# Nikko Asset Management Group Response to the UK Stewardship Code 2020

April 2022

nikko am
Nikko Asset Management

For the reporting period 1st January to 31st December 2021

## Foreword

We know how important stewardship is to our clients – we hear it from them on a day-to-day basis. They have increasing expectations of what we do on their behalf, how we do it, and how it is reported – and rightly so. In an increasingly interdependent post-pandemic world, the challenges ahead of us are significant, and, as stewards of our clients' capital, we have a duty to ensure that we are acting responsibly on their behalf. We also recognise that we have a wider role as guardians of market integrity and a responsibility to minimise systemic risks to ensure that markets continue to be run for the benefit of the whole of society.

At Nikko Asset Management we take these responsibilities very seriously and are committed to putting the best interests of our clients first. Fiduciary, environmental, social and governance principles are at the heart of our business and together represent the highest guiding theme of our management philosophy. Our investment beliefs have always centred on concepts such as governance and sustainable growth. Our typically long holding periods have allowed us to develop strong relationships with many of the companies in which we invest, helping us to make better-informed investment decisions.

As in any relationship, this is a two-way process. While we listen to what companies tell us, we also use our voice as shareholders to encourage them to focus on material issues such as climate change, board diversity and gender equality alongside financial performance – and we hold ourselves to the same standards. In 2021 we made changes to a number of stewardship related policies and position statements, as well as making commitments to a number of diversity, inclusion and climate-related initiatives which are detailed within this report.

We believe high standards should start at the top. As a former Chairman of the Japan Investment Advisers Association and member of the Panel for Vitalizing Financial and Capital Markets, which was hosted by the Japan Financial Services Agency, I promoted the introduction of Japan's own Stewardship Code in 2014. I therefore fully support and commend the work of the UK Financial Reporting Council in raising the bar to promote effective stewardship by improving the quality of disclosure, transparency and accountability of both companies and investors.

We have made significant investments in enhancing our ESG integration and stewardship capabilities, but we recognise that all these areas require continuous improvement to match the evolving needs of our diverse client base. We appreciate the opportunity to share our progress with you in this report and trust that it evidences our strong commitment to stewardship.

**Yoichiro Iwama**
**Outside Director and Chairman of the Board of Directors**

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# Principle 1:

## Signatories' purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

### Nikko AM Group Statement of Purpose

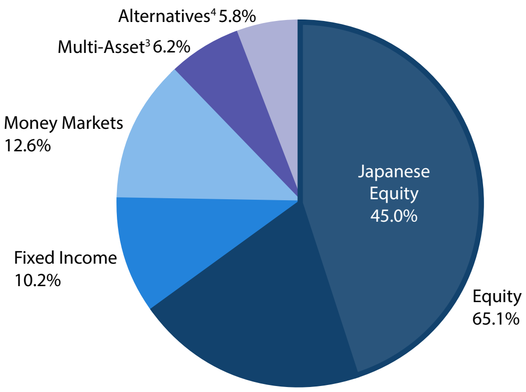
"Nikko AM, as an asset management company, acts as a fiduciary on behalf of its clients and is firmly committed to putting its clients' best interests first. It places fiduciary and ESG principles as the highest guiding themes of its corporate values and actions."

### Context

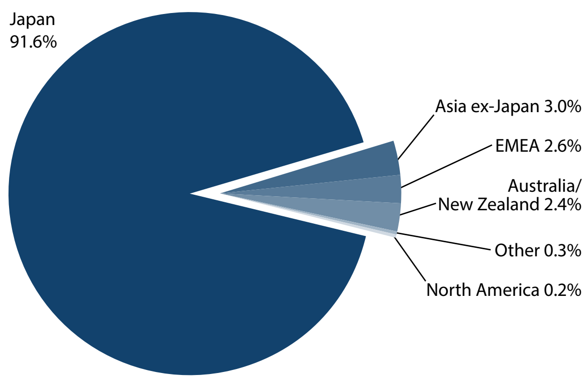
With its origins in Japan, the Nikko Asset Management Group ("NAM Group") is today one of Asia's largest independent asset managers, with $271.5 billion[1] under management. Headquartered in Japan, which is home to a large proportion of both our clients and our assets, we also have presence in the rest of the world, including the UK. We combine a global perspective with our Asian DNA to create sophisticated and diverse investment solutions to meet our clients' needs. Japanese culture values harmony, both with nature and with other people, putting less emphasis on the individual and more on society than in Western traditions. We have therefore grown up over the past 60 years infused with the knowledge that we must be good corporate citizens. Our approach to stewardship and engagement has evolved against that background and it informs the way we have addressed our response to the UK Stewardship Code.

A breakdown of our AUM by asset class, client segment and domicile is shown in the following charts.

