

# Lazard ESG Integration Report

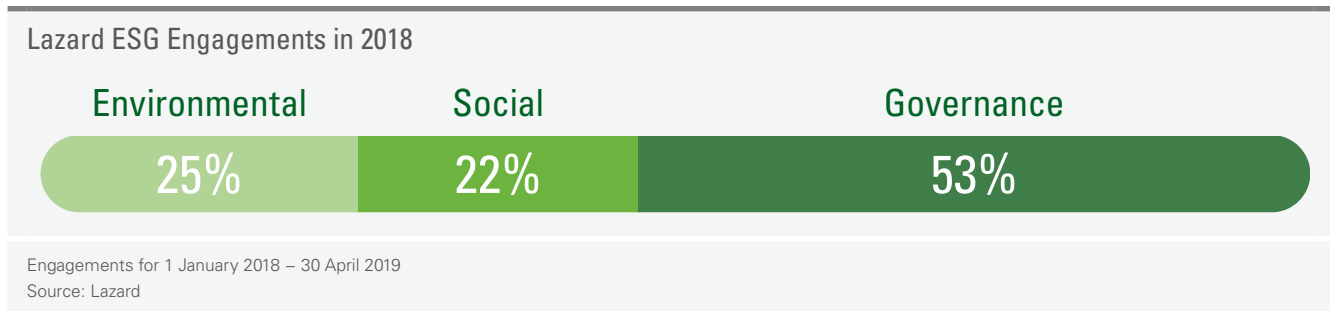


At Lazard, we are committed to providing clients with innovative investment solutions and superior performance. Environmental, social and governance (ESG) is a critical component of this investment philosophy. We recognize that ESG considerations, such as board structure, environmental practices, or labor policies, can affect a company's long-term fundamental valuation. Therefore, our investment professionals integrate ESG analysis into their research and decision-making process.

Our more than 275 investment professionals worldwide are responsible for identifying ESG risks and opportunities and incorporating them into their investment analysis. Our research is documented in our internal research database and is available to all investment professionals globally. Yet, this ESG evaluation does not end once a buy or sell decision is made. As active investors, we strive to maximize shareholder value for our clients by voting proxies and regularly engaging with companies. In this report, we provide select examples from our wide-ranging ESG-related efforts.

# Engagement

During 2018, our investment professionals participated in more than 3,800 meetings with company management and boards of directors. In 41% of those meetings, an ESG issue was discussed. In many of those meetings, the discussion was often elevated to a point where we made recommendations to management or the board because we believed that their ESG practices could have a material impact on the company's financial performance.



## Case Studies

### Rockwell Automation, Industrial Automation

We engaged with senior management to better understand Rockwell's commitment to diversity and inclusion, particularly since gender diversity challenges tend to be more pronounced in engineering and industrial sectors. As the competition for talent is becoming more intense globally and across industries, it is increasingly important to attract high-caliber candidates from a diverse pool and create an inclusive culture to retain them. Catalyst, a global non-profit, has shared many studies linking diversity to indicators of profitability and financial health, including higher return on sales, return on assets, and return on equity.

Their efforts to date have seen the number of women engineers increase by 38% and the number of female directors by 65% between 2008 and 2017.

In addition to discussions with management, we have attended events that provided insights into the company's ESG efforts. For example, at recent Investor Meetings/Automation Fairs, Rockwell has demonstrated the importance of diversity, inclusion, and employee engagement for itself and its supply chain and distribution partners.

We are encouraged that Rockwell recognizes the need to build inclusion into their engineering culture so that their employees produce their best work, and we will continue to monitor their progress.

### **Deere & Co., Equipment Manufacturer**

We engaged with the CEO/CFO and the Corporate Secretary/Director of Compensation of Deere to discuss changes in the company's executive compensation program. As a shareholder, we believe executive compensation programs should have robust performance metrics that are aligned with shareholders' interests and we expressed this to Deere during our discussions. Over the past three years, we have seen Deere improve its executive compensation program by significantly increasing its operating return on operating assets (OROA) performance hurdles and adding two new metrics, revenue and net income. We believe these changes help improve the executive compensation program's alignment with shareholders' interests. As a result, we voted for its Say-on-Pay vote at the 2019 Annual General Meeting (AGM). We also voted for the shareholder proposal to provide the right to act by written consent at the 2019 AGM as we believe it is in the best interests of shareholders and a positive corporate governance practice.

