophisticated, developing investment products, etc.

We spoke with Takuya Kitabayashi, a Quantitative Analyst who has been loaned to Nikko GW since 2021.

Q What type of work are you doing currently?

I mainly develop and manage models for multi-asset investment. I analyze factors such as the effects of asset allocation for the funds I oversee and the strategic impact of models on performance, and submit reports at monthly meetings. Additionally, I also submit proposals in cases when improvements to models seem necessary from a forward-looking perspective based on previous strategic effects and recent market trends, as part of my endeavor to improve performance.

Q Are there any synergies from the aggregation of development and management functions in Nikko GW?

Previously, fund managers were responsible for both developing and managing models and fund investment, meaning it was difficult to allocate sufficient time to model development. The aggregation of development and management functions will enable a greater level of focus than before on model development. Nikko GW is a company that focuses on basic research, and it has various types of academic knowledge. Additionally, Nikko GW has access to a wide variety of alternative data through contracts with data providers. As a result, I feel there is a broader scope for the development of new models and the improvement of existing models.

Screening based on International Standards

Unlike ESG scores, which give different conclusions depending on the evaluation institution, international standards represent a global consensus that goes beyond political systems and economic scale. SMDAM monitors for any violations of international standards and promotes improvements through more effective engagement based on collaborative dialogue.



International Standards as a Baseline for the Minimum Level of Compliance Shared by Various Stakeholders

International standards such as the “UN Global Compact” and “OECD Guidelines for Multinational Enterprises” are soft laws that have been discussed and created over many years by various stakeholders, including international agencies, national governments, private-sector companies, and NGOs. In particular, we recognize the Ten Principles of the “UN Global Compact,” which are related to human rights, labor, the environment, and corruption prevention, as a common global baseline that represents the minimum level of compliance for companies, regardless of factors such as region or sector.

International standards call on companies to evaluate their direct and indirect impact on stakeholders throughout the supply chain, and take measures to mitigate or rectify any negative impact. In an increasing number of cases, international standards are incorporated into the hard laws (laws and regulations) of various countries and regions, individual contractual terms, etc., partly owing to compliance requirements related to the likes of economic sanctions and money laundering. Based on such trends, we expect to see an acceleration in the trend among major institutional investors and banks to reflect international standards in investment and lending policies and criteria for the exercise of voting rights.

Screening for International Standards for All Asset Classes

Companies that violate international standards face financial risks affecting business performance, cash flows, and more, as a result of violations of laws and regulations and related lawsuits, exclusion from government procurement and contract cancellation, the withdrawal of

investment and lending, etc. Under the Sustainable Finance Disclosure Regulation (SFDR) enacted in March 2021, we are expected to take into consideration the Principal Adverse Impacts (PAIs) of the business activities of investee companies, etc., on the environment and society. In order to avoid any destruction in the corporate value of investee companies, etc., and address various regulations, SMDAM has introduced screening using a database related to international standards provided by external evaluation institutions, for all asset classes. Companies found to be violation are reported to “Stewardship/ESG meetings,” and in cases where the materiality of the violations is particularly significant and there is no outlook for improvement based on dialogue, we prohibit investment.

Responsibility for Dialogue Aimed at Improving the Status of Violations of International Standards

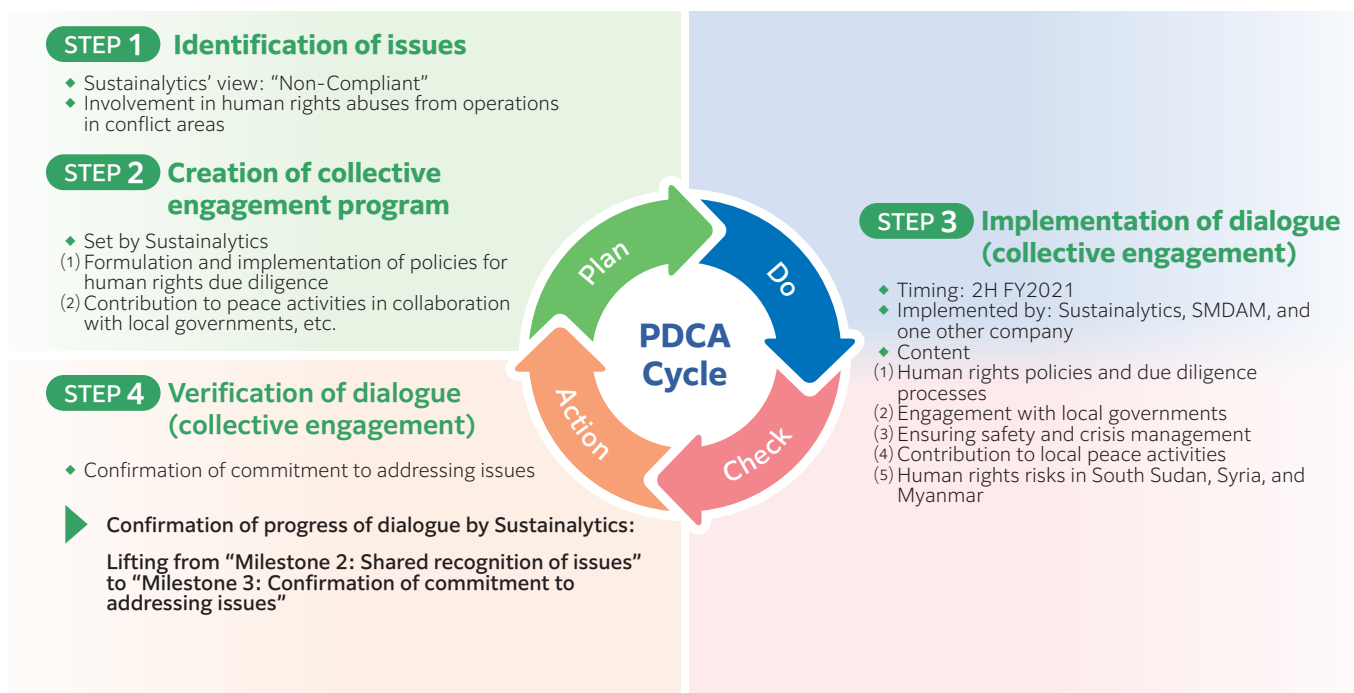
At SMDAM, we believe that it is our responsibility as responsible investors not just to prohibit investment in companies that violate international standards, but also to promote improvement through engagement. Accordingly, we have entered into a collective engagement contract with Sustainalytics. We will enhance the effectiveness of the engagement that we aim for through the utilization of the knowledge of Sustainalytics’ engagement experts, who have a deep knowledge of the environment, human rights, international law, etc., as well as influence based on the scale of the assets under management of institutional investors around the world.