**Assets Under Management by Asset Class[2]**



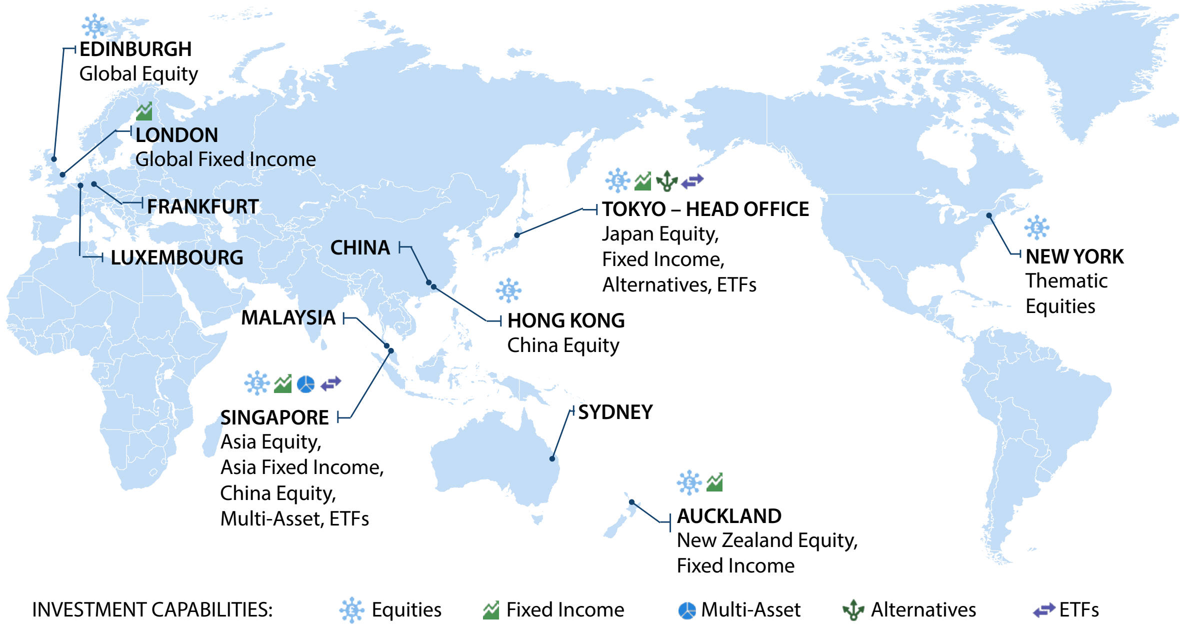

**Assets Under Management by Client Domicile[2]**




The NAM Group and its affiliates have a presence in 11 countries, with our in-house investment teams located in seven of our offices across four continents. We have a diverse workforce that includes 26 nationalities working together with the common purpose of protecting and growing the assets of our customers in a way that best meets their long-term investment goals. Together we provide high-conviction fund management from across our global network, as well as across a range of active equity, fixed income and multi-asset strategies[2] (combining both equity and fixed income assets), with our complementary range of passive strategies covering more than 20 indices, including some of Asia's largest exchange-traded funds (ETFs).

[1] As of 31 December 2021. Consolidated assets under management and advice of Nikko AM, including subsidiaries but excluding minority affiliates and minority joint ventures.
[2] Totals may not sum due to rounding of data at source.
[3] 'Multi-Asset' funds are made up of Equity and Fixed Income assets; the stewardship of each of these assets is addressed individually in this report.
[4] 'Alternatives' constitutes REITs, Equity Long/Short and Infrastructure funds. Infrastructure represents 0.2% of group AUM and is managed by external managers. These managers are subject to Nikko AM's external manager due diligence process, which includes a review of ESG policies.

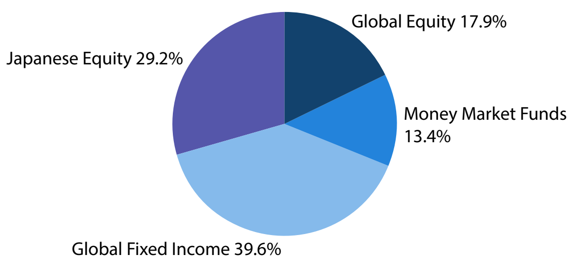
**Locations of our Offices and Investment Teams**



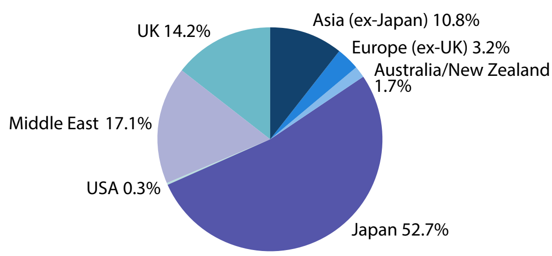

While most of our assets under management (AUM) and clients are based in Asia, our long-term business goal is to offer best-in-class investment solutions for clients worldwide.

We implement cross border delegation arrangements whereby the locally contracted Nikko AM office manages business development supported by local client servicing teams, with portfolio management delegated to the respective regional Nikko AM group entity where the relevant investment expertise is based. For example, the AUM of our UK entity, accounting for approximately 8% of Nikko AM Group AUM represents assets managed on behalf of institutional clients in the UK, Europe and the Middle East who are accessing the investment capabilities of both our local and global investment teams, as well as investors from across the globe accessing the expertise of our Edinburgh-based Global Equity and London-based Global Fixed Income teams. A breakdown of the AUM of our UK entity as at 31 December 2021 is provided in the charts below:

**Nikko Asset Management Europe Limited:
AUM Breakdown by Asset Class**




**Nikko Asset Management Europe Limited:
AUM Breakdown by Client Domicile**




We believe in a sense of responsibility, stressing stability and harmony. We believe in promoting respect for our environment, for our community and for other people. As active owners we recognise the value of building long-term relationships built on trust and respect for the companies in which we invest to promote better outcomes for our clients, the economy, the environment and society. In doing so, we strive to be better global citizens.

# Principle 1:

## Code of Ethics

Below we outline our values in the context of investment beliefs, culture and engagement and, within the activity section, explain how these enable effective stewardship. These values are encapsulated in our Code of Ethics, which commits us to upholding:

- our fiduciary duty to our clients
- the integrity of capital markets
- our responsibilities to environmental conservation, and
- our social responsibility.

The Code of Ethics is reviewed by the NAM Group Board of Directors (more details of the review process are described in Principle 5) and attested to annually by all employees globally. It acknowledges that, as a fiduciary, we owe our clients a duty of loyalty and care. When acting in a fiduciary capacity, all employees must act for the benefit of our clients, placing their interests before the interests of the NAM Group, a third party or their own. Employees must also act with reasonable care and diligence and exercise prudent judgement in the performance of their duties. The code provides guidance and sets standards in a number of specific areas, including our duties to regulators and the public, to upholding the integrity of financial markets, to ethical business practices, fair competition and personal trading, and also our environmental and social responsibilities.

At the heart of our culture is the belief that, as stewards of our clients' money, we have a duty to provide the right investment solutions to meet their goals. To do this requires us to understand their investment objectives, risk appetite, and regulatory and accounting frameworks, as well as the wider social and environmental climate in which we all live.

