ESG-themed Initiatives in Our Asset Management Businesses

Corporate activities are having increasing impacts on the environment and communities, and it has become increasingly important to respond through supply chains to such environmental and social problems.

The Group integrates ESG perspectives into asset management and carries out ongoing dialogue with investee companies, and it strives to create positive impacts toward SDGs for each related sector.

SUSTAINABLE DEVELOPMENT GOALS

ESG Investment Initiatives

As a "responsible institutional investor," SuMi TRUST Bank strives to manage stocks and bonds in ways that take into account ESG information as a factor that affects corporate value via medium- to long-term business opportunities and risks, in addition to financial information such as corporate earnings that affects near-term share price trends. We regard stewardship activities such as engaging with companies and exercising voting rights as vital to addressing ESG challenges.

ESG challenges not reflected in financial information are the challenges in non-financial domains, which may give a significant impact on corporate value over time. We believe the Bank's responses to ESG challenges lead to upside potential while limiting downside risk over the medium- and long-term, and actively responding to ESG challenges will enable us to meet our responsibility to expand investment returns for our clients, one of our stewardship responsibilities.

1. Milestones in the Bank's ESG Activities

Amid the rapid global increase in ESG investment, the Bank is actively promoting initiatives on a host of ESG-related issues and advancing activities which contribute to the interests of its clients.

We ramped up our ESG activities in earnest from 2003, when we launched a Japanese equity SRI fund. The Bank has been a signatory to the Principles for Responsible Investment (PRI) since PRI's launch in May 2006. Our PRI initiatives are based on the latest trends, with policies we have formulated and put into place based on the six PRI principles.

In April 2015, as a mechanism for looking carefully at the earnings power of companies, we introduced MBIS®, an in-house developed tool for analyzing and evaluating ESG and other non-financial information. We also launched a "quality growth" Japanese equity fund, which harnesses MBIS® as a driving force of corporate engagement.

Milestones in the Bank's ESG Activities

2003	Launched a Japanese equity SRI fund for corporate pensions, the first of its kind in Japan
2004	Launched a SRI fund for defined contribution pension plans
2006	The Bank became a signatory to the Principles for Responsible Investment (PRI)
2008	Launched a SRI fund with a major public sector mutual aid association
2010	Launched a Chinese equity SRI fund as a publicly offered investment trust
2014	Declared acceptance of Japan's Stewardship Code
2015	Introduced MBIS®, a tool for evaluating non-financial information Launched a "quality growth" Japanese equity fund Started factoring ESG concepts into business risk evaluations for corporate bond management Awarded an Outstanding Prize*1 in 2015 Sustainable Finance Awards*2
2016	Awarded an Outstanding Prize for second consecutive year in 2016 Sustainable Finance Awards*3
2017	Declared acceptance of Japan's revised Stewardship Code and established the Stewardship Activities Advisory Committee and Stewardship Development Department

*1 ESG integration into active domestic equity investment

*2 Research Institute for Environmental Finance (RIEF) selects award recipients for its annual Sustainable Finance Awards program

*3 Global engagement activities based on international norms and rules

Active Involvement in Principles for Responsible Investment (PRI)

Principles for Responsible Investment (PRI), developed in a process convened by the United Nations (UN), encourages institutional investors to incorporate environmental, social, and governance (ESG) factors into investment decision-making processes. Since the Bank became a signatory to PRI in May 2006, it has devised policies in accordance with the six principles and implemented initiatives based on the latest PRI-linked trends. The PRI assessment team evaluates reports from signatories on their commitments relating to the six principles and progress in meeting them on a scale ranging from A+ (the highest possible score) to E (the lowest). As shown in the table below, the Bank received an A+ for a third successive year for the comprehensive assessment category, while receiving favorable scores on the whole. We will strive to improve our score in areas such as ESG integration into fixed-income investment.

The Bank's Annual Assessment by PRI

		2017
Overall Approach to PRI (comprehensive assessment)		A+
Listed Equity—PRI Incorporation		A+
Listed Equity—Active Ownership		A
	Engagement	A+
	Proxy voting rights	B
Fixed Income—PRI Incorporation		C
	Government bonds	C
	Corporate bonds	B

2. MBIS®: Our Non-financial Information Evaluation Tool

To closely assess the basis for sustainable growth at investee companies, the Bank collects non-financial information (ESG information) that does not often appear in quantitative financial information such as the scale and sustainability of value added from services and products companies supply, their governance systems, which support the provision of added value, and their degree of impact on society and the environment, which are the foundations of sustainable growth. We tabulate this data for analysis and evaluation.

