IQ INSIGHTS

SSGA's Fixed Income ("FI") Stewardship Program

The Need for FI Stewardship

Traditionally equity investors, as owners of companies, have taken the lead on environmental, social and governance ("ESG") stewardship since they are directly impacted by the failure to manage or mitigate corporate governance and sustainability-related risk inherent to a business. In addition, proxy voting at shareholder meetings provides equity owners the leverage needed to engage with companies on a host of matters that range from long-term strategy to environmental management practices.

Without an annual vote, creditors have limited ability to engage and influence management behavior. Their relationship with issuers is largely contractual. Consequently, debt issuers have typically focused their engagement efforts on matters that directly influence their returns such as strategy, cash flow generation and utilization, and financial leverage. However, ESG risks can also impact returns on fixed income assets.[1] These risks need to be managed and addressed in fixed income stewardship programs of asset managers.

While State Street Global Advisors (SSGA) has provided active ESG stewardship for our equity holdings for a number of years, in 2015, SSGA formally integrated ESG stewardship in its fixed income investment process.

SSGA's FI Stewardship Program at a Glance

- Program is to be implemented in a phased manner.
- Phase 1: Focuses on corporate debt,* which accounts for over 65% of SSGA's FI AUM.
- Proxy voting and issuer engagement are two elements to the stewardship program.
- Issuer engagement selection process is different for investment grade and high-yield corporate debt issuers.
- SSGA has developed a proprietary ESG screening tool to identify issuers for engagement in its investment grade corporate bond universe.
- Ad-hoc engagement undertaken with high-yield corporate bond issuers.

* As of 3/31/2016.

SSGA's Approach to FI Stewardship

The unique characteristics of different fixed income asset classes require different stewardship approaches. Therefore, SSGA will be developing and rolling out its FI stewardship program in a phased manner. Recognizing that there are significant crossovers between ESG stewardship as it relates to equities and corporate bonds[2], in the first phase, SSGA has developed a FI stewardship program that focuses primarily on corporate debt. This allows SSGA to leverage its expertise from its equity stewardship program and extend it to its fixed income stewardship program. Further, given SSGA's risk-based approach to stewardship, we have chosen to initially focus our stewardship efforts on an asset class that accounts for over 65% of SSGA's FI AUM. Within the corporate debt universe, our program is differentiated by investment grade ("IG") and high-yield ("HY") corporate debt as it relates to the screening process adopted to identify companies for ESG engagement (see Issuer Engagement below).

The two elements of SSGA's FI stewardship program are:

Proxy Voting

SSGA has adopted proxy voting guidelines to address typical matters that are referred to creditors at bondholder meetings. These guidelines apply to all FI asset classes. The FI voting guidelines are part of SSGA's Global Proxy Voting and Engagement Principles that can be found on our website: https://ssga.com/global/en/about-us/asset-stewardship.html.

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While matters that come up for a vote at bondholder meetings vary by jurisdiction, examples of common proxy voting resolutions at bondholder meetings include:

- Approving amendments to debt covenants and/or terms of issuance;
- Authorizing procedural matters such as filing of required documents/other formalities;
- Approving debt restructuring plans;
- Abstaining from challenging the bankruptcy trustees;
- Authorizing repurchase of issued debt security;
- Approving the placement of unissued debt securities under the control of directors; and
- Approve spin-off/absorption proposals.

Given the nature of the items that come up for vote at bondholder meetings, SSGA takes a case-by-case approach to voting bondholder resolutions. Where necessary, SSGA will engage with issuers on voting matters prior to arriving at voting decisions. All voting decisions will be made in the best interest of our clients.

Issuer Engagement

SSGA recognizes that debt holders have limited leverage with companies on a day-to-day basis. However, we believe that given the size of our holdings in corporate debt, SSGA can meaningfully influence ESG practices of companies through issuer engagement. Moreover, as a large global equity manager, SSGA has large ownership stakes in a majority of companies and has developed relations with senior management and directors at these companies. Our asset stewardship team, which manages all of SSGA's stewardship efforts, can leverage these relationships to address ESG issues that are relevant to the creditworthiness of an issuer.

Issuer Identification and Screening Process

A challenge for asset managers with passive investment strategies is identifying the right issuers within a large universe of companies for ESG engagement. At SSGA, we rely on proprietary screening tools to help us identify companies for engagement. Consequently, SSGA has developed an ESG screen for its holdings in corporate bonds that takes into consideration factors such as SSGA's absolute and relative holdings position in a company, the bond rating, and the bond's ESG rating to help identify issuers for engagement.

Given the relative size of our holdings in IG corporate bonds, we intend to use this screening process to identify and engage with IG companies within our corporate debt portfolio. Our engagement with HY corporate bond issuers will be conducted on an ad-hoc basis.

Objectives of the Engagement Program

Through engagement, SSGA will seek to:

- Engage issuers to gain information on ESG practices and understand how they mitigate ESG risks;
- Encourage issuers to enhance disclosure on ESG practices allowing bondholder to assess ESG risks that may impact the creditworthiness of the issuer;
- Engage with issuers on thematic ESG issues that are relevant to their business;
- Identify high-risk sectors within the portfolio and engage with issuers in these sectors on ESG issues; or
- Be reactive to media reports that may increase reputational risk for the company.

Types of Engagements

Active

SSGA will actively seek direct dialogue with the board and management of companies we have identified through our screening processes. Such engagements may lead to further monitoring to ensure the company improves its governance or sustainability practices. In these cases, the engagement process represents the most meaningful opportunity for SSGA to protect long-term bondholder value from risk stemming from the company's governance and sustainability practices.

Reactive

Reactive engagement is generally initiated by the issuers to address specific voting issues with investors. SSGA views reactive engagement as an opportunity to address not only voting items, but also a wide range of governance and sustainability issues.

Reporting of ESG Engagement

SSGA will report on its FI ESG engagements on a yearly basis in its Annual Stewardship Report.

Any questions or comments regarding this guidance may be directed to Rakhi Kumar, Head of ESG Investments and Asset Stewardship, at **Rakhi_Kumar@ssga.com**.

[1] Corporate Bonds: Spotlight on ESG Risks, December 2013 and Sovereign Bonds: Spotlight on ESG Risks, September 2013.

[2] PRI Fixed Income Investor Guide, 2014.

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Equity securities may fluctuate in value in response to the activities of individual companies and general market and economic conditions.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

International Government bonds and corporate bonds generally have more moderate short-term price fluctuations than stocks, but provide lower potential long-term returns.

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