## Environmental, Social and Governance Considerations

We strongly believe that environmental, social and governance (ESG) considerations are inherent to long-term corporate value creation and contribute to the realisation of sustainable economic growth. In the light of this, we view ESG issues as an integral part of our fiduciary duty to clients and endeavour to incorporate ESG principles in all our investment processes. Our approach to ESG is outlined in more detail under Principle 7. Our policies on ESG, responsible investing and stewardship are available on our website: Fiduciary and ESG Principles, Commitment to Responsible Investing, Position Statement on Climate Change, Climate-related Financial Disclosure, Engagement and Stewardship Strategy, Stewardship Activities Report and Self-assessment, and our Sustainability Report.

## Culture

We believe that our diverse, inclusive and collaborative culture is a key competitive advantage and supports our ability to generate differentiated insights. Our commitment to diversity is enshrined in our Code of Ethics and our staff members come from a rich diversity of backgrounds, with language capabilities covering all the main Asian and European languages.

Our team meetings encourage widespread participation, drawing on the collective intellect, experience and cultural and gender diversity of our teams and each individual's experience to question the market consensus. Combined with common values based on mutual respect, our teams are well-composed to meet the challenge of investing in diverse, and fast-moving global and regional markets. These principles of respect for diversity and the rights of our fellow workers are set out in our Code of Ethics.

Our investment teams have autonomy to implement their own investment philosophies and processes in the markets and asset classes in which they specialise. In order to support these philosophies and processes, we are making investments in both our investment and our stewardship teams and developing and building further the resources we devote to ESG. Specifically, in this last area, we are expanding our teams in the UK and Asia to bring in additional dedicated ESG staff to work alongside our investment teams starting with three additional full-time ESG hires in 2022. This is discussed in more detail under Principles 2 and 7.

## Engagement

We believe that engagement is a key factor in the stewardship of our clients' assets. We find that constructive dialogue with our investee companies helps foster their long-term value and sustainable growth characteristics, improving both returns for clients and managements' accountability to society and the environment. This requires in-depth knowledge of the companies and the environment in which they operate, as well as wider considerations of sustainability consistent with our investment management strategies. Our long experience in these areas means that the approach to engagement we adopt sometimes needs to be adapted to cultural differences in different parts of the world. We discuss engagement further under Principles 9, 10, 11 and 12.

## Activity

### Policies and Position Statements

In line with our commitment to continuous improvement, during 2021 we took steps to ensure that our investment approaches, strategy and culture continue to foster effective stewardship. We reviewed and updated a number of policies, including our Code of Ethics, Conflict of Interest and environmental policies on climate change. For example, we amended our Environmental Policy to set a target of reducing our greenhouse gas emissions from operations per employee by 40% by 2030 compared to our 2019 level. These changes are discussed more fully under Principle 5. We were also active in our collaborative efforts with others in the industry. Our ESG Global Steering Committee approved our membership of the Net Zero Asset Managers Initiative (see Principle 10). We invested in people, technology and ESG data extraction and integration capabilities to ensure that we are able to provide the level of service required to meet the needs of our clients, which is described in more detail under Principle 2.

As a result of our review process, updates were made to a number of our policies and position statements in 2021 such as the amendment to our Position Statement on Climate Change made by our ESG Global Steering Committee. In addition, our Global Equity team updated their proxy voting policy to emphasise the importance of ESG. As part of our culture of continuous improvement, we continue to monitor the effectiveness of these policies, which we anticipate will evolve and may be strengthened in due course.

### Staff Diversity and Inclusion

In terms of staff diversity, we recognise that we can do better. Currently,[5] women make up 37% of our total staff and occupy 20% of our management positions. We are actively trying to raise the numbers. We give staff in Japan at least two years' time off to look after children – which may be extended to three in special circumstances – after which they are welcomed back at the same level as when they left. We are long-time supporters of the Women's Empowerment Principles, established by the UN Global Compact and the United Nations Entity for Gender Equality and the Empowerment of Women. We are also a member of the 30% Club Japan Investor Group, which aims to have 30% of all board seats of TOPIX 100 companies occupied by women by 2030. Last year we went a step further and signed up to a "30 by 2030" initiative, committing the firm to ensuring that at least 30% of all our managerial positions are occupied by women in 2030. We have already started to put that commitment into practice, raising the proportion of female managers at the firm from 18.4% to 20.0% over the year to January.

We are also actively seeking to create more welcoming working conditions for LGBT employees. For instance, employees in same-sex relationships receive the same benefits as employees in traditional marriages. We are an official member of LGBT Finance, an organization set up by financial institutions in Japan to support LGBT people. This initiative enjoys very visible grass-roots support from our employees and very engaged sponsorship from our senior management. In 2021, for the third year running, Nikko AM was awarded a gold award in the Pride Index, created by work with Pride, a non-profit-making organisation that helps companies and other organisations adopt and promote LGBTQ-related diversity and inclusion initiatives.

We set up our first Diversity and Inclusion (D&I) Working Group (the Women's Working Group) in 2015 and we currently have four D&I working groups supported by the Corporate Sustainability Department—Women's, LGBT, Disabilities, and Racial Equality—where employees plan initiatives and events to promote diversity. For instance, our working group for people with disabilities helps to provide a better working environment for employees living with disabilities. It also works to enhance employees' understanding of each other's needs and encourages cross-departmental co-operation.

We adopted a new Diversity and Inclusion Policy in December 2021, underlining the firm's commitment to embracing diversity and creating a work environment free from discrimination and harassment. In it we state that Nikko AM embraces and encourages individual differences amongst staff and has a zero-tolerance policy towards discrimination of any kind. These principles apply, amongst other things, to our practices and policies on recruitment and selection, compensation and benefits, professional development and training, promotions, transfers, social and recreational programmes, redundancies and terminations.

**In line with our commitment to continuous improvement, during 2021 we took steps to ensure that our investment approaches, strategy and culture continue to foster effective stewardship.**

[5] As at 1 January, 2022.

It aims to ensure that:

- all staff treat others with respect;
- teamwork and participation are inclusive, allowing all groups and perspectives to be represented;
- a healthy work/life balance is promoted and encouraged through flexible work schedules;
- both we and our employees contribute to our communities and develop programmes that support them.

