Sustainable Finance and ESG Product Governance

Sustainable Finance Trends

With the global expansion of ESG investing and sustainable finance in recent years, countries around the world are tightening regulations related to ESG investments. As investors' interest in ESG increases year by year, investment behavior that is presented as environmentally and socially conscious despite lacking substance (commonly referred to as "ESG washing") is being spotted and called out. In particular, Europe is leading the movement toward tightening regulations. A major example of this is the SFDR (Sustainable Finance Disclosure Regulation) that the European Commission put into effect in March 2021.

The SFDR is a disclosure rule that defines "sustainability" according to certain criteria and requires the disclosure of supporting information to demonstrate the extent to which a financial product takes sustainability into consideration. Within the SFDR, regulations are being introduced to encourage disclosure and regular reporting not only on an individual product basis but also on a company-wide basis, and asset managers' stance on sustainability is being robustly questioned.

Changes can also be seen in the philosophy regarding the fiduciary duty that asset managers are required to fulfill. For example, looking at stewardship responsibilities, thus far the so-called “double code” (Stewardship Code and Corporate Governance Code) has been the underlying premise. Responsibility for a company’s sustainability, and the sustainability of society connected to it, lies with the company, and the Corporate Governance Code was established as the code of conduct covering the company’s board of directors, which has the responsibility to oversee the company’s sustainability posture. The Stewardship Code was established as a code of conduct for institutional investors to follow when examining a company’s board of directors, but the main objective of the Stewardship Code was to enhance corporate value, and in form it was decoupled from societal sustainability.

In the UK Stewardship Code, which was revised in 2020, the benefits to the ultimate beneficiaries were amended to also include sustainable environmental, social and economic benefits.

In the investment chain approach, there are ultimate beneficiaries behind investors, which include individuals as well as overall society, so it is made clear that they are connected to investors. However, in the approach embraced by the 2020 revised version of the UK Stewardship Code, this has changed, and institutional investors also have a responsibility to society and individuals which are both closely connected to companies and investors. Behind these changes, there has been a strong push around the world for the concept of “a vision for society” when it comes to investment. For example, in December 2019 the “European Green Deal” (the European Commission's 2050 climate neutrality goal) was launched. In its introduction, the European Green Deal advocates for a new growth strategy that aims to transform the EU into a fair and prosperous society, with a resource-efficient and competitive economy where there are no net emissions of greenhouse gases by 2050 and where economic growth is decoupled from resource use. The European Commission announced an investment plan totaling 1 trillion euros over 10 years in order to realize the goals of the European Green Deal.

> *Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy,*
> *the environment and society.*
>
> —— Introduction of the UK Stewardship Code 2020

> *It is a new growth strategy that aims to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use. It also aims to protect, conserve and enhance the EU’s natural capital, and protect the health and well-being of citizens from environment-related risks and impacts. At the same time, this transition must be just and inclusive.*
>
> —— An excerpt from the introduction in the European Green Deal

Originally, the EU in 2018 announced a 10-point action plan to achieve sustainable growth, and the European Green Deal comprised a part of that. Regulations, including the SFDR, have been bolstered to create investment flows to transform society as a whole. If we think of the current ESG regulations as mere tools for regulatory compliance and fail to recognize the grand goal behind them, we may lose the trust of customers and society who will view our efforts as “unintentional” investment.

This movement has also expanded to countries and regions outside of Europe. For example, in the ASEAN region, an initiative called the Corporate Governance Scorecard was launched in 2011 with the aim of reforming corporate governance in each country. Since 2017, these countries have been steadily bolstering their environmental and social initiatives, such as creating standards for green bonds and social bonds, formulating a roadmap for sustainable capital markets, and establishing an ASEAN Taxonomy for sustainable finance. Japan also announced a green growth strategy in December 2020. Indeed, countries throughout the world are now advancing various initiatives to attract investment funds into their own country with the purpose of building a sustainable society. We have entered an era of competition for capturing sustainable investment funds.