Additionally, we have also added violations of international standards to criteria for selecting companies for “target lists” for priority engagement. Through SMDAM’s independent engagement or collective engagement, we will endeavor to improve corporate behavior and avoid the destruction of corporate value.

Case Study: Collaborative Engagement with a Company Violating International Standards

Example 6: Energy-related Company F (China)

< Main Applicable International Standard > UN Global Compact/Principle 2 [Human Rights] Businesses should make sure that they are not complicit in human rights abuses



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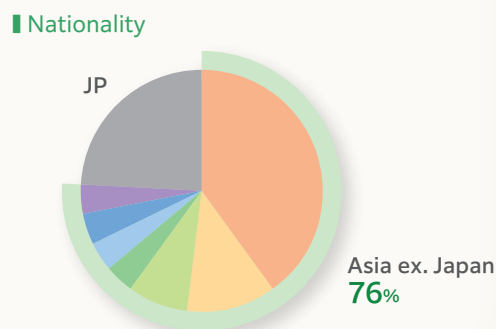
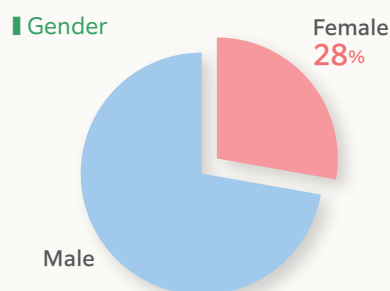
Engagement Systems in Asia

Diversity and One Asia Team

The investment management business requires investment decisions based on the analysis of complex matters pertaining to financial markets. It is said that diversity within organizations contributes to better decisions and discussions from a broad range of perspectives, and is thus effective for complex decision-making. We also believe that diversity is effective in avoiding irrational decision-making as a result of various biases in decision-making that have been indicated by behavioral economics (overconfidence, prospect theory, groupthink, etc.).

Naturally, diversity within organizations does not have an immediate impact. To make diversity an advantage, it is vital that each and every employee is flexible and respects differing points of view, and the organization has strategic goals that all employees can sympathize with.

In the Asia Group of the Investment Department, 25 investment professionals working in offices in Hong Kong, Shanghai, and Singapore work as a single team on day-to-day investment and research activities. A diverse range of human resources of differing genders, nationalities, languages, and other attributes combine their views with the aim of enhancing investment performance, thereby contributing to the innovativeness and robustness of decision-making.



(as of May 2022)

Progress in Sustainable Business Operation

SMDAM aims to contribute to the creation of an abundant and sustainable society through the investment management business.

In order to achieve this aim, we think it is essential to respect all stakeholders and create a workplace where each and every employee can actively participate and demonstrate their skills, and we are putting into practice everything that we should and can do to this end.

Indicators Related to DE&I and Health and Productivity Management	FY2020 Actual	FY2021 Actual	FY2022 Target
Percentage of female managers	11.30%	13.70%	15%
Percentage of paid holidays taken	59.30%	61.40%	75%
Overtime hours (monthly average)	26.3 hours	25.2 hours	20.0 hours
Percentage of employees with disabilities	1.80%	2.10%	2.30%
Percentage of male employees taking childcare leave	108.00%	108.30%	100%
Male-female wage gap (Note)	55.80%	56.20%	—

(Note) Wage Levels for All Female Employees When Male Employee Wages are Set to 100

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Message from Head of Corporate Planning & Administration Division

Tsuyoshi Imai

Senior Managing Executive Officer and
Head of Corporate Planning & Administration Division

As an investment management company, SMDAM works to ensure that investee companies promote measures to realize a sustainable society, through engagement, the exercise of voting rights, and other methods. On the other hand, we ourselves are an operating company, and we must not only promote activities in the investment management business, but also engage in activities as an operating company to realize a sustainable society in the same manner as investee companies. In addition to environmentally-friendly operations, such as reducing GHG emissions and the promotion of a shift to paperless processes, we have also begun measures aimed at solving social issues, such as formulating human rights policies and social contribution activities.

Using Materiality to Share Key Issues Across the Company

In 2022, we set forth our materialities as key management issues for the realization of a sustainable society. Taking into account the actions we should take as a member of the investment management industry and the actions we should take as an operating company, our materiality categories consist of “Materiality for Investment Management” and “Materiality for Business Operation.”