### **Societe Bic, Consumer Products**

We engaged with the CEO, who is also heir to the founding family, to better understand the company's environmental impact as plastic represents a large proportion of Bic's input cost. Consumer awareness regarding the impact of plastics on the environment has resulted in a material change in the attitude towards disposable plastics. This has, in turn, resulted in action from policy makers, causing manufacturers to re-examine the life-cycle of their products. Having a credible sustainability policy for Bic to reduce its environmental impact is thus crucial for the long-term success of the business. The engagement improved our understanding of Bic's focus on product longevity and partnership with R&D centers on innovative materials, which we view as a strength. We also noted the company's long track record in managing down power consumption and the PVC content of plastic. We will continue to monitor the company's progress towards the use of renewable materials and the improvement of collection infrastructure.

## Participation in Collaborative Initiatives

Lazard is a signatory to, and a member of, several organizations that promote responsible investing. We have been a signatory to the United Nations—supported Principles for Responsible Investment (PRI) since 2014. We are signatories to the UK Stewardship Code, the Japan Stewardship Code, and the UK Women in Finance Charter. We are also members of the International Corporate Governance Network (ICGN), Pensions and Lifetime Savings Association (PLSA), and International Accounting Standards Board (IASB) Investors in Financial Reporting programme. In addition, one of our investment professionals serves on the PRI Fixed Income Advisory Committee.

Lazard Asset Management London became a signatory to the UK Women in Finance Charter in June 2018, an initiative led by HM Treasury which seeks to promote gender balance across the financial services industry. Becoming a signatory demonstrates our commitment to supporting diversity and inclusion, and the advancement of women in the industry.

We also regularly attend and speak at industry events. In 2018, Lazard investment professionals from around the world participated in several ESG-focused conferences and investor initiatives.

## ESG Collaborative Initiatives Activity in 2018

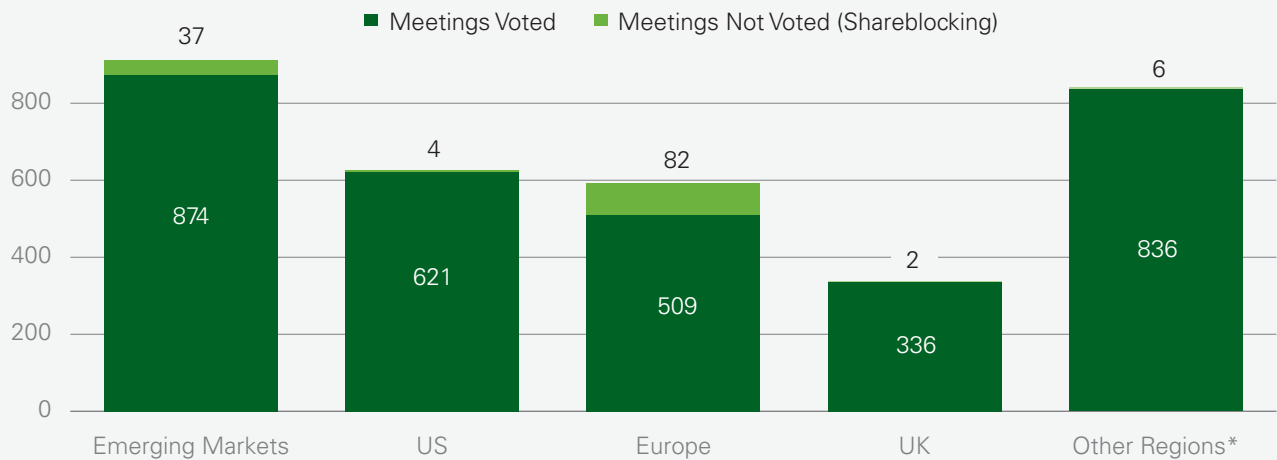
Initiative	Date	Location	E	S	G
Solar Wakeup Live!	January	New York	●		
Mission-Related Investing: New Names, Same Mission. What to Expect Next	January	New York	●	●	●
FNG-Dialogue: Sustainable Investments from an Employee's Perspective	February	Germany	●	●	●
SEB/IEB ESG Conference	February	New York	●	●	●
PRI FI Advisory Committee Quarterly Meeting	March, June	New York	●	●	●
DVFA Frankfurt Sustainable & Positive Impact Finance Conference	March	Germany	●	●	●
2018 MIT Sustainability Summit on Human Capital Management	March	Boston		●	
ClimateCAP: The Global MBA Summit on Climate, Capital & Business	March	North Carolina	●		
Sustainability Day 2018	April	Germany	●	●	●
2018 Columbia Global Energy Summit	April	New York	●		
Western North American PRI Network Event	May	Vancouver	●	●	●
2nd Annual Green Bonds Event	May	New York	●		
International Corporate Governance Network (ICGN) Annual Conference	June	Milan			●
Meeting with HSBC CFO, Sustainable Finance Group (Rebecca Self)	May	New York	●	●	●
ESG Investing Forum 2018 hosted by TruValue Labs, State Street, & Thomson Reuters	May	New York	●	●	●
Sustainable Investing with a Gender Lens—Financial Women's Association of NYC	May	New York		●	
Meeting with SEB Strategists / Traders for SSA / Green Bonds in Scandinavia	June	New York	●		
SDG Business Forum Hosted by the United Nations	July	New York	●	●	●
PRI in Person	September	San Francisco	●	●	●
Climate and ESG Asset Owner Summit	September	New York	●	●	●
AIMSE Europe Roundtable ESG Discussion	September	London	●	●	●
Demystifying Gender Lens Investing—How to Integrate Financial Returns with Social Impact	July	New York		●	
Green Bonds Americas	September	New York	●	●	
Bank of America Merrill Lynch—Sponsored Green Bond Event/Issuer Engagement	September	New York	●	●	●
Ethical Finance 2018	October	Edinburgh	●	●	●
ESG Investing Conference 2018	October	Boston	●	●	●
Data and Goliath: Can ESG Data Improve Performance in Emerging Markets?	October	New York	●	●	●
National Federation of Municipal Analysts Advanced Seminar of the Impact of ESG and Resiliency Issues on Credit Analysis	October	Boston	●	●	●
CFA Society Boston Sustainable Investing Seminar	November	Boston	●	●	●
Financial Reporting Council Review of UK Stewardship Code	November	London	●	●	●
Columbia Impact Investing Initiative: The Intersection of ESG and Impact Investing	November	New York	●	●	●
IFRS Conference Call: Financial Instruments with Characteristics of Equity Paper	December	London			●
Bloomberg Live: The Global Responsible Investing Forum	December	New York	●	●	●
PRI Sovereign Working Group Meeting	December	New York	●	●	●
Responsible Investing Americas 2018 Conference	December	New York	●	●	●