Our ESG Product Governance Initiatives

To earn and keep our clients' trust, we believe we must be able to comply with global ESG regulations and provide high-quality investment products with accountability. For that reason, we not only manage ESG investment quality, but also continuously engage in ESG product governance initiatives, including those related to information disclosure. Our ESG investments are not limited to investments we manage internally, but also includes funds managed by third-party asset managers, and we are bolstering our governance efforts targeting these funds as well. (Please refer to "Overall ESG Product Governance System for the Investment Side" on Page 52 for more information on our overall product governance structure).

Our ESG Committee is the body responsible for quality control for ESG investments for which we make investment decisions internally. In addition to checking the ESG processes of Japan-domiciled funds, when it comes to overseas-domiciled funds (funds compliant with the European Commission's UCITS Directive), the ESG Committee is responsible for complying with the SFDR and other overseas regulations, sorting out the issues regarding ESG investment policies to ensure such compliance and identifying matters to disclose, among other issues. In addition, for our Europe-domiciled funds, we have established a Responsible Investment Oversight Committee (RIOC) in our UK European base to strengthen supervisory functions in Europe, including dealing with local regulatory authorities.

Meanwhile, the ESG Investment Process Evaluation Meeting, which evaluates ESG investments by third-party asset managers, regularly monitors and evaluates the internal structures, engagement policies, ESG investment processes and other aspects of these third-party asset management firms.

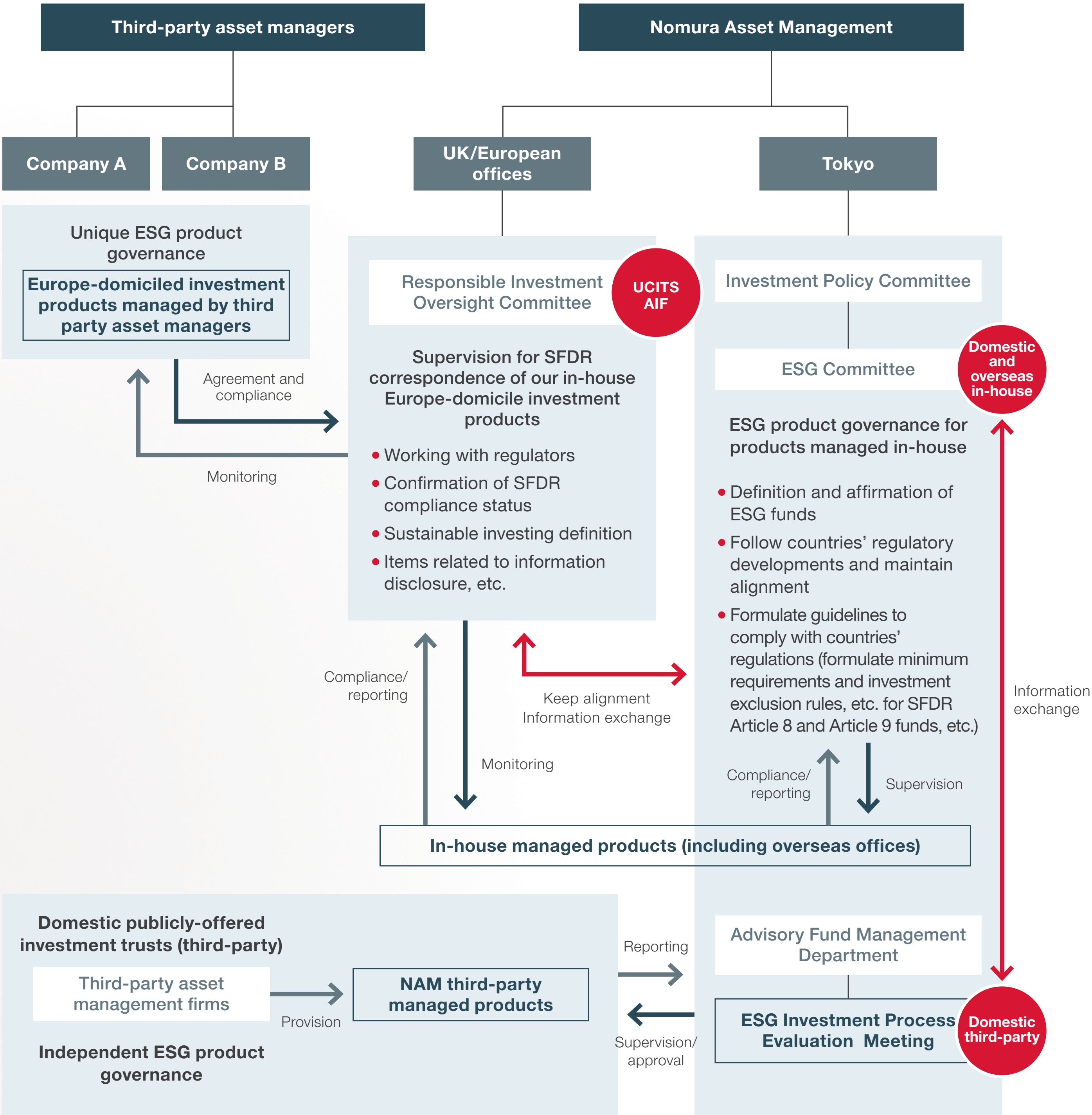
In addition, we are revising our prospectuses and reports to provide more details about our methodologies for utilizing ESG, and we have bolstered disclosure by describing how ESG considerations have contributed to the growth of trust assets and which ESG issues have been assessed as being of high importance. In individual disclosure reports, we include information about the investment philosophy and framework, engagement, ESG officers and other matters, as we work to make ESG more accessible to our customers.

