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ESG Fixed Income Engagement Report

Developed Markets Corporate Credit

THE DEVELOPED MARKETS CORPORATE CREDIT RESEARCH TEAM BELIEVES THAT MATERIAL ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) FACTORS HAVE A MEANINGFUL IMPACT ON CREDIT QUALITY AND THEREFORE MUST BE AN IMPORTANT COMPONENT OF THE CREDIT RESEARCH PROCESS.

We believe that material Environmental, Social and Governance (ESG) factors have a meaningful impact on credit quality and therefore must be an important component of the credit research process. Additionally, engaging with issuers on ESG topics can improve the risk profiles of portfolios over time and aligns with our firm-wide commitment across asset classes to ESG integration and engagement. As a result, Neuberger Berman's Developed Markets Corporate Credit research team has engaged on approximately 670 ESG issues from April 1, 2017 to September 30, 2018 as we continue to lead efforts to increase issuer ESG awareness within our markets.

Importantly, our credit research team is directly leading our engagement efforts with issuers across the high yield, leveraged loan and investment grade credit markets. Our efforts extend beyond the parts of the market historically viewed as easiest to access, as our engagements include privately owned companies, issuers not rated by third party ESG providers and issuers not typically targeted for ESG engagement. We closely track our engagement activities, measure progress and report internally on our current priorities and initiatives. In this report, summary information on our efforts includes an overview of our engagement process, key themes and observations, data summarizing our engagement activities and relevant case studies. We plan to report on our engagement activities on a semi-annual basis going forward in order to provide increased transparency to our investors.

VALUE OF ESG INTEGRATION AND ENGAGEMENT IN FIXED INCOME

- ESG-related factors can have a material impact on credit quality and therefore must be integrated into the investment process
- Through issuer engagement the investment team can identify, understand and evaluate ESG-related risk factors that are most relevant to an issuer
- A systematic approach to ESG engagement can reduce the credit risk of a portfolio while also affecting positive outcomes for people and the planet

ESG Issues Engaged upon with Developed Markets Corporate Credit Issuers from April 1, 2017 to September 30, 2018

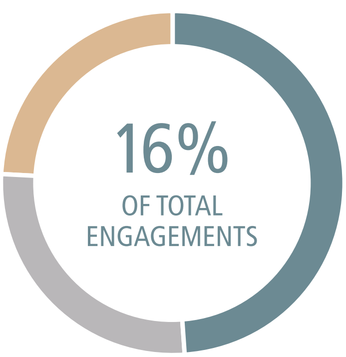
~670 ESG ISSUES ENGAGED UPON

55% OF ENGAGEMENTS WITH CFO OR CEO

9% OF INSTANCES WHERE PORTFOLIO ACTION FOLLOWED ENGAGEMENT

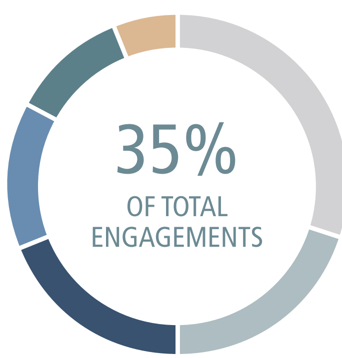
11 INSTANCES EXPOSURE WAS REDUCED TO ZERO OR WHERE WE NEVER INVESTED IN THE CREDIT

ENVIRONMENTAL



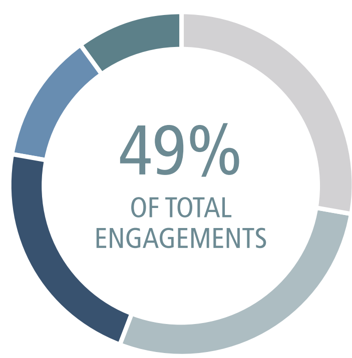
- **49%** CLIMATE CHANGE
- **27%** POLLUTION AND MITIGATION MANAGEMENT
- **24%** WASTE AND WATER MANAGEMENT

SOCIAL



- **30%** COMMUNITY RELATIONS
- **20%** LABOR RELATIONS
- **19%** HUMAN CAPITAL MANAGEMENT
- **14%** CYBER SECURITY
- **11%** HEALTH AND SAFETY
- **6%** HEALTHCARE PRICING

GOVERNANCE



- **28%** FINANCIAL CONTROLS AND DISCLOSURE
- **28%** LONG-TERM BUSINESS STRATEGY
- **22%** BOARD INDEPENDENCE
- **12%** RISK MANAGEMENT
- **10%** COMPENSATION STRUCTURE

Systematic ESG Engagement Framework

Neuberger Berman follows a systematic process to conduct our ESG engagement efforts. Our ESG Engagement Tracker is used to document objectives and outcomes, and to track progress over time. Our Developed Markets Corporate Credit research and portfolio management teams are directly involved in these conversations because we view these ESG considerations as important drivers of credit quality and our investment decisions.