Under “Materiality for Business Operation,” we have selected five materialities, namely “environmentally conscious business operations,” “human capital,” “social contribution activities,” “improvement of business quality,” and “business ethics and corporate culture,” from the two perspectives of “importance in the realization of a sustainable society” and “importance in our corporate sustainability,” across each area of “Environment issues: Safety of Life,” “Social issues: Improving Quality of Life,” and “Governance.” These items include the various initiatives that we have been conducting over time as part of our business operation, and constitute a summary of those and other priority issues of ours.

Promoting initiatives for business operation

The peculiarities of the asset management business limit the extent of the footprint that associated operations leave on the environment. At the same time, we believe that initiatives geared towards mitigating that footprint through reducing future greenhouse gas (GHG) emissions and waste are a must. That being said, the most important asset from the perspective of asset management firms is human capital. The development and utilization of such capital is a theme that we must perpetually tackle.

We also promote social contribution activities that our individual employees participate in of their own accord with a view to realizing a sustainable society. Please refer to the pages that follow for a detailed description of these initiatives.

We are proud to say that over time, we have been carrying out a certain level of initiatives in the name of realizing a sustainable society. However, we feel that there is still much we have to do.

To give an example, although we have relocated to an office with greater energy efficiency and otherwise pursued reductions in GHG emissions, we have still not managed to completely negate those emissions. We also need to consider the reduction of GHG emissions outside of the office, such as those pertaining to means of transport upon commuting to work and travelling on business. The same goes for the reduction of waste. While the transition to paperless processing continues to progress, there are numerous initiatives that we want to promote going forward, such as the further reduction of plastic waste. Factoring in the costs necessitated by the implementation of those initiatives and other elements as well, we intend on steadily pushing forward with them starting with the initiatives that we are capable of. We also seek to further increase types of social contribution activities that our employees find easy to take part in. Enhancing employee awareness of areas such as human rights issues is also a challenge.

Supporting our employees' active actions

It is a given that we promote individual initiatives as a company. More than that, however, we believe that all of our employees possessing the mentality that they want to do their part to realize a sustainable society is of the greatest importance. Taking that into consideration, we set forth our “Materiality for Business Operation” to clarify our associated initiatives as a company. As our next step, it will be critical for us to address how all of our employees will take action towards realizing a sustainable society based on that materiality. SMDAM seeks to establish mechanisms that enable it to support such action by its employees.

DE&I and Human Capital

Naofumi Yamamoto

Executive Officer and
General Manager of the Human Resources Department



Based on our Mission, Vision and Values and our Principles of Fiduciary Duties and Sustainability, we promote the improvement of our workplace environment and DE&I so that our employees, with their diverse attributes and values, can each fully demonstrate their individual abilities and outfit themselves with professional skills and knowledge as they take pride in their work.

Five Focus Areas for Diverse Human Capital to Play an Active Role In

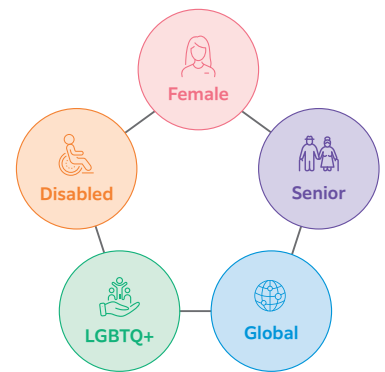
To promote innovation that is indispensable in accommodating environmental change in the medium to long term, forging an environment where human capital with differing attributes and backgrounds can play an active role is of the essence. We are focused on the following five areas in particular.

- 1 Development and promotion of female employees in managerial positions
- 2 Provision of opportunities to play an active role to senior human resources based on the future extension of mandatory retirement age
- 3 Worldwide recruitment and development of competitive global human resources
- 4 Application of programs to diverse gender identities and sexual preferences (LGBTQ+)
- 5 Provision of opportunities to play an active role that are not dependent on disabilities or other individual attributes

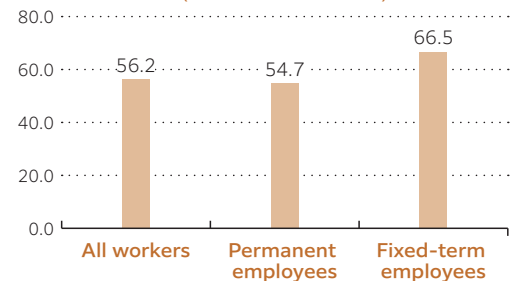
Disclosure of gaps in wages between male and female employees

The state of gaps in wages between male and female employees at SMDAM, whose disclosure has been required starting FY2023, is as indicated in the graph to the right. Going forward, we will take action based on the following policy.

- 1 Unifying the occupational ladder for career-track and general positions and making the transition to an HR system in which all employees can pursue a more specialized career regardless of their gender
- 2 Accelerating the improvement of the ratio of female employees who hold managerial and specialized positions by recruiting, developing and promoting them
- 3 Promoting flexible working styles, correcting long work hours and making the transition to an evaluation system with a greater emphasis on productivity



Wage Levels for Female Employees When Male Employee Wages are Set to 100
(Results from FY2021)



Providing a workplace environment through which employees can fully demonstrate their capabilities through work reforms, health and productivity management, and career support

We help our employees strike a balance between work and non-work elements such as childrearing, nursing care for aging relatives and recuperation through a program in which they can flexibly choose the hours and location when and where they do their job. Additionally, we promote our various measures for respecting work-life balance after setting associated KPI.