In order to fulfill our fiduciary responsibility, when using a third-party asset manager we believe we should check and understand that asset manager's investment system, investment strategy, investment performance, and other specifics in the same way as we do for investments we manage internally, at an appropriate frequency and level of depth. In addition, in order to conduct more in-depth corporate research and analysis, we believe we should properly verify ESG evaluators and data providers in order to ensure the accuracy and quality of ESG evaluations and individual data. Therefore, in the same way as for in-house investments, we are improving the quality of funds by performing due diligence on, and enhancing disclosure about, funds managed by third-party asset managers and funds based on indices provided by ESG index providers. (Please refer to Pages 53-54 for more information about ESG index providers, and refer to Pages 55-56 for more information about third-party asset managers.)
ESG investing is transitioning to an era in which investments will be stringently selected. We will continue to monitor ESG-related regulations and developments, pursue true ESG investment, and continue to enhance our information disclosure to help investors make investment decisions.

In August 2022 we clarified the above system-related initiatives as well as our definition of ESG funds. Currently, among ESG investment techniques, we define "ESG funds" to be those funds that actively utilize ESG integration, engagement/proxy voting, and that actively utilize other sustainable strategies.

Reference **Please refer to the following link on our website for more information about our main ESG funds.**
https://www.nomura-am.co.jp/special/esg/strategy/esglineup.html

Overall ESG Product Governance System for the Investment Side



ESG Product Governance for Index Funds

Nomura Asset Management is working to expand ESG investment solutions by providing individual and institutional investors with funds that track ESG indices. We are also endeavoring to improve the quality of these ESG index funds by reviewing the ESG profiles of the adopted benchmark indices and bolstering communication with index providers.

Reasons for Selecting ESG Indices

In selecting ESG indices, we examine whether an index's methodology aligns with solving the particular ESG issues that index seeks to address, whether the index will provide an effective solution for beneficiaries, as well as compare it to similar indices to determine if it is superior to them. In addition to qualitative considerations, we also look at quantitative assessments of the ESG profiles of ESG indices prior to selecting them.