Drawing on these kinds of non-financial information, our in-house developed MBIS® tool is a framework we use to evaluate the strengths companies bring and the challenges they face in achieving sustainable growth.

M is for "management," B is for "business franchise," I is for "industry," and S is for "strategy." Evaluation of a company's ESG initiatives is included in "M," whereas evaluation of the net contribution to income generation and new business creation from ESG is included in "S."

ESG initiatives are evaluated based on the seven core subjects of ISO26000, an international standard that offers guidance on social responsibility developed by the International Organization for Standardization. Through ISO26000, we strive to ensure ESG initiatives are aligned with Sustainable Development Goals (SDGs).

MBIS® is a tool which our highly experienced analysts in the Investment Research Department provide. MBIS® score is the aggregate of the scores granted for each of M, B, I, and S subjects. Each of M, B, I, and S subjects is based on a comprehensive set of items to check we developed for forming an in-depth understanding of the strengths companies have and the challenges they face. In cases where the score granted reflects an outsized impact from specific items linked to strengths or challenges, it is possible to derive a score based solely on evaluation of those items alone.

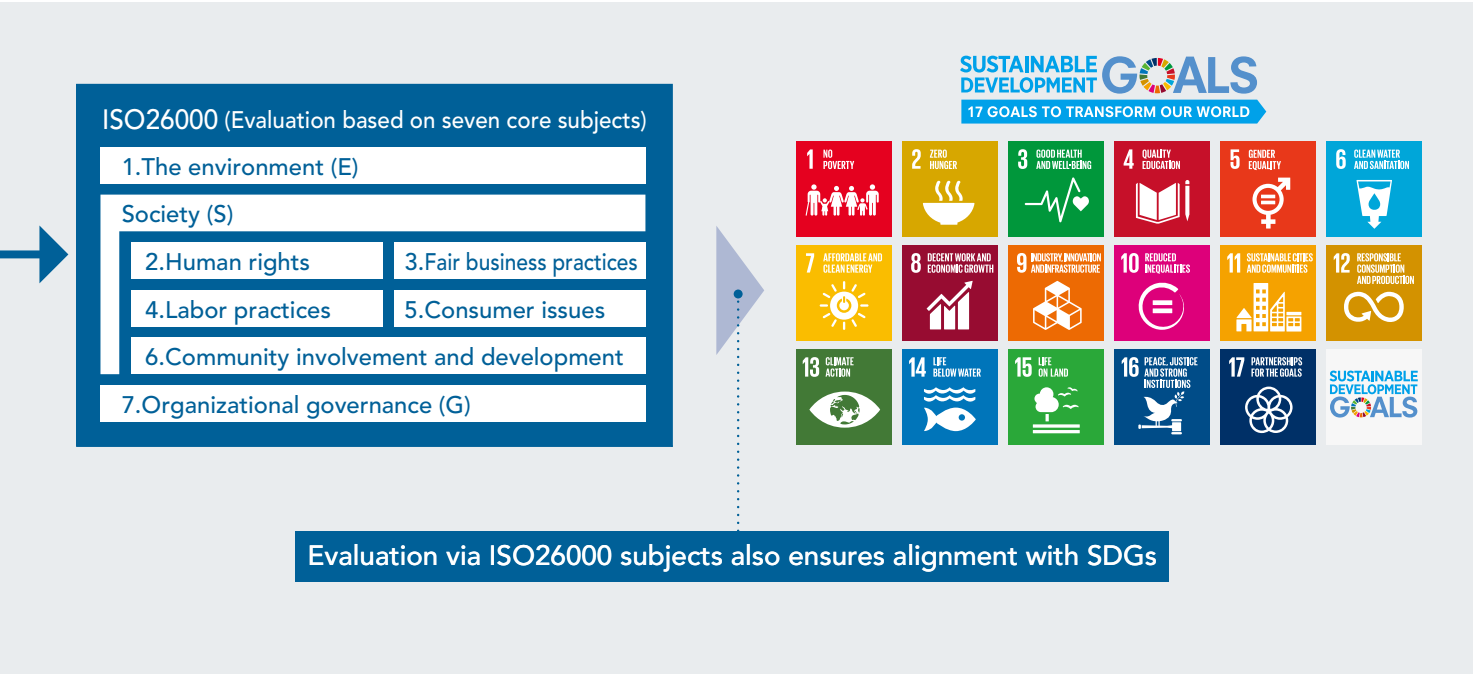
The purpose of MBIS® is to enable analysts to form an in-depth understanding of the strengths companies bring and the challenges they face in transitioning to sustainable growth, and it is to ensure analysts do not lose sight of specific items linked to strengths and challenges amid their evaluation of other items.