# Proxy Voting

Our *Proxy Voting Policy* was designed with our clients' best interests in mind. We do not employ outside vendors to vote on our behalf. Rather, our investment professionals are responsible for providing vote recommendations, which are considered independent of management.

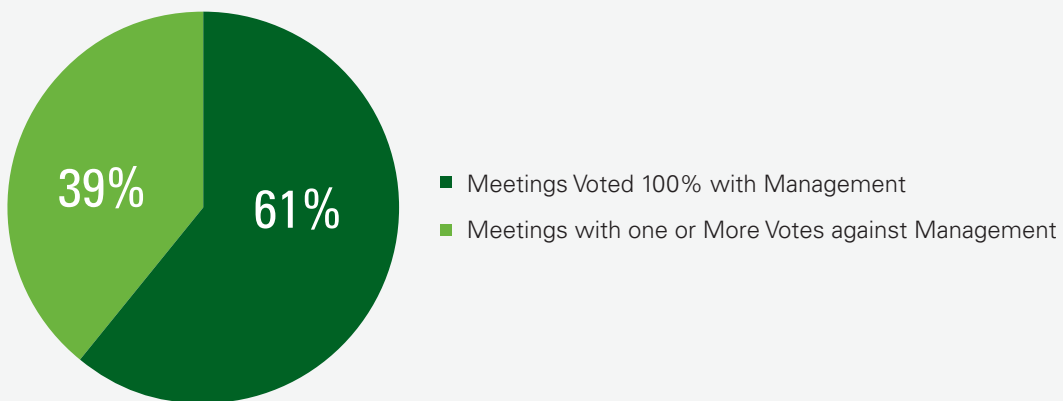
In 2018, Lazard voted at more than 3,100 annual company meetings, covering more than 36,000 proposals. Globally, we voted against management on one or more recommendations at 39% of these meetings.

Meeting Breakdown by Region



\*Includes North America ex-US, Developed Asia Pacific, Israel, Saudi Arabia, and Frontier markets.