ESG Index	Reasons for Selection
FTSE4Good Developed 100 Index	■ In 2004, when the Nomura Global SRI 100 and the Nomura World ESG Equity Index Fund (for defined contribution pension plans) were established, corporate social responsibility (CSR) was already a social requirement that international companies could no longer ignore. Under these circumstances, these funds were established with the aim of bringing about a virtuous cycle in which companies and society develop synergistically by focusing investments in companies that actively engage in CSR, making it Japan's first SRI-type global index fund. ■ The current FTSE4Good Developed 100 Index started being calculated in June 2001 as a socially responsible investment (SRI) index. The FTSE4Good Developed 100 Index was selected as the index for these funds because, compared to other indices, it had a well-established global equities research platform along with a high level of management efficiency resulting from the fact that it was comprised of a relatively small number of stocks. ■ Since then, this index has continually incorporated new criteria and revised its existing standards, including new criteria that have emerged in response to societal demands and regulations. Since September 2014 the index has been calculated with its current ESG rating model that uses 14 topics. ■ Going forward, we hope and expect that this index will continue to properly incorporate the issues that companies should consider from an ESG perspective, both in response to the changing times and based on communications with us.
Nomura Enterprise Value Allocation Index	■ Nomura Asset Management has developed new indices and financial products in collaboration with Nomura Securities in response to the growing demand for investment in companies that place an emphasis on shareholder returns and ROE. ■ The Nomura Enterprise Value Allocation Index invests in companies that are highly profitable and have appropriate shareholder return policies. We have decided to commercialize an ETF that we can promote to a wide range of investors, including both individuals and institutions, based on our belief that this index can provide returns exceeding the TOPIX index over the medium- to long-term.
MSCI Japan Empowering Women (WIN) Select Index	■ We collaborated with MSCI (which has a strong presence in ESG-related indices) to consider developing new indices and financial products amid growing interest in promoting women's active participation in the workplace within Japan, as represented by the enactment in 2016 of the Act on Promotion of Women's Participation and Advancement in the Workplace. ■ Centered on Japanese companies that take a positive stance towards gender diversity initiatives, we believe we can expect returns exceeding the TOPIX index in the medium- to long-term by considering factors such as companies' growth potential (sales, capital investment), and we decided to create an ETF that we could promote to a wide range of investors with a strong interest in ESG investment.
S&P 500 ESG Index	■ We looked into developing financial products that address the strong demand in Japan for investing both in U.S. stocks as well as in ESG. ■ Based on the S&P 500 index, which is a popular index of U.S. equities, the S&P 500 ESG Index was expected to improve ESG characteristics without significantly changing the risk-return profile, and we determined that it would be the index most accepted by investors. We therefore decided to create an investment product based on this index. ■ By also listing the S&P 500 (Unhedged) ETF and S&P500 (Hedged) ETF along with the above ETF, we determined that we would be able to promote these ETFs to investors as a series of S&P500-linked ETFs.

ESG Index	Reasons for Selection
MSCI Japan Country ESG Leaders Index	■ The MSCI Japan Country ESG Leaders Index is one of MSCI's standard ESG indices comprising stocks with high ESG ratings, and is based on MSCI Japan as its parent index. ■ The index has stringent ESG criteria including negative screening in index construction and ESG rating restrictions (it is limited to ESG scores of BB or higher). We determined that these criteria make it an ESG index capable of meeting a wide range of demand for ESG investment both in Japan and overseas. ■ The key reasons for choosing this index for the ETF include the fact that MSCI's ESG-related indices are widely-adopted and well-known globally, and that the parent index, MSCI Japan, is comprised of large- and mid-cap stocks, which allows for more market liquidity.
Solactive Japan ESG Core Index	■ The Solactive Japan ESG Core Index has an excellent risk-return profile because it adds ESG factors to a group of sectors expected to grow over the medium- to long-term. We decided that this index would allow us to provide a new opportunity for investing in Japanese stocks incorporating ESG elements. ■ In addition to incorporating ESG risk ratings in the negative screening and the weighting of constituent stocks in the index construction process, this index considers the overall carbon intensity of its constituents. ■ Another reason for selecting this index is that it uses ESG assessments provided by Sustainalytics, which has a proven track record as an ESG assessment firm.