In order to improve MBIS® we perform appropriateness verifications of MBIS® scores via regular monitoring, as well as regular reviews and updating of MBIS® check items based on discussions with external experts and other consultants.

Application of SDGs in ESG Investment

The Sustainable Development Goals (SDGs) are global goals listed in the 2030 Agenda for Sustainable Development, which were adopted at a United Nations Summit in 2015. The SDGs are derived from the purposes and principles of the UN Charter, including recognition of the importance of international law, for responding directly to ESG challenges on a global scale. SDGs are composed of 17 goals with 169 targets for realizing a sustainable planet.

The SDGs call on all businesses to apply their creativity and innovation to solve sustainable development challenges, and awareness of the SDGs among companies has been growing. The Bank has adopted SDG concepts into MBIS® with the understanding they will facilitate sustainable growth and future business opportunities for companies. With the 17 goals in mind, we are engaging with companies.



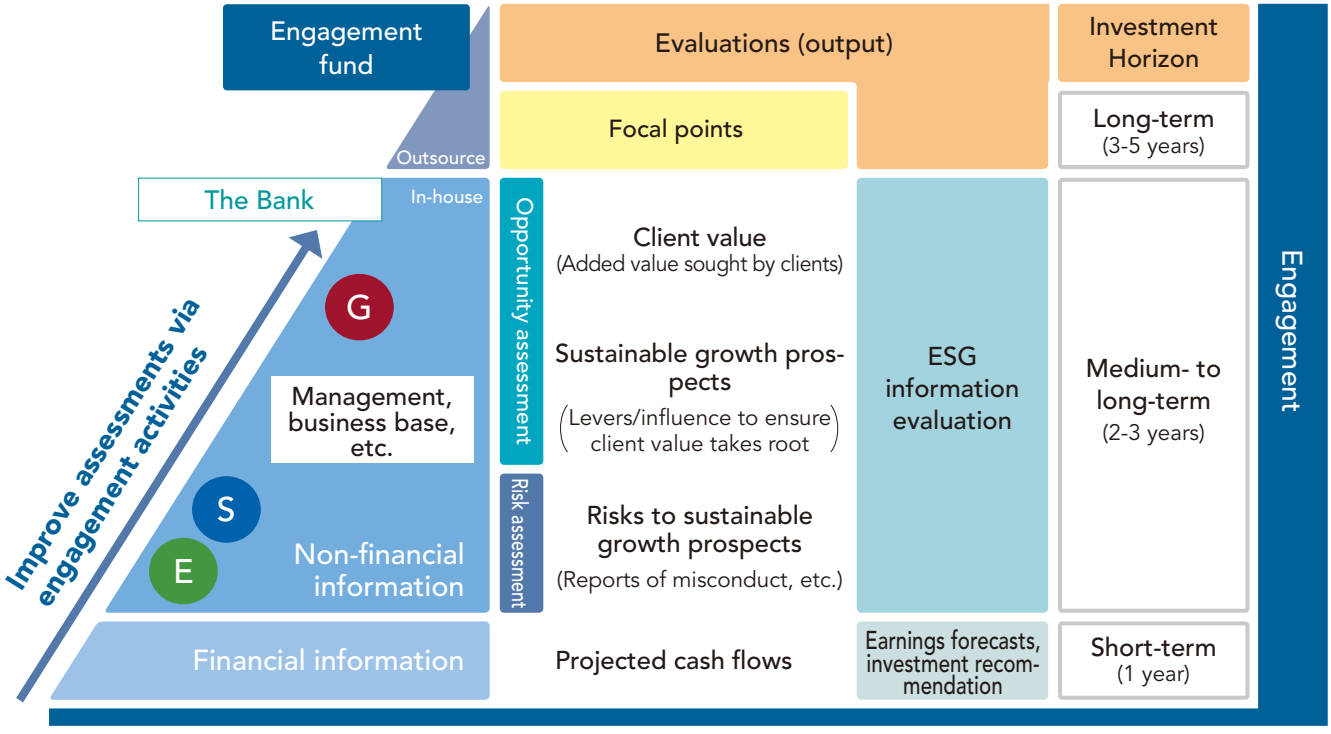
3. ESG Integration

In addition to the normal schedule of financial disclosures released over the fiscal year, we also use ESG information (non-financial information) in our process of evaluating investee companies. While financial information such as earnings reports are important in the short-term in evaluating companies as investments, we think assessments relating to the sustainable growth prospects of investee companies are important in the medium- to long-term.