MARKET-WIDE INITIATIVES

- Engage with regulators and market infrastructure providers
- Recent examples include engaging with S&P and Moody's regarding ESG intergration into credit ratings
- Publish timely and relevant insights at nb.com/esg
  - "Rating the Raters on ESG"
  - "Engaging in ESG"
  - "Non-IG Engagement Case Studies"
- Industry-level collaboration with established organizations such as UN, PRI, SASB and others

DIRECT ISSUER ENGAGEMENT

- Developed Markets Corporate Credit research analysts conduct engagements on factors most relevant to credit risk in each industry based on our proprietary ESG Scoring System
  - ESG engagements covering ~670 issues from April 1, 2017 to September 30, 2018
- Company-specific engagement
  - Long-term strategy and incentives
  - Management of material Social and Environmental risks
- Sector-specific engagement
  - Multiple issuers within the same sector
  - Recent examples include incentive structures in the Oil & Gas industry

EVALUATE PROGRESS

- ESG Engagement Tracker
  - Track objectives, outcomes and progress at the issuer and industry levels
  - Identify engagement priorities which contribute toward Sustainable Development Goals (SDGs)
- Quarterly ESG Review reported to Credit Committee
  - Reiew of current priorities
  - Assess performance impact and develop data over time

Insights from Our Engagements

Our ESG engagement activities seek to raise issuer awareness on relevant ESG topics, identify potential ESG-related business risks and track mitigation of identified risks by issuers. Our direct engagement is an important tool to affect outcomes that reduce the credit risk of a portfolio. ESG and traditional credit engagement often occur concurrently, consistent with our view that ESG is an integrated part of the credit research process as opposed to a separate non-integrated overlay. These convictions are deeply rooted in our investment DNA as evidenced by our longstanding Credit Best Practices Checklist, which highlights our commitment to identifying these risks for over 20 years. ESG-related risks and their impact on issuers and markets continue to evolve and therefore require a dynamic approach to issuer engagement. Below, we share insights from recent engagement activities, including areas of growth and our key observations across the high yield, leveraged loan and investment grade credit markets.

OUR DIRECT ENGAGEMENT IS AN IMPORTANT TOOL TO AFFECT OUTCOMES THAT REDUCE THE CREDIT RISK OF A PORTFOLIO.

Engagement Prioritization

Our engagement prioritization is a function of the following considerations: severity of ESG concern as assessed by our proprietary ESG Scoring System, economic exposure to identified risks and our relative level of influence within a company's capital structure. Ultimately, we aim to prioritize engagement that has the largest impact on the protection and improvement of our clients' assets. This can be achieved by deepening our understanding of risk management practices at an issuer, through the advancement of actionable disclosure, or through action to mitigate risks and take advantage of investment opportunities.

Timing of our engagement activities is ongoing in nature, and is most often initiated at the time of new issuance or initial purchase of an issuer in the secondary market. In many instances, we also maintain longstanding engagement with issuers before we invest in their capital structure due to our active evaluation of secondary market investment opportunities on an ongoing basis. Through our proprietary ESG Scoring System, our goal is to be proactive in nature with our engagement efforts because we believe that this helps us avoid downside risks in our portfolios.

Growing Areas of Engagement

While governance, capital allocation, climate change and social impact have been longstanding engagement topics, areas of our engagement that have experienced particular growth over the past 18 months include cyber security, community relations and water management.

Cyber Security

- We view cyber security as a critical business risk factor across many industries in the years ahead, and we have increased our dialogue with issuers in this important area.
  - Goals of our engagement on cyber security:
    - Identify issuers with leading practices in cyber security risk management.
    - Promote practices that protect consumers and the security of confidential data and information.
    - Incorporate increased business risk into our thesis for issuers identified as laggards, engage with management regarding desired improvements and track their progress over time.