At SMDAM, where human capital is the most important capital, we work to maintain and improve productivity by promoting health and productivity management. This includes supporting the promotion of employees' mental and physical health, preventing them from developing diseases, and enhancing their health literacy. We also carry out other measures such as assisting employees with changing their careers and pursuing parallel careers and offering them career training according to their age group in order to support autonomous career-building by employees with diverse attributes and career aspirations.

Working Style Reforms	Assistance with achieving a work-life balance (promotion of childcare leave taken by male employees included), reduction of long work hours, availability of paid work leave, flexible-time system, telecommuting, etc.
Health and Productivity Management	Promotion of health, prevention of diseases, preservation of mental health, initiatives aimed at health challenges specific to women, etc.
Autonomous Career-Building	One-on-one engagement, career training by age group, internally-conducted open recruitment, side work, recurrent training, etc.

Due Diligence on Human Rights



In FY2021, we formulated SMDAM's Human Rights Policy for the purpose of organizing our view on human rights and making more comprehensive efforts on human rights. As of this fiscal year, we have been implementing human rights due diligence, a mechanism for putting that Human Rights Policy into practice.

Carrying out human rights due diligence on four human rights risks

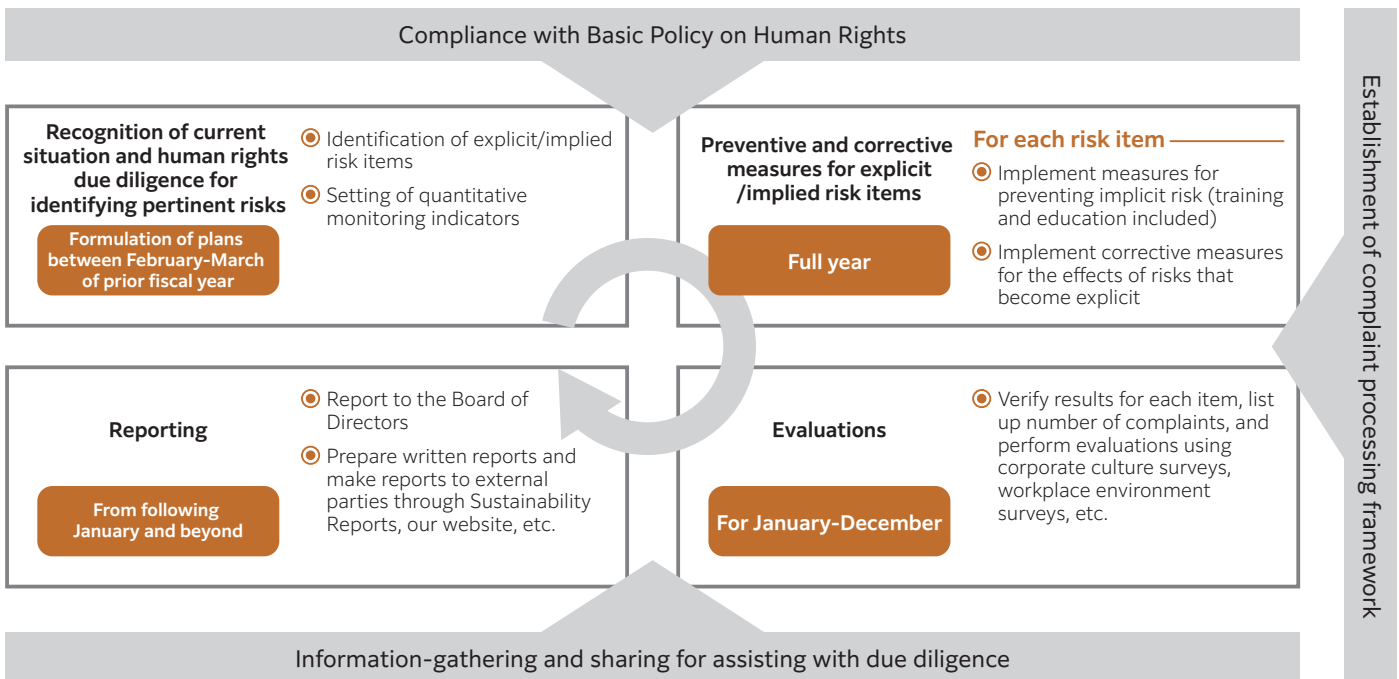
Human rights due diligence is an internal control mechanism to facilitate respect for human rights and the prevention of human rights violations in business activities through the recognition, inhibition and handling of human right risk by stakeholders. In its capacity as an asset management firm, SMDAM has identified the following human rights risks that may potentially arise in its own business activities or those of its subsidiaries within and outside Japan. We have been devising and implementing action plans for inhibiting and preventing each of these risks at our headquarters since FY2022, and intend to successively expand those plans to our domestic and overseas subsidiaries.

- 1 Human rights risk inside SMDAM and its overseas and domestic subsidiaries
- 2 Human rights risk at investee companies under asset management operations
- 3 Human rights risk at consignees under asset management operations
- 4 Human rights risk at outsourcees and business partners pertaining to other operations

In our internal regulations, we have clearly documented that in the event that our officers, employees, third parties or investee companies encounter various complaints, including those involving human rights violations, we will report the content of those complaints to the related departments and handle them swiftly and in good faith. Each business year, in addition to compiling the results of our efforts to inhibit human rights risk and numbers of complaints, we evaluate the effects that our business activities have on human rights through an internal questionnaire survey and other means. We report the results of this evaluation to the Board of Directors as well as disclose them to external parties on our website, in our Sustainability Report, and so forth.