Support for our Diversity and Inclusion initiatives comes from the highest levels of the organisation, with particular focus from Stefanie Drews, who was appointed NAM Group President and COO of Nikko AM in April 2022. Ms. Drews has been a champion of diversity and sustainability issues within the company since joining Nikko AM in 2014 as Head of Institutional Marketing and Proposition and has been an internal campaigner on matters of equality as she has moved through the ranks of the organisation.

**Investments**

Our main instrument for translating our investment beliefs, strategy and culture into effective stewardship is our investment teams. They have different approaches and different opportunities to exercise stewardship, which are described below and in the rest of this report.

***Equity***

The nature of equity voting rights and accessibility to companies as a shareholder allows us to implement our investment beliefs and enact our stewarding responsibility in many ways other than making an investment decision. These are discussed further throughout the report, with our engagement and voting activity covered in particular under Principles 9, 10, 11 and 12.

One example of enacting our stewardship responsibilities during 2021 was our Global Equities team liaising with several clients regarding their ESG priorities and developments. The team intends to continue this dialogue and is working with our client services team to enhance quarterly ESG reporting. Their goal here is to enhance our engagement by making reporting more of a two-way process, with discussions regarding clients' ESG requirements included as part of our regular client meetings and feedback loops.

**We adopted a new Diversity and Inclusion Policy in December 2021, underlining the firm's commitment to embracing diversity and creating a work environment free from discrimination and harassment.**

***Fixed income***

Fixed income is an area where it can be more difficult to have a direct influence on the direction of investee companies, given the lack of voting power normally attached to bond investments and generally more limited access to companies' management. Nonetheless, our teams have been active in extending our stewardship activities in a number of areas during the year, further discussed throughout the report.

An example is where our Global Fixed Income team now regularly engages with our Japanese clients on ESG and broader stewardship questions and has started to be more active in engaging with bond issuers. The pandemic has raised anxieties amongst some clients about its impact on returns, prompting the team to increase engagement. In 2022, the Global Fixed Income team will be continuing to review the effectiveness of both MSCI's ESG company monitoring tools and our own proprietary versions with a view to moving exclusively to the latter. The team will also continue its regular overview of trading conditions and make any necessary further refinements based on client feedback. Our other Fixed Income teams also have their own analytical tools to integrate ESG factors more effectively. Our Asia Fixed Income team, for example, made significant improvements to its ESG monitoring system during 2021 and formalised the process by which ESG risks and opportunities recorded during the issuer analysis process are factored into the outcome of our proprietary Internal Credit Rating.

## Outcome

Our activities to date, particularly those undertaken during 2021, reflect our commitment to fiduciary duty and have been effective in embedding stewardship values across the organisation.

We enhanced a number of policies and processes during the year in order to ensure that we continue to evolve our oversight and reinforce our culture of stewardship and put them into practice in several areas. Much of the evidence for our activity will be found in later sections of this report.

We face different challenges to asset managers that have a European or North American heritage. Japanese culture values stewardship, but often approaches it from a different perspective than Western societies. As we have grown over the last 60 years from an organisation focused on the domestic Japanese market into a global asset manager, we have brought with us these Asian traditions of stewardship which are themselves evolving as they meet Western practice. This process is challenging us to review and enhance our approach to stewardship, which has tended to be equity-driven and focused on generating the best possible investment returns for our clients.

We are bringing greater focus to environmental and societal outcomes, whilst recognising that there are opportunities for further development. This process of evolution involves long-term initiatives and a commitment to continuous improvement – values that are consistent with our Japanese heritage.

# Principle 2:

## Signatories' governance, resources and incentives support stewardship.

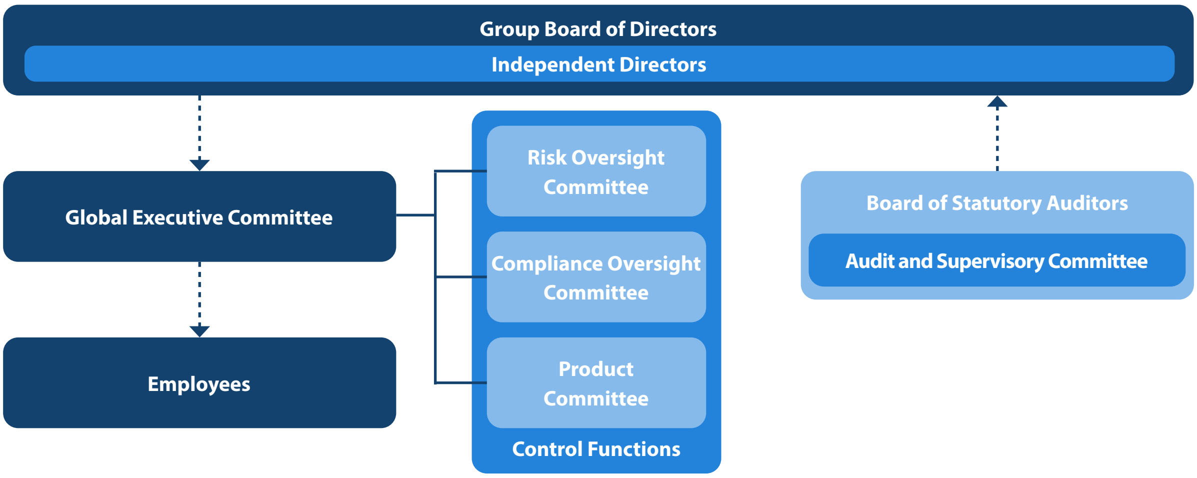
### Activity

We regard fiduciary and ESG principles as paramount guides in fulfilling our duties as stewards of our clients' assets. In implementing these principles, corporate governance is critical. Our fiduciary and stewardship responsibilities are overseen by the NAM Group Board of Directors, which is headed by Non-Executive Director and Chairman, Yoichiro Iwama, and, effective from April 2022, our Executive and Chairman, Yutaka Nishida, and President, Stefanie Drews.

As of April 2022, three of the ten members of the NAM Group Board are female, reinforcing our commitment to gender diversity.

The NAM Group Board delegates responsibility for day-to-day decision-making to our Global Executive Committee (GEC), comprising members of the senior management team, whose details can be found under the Leadership section of our website. See chart below for a simplified diagram of our group governance structure, including how other key control and audit functions relate to these committees.