As a result, with the aim of identifying ways to improve and support sustainable earnings at investee companies, we gather ESG information such as how much value added derives from the products and services of companies and whether this value added is sustainable, and the resilience of their governance systems, which support the provision of added value. We assess this ESG information with MBIS®, our in-house developed non-financial information evaluation tool and apply our analysis to stock selection as a way to improve active returns on equity investments while reducing downside risk.

This is the Bank's approach to ESG integration. We commenced application of this strategy in 2015, and all our actively managed domestic equity funds now factor in ESG considerations. In addition, some of our actively managed domestic fixed income funds also apply this kind of approach (total assets under management in this category using this strategy stands at about ¥2.4 trillion).

The way ESG ratings are applied differs according to the investment style of each fund. In equity investments, for example, ESG ratings are used for screening in the selection of stock universes, or they can be used to narrow down stocks deemed investable.



SRI Fund: Flagship Japanese Equity Responsible Investment Fund

One of the oldest socially responsible investment funds in Japan, SRI Fund was launched in 2003. With a focus on ESG in selecting investment stocks, the fund takes into account the degree of contribution from ESG to improving financial returns. Its defining features are the knowledge of our SRI fund management team, and its use of basic research performed by the Japan Research Institute (JRI).

JRI, one of the most influential think tanks in Japan, selects "best-in-class" companies as candidates for its SRI universe using a survey it conducts covering 2,000 companies. The evaluation consists of E (environmental), S (social), and G (governance) themes, and since fiscal year 2013, V (Value, or valuation of growth prospects) theme has been added. The V evaluation links the contribution of ESG initiatives to a company's earnings.

We exclude companies with high credit risks from the list of SRI universe candidates selected by JRI. A monthly committee, chaired by the General Manager of the Equity Investment Department, decides candidate stocks for our SRI universe. Fund managers evaluate stocks among our SRI universe based on 1) valuation of the growth prospects of prospective investee companies stemming from ESG initiatives, and 2) equity valuation and earnings momentum derived from the earnings forecasts of our Japanese stock analyst teams. The SRI Fund seeks excess returns versus the benchmark TOPIX.

Quality Growth Japanese Equity Fund (Research, ROE Improvement)

With a focus on the earnings power of companies, the "quality growth" Japanese equity fund (Japan Quality Growth Fund), which we launched in 2015, holds a portfolio concentrated in stocks expected to achieve sustained ROE improvement based on company analysis using MBIS®, which harnesses non-financial information.

The fund's approach is focused on business margins, an ROE composition factor, and for stock selection purposes, the fund assesses companies likely to realize earnings growth on the two factors of client value and sustainable growth prospects. ROE improvements that derive from shrinking the capital base are short-lived, so the fund focuses on improvements that come from expanding earnings (improving earnings power).

The share prices of companies with consistently high ROE outperform the market. The fund selects companies where we expect ROE to improve driven by earnings growth from top-line growth.

The fund applies quantitative and qualitative screenings on stocks in our analyst coverage in an investment process designed to enable our fund managers to ultimately construct a portfolio of 20-50 stocks.

Fixed Income Investment and ESG Integration

In our process of selecting corporate bonds for investment, we apply our internal ratings to form our own judgments about creditworthiness in evaluating the creditworthiness of relevant companies.

Our internal ratings determine creditworthiness based on a quantitative model that focuses on scale, financial composition, earnings power, and repayment capacity, which has high predictive power for credit ratings. In addition, we add a qualitative judgment that addresses concerns our quantitative model cannot.

We strive to implement ESG integration into fixed income investment by embedding ESG concepts into our business risk evaluations, which are an important element in qualitative judgments.