Focusing on training and education to deepen understanding of human rights issues

In line with such initiatives for human rights due diligence, we endeavored to enhance our training and education programs pertaining to human rights so that our officers and employees could deepen their understanding of human rights issues and take appropriate action in our business activities. The participation rate of the target audience for the "Human Rights at Corporations" online training session that we conducted in December 2021 was 94%. We have made it mandatory for employees who joined SMDAM after that to also participate in this training as part of their introductory education.



Environmentally-Friendly Business Management

In 2021, SMDAM set forth its Sustainable Procurement Policy for each of its employees to carry out environmentally-friendly business activities. In addition to pursuing reductions in the energy we consume in the office, we take a better global environment into thorough consideration for the goods that we use as well.

Basic policy

Our basic policy is to commit to the dual areas of the reduction of GHG emissions and environmental conservation.

Reduction of GHG emissions	<ul style="list-style-type: none"> • We will endeavor to reduce GHG emissions through means such as the use of renewable energy and energy conservation with the goal of achieving essentially net zero emissions at SMDAM by 2030. • We will endeavor to promote paperless processing and reduce waste to cut indirect GHG emissions (Scope 3).
Environmental conservation	<ul style="list-style-type: none"> • We will procure plastic-free products, recycled products, materials free from harmful substances, and other goods in consideration of environmental conservation and the reduction of our environmental footprint.

Our Progress

SMDAM proactively encourages its employees to take part in social contribution activities to reduce energy emissions and waste at the office while simultaneously tackling environmental issues. In doing so, we forge a corporate culture while fostering strong awareness of the environment by each individual employee, and work towards mitigating the environmental burden that accompanies our operations.

Reduction of GHG emissions by relocating office

By relocating our headquarters to the Toranomon Hills Business Tower, which boasts sophisticated environmental performance, in 2020, we significantly reduced GHG emitted when using our office over preexisting levels. In September 2022, we consolidated our wholly-owned subsidiary Nikko Global Wrap at our office space as part of our ongoing endeavors to reduce the amount of office area used and GHG emitted by the Group as a whole. In May 2022, we relocated our Osaka Branch to an office used by the Sumitomo Mitsui Financial Group.

Promoting paperless processing

We are promoting the digitization of documents for preservation on an ongoing basis as an initiative for promoting paperless processing. This includes the paperless processing of expense receipts in accordance with Japan's Act on Special Provisions concerning Preservation Methods for Books and Documents Related to National Tax Prepared by Means of Computers, electronic signatures for minutes of Board of Directors meetings set forth in the Companies' Act, and the digitization of legal documents in accordance with domestic laws and regulations. Such initiatives also enabled us to simultaneously pursue reductions in storage space at our offices. Every year, the amount of paper we use at our offices has been decreasing in line with the effects of promoting telecommuting and DX.

Movements in GHG emissions by SMDAM (※1)	Fiscal 2019	FY2020	FY2021
GHG emissions by offices at our headquarters (Ratio when emissions for FY2019 are set to 100)	1,344tCO ₂ e (100%)	1,139tCO ₂ e (84.7%)	923tCO ₂ e (68.7%)
Amount of paper used in printing (Ratio when emissions for FY2019 are set to 100)	10,296 thousand sheets (100%)	4,040 thousand sheets (39.2%)	2,608 thousand sheets (25.4%)

(※1) This includes direct GHG directly emitted in our corporate activities (Scope 1) and GHG indirectly emitted with the use of energy in those activities (Scope 2).

Environmentally-Friendly Procurement

Pursuant to our Sustainable Procurement Policy, in addition to changing certain types of paper we use in our offices to FSC-certified (※2) paper, we are successively switching over the beverages that we serve in our offices from plastic bottles to paper cups.

(※2) A certification system by the FSC (Forest Stewardship Council).

Social Contribution

As a corporate citizen, SMDAM engages in activities for solving environmental and social issues. Through these activities, we develop spiritually-enriched human capital capable of understanding our mutual positions and roles within this increasingly diverse society as we aim to make it a more sustainable one.

Forest conservation activities

Employees of SMDAM took part in “Mori no Gakko” (Forest School), a hands-on forest development program by the approved NPO JUON NETWORK, in order to preserve our rich global environment. This program constitutes a rare opportunity to get both a mental and physical feel of what is needed to preserve Japan’s forests by seeing unkept, neglected forests up close and conducting activities while interacting with local residents.



Donating to organizations working towards realization of decarbonized society

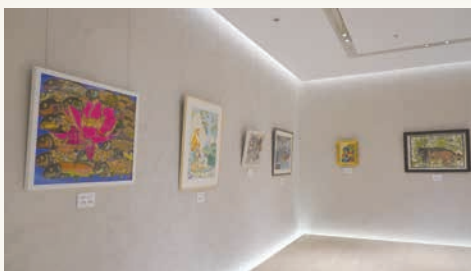
We donate part of our earnings obtained through the “Innovative Carbon Neutral Strategy Fund,” an SMDAM-managed investment fund, to organizations that conduct initiatives aimed at realizing a decarbonized society and research that contributes to innovation.