Due Diligence on ESG Index Providers

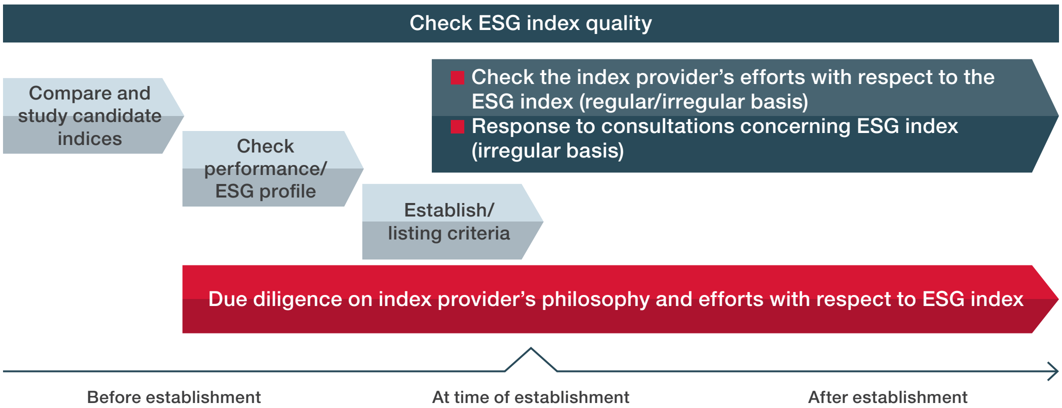
We regularly interview index providers to check on matters including the status of their efforts to ensure index quality and secure the transparency of ESG evaluations. Based on the results of these interviews, we evaluate index providers in cooperation with the Investment Department, the Responsible Investment Department and other relevant departments, and report the results to the ESG Committee. Through the evaluation of ESG providers, we learn about the relative strengths and issues for each provider. Also, we consult with the index providers and request improvements, as necessary.

Main Interview Content

- Status of efforts to secure ESG index quality
- Status of ensuring transparency and independence in computing ESG index
- Efforts for ensuring specialized ESG assessment data as well as initiatives in collecting ESG assessment data

Communication with ESG Index Providers

We regularly communicate with ESG index providers regarding matters such as whether their ESG indices are maintaining methodologies aligned with addressing ESG issues, as well as whether they are appropriately reflecting market structural changes in their indices. In addition, in response to consultations about ESG indices, we communicate our opinions, request improvements, or urge them to enhance index quality, as needed.

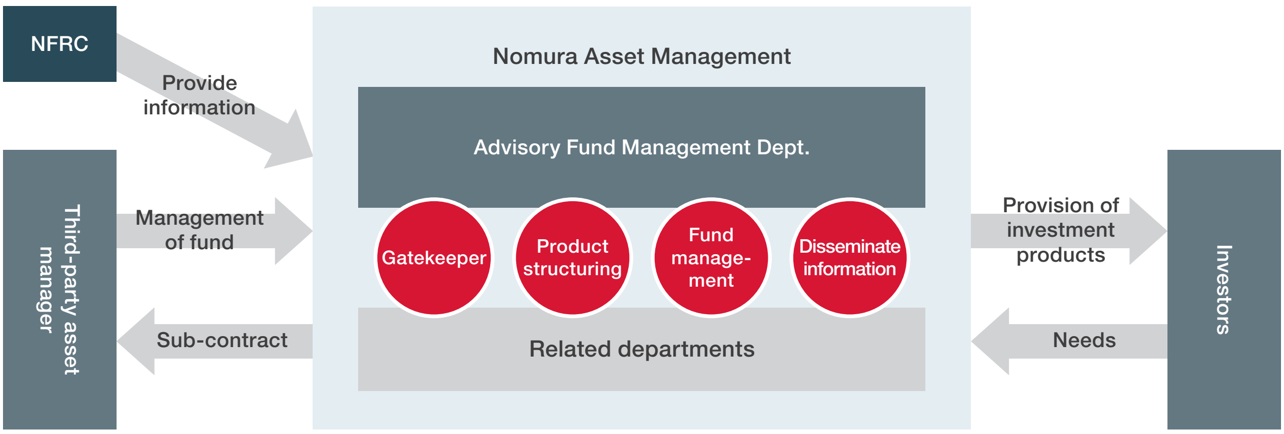


Governance of Third-Party Asset Managers' ESG Products
Overview and Qualitative Assessment of Third-Party Funds