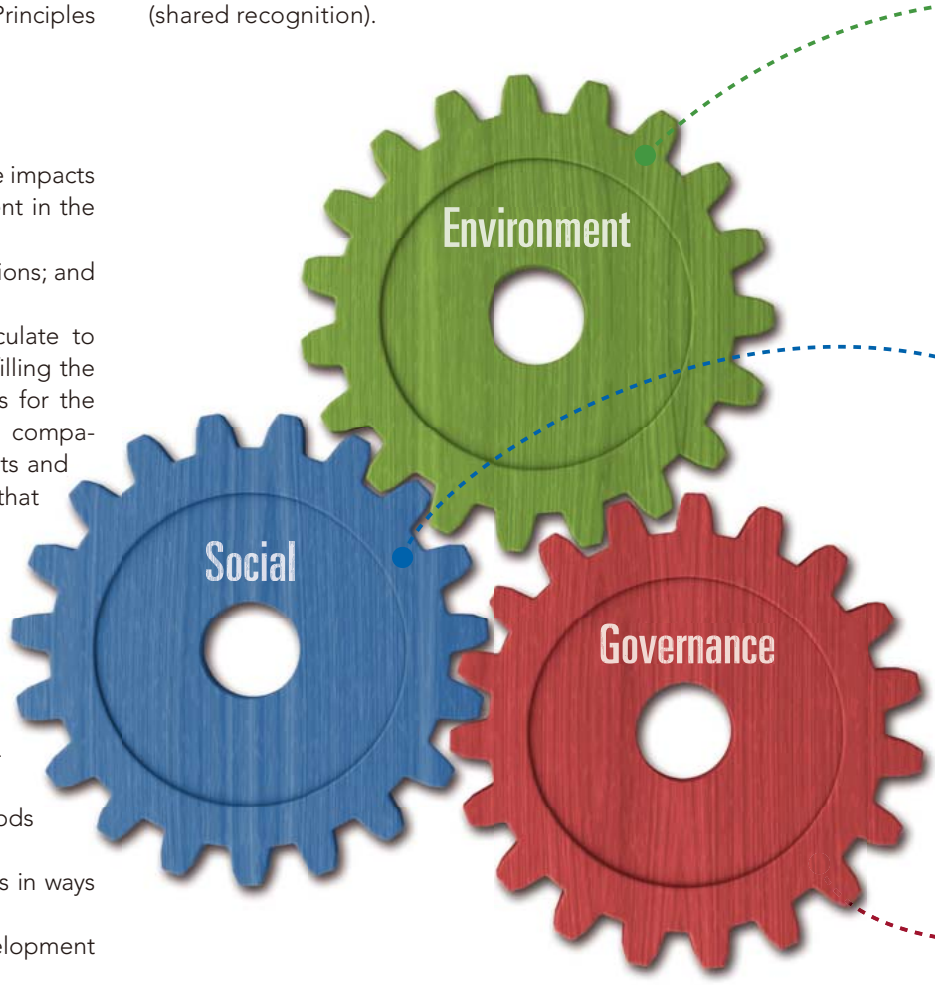
4. Guidelines for ESG Challenges (ESG Guidelines)

Our Guidelines

Institutional investors have an important role to play in putting global ESG challenges into the spotlight and encouraging improvements. One aspect of this role is performing accurate analysis of non-financial information concerning investee companies and identifying ESG challenges and risks that they may face in the future. On this basis, global institutional investors should regard as a vital priority the implementation of activities that encourage companies to improve their responses to such challenges and issues.

As a "responsible institutional investor" that embraces Japan's Stewardship Code and a signatory to the Principles for Responsible Investment (PRI), the Bank actively seeks to work with investee companies on ESG challenges via engagement and the exercise of voting rights. Through efforts to promote solutions to challenges and issues, we aim to facilitate sustainable growth for companies and society as a whole.

Based on this viewpoint, the Bank has formulated the following ESG guidelines. Our guidelines respect the basic framework that has been ratified internationally and are based on the principles in the UN Global Compact (shared recognition).



Full Text of the Bank's ESG Guidelines

(Environment)

Companies are expected to be responsible for the impacts of their products and activities on the environment in the following ways:

1) Comply with all environmental laws and regulations; and
2) Minimize impacts on the environment.

The Bank expects companies to clearly articulate to shareholders their policies and guidelines for fulfilling the obligations that derive from their responsibilities for the impacts on the environment. The Bank expects companies to prevent or minimize environmental impacts and strive to develop and disseminate technologies that encourage environmental preservation.

(Social and Labor)

Companies are expected to adhere to international labor rights and create safe and sound work environments in the following ways:

1) Adhere to all labor laws and regulations;
2) Ensure proper procedures are followed to maintain sound labor standards;
3) Prescribe health and safety management methods and make sure they are adopted into practice;
4) Provide employment opportunities to employees in ways that are fair;
5) Prepare plans and policies relating to self-development and training;
6) Recruit highly capable employees and encourage them to follow the policies and direction the company sets; and
7) Adopt measures to ensure internationally recognized human rights are not violated, and establish guidelines on order placement and suppliers for countries where the risk of human rights violations is high.