[Donation Overview]

Date of donation: April 28, 2022

Amount of donation: 15,000,000 yen (7,500,000 yen per organization)

Institute of Physical and Chemical Research (RIKEN)	Research Institute of Innovative Technology for the Earth (RITE)
<p>As Japan’s sole comprehensive research institute for natural science, RIKEN advances research in a wide range of fields that include physics, engineering, chemistry, mathematics, information science, computational science, biology, and medical science. RIKEN hosts a center conducting research that contributes to sustainable growth and the solving of global issues centered on the concept of manufacturing methods with reduced environmental impact as well as a center conducting research aimed at realizing new properties that contribute to solving energy issues through collaboration between the three fields of physics, chemistry, and electronics.</p>	<p>Established as a core research institute for international movement toward the development of innovative environmental technologies for addressing the global warming issue. RITE has become renowned both in Japan and overseas as an institute conducting highly unique research focused on the global environment, particularly global warming. Its work includes the development of carbon capture and storage (CCS) and biorefining technologies, and analysis of systems for countering global warming.</p>



Support for ParaArt (art and culture for people with disabilities)

We are active supporters of the ParaArt project run by Nippon Charity Kyokai to promote the art and culture of people with disabilities. Similar to 2021, in support of the International ParaArt Exhibition organized by that charity, we have featured a painting from the exhibition on the cover our Sustainability Report for 2022 as well. We are holding a exhibition of works from ParaArt in our headquarters office gallery so that as many people as possible can see and experience them.

Governance

By having Outside Directors serve as four out of our eight Directors, we ensure our independence as an asset management firm and practice highly-effective corporate governance. We also endeavor to develop a sound corporate culture based on our belief that the ability of employees to engage in frank discussion constitutes true governance.

Practice of highly-effective corporate governance

Board of Directors

SMDAM's ratio of independent outside Directors has increased over last year to 50%. Our Board of Directors performs yearly effectiveness evaluations. It endeavors to improve its methods of operation and otherwise work towards enabling it to further demonstrate its supervisory functions.

Observations in Board of Directors Effectiveness Evaluations (*) and Action Status

Similar to 2021, the operation of the Board of Directors of SMDAM was evaluated as being by and large appropriate. Conversely, issues such as Director diversity and terms and the nature and number of agenda were raised. With respect to the future, a high level of interest in skill management for employees was indicated, and requests were made to identify insufficient skills and synchronize human resource plans after first ascertaining human capital in its current state, providing information on effective development plans, and moving forward with growth strategies.

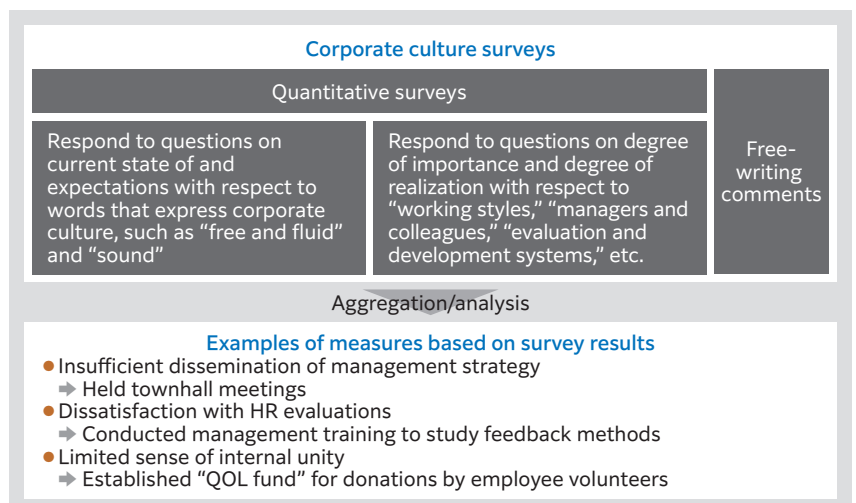
Observations	Evaluations and actions
Composition of Board of Directors <ul style="list-style-type: none"> Improvement of Director diversity Lengthening of terms 	The promotion of female and non-Japanese employees and employees with experience in leading asset management to Directors will continue to be addressed as a challenge. Officer terms will be addressed as a challenge in the next fiscal year and beyond.
Operation of Board of Directors <ul style="list-style-type: none"> Early presentation of meeting materials Insufficient setting of agenda for strategy meetings Securing of discussion time 	We will handle these challenges by providing meeting materials in advance via electronic media. While there continues to be considerable room for improvement, we will take actions such as securing opportunities for the deliberation of medium-term management plans. The enhancement of the discussion of strategy, including verifying the effects of strategy and delving into it, will continue to be addressed as a challenge. For matters other than important ones, explanation times on meetings days were omitted or shortened largely through officers in charge of the proposing departments participating in advance explanations.
Framework/free opinions, etc. <ul style="list-style-type: none"> Promotion of paperless processing for materials Meeting operation framework based on coexistence with COVID-19 Ongoing securing of opportunities to exchange opinions with shareholders 	Materials for meetings of the Board of Directors will be viewed in the form of electronic media as a general rule. We established an environment that allows meetings to be held remotely in accordance with the state of COVID-19 infection. We held meetings with shareholders following the conclusion of meetings of the Board of Directors. We plan on continuing those actions on an ongoing basis in each quarter hereafter.

(*) Conducted in July 2021 with July 2020 to June 2021 as the target period.

(Method of evaluation) Every year, a Board of Directors Secretariat performs an evaluation of the effectiveness of the Board through Director questionnaires and interviews and reports the results of that evaluation to the Board. (Last conducted in September 2021) Questionnaires inquire about the adequacy of items pertaining to the likes of the composition and operation of the Board of Directors. Interviews are conducted to gather opinions from multiple sides.