Breakdown by Votable Meetings



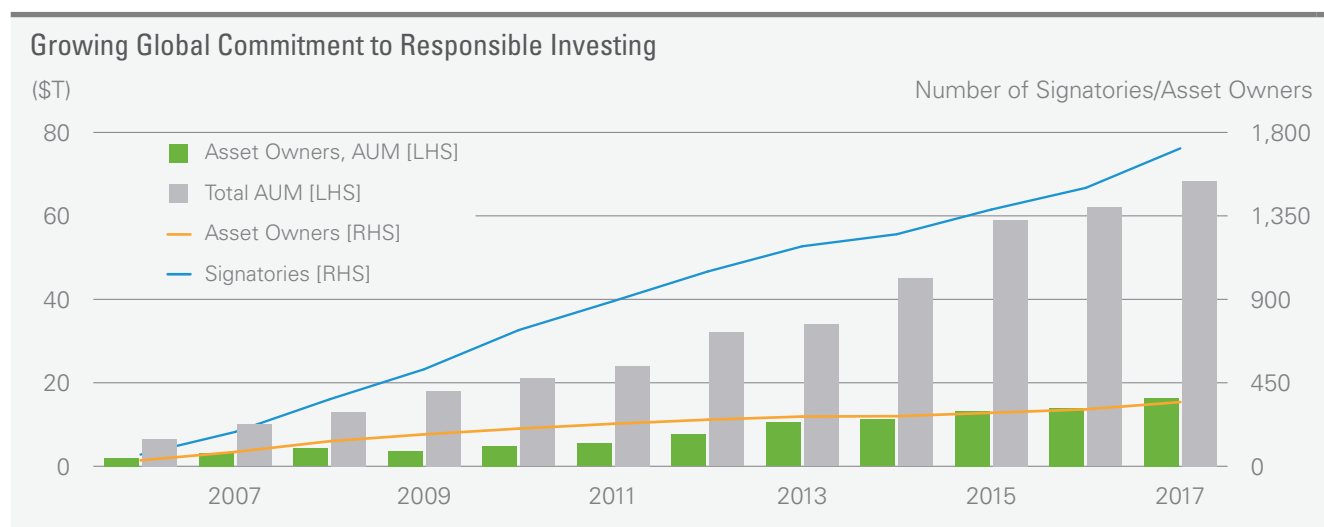
# ESG Thought Leadership

At Lazard, portfolio managers and analysts are responsible for assessing the material risks and opportunities related to ESG issues. Many of these issues are sector and geography-based or relevant to a specific asset class. Our investment professionals are encouraged to develop subject matter expertise on ESG topics that are relevant to their investment universe. In 2018, we published a selection of such thought leadership pieces on topics from green bonds, to structural shifts in the transportation sector due to specific environmental issues, to a study of Japan's corporate governance reforms.

## Green Bonds' Growing Role in ESG Investing

**Yvette Klevan**, *Managing Director, Portfolio Manager/Analyst*

The focus on responsible investing has grown rapidly over the past decade, and it is now considered mainstream in many parts of the world to incorporate ESG factors into investment analysis. Since the Principles for Responsible Investing (PRI) initiative was launched in 2006 with support from the United Nations, more than 1,800 signatories—nearly 400 of which manage roughly \$70 trillion of assets—have joined this effort. There is also increased awareness of the UN Sustainable Development Goals (SDGs)



which cover a broad range of economic and social development issues. Here, we describe green bonds and their underlying principles, and explain the market for these securities as well as their issuance.

From an investment perspective, green bonds provide an option for investors wanting to navigate the transition away from fossil fuel investments and reduce exposure to “stranded assets,” such as coal companies. Investor interest in green bonds has strengthened as various global institutions and organizations increasingly focus on mitigating or addressing climate change. This trend should help support strong valuations for green bonds. Issuance is also increasing as the “labeled” (bonds that are certified as green) and “unlabeled” (projects that are linked to environmental benefits but are not certified green) markets evolve. We believe that countries and companies that can reduce carbon emissions and adapt to, or mitigate, climate change will be better positioned to prosper.

The green bond market is rapidly growing and evolving, but it is still in the early stages of development. A key driver of its momentum is the increasing focus on ESG and sustainable investing on the part of issuers and investors. Green bonds offer governments and companies a way to raise funding for projects that will support the transition to a lower carbon economy and more sustainable future. We believe portfolios that recognize this structural change are better positioned to outperform the broad market. We believe an investment approach that emphasizes sustainability is better placed to add value in the long run. Based on our observations as managers of global fixed income portfolios, the integration of ESG factors and green bonds into the investment process can help investors reap opportunistic gains as well as defend returns.