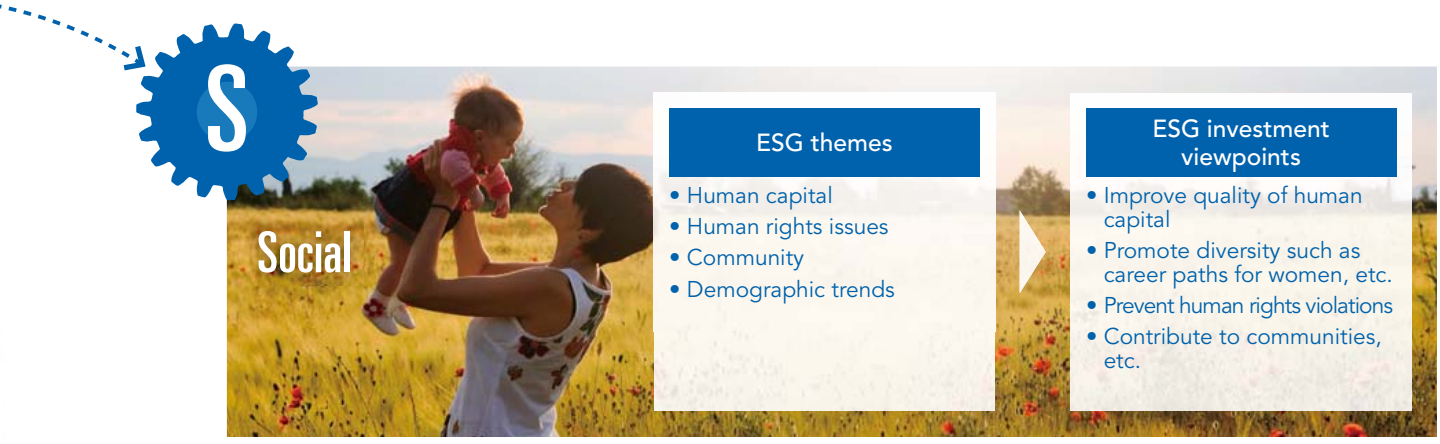
The Bank does not tolerate human rights violations by companies. Companies are expected to observe to international labor standards and provide safe and sound work environments for their employees. In particular, we think it is important for companies to prohibit discrimination in employment, prohibit child labor, eradicate forced labor, and ensure the collective bargaining rights of labor.

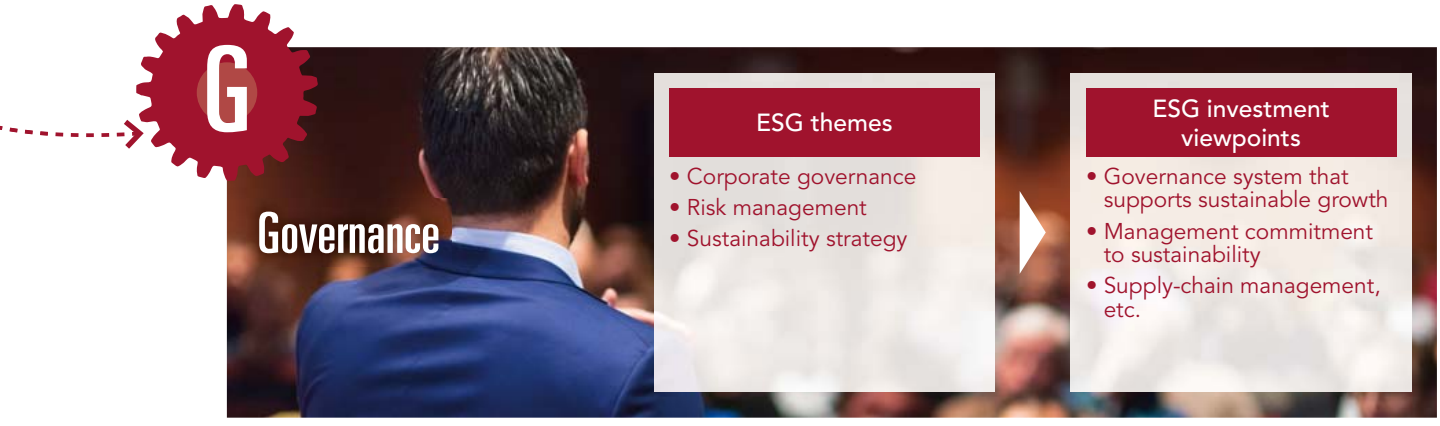
(Governance)

Companies are not only expected to fulfill their obligation to avoid corruption such as bribery and extortion but they are also expected to embrace their responsibility to establish policies and specific programs to address and prevent corruption in the following ways:

1) endeavor to prevent all forms of corruption, including bribery and extortion; and
2) uphold business ethnics and observe internationally accepted norms of morals, and work to ensure their image and reputation are not harmed.

