

HOW WE INCORPORATE ESG

By Garry Creed, CFA, Chief Credit Strategist

ESG investing: Our philosophy

Aegon Asset Management US (Aegon AM US) believes environmental, social, and governance (ESG) factors are a meaningful component of sound fundamental credit analysis that can drive alpha and help manage risk in our client's portfolios. Though historically not always referred to as ESG, the underlying concepts have been components of our investment methodology for decades, and remain an important and evolving part of our investment process today. As an active fixed income manager, our research analysts and portfolio managers dynamically integrate ESG information into their investment analyses, engage with issuers directly on ESG matters, and offer our clients exclusion lists when desired.

Integration

Analysts and portfolio managers continually monitor and evaluate ESG-related information from various third-party sources, including issuer disclosures, independent research providers and consultants. Given the increasing availability of ESG-related information, the growing complexity of the issues and the increasing importance clients place on these topics, Aegon AM US has continued to invest in our fundamental research teams to ensure that we have the capacity and capability to incorporate these factors into our investment process. This enables our teams to more effectively analyze and integrate these factors in to their view of an industry, country, or individual issuer.

When identifying and integrating ESG factors, we focus on the potential economic impact ESG issues may have on the issuer's ability and willingness to meet debt obligations. One of our primary areas of research is, and always has been, related to governance risks, such as organizational structure. In the case of corporate issuers, this manifests in management's historical aggressiveness towards bondholders. In the case of sovereign issuers, we evaluate the strength of governmental institutions. We also assess environmental risks, such as potential costs a corporation may incur for environmental compliance or remediation of damages. For sovereign issuers, we consider topics like how droughts in agriculturally-sensitive regions may affect GDP and potentially cause civil strife. With respect to social risks, we monitor labor practices and how companies interact with and treat their employees, in order to identify risks of prolonged strikes. And at the country level, we discern how wars may affect consumption and fixed asset investment, which are inputs to our sovereign economic forecasts.

While we utilize a number of third-party sources of information to help identify areas requiring additional scrutiny, we do not believe that explicitly following third party ratings is appropriate. Simply put, if our integrated assessment implies that the market misunderstands ESG factors, we adjust our view of the risk premium required when considering the investment for client portfolios.

While we identify and assess these risks individually, we take a more holistic approach that integrates the ESG-specific risks with

more traditional credit risk analysis to understand the risk profile and how it impacts the investment opportunity as a whole. Once we have developed our view of the potential economic impact, we will probability-weight the various scenarios and outcomes to help understand the potential for stress to the issuer's creditworthiness. Similarly, issues that cannot be readily quantified are assessed on a qualitative basis in terms of the impact on the issuer's willingness or ability to service their debt obligations.

By integrating ESG with more traditional economic variables and analysis, we can arrive at our view of a credit's fair value, and this ultimately drives the portfolio construction process for our client portfolios.

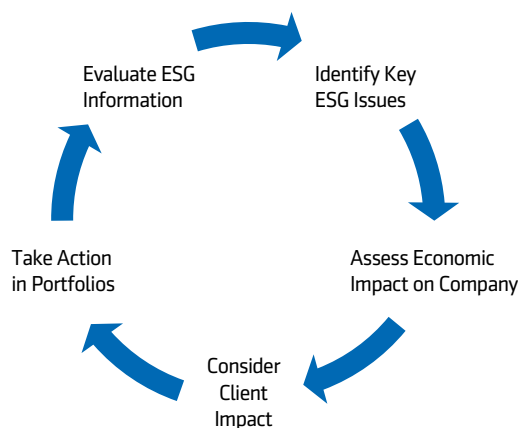
Engagement

We also work closely with Aegon Asset Management's Responsible Investments team to engage with issuers who demonstrate shortcomings in their ESG practices. We believe that engagement can be successful when our client's financial interests and society's interests are aligned to achieve mutually beneficial outcomes.

When engaging with issuers, we strive to leverage our financial stake in an attempt to encourage companies to adopt changes that we believe will enhance their business model and creditworthiness. If we do not feel successful resolution can be achieved, we will make the appropriate portfolio decisions that we believe are in our client's best interest.

Exclusion

For clients who wish to go beyond our integrated ESG approach that focuses on risk-reward assessments, we may exclude an issuer altogether. Aegon AM's dedicated Responsible Investment team, which was established in 2010, has developed a proprietary list of excluded issuers that is updated periodically and can be available for client mandates. Use of our exclusion list, which can be tailored to each client, prohibits investment in issuers with certain undesirable ESG characteristics, such as corporates associated with controversial weapons or thermal coal; or sovereign countries with a history of social repression.



Conclusion

Through our integrated approach, Aegon AM US feels that we can leverage the strength of our research platform, our access to Aegon AM's dedicated Responsible Investment team, and a holistic approach to incorporating our ESG analysis to improve the construction of our client portfolios. We are in a unique position to leverage these assets in ways that align and grow with the evolving ESG landscape and our client's needs.