**NAM Group Governance**




In 2019 we restructured the NAM Group's supervisory and governance structure. This involved creating an audit and supervisory committee, while increasing the proportion of outside directors on the board to 60%. The role of the new committee is to strengthen oversight and enhance our corporate governance framework. At the same time, Mr Iwama was appointed an outside director on our Japanese Stewardship and Voting Rights Policy Oversight Committee (further details of this committee are provided later in this section), where over half the members are now independent of Nikko AM. We believe this structure is a robust demonstration of our commitment to diversity and independence at board level, and thorough stewardship oversight.

**Yoichiro Iwama**
**Outside Director and Chairman of the Board of Directors**

**Stefanie Drews**
**President**

**Yutaka Nishida**
**Executive Chairman**

# Principle 2:

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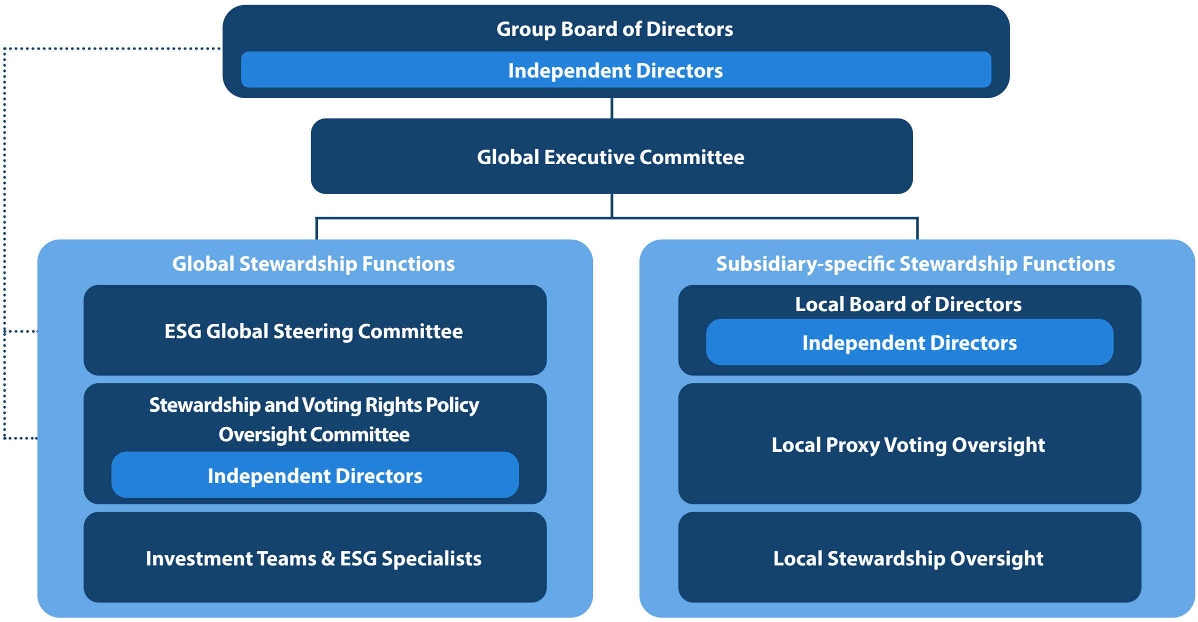
### The Governance of Stewardship Activities




Governance of stewardship activities is applied at both the global and local subsidiary level. The oversight overall employment of ESG is the responsibility of the ESG Global Steering Committee which was established in 2016. It oversees the integration of ESG within investment teams, sets policy and develops strategy, makes external disclosures and recommends ESG-related initiatives and participation in external bodies. The ESG Global Steering Committee is governed by the GEC but in addition reports directly to the NAM Group Board. It is chaired by the Global Head of Investment and other members are the heads of our investment teams worldwide, who are in charge of stewardship implementation in their individual investment processes (including ESG integration, company engagement and proxy voting, where applicable). As well as its monitoring and guidance activities, the Steering Committee drives our implementation of the United Nations-supported Principles for Responsible Investment (PRI).

## Our Commitment to Stewardship

We believe our actions over the past few years demonstrate our readiness to put principle into practice, starting at the top of the firm. Our Non-Executive Director and Chairman, Mr Iwama, has a wealth of experience within the Japanese asset management industry, particularly in developing stewardship policy in Japan. As a previous Chair of the Council of Experts on Japan's Stewardship Code (a body created by the Japanese Financial Services Authority), Mr Iwama played a leading role in introducing the concept of stewardship to the Japanese asset management industry and was heavily involved in establishing the current version of the Japan Stewardship Code. As Chairman of the Japan Investment Advisers Association from 2010 to 2017, he was intimately involved in the introduction of Japan's Stewardship Code in February 2014, which was later revised in May 2017 and again in May 2021. He has played a crucial role in heightening stewardship within the Japanese asset management industry and corporate governance at investee companies.

During 2021, Mr Iwama also served as a member of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code, which made recommendations about revising the two corporate codes. Details of the revisions proposed by the council during 2021 can be found on the website of the Japanese Financial Services Agency here but include measures to:

- enhance board independence,
- promote diversity,
- give greater focus to sustainability and ESG.

Under Mr Iwama's supervision of the NAM Group Board, we continue to strive for the highest standards of governance and stewardship.

Our new Group President and COO is herself a vocal champion of sustainability and diversity issues, both within the organisation and publicly. During her years with the company, she has worked at fostering a culture based on recognising talent and merit. She is also keen to boost the number of women in senior roles. As stated under Principle 1, the number of women in managerial roles has increased to 20% (and 30% at Group Board of Directors level as of April 2022), putting us on track to achieve our goal of 30% of managerial positions by 2030. However, we see this as only an interim goal on the way to parity.

### Subsidiary-Level Governance

Each NAM Group subsidiary has an independent executive team led by a regional head who reports to the NAM Group President and is responsible for formulating and executing targets and plans decided by the Group Board and GEC in line with local regulations and customs. Each regional office is required to present its ESG implementation activities regularly to its respective board. The global and local stewardship framework is illustrated in the diagram " The Governance of Stewardship Activities". There are differences in detail as to how these processes operate at subsidiary level, but they are most developed in our main Japanese equities business, which we discuss below.