At Nomura Asset Management, we collaborate with third-party asset managers both in Japan and overseas to provide investors in Japan with third-party funds in a wide range of asset classes. The Advisory Fund Management Department and other departments specializing in third-party investment are responsible for managing third-party funds. The Advisory Fund Management Department, which primarily handles traditional assets, collaborates with more than 100 asset management firms to provide third-party funds (net assets totaling approximately ¥6 trillion as of December 31, 2022) to investors. These assets are broadly diversified in different asset classes, including equities, fixed income, and FOFs (funds of funds).

When we outsource investments to a third-party asset manager, we carefully examine the investment capabilities and operational execution capacity of that asset management firm before selecting them. In addition, in order to ensure the quality of a fund after we select it, we collaborate with Nomura Fiduciary Research & Consulting (NFRC) to continuously monitor the asset management firm, its investment system, investment processes, performance, and other matters as a part of an annual third-party fund qualitative assessment. If we identify any serious issues in a third-party fund's management, we demand that the asset manager make improvements to its investment operations. This is part of our effort to maintain and improve the quality of these third-party funds.

Management of Third-Party Funds



ESG Evaluations of Third-Party Funds

In 2018, we added questions about ESG (responsible investment) to our annual qualitative evaluations of third-party funds, and began monitoring ESG, including engagement activities and proxy voting processes. From 2021 onwards, with the aim of confirming the extent of ESG integration into the investment process, we have added questions about ESG research systems, specific investment processes, and other related matters as a part of enhancing assessments.

In addition, based on the importance of ESG issues as well as our fiduciary duty, in 2021 we began monitoring the funds that fall under our definition of "ESG funds" under a framework separate from our annual qualitative assessments of third-party funds. We define ESG funds as funds that actively utilize ESG integration, engagement/proxy voting, and other sustainable strategies. As of December 2022, 11 of the third-party funds we offer are ESG funds.

Qualitative Evaluation of ESG Funds

We conduct ESG-specific qualitative evaluations of ESG funds. If an evaluation reveals a serious issue in the management of an ESG fund, we will ask the third-party asset management firm to improve its management in the same way as we would for any other third-party funds. Qualitative evaluations of ESG funds are led by the Advisory Fund Management Department, which is responsible for managing third-party funds, and starting from 2022 the Advisory Fund Management Department has been strengthening collaboration with the Responsible Investment Department and other ESG-related departments as part of an effort to build a framework under which a wide range of relevant internal parties participate in evaluating third-party funds, as part of our progress on bolstering our evaluation system.

The evaluations are performed based on the seven investment styles identified by the Global Sustainable Investment Alliance (GSIA). These are: corporate engagement and shareholder action, ESG integration, negative screening, positive screening, norms-based screening, sustainable-themed investment and impact investing. From 2022, among the ESG efforts subject to evaluation, we added third-party asset managers' response to climate change and other ESG issues as well as cooperation with various initiatives.

The ESG fund evaluations we carried out in 2022 confirmed that all ESG funds are being appropriately managed. It is particularly noteworthy that we found that each fund is proactively addressing the issue of climate change.

From 2023 onward, disclosure rules related to ESG investment in countries around the world are expected to become more stringent, while ESG investment methodologies will become more rigorous and advanced. We will closely monitor the situation surrounding ESG investment and incorporate any necessary assessment items as we work to improve and expand our evaluations of third-party managed ESG funds as we maintain and improve the quality of ESG funds.

Qualitative Evaluation Process for ESG Funds