Water Management

- Water resource management is a growing component of our engagement efforts. We view the appropriate management of water as a critical business factor for issuers in the years ahead and have increased our dialogue with issuers on this topic.
  - Goals of our engagement on water resource management:
    - Identify best practices across industries and issuers implementing these practices.
    - Promote practices that conserve or recycle water resources.
    - Incorporate increased business risk into our thesis for issuers with outsized exposure or sub-par water management practices and track their remediation over time.

Community Relations

- The impact of an issuer on the communities and environments where they operate represents an important consideration and an increasingly important component of credit analysis.
  - Goals of our engagement on community relations:
    - Identify issuers that value their relationship with communities.
    - Understand how an issuer's operations impact the communities where they operate and any related controversies.
    - Engage with issuers to promote techniques that mitigate the impact of operations to the surrounding community and environment.
    - Incorporate increased business risk into our thesis for issuers identified as laggards, engage with management regarding desired improvements and track their bridge-building to communities over time.

MATERIAL ESG RISKS ARE ALWAYS EVOLVING; IT IS IMPORTANT TO ENGAGE NOT ONLY ON TRADITIONAL RISKS, BUT ON EMERGING RISKS AS WELL.

Reflections from a Fixed Income Perspective

SCALE AND SECTOR IMPACT RESPONSIVENESS

Based on our experience, issuers of scale that operate in sectors with clear environment and social risks— such as Oil & Gas, Mining, Banking, Healthcare and Gaming—are the most responsive to our engagement activities along with issuers that have an investor relations infrastructure in place that is capable of taking action after receiving specific feedback.

LONG-TERM RELATIONSHIPS MATTER

We have been most successful in situations where we engage in meaningful and regular dialogue with issuers, have a large or long-term presence in the capital structure and make specific recommendations. When issuers view us as a meaningful, long-term creditor who makes specific recommendations, we can most successfully encourage management teams to implement our recommendations.

IMPORTANCE OF COLLABORATION WITH ISSUERS

We have observed that once we initiate a discussion regarding the importance of implementing ESG practices and disclosing related information to investors, it is easier to subsequently address specific aspects of an issuer's policies.

OPPORTUNITY TO PROMOTE ESG AWARENESS

Privately owned issuers that operate outside of industries with obvious ESG-related risks—such as Oil & Gas, Mining, Banking, Healthcare and Gaming—are generally less familiar with this line of inquiry. We expect that this will change over time with consistent engagement and as ESG considerations become increasingly reflected in an issuer's cost of capital.

ENGAGEMENT CASE STUDY

Driving Reduced Credit Risk through Engagement

Background

Diversified financial issuer with a focus on global aircraft leasing. First-time issuer in the high yield and leveraged loan markets during 2017.

Objective

Our engagement with the issuer was focused on enhancing the company's governance structure and covenant protections. The issuer benefits from economies of scale, moderate debt levels and positive industry growth trends. Despite these fundamental strengths, the company's governance and ownership structure led to heightened investor concerns and trading volatility due to the company's ownership structure. Media attention surrounding the leveraged balance sheet of a key equity owner drove investor concern that value would be extracted to the detriment of creditors.