### *Japan Stewardship Functions*

Our Japanese operations represent more than half the business, so we devote a great deal of resources to its governance and stewardship. The Stewardship and Voting Rights Policy Oversight Committee monitors and supervises our engagement with Japanese investee companies and proxy voting, ensuring that both remain in line with our Fiduciary and ESG Principles and truly meets the interests of investors. The committee was launched in 2016 as a way of enhancing the transparency of our stewardship activities and strengthening our governance. Four out of the committee's seven members are from outside Nikko AM, making it highly independent. Its decisions carry weight, as it reports directly to the NAM Group Board on matters such as the governance of our stewardship activities and conflicts of interest, ensuring, for example, that proxy votes are used in line with our Conflict of Interest Control Policy. (For more on this committee, see Principle 12.)

Directly answering to the Oversight Committee is the Stewardship and Proxy Voting Committee, which is responsible for formulating stewardship policy, providing guidance on stewardship activities, and is also responsible for updating our Group Proxy Voting Policy (addendums to which can be applied at the subsidiary level in line with local customs and the requirements of the respective investment teams). An example of this was an update in December 2021 to our policy on Standards for Exercising Voting Rights on Japanese Stocks, which came into effect in April 2022. This is discussed in further detail in our response to Principle 5.

**Oversight of Proxy Voting at our Japanese entity**

Japan Subsidiary Board of Directors

Report ↑ ↓ Oversight/Resolution

Stewardship and Voting Rights Policy Oversight Committee

Report ↑ ↓ Oversight/Resolution

Stewardship and Proxy Voting Committee

Our Active Ownership Group (AOG) was set up in 2017 in order to enhance the firm's ability to: 1. make judgements on how to exercise voting rights and implement stewardship activities in our Japanese equity portfolios; and 2. conduct engagement with Japanese companies not already covered by sector analysts in actively-managed portfolios. As a result, even stocks which are held only in passive portfolios are now subject to engagement.

The AOG's analysts are responsible for conducting the risk assessments we use to filter out from our investment universe companies at high risk of governance failings. They also provide the Japanese equity investment teams with other relevant ESG-related information derived from their research and engagements. In 2021, Active Ownership analysts started engaging with large and mid-sized firms specifically on ESG issues, with further developments planned for 2022. The AOG is headed by Masahiko Komatsu, whose background and experience are described below. Further detail about the AOG's activities are provided under Principle 7.

**Masahiko Komatsu, Group Manager, Active Ownership Group** – Masahiko Komatsu joined Nikko AM in April 2021 as group manager of the Active Ownership Group. His experience prior to joining us includes working as a portfolio manager at Portfolia and nearly 23 years as an analyst at Prudential Investment Management, Schroders, and Polar Capital Partners. While at Polar Capital, he concurrently served as head of the Japan equity research team and as head of the firm's Japan office. He has extensive experience in company engagements, including collaborative engagements with other investors, which he gained mainly at Polar Capital. He holds an MBA from Waseda Business School and is also a chartered member of the Securities Analysts Association of Japan.

# Principle 2:

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### Stewardship Resources and Incentives

It is our global network of close to 200 investment professionals, with their wide breadth of experience, who are at the forefront of our stewardship activities, aided by our stewardship and ESG teams. As an organisation we are committed to sustainable and responsible investing and our portfolio managers, analysts and governance specialists all share in this commitment. They apply this philosophy by implementing stewardship in their day-to-day activities and practising active ownership.

They are compensated using a methodology that is intended to align their interests and motivation with the outcomes of client portfolios. Annual evaluations are based on quantitative metrics such as the long-term returns of client portfolios (for example, weighted portfolio returns for investment staff, or performance of securities recommended for analysts), but also the qualitative aspects of individual as well as group performance (for example, quality of analysis and contributions to the team).

In recent years, all employees have had sustainability goals incorporated into their annual performance objectives. This has given staff the opportunity to think about how they can practise sustainability in their roles and has sparked in-depth discussions with management on how this can be further achieved at departmental and group level. We view this goal-setting exercise as part of a multi-year process of weaving sustainability into our culture. Further information on these matters can be found in our annual Sustainability Report which can be downloaded from the Sustainability section of our website.

We have a strong emphasis on internal training as stewardship is the responsibility of our entire workforce, and therefore all employees have an annual training plan that includes, but is not limited to, topics such as conflicts of interest, personal trading and our code of ethics. Investment employees across the firm's global network undertake responsible investment training via an online course offered by the PRI Academy as part of our continuing focus on implementing the PRI's six Principles for Responsible Investment. The training concentrates on how ESG issues affect business and investment decision-making through the use of financial modelling and in-depth case studies.

Our long commitment to ESG is reflected in the fact that we launched Japan's first socially responsible investment fund as long ago as 1999. We now practise deep and direct ESG integration across the firm, where every investment team and department integrates ESG directly into their work. We have a number of systems, platforms and forums which allow our global investment teams to share research analysis on events and issues, especially those that may not always be covered in the media. During the year, we have invested in people, technology and ESG data extraction and integration capabilities to ensure that we are able to provide the level of service required to meet the needs of our clients. This investment has ranged from ESG-specific resources, training in stewardship themes across the workforce, client communications, through to the means to engage and monitor company engagements on a larger scale.

### ESG Resources

We have been cultivating a global ESG community supported by dedicated resources in each region which supports our investment teams, with the aim of having all investment professionals integrate ESG into their investment processes to the fullest extent. At a global level, we also have a multi-office team working on our strategic ESG data strategy.

In our UK and Luxembourg offices we have taken a strategic approach, with project teams which have focused throughout 2020 and 2021 on the regulatory evolution of ESG in the European and UK markets. Working groups, including investment and operational staff, have focused on areas such as ESG data disclosure and convergence projects under the EU's Sustainable Finance Disclosures Regulation and taxonomy regulations.