To illustrate our approach in greater detail, we present the following case studies.

Case Study 1: Credit

Chemours Company was spun off from DuPont Corporation in 2015. Our analysis of the newly-formed entity identified two ESG concerns.

First, we had material concern with potential environmental and health problems caused by a chemical compound known as perfluorooctanoic acid (PFOA). The company used PFOA to manufacture its flagship product, Teflon. PFOA production led to contamination in areas near production facilities and PFOA exposure was found to be associated with increases in various negative health outcomes including, among other things, kidney and testicular cancer. These risks were flagged by our ESG process. Additionally, our research highlighted how these ESG issues could generate potential legal liabilities, negatively affecting the company's financial wherewithal and ability to ultimately service its debt obligations.

Second, our analysis also raised governance concerns. Chemours was set up to pay a disproportionately large dividend to DuPont, which magnified our concerns of whether Chemours would have sufficient resources to handle debt service and legal liabilities.

Finally, we also identified that Chemours had indemnified DuPont against legal liabilities, again creating additional possible liability related to environmental claims.

Subsequent to the initial assessment, our ongoing ESG monitoring revealed a number of legal outcomes related to adverse health conditions caused by PFOA contamination. This additional information, combined with our prior analysis, aided us in quantifying the potential economic impact stemming from Chemours' Teflon manufacturing process.

Case study 2: Sovereigns

Iraqi bonds were evaluated for investment in our emerging market portfolios, during which we integrated our views on various ESG topics into our outlook for the credit profile of the sovereign entity.

Given a significant portion of Iraq's economy is tied to crude oil exports, we evaluated the growing impact of renewable energy sources and how they might impact Iraq's GDP over the medium and long term. We developed various renewable energy growth scenarios and considered how Iraq's ability to pay its debts was affected by a technological disruption.

We also tracked and evaluated the human capital damage from the ongoing war with ISIS on consumer spending. We found that consumer spending acts with a noticeable lag relative to the war intensity, suggesting that a decline in war-related deaths might result in higher consumer spending in the future.

Lastly, Iraq suffers from significant governance and institutional strength issues. We measured these issues on a relative basis to determine the prospective credit impact from governance changes. Specifically, we were encouraged by the International Monetary Fund's renewed agreement with the country and commitment to engage with the political leadership during a turbulent governance period.

Incorporating these factors enhanced our understanding of the risks related to investing in Iraq, and were a contributor to our portfolio decisions.

Disclosure

The archived content contains information that is historical in nature and may be outdated. This material is provided for informational purposes only and should not be relied upon for investment decisions.

This material is to be used for institutional investors and not for any other purpose. The enclosed information has been developed internally and/or obtained from sources believed to be reliable. This material contains current opinions of the manager and such opinions are subject to change without notice. Aegon Asset Management US ("Aegon AM US") is under no obligation, expressed or implied, to update the material contained herein. This material contains general information only on investment matters; it should not be considered a comprehensive statement on any matter and should not be relied upon as such. If there is any conflict between the enclosed information and Aegon AM US Form ADV, the Form ADV controls. The information contained does not take into account any investor's investment objectives, particular needs, or financial situation. Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to you. The value of any investment may fluctuate. Past performance is not indicative of future results.

The information presented is for illustrative purposes only. Individual accounts may vary based on restrictions, substitutions, cash flows and other factors.

Specific sectors mentioned to not represent all sectors in which Aegon AM US seeks investments. It should not be assumed that investments of securities in these sectors were or will be profitable. References to specific securities and their issuers are not intended and should not be interpreted as recommendations to purchase, sell, or hold such securities. Aegon AM US products and strategies may or may not include the

securities referenced and if such securities are included, there is no representation that such securities will continue to be included.

Aegon AM US may trade for its own proprietary accounts or other client accounts in a manner inconsistent with this report, depending upon the short-term trading strategy, guidelines for a particular client, and other variables.

This document contains "forward-looking statements" which are based on change to the firm's beliefs, as well as on a number of assumptions concerning future events based on information currently available. These statements involve certain risks, uncertainties and assumptions which are difficult to predict. Consequently, such statements cannot be guarantees of future performance and actual outcomes and returns may differ materially from statements set forth herein. In addition, this material contains information regarding market outlook, rates of return, market indicators and other statistical information that is not intended and should not be considered an indication of the results of any Aegon AM US-managed portfolio.

Aegon USA Investment Management, LLC (AUIM) is a US-based SEC registered investment adviser and is also registered as a Commodity Trading Advisor (CTA) with the Commodity Futures Trading Commission (CFTC) and is a member of the National Futures Association (NFA).

Recipient shall not distribute, publish, sell, license or otherwise create derivative works using any of the content of this report without the prior written consent of Aegon Asset Management US, 6300 C Street SW, Cedar Rapids, IA 52499.

©2019 Aegon Asset Management US