Read the entire paper: [https://www.lazardassetmanagement.com/us/en\\_us/research-insights/lazard-insights/Green-Bonds-Growing-Role-in-ESG-Investing](https://www.lazardassetmanagement.com/us/en_us/research-insights/lazard-insights/Green-Bonds-Growing-Role-in-ESG-Investing)

## The Growing Importance of the “E” in ESG

**Jeremy Taylor**, *Managing Director, Co-Chief Executive Officer, Lazard Asset Management Limited (London)*

**Nathan Cockrell**, *Managing Director, Co-Director of Research and Research Analyst*

**Alistair Godrich**, *Senior Vice President, Research Analyst*

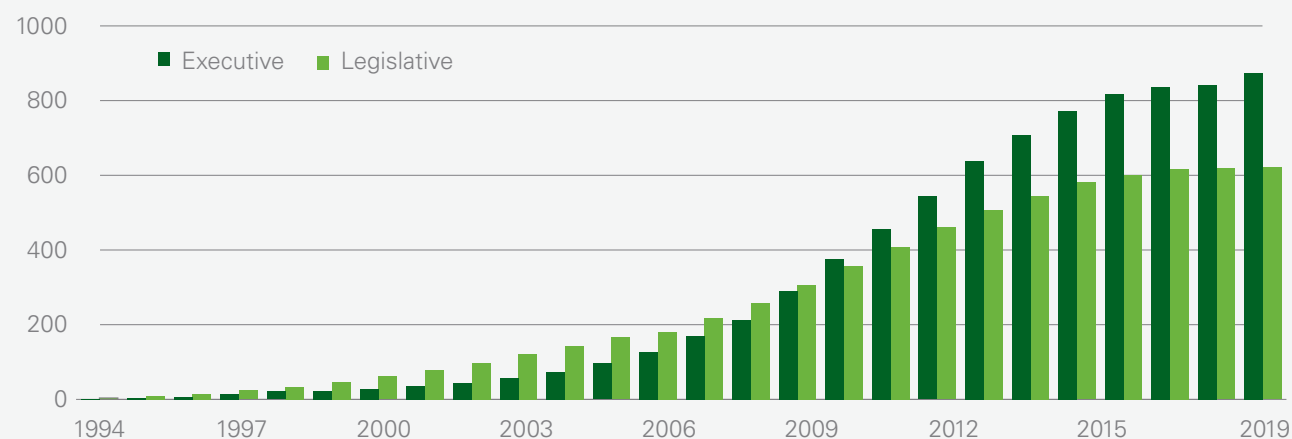
**Neil Millar**, *Senior Vice President, Research Analyst*

Environmental regulation has grown in volume and stringency over the past 20 years, causing large-scale changes across many industries. Pinpointing the source of these changes and identifying the impact on specific companies and sectors is challenging, even for well-informed investors.

The global effort to reduce greenhouse gas emissions has had a clear and widely recognized impact on the automotive industry—namely automakers reorienting production toward electric vehicles and away from diesel cars. However, the effect on suppliers tends to draw less focus.

### Volume of Climate Change Laws Has Mushroomed

Number of Global Laws and Executive Policies



As of 27 April 2018

Countries use different routes to address climate change. In some countries the primary avenue is acts of parliament, i.e., formal laws passed by the legislative branch of government. In other countries, it is executive policies.

Source: Climate Change Laws of the World database, Grantham Research Institute on Climate Change and the Environment, and Sabin Center for Climate Change Law

The value in the supply chain has shifted away from car manufacturers towards suppliers, as automakers have started to outsource the manufacture of a growing number of components to their supply base. The increasing level of sophistication in the technology used has meant that some parts have started to account for a greater proportion of a car's overall value, creating economic moats for those companies that manufacture or supply them.

However, this does not mean that investors should simply favor the stocks of suppliers over car manufacturers. In some cases, carmakers have de-rated significantly to the point where environmental risks are being factored into their share price. Spotting where the opportunities lie comes down to having a deeper appreciation of how regulations alter company behavior and competitive dynamics.