# Principle 2:

In Singapore meanwhile, we have a working group driving our response to the local regulator's Guidelines on Environmental Risk Management for Asset Managers, focusing on the themes of governance and strategy, research and portfolio construction, portfolio risk management, stewardship and disclosure of environmental risk information.

In New Zealand, our team is preparing for upcoming climate-related disclosure requirements, one of the aims of which is to ensure that the effects of climate change are routinely considered in investment decisions and to help smooth the transition to a more sustainable, low emissions economy.

Natalia Rajewska, our Lead Global ESG Specialist based in Singapore, works closely with investment teams across regions with the aim of strengthening the firm's ESG capabilities and providing further insight on broader ESG topics. She is also supporting our compliance with various regulatory requirements as well as mandatory and voluntary ESG reporting requirements. Ms Rajewska has been leading an initiative with investment managers globally to identify processes that could be strengthened and also areas of potential collaborative engagement. We will be further building and developing our team of ESG specialists, including additional hires in 2022. (For more on ESG integration see Principle 7, engagement, Principle 9, and collaboration, Principle 10.)

Natalia works very closely with the Investment Support & Planning Department (ISP) and ESG Specialists in Japan, who jointly serve as a secretariat to the ESG Global Steering Committee, providing dedicated expertise and administrative support. This support includes meeting voluntary and mandatory sustainability reporting requirements, drafting new and updating existing ESG policies and strategies, arranging staff training, sharing various tools and resources, reporting and both hosting and attending ESG-related seminars. Our aim with these efforts is to build an ESG community throughout the firm.

One of the key members of the ISP team in Japan is ESG Specialist Yukari Kaito, who ensures ESG is integrated into the work of investment teams by supporting them with ESG data, managing relationships with external organisations and assisting in communicating with clients on our ESG activities (see box).

In Japan, we also have four engagement and proxy voting specialists in the AOG involved in ESG engagement with investee companies and other stakeholders, as well as making proxy voting decisions. Additionally, we have a stewardship and proxy voting specialist in the ISP team, in charge of incorporating ESG into our engagement and proxy voting decisions in non-Japanese holdings held by our Tokyo office.

We are mindful that the ESG industry and market expectations are evolving. As a result, we recognise that our current structure must also evolve to further improve our stewardship activities.

**Our aim with these efforts is to build an ESG community throughout the firm.**

**Natalia Rajewska, Lead Global ESG Specialist** – Natalia Rajewska joined Nikko AM from ING Bank in Singapore, where she was a vice president covering APAC clients, having originated and structured several market-leading sustainable finance instruments. She has over seven years of international experience in sustainable investment and ESG consulting with global ESG leaders. Prior to ING, Ms. Rajewska worked at Aviva Investors as an ESG analyst, where she supported the investment team with ESG analysis and engaged with boards on ESG issues. She has also worked at Corporate Citizenship, a sustainability consultancy, and an impact investment foundation in Singapore. Ms. Rajewska holds a Bachelor of Business Administration from The Hague University and an MSc in Economic History and International Development from The London School of Economics and Political Science

**Yukari Kaito, ESG Specialist** – Yukari Kaito joined Nikko AM's Investment Support & Planning Department as an ESG specialist in December 2018. Prior to joining Nikko AM, she was a Specialist in the Global Corporate Responsibility team of a listed company in Japan, working on enhancing corporate value by implementing ESG throughout the organization and increasing corporate ESG disclosure. Prior to this, she worked for more than five years as an ESG analyst, most notably as a principal ESG analyst overseeing ESG research on over 1,800 companies, providing advice on proxy voting and engaging with boards of directors on behalf of clients. She holds a Master of Environment from the University of Melbourne and has co-authored a children's book on Climate Change.

# Principle 2:

Data from external service providers is used as one input in our investment decision-making process to supplement our proprietary analyses. We use a wide range of data from a combination of public disclosures (issuers' annual and sustainability reports etc.) for the purpose of research, as well as through direct engagement and communication with companies and external ESG analysts and data providers such as MSCI ESG, Sustainalytics, Good Bankers, Institutional Shareholder Services (ISS) and Bloomberg. ISS, for example, is used to execute our proxy voting, which we consider a key activity in respect of our stewardship responsibilities. ISS also provides research and customised voting recommendations based upon our voting and responsible investment policies but, again, the ultimate decision on how we vote is taken in-house. Our interaction with ISS is discussed in more detail under our response to Principles 8 and 12.

Having access to multiple sources of data can be useful in allowing us to cross-check our assumptions. However, we recognise that third-party data providers have shortcomings, including a lack of consistency arising from differences in methodology, therefore we treat this data as supplementary to our proprietary research as further outlined in Principle 8.

**As stewardship needs and expectations are continuously evolving, we continue to adapt and fine-tune our responsibilities and activities as stewards of our clients' capital.**

## Outcome

As a Group we are committed to active stewardship. Our governance structures and stewardship processes address several areas, including the management of conflicts of interest, engagement in active and passive investment management, our sustainability efforts and information disclosure.

As stewardship needs and expectations are continuously evolving, we continue to adapt and fine-tune our responsibilities and activities as stewards of our clients' capital. This includes our responsibilities to the economy, the environment and society. We understand that we have an important role to play as guardians of market integrity and in working to minimise systemic risks, and we will continue to implement meaningful changes to advance our ability to meet these responsibilities.

We recognise that the topics that fall under the umbrella of stewardship are rapidly developing and we are taking a proactive approach to strengthening the management of our stewardship activities. For example, whereas we publicly disclose results of proxy voting records for the vast majority of our equity AUM, in some regions in which we operate this is provided only to clients on request in line with local stewardship requirements.

As a result of our review process, updates were made to a number of our policies and position statements in 2021. These and audit assessments are covered in detail under Principle 5. We continue to monitor the effectiveness of these policies and will be actively looking to strengthen them as our approach to stewardship evolves.