The Bank expects companies to prevent corruption and adhere to business ethics, and with regards to corporate activities, it expects the Board of Directors to set the direction and monitor compliance with anti-corruption efforts.





5. ESG Engagement around the World

Based on our aforementioned ESG guidelines, the Bank conducts a variety of engagements on ESG challenges with companies around the world.

In Japan, our highly experienced research analysts and the specialists in the Stewardship Development Department conduct their own engagements with companies, and we also intend to make effective use of collective engagement through the Institutional Investors Collective Engagement Forum (IICEF) to encourage investee companies to improve their response to ESG challenges.

Overseas, we have specialists who conduct their own engagements, and the Bank also carries out initiatives harnessing a variety of international frameworks.

In particular, we engage on three fronts 1) activities based on PRI, etc., 2) activities to address misconduct, etc. based on international norms, and 3) activities that call for building high-quality corporate governance structures and efficient corporate management. We participate actively in such activities, working to effectively and efficiently limit the risks facing companies in their exposures to ESG challenges by accepting, for example, the role of lead manager for working groups in some international frameworks.

In following paragraphs, we report on our ESG engagements across the world while also focusing on points that are in the spotlight internationally.

Climate Change and Engagement

The Bank conducts engagements, calling on companies to disclose information on climate change challenges and assess climate-related risks. The Bank calls on energy companies and electricity utilities, where climate change is expected to have large impacts on shareholder value, to make disclosures on governance, strategy, risk management, and risks and opportunities required by the Task Force on Climate-related Financial Disclosures (TCFD).

Promotes Disclosures on Water Risk and Forest Resources-related Information at Investee Companies via CDP Participation

Carbon Disclosure Project (CDP) is an international non-governmental organization (NGO) that enables institutional investors to coordinate their efforts to call on companies to disclose environmental information such as their climate change strategies. CDP started out focused mainly on climate change but has since added water risk and forest resources as new themes, and these three themes are now the primary domains of its activities. In CDP's 2017 survey, of the 1,461 companies to which it sent questionnaires on water risk, 764 companies responded, and of the 838 companies to which it sent questionnaires on forest resources, 211 companies responded. While response rates remain low, they are gradually increasing.

The Bank participates in CDP, and uses information CDP discloses in its ESG engagements and asset management processes. Through working groups on palm oil and water risk of PRI in which the Bank is a member, we strive to promote engagement on these issues with investee companies based on CDP survey results.

Participation in Climate Action 100+

The Bank has become a member of Climate Action 100+, a five-year initiative that commenced in December 2017 to urge companies through a joint-engagement effort to reduce greenhouse gas emissions. This initiative is based on TCFD, brings together partner organizations such as PRI and CERES in a collaborative engagement effort with the listed world's top 100 greenhouse gas emitters, requiring climate-related information disclosure. Responsible for the Asia-Pacific region, the Bank is engaging with Japanese companies in this effort (see page 14).

Natural Capital and Engagement

Natural capital is one of the six capitals on which legal corporations and other organizations depend in creating value. In the abstract, natural capital is defined as all the renewable and non-renewable environmental resources and processes that enable the provision of goods and services that are the basis of the past, present, and future success of organizations. In concrete terms, natural capital as a concept includes air, water, soil, mineable minerals, forests, biodiversity, and healthy ecosystems.

Human life is made up of natural capital and the ecosystem services it provides. We thus feel wise use of natural resources which make up natural capital over the long run goes beyond mere environmental conservation. It extends to putting communities on a solid social foundation to enable sustainable economic development. In contrast, like the impacts arising from climate change, the destruction of natural capital results in negative external economy effects.

The Bank urges investee companies in its engagement to devise policies and guidelines on the state of their natural capital use and risks, including supply chains, and asks them to control risks from a long-term perspective.

Engagement based on International Norms and Rules

For corporate conduct we determine is in need of correction in light of international norms such as the UN Global Compact and the OECD Guidelines for Multinational Enterprises, the Bank collaborates with the responsible investment team at ISS-Ethix* to engage with investee companies in a discussion toward resolving such issues and verifying their implementation of countermeasures. This investment strategy is aimed at unlocking and increasing latent value by resolving problems at investee companies. We seek to promote progress based on the view that the global stock market is a microcosm of the international community (see page 27).