A similar theme is unfolding in the oil refining sector, as structural shifts in the shipping sector look set to create opportunities for some refiners. The shipping industry is bracing itself for tighter sulphur emissions regulations, which are due to come into effect in January 2020. At present, fuel costs represent around 15% of total costs for a shipping company, so the change in regulation is likely to have a material financial impact.

A spike in demand for low-sulphur fuels is expected ahead of impending, regulation which will likely result in shock to refiners. Capacity will be an important determinant in gauging the scale of the impact each refiner faces.

The impact of environmental regulation is likely to differ across companies, sectors, and regions, and will change over time. We believe that active, bottom-up fundamental managers are better able to anticipate the risks and opportunities created by structural shifts compared to other investment approaches, as thorough and regular engagement with company management in combination with rigorous fundamental analysis generate unique insights into how different businesses are developing.

Read the paper: [https://www.lazardassetmanagement.com/docs/-m0-/67480/TheGrowingImportanceOfTheEInESG\\_LazardResearch\\_en.pdf](https://www.lazardassetmanagement.com/docs/-m0-/67480/TheGrowingImportanceOfTheEInESG_LazardResearch_en.pdf)

## Japanese Policy Reforms

A series of powerful policy initiatives began to take shape in 2013, when the Abe administration made corporate revitalization a key plank in its growth strategy. The administration believed corporate governance reform was an important response to a number of challenges Japan faces, including demographic headwinds and the rise of China.

Key Reforms	Objective	Progress
The Stewardship Code	Encourage investors to engage with company management to "promote sustainable growth of companies through investment and dialogue." It requires investors, in some cases, to disclose their proxy votes and explain them in terms of their fiduciary duty.	The Stewardship Code has improved the quality of meetings with company management. However, proxy voting support for underperforming management teams has remained disappointingly high through the June 2018 AGM season.
The Ito Review	Required companies to improve their corporate value by setting clear performance metrics. Each company should aim to generate a minimum 8% ROE.	The Ito Review has contributed to a change in management behavior, and the structural improvement in capital efficiency. However, ROE targets are often not well integrated with company key performance indicators.
The Corporate Governance Code	Instructs all publicly traded companies to follow "fundamental principles for effective corporate governance." Companies must explain their "policies regarding the reduction of cross shareholdings" and justify them in relation to "the company's cost of capital."	The most impactful of the initiatives, the Corporate Governance Code has contributed to the structural decline in cross shareholdings. However, adherence is often superficial and the pace of change varies substantially by company.

Information and opinions are subject to change

## Are Japan's Corporate Governance Reforms Working?

**Scott R. Anderson**, *CEA, Director, Portfolio Manager/Analyst*

Japan, home to some of the world's most renowned companies in terms of operational excellence, has lagged its global peers in the areas of profitability and capital efficiency over the past three decades. This gap, which can be largely explained by the country's approach to corporate governance, is showing signs of narrowing. While there have been setbacks and disappointments in the past, policy reforms ushered in by Prime Minister Shinzo Abe are driving corporate change, and we are starting to see a difference in our interactions with management teams. Better corporate governance has driven improved profitability and, we believe, could lead to a rerating of the Japanese markets.

We believe Japanese corporations have made significant strides in corporate governance, but some key issues remain. We believe the decline in stable shareholdings is likely to persist and encouraging this trend remains a focus of our team's engagement activities. Japanese boards have become more diverse and independent, in line with the government's policy goals, but independent directors in many cases lack the ability and motivation to provide real oversight to management teams. To empower Japanese boards, we believe more senior business executives need to join the boards of other companies. A good example is Nidec's (a Japanese manufacturer of electric motors) talented CEO Shigenobu Nagamori, who serves on SoftBank's board (a global telecommunications and technology investment company). Overall, our discussions with management are increasingly two-way, with companies expressing increased interest in our ideas and suggestions. We expect this process to continue.

Read the entire paper: [https://www.lazardassetmanagement.com/us/en\\_us/research-insights/investment-research/Are-Japans-Corporate-Governance-Reforms-Working](https://www.lazardassetmanagement.com/us/en_us/research-insights/investment-research/Are-Japans-Corporate-Governance-Reforms-Working)

### Our Commitment

At Lazard, we conduct independent ESG analysis to ensure our clients receive differentiated insights that can be critical to investment outcomes. And we go further by engaging with companies to advocate for positive change on behalf of shareholders. As the global business environment evolves, we are committed to continuously improving our ESG Integration approach.

## Important Information

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