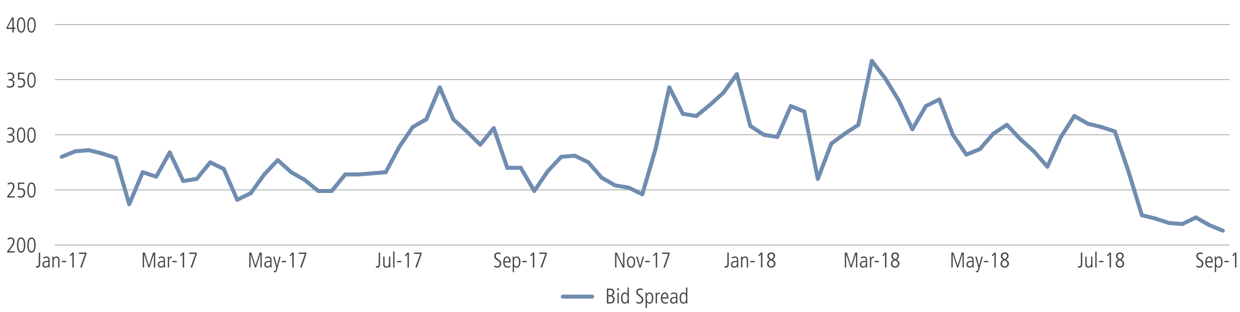
Scope and Process

Our engagement with the issuer was frequent since the company's initial issuance, including 15+ points of contact with various members of its leadership team (CEO, CFO, investor relations). The focal points of our engagement were discussions of material governance matters, including avenues to strengthen the existing separation framework from the key equity owner and reinforce the company's independent governance structure. We believed it was critical for management to address investor concerns in a timely manner due to the nature of its business model, which relies on consistent access to capital markets. We encouraged management to commit to and maintain a transparent capital allocation policy. We felt this policy would be further reinforced by the addition of structural covenant protections for creditors.

Outcome

The issuer voluntarily instituted credit-enhancing covenant protections during February 2018 that included the addition of restricted payment protections. We viewed the implementation of these protections favorably. Our engagement with the issuer continued as we believed the company's ownership and governance structure still hindered its ability to achieve its credit rating goals. The issuer subsequently diversified its equity owner base in a credit-enhancing manner. Additionally, the company made further enhancements to its board structure in which no material shareholder undertaking could be implemented without the approval of a second large equity owner. The market and rating agencies viewed these actions favorably and they drove spread tightening across the structure. We anticipate that the governance enhancements made by the company will ultimately drive a move from high yield ratings to investment grade.

ISSUER SPREAD TO WORST OVER TIME



ENGAGEMENT CASE STUDY

Avoiding Credit Deterioration through Engagement

Background

We believe there is increased focus on reducing healthcare costs for society at large. We believe that companies in the healthcare sector will be unable to continue raising prices to the extent they have historically and will face revenue and earnings pressure over time unless they can grow volumes or provide innovative solutions to improve the lives of patients.

During our due diligence on an issuer within the Healthcare Services sector, we identified that the issuer had historically grown revenues through significant price increases that persisted over many years for commercially insured patients. Moreover, we also identified that patients were often left with large payment obligations, even for those with insurance coverage, without taking into account their ability to pay.

Objective

Our engagement goals in this case were to evaluate the following factors:

- Did the issuer maintain plans to normalize its pricing practices in the future?
- Was the management team aware of the impact that large price increases have on society and were they taking this into account in their business planning?
- What was the likelihood that past aggressive pricing activities would negatively impact the business in the future through reduced volume growth, heightened regulatory scrutiny or over-reliance on pricing to grow cash flows?

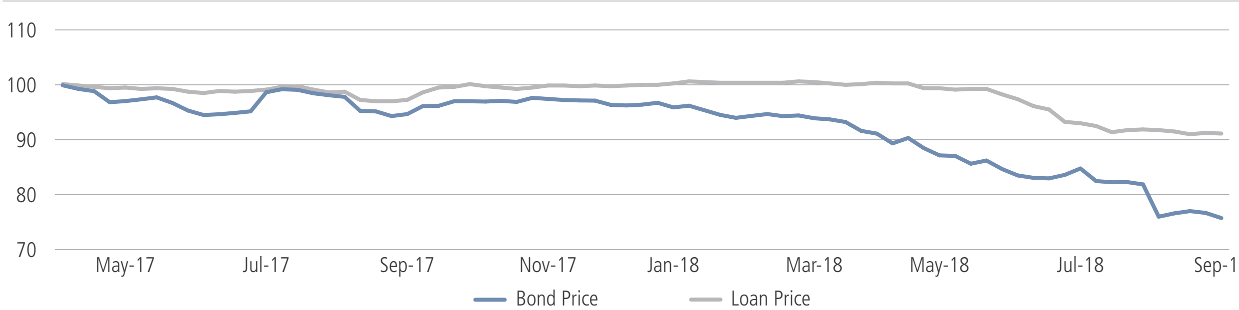
Scope and Process

Our engagement with the issuer was initiated during an LBO financing syndication process and encompassed various levels of management and other sources. We engaged with the company's CEO and CFO, the financial sponsor purchasing the company, the financial sponsor of the issuer's primary competitor, as well as regulatory experts focused on the Healthcare sector. Our discussions identified that there was no plan in place to normalize aggressive pricing activities, and we concluded that the historical rate of pricing growth was not sustainable going forward due to its negative impact on patients and the cost to insurance providers.