*Institutional Shareholder Services Inc., a leader in proxy voting advisory services, acquired Sweden-based Ethix SRI Advisors and renamed it ISS-Ethix, to provide ESG-related advisory services.

Engagement on Social Issues and Human Rights

With corporate activities growing on a global scale, markets are making the issues facing an increasingly borderless international community more complicated, and so how companies are run has multiple impacts. In step with the globalization of business, companies are facing increasing pressure to address social issues and human rights beyond the workplace, where they have focused to date, to encompass concerns such as human rights issues in their supply chains and the rights of local communities. As an international community-led initiative, the UN Human Rights Council endorsed the UN Guiding Principles on Business and Human Rights in 2011, setting expectations for how companies ought to think about their involvement in addressing the impact of businesses on human rights.

The Group's Policy on Initiatives involving Human Rights

Under the "Basic Policy on the Social Responsibility of Sumitomo Mitsui Trust Group (Sustainability Policy)," the Group respects the values of diversity and human rights for individuals in all its corporate activities and rejects unjustifiable acts of discrimination in all its activities. To ensure the execution of the aforementioned basic policy, the Group formulated in December 2013 its human rights policy, which serves as a standard for acts and judgments concerning human rights.

Based on the aforementioned policy, the Bank not only seeks to steer clear of activities and cases in its corporate endeavors that directly raise concerns about human rights violations, social issues, and inhuman conduct but also strives to avoid risk in its supply chain, and thus seeks compliance with related laws, regulations and standards.

TOPIC

Engaging Companies Involved with Anti-personnel Mines and Cluster Bombs

The issues of anti-personnel mines and cluster bombs are being addressed on an international level and from a humanitarian viewpoint. These weapons undermine peace and stability, and disrupt recovery and development in affected regions. To avoid aiding companies involved in such businesses, an effort by the global financial industry to end their access to financial services such as loans and investment banking services and end investment in their stocks and bonds is gathering steam as a way to discourage production of these weapons.

The Bank actively engages with companies* producing cluster bombs to urge them to stop production, and it publicizes its actions. For example, the Bank continued to engage with Textron, a U.S.-based manufacturer of cluster bombs to urge it to stop production, and after Singapore Technologies Engineering declared its intent to exit this business in November 2015, Textron also declared its withdrawal in August 2016. A Dutch NGO maintains a list* of financial institutions that ban loans and investment in businesses involved in cluster munitions, and in recognition of our efforts, the Bank was included in the runners-up list (46 companies)* as the only domestic financial institution to make the cut.

*We reference the aforementioned list of companies maintained by Dutch NGO PAX CHRISTI in a report series entitled "Worldwide Investments in Cluster Munitions: a shared responsibility."

Engagement relating to Diversity Initiatives

Companies that are active globally need to work to bolster their competitiveness by recruiting and harnessing capable people regardless of their ethnicity or gender. In corporate governance, this trend can be seen in many nations in membership diversity on corporate boards, and increasingly there are calls around the world for companies to promote diversity on their boards. In concert with this trend and relevant laws, regulations and norms, the Bank has strengthened engagement initiatives globally to promote diversity, with a particular focus on appointing female directors to boards.

In countries such as France, the Netherlands, and Norway where there are clear laws, regulations and norms*1 on gender diversity quotas, the Bank confirms progress toward target ratios for female representation on company boards through materials such as disclosure reports and materials prepared for general shareholders meetings. In France, quotas aim that at least 40% of board members to be female by 2017 against a ratio of 34.4% as of 2016*2.

In contrast, normative frameworks are not in place in the United Kingdom and United States, so this kind of efforts relies on voluntary initiatives such as organizations that promote new initiatives at companies to boost female representation on boards. In the United Kingdom, the "30% Club" promotes gender diversity on boards, and in nine countries led by the United States, the "Thirty Percent Coalition" does the same. The 30% Club was launched in 2010 with the aim of increasing female representation on the boards of FTSE100*3 companies to at least 30%. Founded after the 30% Club, the Thirty Percent Coalition is committed to promoting female empowerment in the workplace, including the goal of increasing female representation on company boards to 30%.

The Bank became a signatory to these two initiatives in February 2017. Through these activities, we conducted a total of six engagements from April to September 2017. The Bank plans to further increase its activities in this field in the years to come.

*1 Nations that make attaining quotas for female board appointments (or efforts) mandatory.

*2 European Women on Boards, Gender Diversity on European Boards, 2016

*3 FTSE100 Index is seen as representative of large-cap companies listed on the London Stock Exchange.