Progress in developing sound corporate culture

Our belief is that a sound corporate culture that is free and fluid and has open communication is the most indispensable element in organizational governance. Since 2018, which was prior to our merger in April 2019, we have been conducting corporate culture surveys roughly every October. We form a grasp of employees' perception and the causes of problems through quantitative scores and free-writing comments and utilize the results in devising measures for the likes of human capital development and internal communication and in revisiting the ideal form of management in each department.



Message from Outside Director

Human capital management is currently becoming an increasing subject of focus.

From the perspective of an asset management firm that maintains no production facilities, human capital is the greatest management resource. The question of how we will proceed to develop that capital constitutes a key agenda for our Board of Directors.



Becoming a “true group of professionals” capable of meeting our investors’ expectations

An asset management firm is a “public institution of society” that links asset owners and numerous other investors with investees. As a firm in the position of holding the assets of its investors in trust, we have adopted the practice of fiduciary duty as the core of our governance. Out of the numerous initiatives conducted by asset managers to meet the needs of numerous investors, we place particular focus on the development of human capital.

My impression is that in recent years, the expectations of investors are gradually taking on a different character. Until now, contributions to society and the environment were secondary to the maximization of economic value as expectations. That balance has now shifted in line with changes in people’s values. Surely the worldwide growth in the orientation towards sustainability is one standout example of this. Issues such as the COVID-19 pandemic, which has yet to abate, and the crisis in Ukraine, which is showing signs of becoming protracted, are currently destabilizing the order of the world as well as exerting a considerable impact on people’s lives. Naturally, investor expectations are not immune to these changes.

As the wave of massive change approaches us, corporations will be forced to come to terms with the need to recalibrate their strategy in order to prepare to survive in the market and achieve further growth. It is safe to say that asset management firms are no exception to this. Undoubtedly, the ability of those firms to sensitively pick up on changes in social values and provide investment products that meet the increasingly diverse expectations of investors largely dictates the fate of asset management firms.

Asset management firms are a pipeline that links investors and companies together

The relationships forged between asset management firms and companies in recent years increasingly contain a sense of tension. That tension comes from engagement with investee companies, a key element of ESG integration. Alongside deepening communication with companies and directly ascertaining the orientation of their strategy, we are now able to convey the expectations of investors to companies. This forms an extremely vital pipeline through which we organically link investors and companies together. We need

to send useful information through that pipeline and turn it into a formidable bond that is trusted by investors and companies alike. To realize that, the presence of capable human resources that are able to connect investors and companies based on our fiduciary duty is a must. Put succinctly, what we require is human capital consisting of asset management professionals who are capable of forecasting the future of continuously-changing capital markets and companies.

What we need is the intelligence to utilize data in clever ways

Progress in the information technology revolution has made the utilization of big data and AI possible. This, in turn, is making room for an environment where large amounts of data can be easily obtained. Utilizing data in clever ways will surely enable us to forecast the future with greater speed and detail as we move forward. At the same time, there are pitfalls that are easy to succumb to upon obtaining such massive volumes of data. As making decisions based on objective analysis steeped in data becomes possible, we will be tested as professionals for our level of caution in not overly trusting data.

Given our aim to answer the commitment of investors around the world and do our part for the quality of life of people, the formation of a true group of asset management professionals and establishment of an environment where diverse human capital can play an active role are never-ending challenges for SMDAM.



Jun Arai Outside Director

Assumed post of Representative Director and President of Showa Shell Sekiyu in 2008. Served as Representative Director and Group COO of Showa Shell Sekiyu in 2013 and as the Representative Director and President of Showa Yokkaichi Sekiyu in 2014. Concurrently served as Director of Daiwa SB Investments in 2016. Assumed post of Director of SMDAM in April 2019.

Important Precautions

Precautions Related to Investment Advisory Contracts and Discretionary Investment Management Contracts (Risks and Expenses)

Risks related to investment advisory contracts and discretionary investment management contracts

Financial products and financial derivatives products that are invested in under discretionary investment management contracts or for which investment is advised under investment advisory contracts may incur losses due to fluctuations in interest rates, currency values, market prices on financial instruments markets, or other financial indicators.

The variable factors include the risk of price fluctuations in marketable securities and other instruments, the credit risk of issuers and other bodies, the risk of fluctuations in interest rates and financial markets, and liquidity risk, specifically, the inability to execute transactions under conditions of sufficient liquidity. (Foreign denominated assets are also subject to foreign exchange risk.)

The client's investment principal, therefore, is not guaranteed, and a loss of principal may be incurred if the value of financial instruments or other assets declines.

When margin transactions or futures/options transactions (hereunder "derivatives transactions") are used in connection with investment of assets under management, the derivatives transactions amount may exceed the amount of the customer margin or other guarantee money (hereunder "customer margin, etc."), and losses exceeding the customer margin, etc. may be incurred as a result of fluctuations in interest rates, currency values, market prices on financial instruments markets, or other financial indicators.

Customer margin, etc. amounts and calculation methods vary depending on the transaction's circumstances and counterparty, so it is not possible to indicate the ratio of the derivative transactions amount to the customer margin, etc. amount.

Fees and commissions on investment advisory contracts and discretionary investment management contracts

Investment management fee

A fixed management fee is charged for investment advisory contracts and discretionary investment management contracts. It is calculated by multiplying the contract asset amount (the base amount used to calculate investment advisory fees) by a rate* set in advance.