Outcome

We avoided investing in the issuer's Senior Unsecured Notes and exited the Senior Secured Term Loan near par due to the concerns that we identified surrounding aggressive pricing activities and our view that this could negatively impact the business going forward. The issuer has subsequently experienced credit deterioration driven by several factors, one of which we believe is negative volume trends, potentially driven by above-market pricing, and increased media and regulatory scrutiny on their sector.

BOND & LOAN PRICE OVER TIME



ENGAGEMENT CASE STUDY

Enhancing Our Underwriting Process through Engagement

Background

A leading global software company planned to raise capital in the investment grade credit market to finance an acquisition. The company's business model focuses on large data centers that store proprietary software and customer data, which we believed exposed the company to a high degree of cyber security risk.

Objective

Our engagement with the issuer was focused on evaluating the company's cyber and data security practices as critical factors in our investment decision. Despite an otherwise favorable credit profile, we were concerned about whether the company's data security infrastructure was sufficient to reduce the risk of a cyber security breach that could result in compromised customer data—a key factor used in our ESG scoring methodology for technology companies. We sought additional details from the issuer regarding their risk management practices in this area because we believe that a security breach affecting its data centers would have the potential to create meaningful customer loss, litigation expenses and credit quality deterioration.

Scope and Process

We engaged with the issuer during the new issue process on multiple occasions, including through a group investor call and then subsequently in a direct manner with senior management. Our discussion with management was focused on whether the company had implemented best practices to mitigate the cyber security risks inherent in its business model. We assessed information regarding its data security investments and cyber security-specific staffing levels, among other factors. We concluded that the issuer has implemented business practices sufficient to lower the risk of potential data security breaches. For example, the issuer's EVP of Security reports directly to the Board of Directors, which we believe demonstrates the importance of data security to the company.

Outcome

Our team invested in the new issuance based on the overall strength of their credit profile, and our view that management was taking appropriate steps to mitigate the data security risks we identified as part of our ESG scoring process. We intend to maintain ongoing dialogue with the issuer as we monitor the company's data security practices going forward.

Sustainable Development Goals

Engagement with issuers can also facilitate positive outcomes for people and the planet with the Sustainable Development Goals (SDGs) providing a good framework to guide these efforts. The SDGs are a set of goals developed by the United Nations with the aim of achieving a better and more sustainable future for all people. Several of our engagements to-date have been aligned with progress toward the SDGs. For example, in the period covered by this report we engaged with an issuer in the Packaging sector on reducing their paper pulp consumption through more environmentally-friendly lightweight products. We also engaged with an issuer in the Energy sector who committed to reducing their water consumption.

To build upon these positive outcomes going forward, we will be assigning each issuer a set of ESG-related goals that are relevant for their business interests and are aligned with progress toward the SDGs. Our investment team will continue to engage with issuers regarding the importance of ESG considerations in our credit research process, share specific goals with companies that are aligned with the SDGs and communicate to issuers our view that progress toward the SDGs should be a consideration in long-term business planning. Goals assigned to issuers are developed by the investment team and we believe accretive to the issuer's long-term credit profile. Through continuous engagement, the investment team will collaborate with issuers on best practices while monitoring the progress made toward achieving established goals. In situations where progress is not achieved, the investment team will evaluate whether further engagement is required or if portfolio action is warranted.

ULTIMATELY, WE BELIEVE ISSUERS WHO EMBRACE BEST-IN-CLASS ESG PRACTICES AND DISCLOSURES WILL BENEFIT FROM A LOWER LONG-TERM COST OF CAPITAL.

Conclusion and Outlook

As a leader within the Fixed Income credit markets, we have a powerful integrated platform to affect positive change and promote good corporate citizenship. ESG-related risk factors can have a material impact on issuer credit quality. Therefore, the evaluation of these risk factors is an important component of our investment process. Engagement with issuers not only serves as an opportunity to better understand investment risk factors, but also as an important tool to educate issuers on ESG topics, improve issuer disclosure and provide feedback that can improve credit quality through the advancement of goals that positively impact people and the planet. Looking forward, we are encouraged by the market's increased focus on ESG considerations. Ultimately, we believe issuers who embrace best-in-class ESG practices and disclosures will benefit from a lower long-term cost of capital.

FOR MORE ABOUT OUR APPROACH TO ESG AND IMPACT INVESTING, PLEASE VISIT WWW.NB.COM/ESG.

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