*This rate varies depending on the provisions of the contract with the client, investment conditions, and other factors, so it cannot be stated in advance. The details of contract asset amounts and calculation methods are determined separately in consultation with the client. Depending on the contract's provisions, an incentive fee may also be charged in addition to the aforementioned management fee.

Other fees and commissions

The following fees and commissions are charged in addition to the aforementioned investment advisory fees.

- (1) Trading commissions for financial products charged on assets under management
- (2) Reserves for trust assets and the trust fees and trust administrative expenses* deducted from trust assets when investments are made in investment trusts in accordance with discretionary investment management contracts.
- (3) Management fees and incentive fees to foreign investment managers, management and custodial fees to investment trust management and custodial companies, trustee fees, audit fees, and other investment trust management expenses deducted from trust assets when investments are made in foreign domiciled investment trusts in accordance with discretionary investment management contracts.

*In the case discretionary accounts invest in investment trusts various expenses include the audit expenses of investment trusts.

As the actual amount of these commissions, etc. are determined based on the specifics of transactions, etc., and are recognized as expenses whenever incurred or billed, or fluctuates depending on the status of investments, etc., the maximum amount and calculation method of these commissions, etc. cannot be stated herein.

The upper limit and calculation method, etc. for the total amount of the aforementioned investment advisory fees and other fees and commissions charged to the client cannot be indicated herein for the reasons stated above.

Note: The above risks, fees, etc. differ depending on the specifics of contracts and the status of investments, etc. Therefore, before entering into a contract, please confirm written documents prior to concluding the contract. [As of September 30, 2022]

For institutional account clients

- These materials have been prepared for the purpose of introducing information on some of the products that we are capable of providing. They do not constitute a disclosure document in accordance with the Financial Instruments and Exchange Act of Japan.
- The risks and returns described herein are calculated based on historical data, our current outlook for the economy, and other factors, and do not constitute a guarantee of future risks or returns.
- Data on rates of returns not from actual funds, including that from simulations described herein, does not include compensation, transaction fees, rebalancing costs, etc. incurred in actual fund management.
- The investment products and methods, etc. described herein do not constitute a guarantee of future investment results or principal. It is possible that losses will be incurred as a result of investments. All investment results, including losses, are attributed to the customer.
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Precautions Related to Investment Trusts (Risks and Expenses)

Risks related to investment trusts

The prices of investment trusts fluctuate because they are affected by the price movements of the securities included in them (foreign currency denominated assets are also subject to exchange rate fluctuations). Losses may be incurred when prices decline, and this may result in a loss of principal.

All gains and losses generated by a fund from its investments are attributed to the beneficiary. Unlike bank deposits, investment trusts do not guarantee principal and also do not guarantee any particular investment performance.

Expenses related to investment trusts

Customers need to pay the following expenses related to investment.

■ Expenses charged directly

Transaction fee: **Up to 3.85% (tax included)**

Redemption (cancellation) fee: **Up to 1.10% (tax included)**

Redemption fee reserved as part of trust assets: **Up to 0.50%**

■ Expenses incurred indirectly during the holding period of the investment trust

Trust fees: **Up to 2.255% annually (including tax)**

■ Other expenses

The following fees and commissions are also paid out of trust assets: audit fees; brokerage commissions and other charges on traded securities; expenses for derivative transactions (including consumption and other taxes); and charges for the custody of assets overseas, etc. Some investment trusts also set incentive fees, and these fees are paid out of trust assets. If a fund invests in other funds, asset management fees and other expenses from those funds are incurred indirectly. Because these charges depend on the specifics of the transaction and other factors and because they change depending on investment conditions, upper limits and calculation methods cannot be specifically stated in advance.

*The total amount of the abovementioned fees and commissions borne by clients, and their upper limits and calculation methods, cannot be stated specifically in advance because they vary depending on the client's holding period and other factors.

Caution: The above risks and expenses pertain to investment trusts in general. The rates listed are the highest applicable for their respective fees among the investment trusts we manage. Furthermore, as the risks and charges entailed by an investment trust vary from one trust to another, before making an investment the client is requested to read carefully all relevant items within the investment trust summary prospectus and the other documents provided prior to signing a contract.

Investment Trusts are unlike deposit/saving or insurance contract, not protected by Deposit Insurance/Saving Insurance/Policyholders Protection Corporation. In addition, when purchased through registered financial institutions, they are not covered by the Investor Protection Fund. Please note that investment trusts cannot be redeemed or canceled during the closed period or on public holidays in Japan or overseas.

[As of September 30, 2022]

For investment trust distributors and individual investors

- This document has been prepared by Sumitomo Mitsui DS Asset Management for the purpose of providing information. It is not intended to recommend or solicit the purchase or sale of any particular investment trust, life insurance policy, stock, bond, or other investment product.
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その一歩で、未来は変えられる。

Explanation of Cover

As a part of our CSR activities, we are active supporters of the ParaArt project run by Nippon Charity Kyokai to promote the art and culture of people with disabilities. The painting on the cover, "Minna Nakayoshi" (Everyone Getting Along) by Hiroki Aida, received the Sumitomo Mitsui DS Asset Management Award at the 9th International ParaArt Exhibition held in September 2022.

Hiroki Aida: Brief History

Born in 1985. Resides in Saitama, Japan.
Began drawing around his third year of junior high school.
Subsequently featured works in various art exhibitions.
Received extensive recognition that included numerous First and Second Prizes in the Nikaten Exhibition.



Sumitomo Mitsui DS Asset Management

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