# Principle 3:

## Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

### Context

We always seek to put the interest of our clients first in all our activities. We aim to identify all actual or potential conflicts of interest and maintain and operate arrangements to minimise the possibility of conflicts giving rise to a material risk of damage to the interests of our clients. We have established a Group Conflict of Interest Control Policy (addendums to which can be applied at the subsidiary level in line with local requirements), which has been designed to prevent us from prejudicing the interests of customers in the conduct of our business and is reviewed at least annually. Potential new conflicts are considered as part of any new business development and/or business process changes.

In addition, group subsidiaries maintain their own conflicts of interest register which records potential conflicts that have come to light during their activities and the measures taken to resolve them. Each register is regularly reviewed and approved by the relevant subsidiary board of directors.

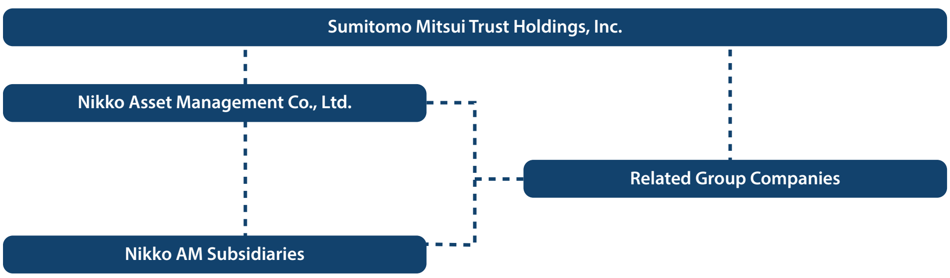
More details about how our conflicts of interest policies operate can be found in the Activity section below. However, in general, when identifying the types of conflict of interest that may arise, we take into account, as a minimum, whether we or our directors, managers or employees or a person directly or indirectly linked to the firm:

- is likely to make a financial gain, or avoid a financial loss, at the expense of a client;
- has an interest in the outcome of a service provided to a client or of a transaction carried out on behalf of a client, which is distinct from the client's interest in that outcome;
- has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;
- carries on the same business as the client; or
- receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monetary or non-monetary benefits, other than the standard commission or fee for that service.

Responsibility for controlling transactions and other conduct likely to give rise to conflicts of interest is managed by our compliance departments. Together, the Group Compliance Heads are charged with maintaining the conflicts of interest control framework and periodically verifying its effectiveness, as well as continuously striving to improve it. They are also responsible for communicating all aspects of conflict control to employees through education and training programmes. They are immediately answerable either to the subsidiary board of directors of the relevant subsidiary or, if the incident occurs in Japan, to the Compliance Oversight Committee, part of the GEC.

One area where conflicts can arise is as a result of our ownership. Nikko AM is ultimately owned by Sumitomo Mitsui Trust Holdings (SMTH), which is a large Japanese conglomerate with interests in, amongst other things, banking, pension administration, real estate, stock transfer, custody services, and asset management. Nikko AM itself has subsidiaries in the UK, Luxembourg, the US, Hong Kong, Singapore, New Zealand and has a branch office in Germany and associates in China, Malaysia and Australia.

**Our Corporate Structure**



# Principle 3:

## Activity

Examples of potential conflicts of interests related to stewardship that may arise during the course of business and how we manage these are summarised in the table below.

| Conflict | Example | Management |
|---|---|---|
| Related group companies | In undertaking business for our clients, our dealings, or other arrangements, with related group companies present possibilities for us to treat our related group companies more favourably than unrelated companies. | We and our related group companies have adopted policies and procedures throughout our businesses to manage conflicts of interests. These policies and procedures are subject to our normal monitoring and review processes. |
| Fair allocation | The processes involved in the research of securities, execution of trades, allocation of securities forming part of a trade and participation in new issues could result in unfair trade execution or allocation among clients' accounts. Investment and/or trades may be executed in a way that favours one or more clients to the disadvantage of others. | All trades across accounts are pre-allocated and trades that are partially filled are allocated pro-rata. Compliance monitoring is conducted to ensure adherence. |
| Proxy voting | Where clients permit us to exercise voting rights attached to securities held in their portfolios, the possible conflicts of interest include circumstances where: (i) we manage assets for companies whose management are soliciting proxies and the failure to vote in favour of management resolutions may harm our relationship with the company, (ii) we may have a business relationship with a proponent of a proxy proposal and may manage assets for the proponent, or (iii) any employee may have a personal or outside business interest in the outcome of a particular proxy vote. | Our Proxy Voting Policy is designed to ensure that votes are cast in accordance with the best economic interest of clients. |
| Outside directorships | Employees who have access to portfolio management or proxy voting activity or directors who hold similar positions with another firm or firms may be able to use their position and information obtained from either firm to obtain financial gain or avoid a loss. | All employees are required to seek Compliance and senior management approval of any outside directorships which they may hold. Any committee members who have oversight of other companies are excluded from agenda items where Nikko AM's stewardship activities involving such companies are discussed. |

An area of particular focus for our efforts to control conflicts of interest is voting. We annually disclose a summary of voting activity records on our website, and on a quarterly basis individual assessments are conducted at a regional level considering the conduct of voting. An example of this monitoring is the work of our Stewardship and Voting Rights Policy Oversight Committee, which meets quarterly to review how we should vote on individual proposals from investee companies in Japan that might trigger a conflict of interest. A regular item on the committee's agenda is reviewing votes involving related group companies and confirming that there was no bias in favour of the related group company or, alternatively, flagging that the voting decision may have been influenced by the connection. In doing so, the committee is aided by advice from our proxy voting agency ISS. We firmly believe that such reviews of individual records help us to increase the transparency of our stewardship activities and minimise conflicts of interest when we exercise our voting rights. We believe that actively explaining the reasons for our voting decisions to the independent Oversight Committee helps us manage potential conflicts of interest and facilitates constructive engagement with investee companies. For more on our voting activities, see Principle 12.

# Principle 3:

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## Outcome

No actual conflicts of interest arose during the year that prevented us from performing our stewardship activities in accordance with the best interest of our clients.

During the 2021 calendar year, comparisons and analyses were performed on our regulations for managing conflicts of interest to identify a common Group approach, as well as matters that need to be addressed in everyday operations. Six additions were made to our related Group companies appendix during the year, reflecting our analysis of the wider SMTH Group.

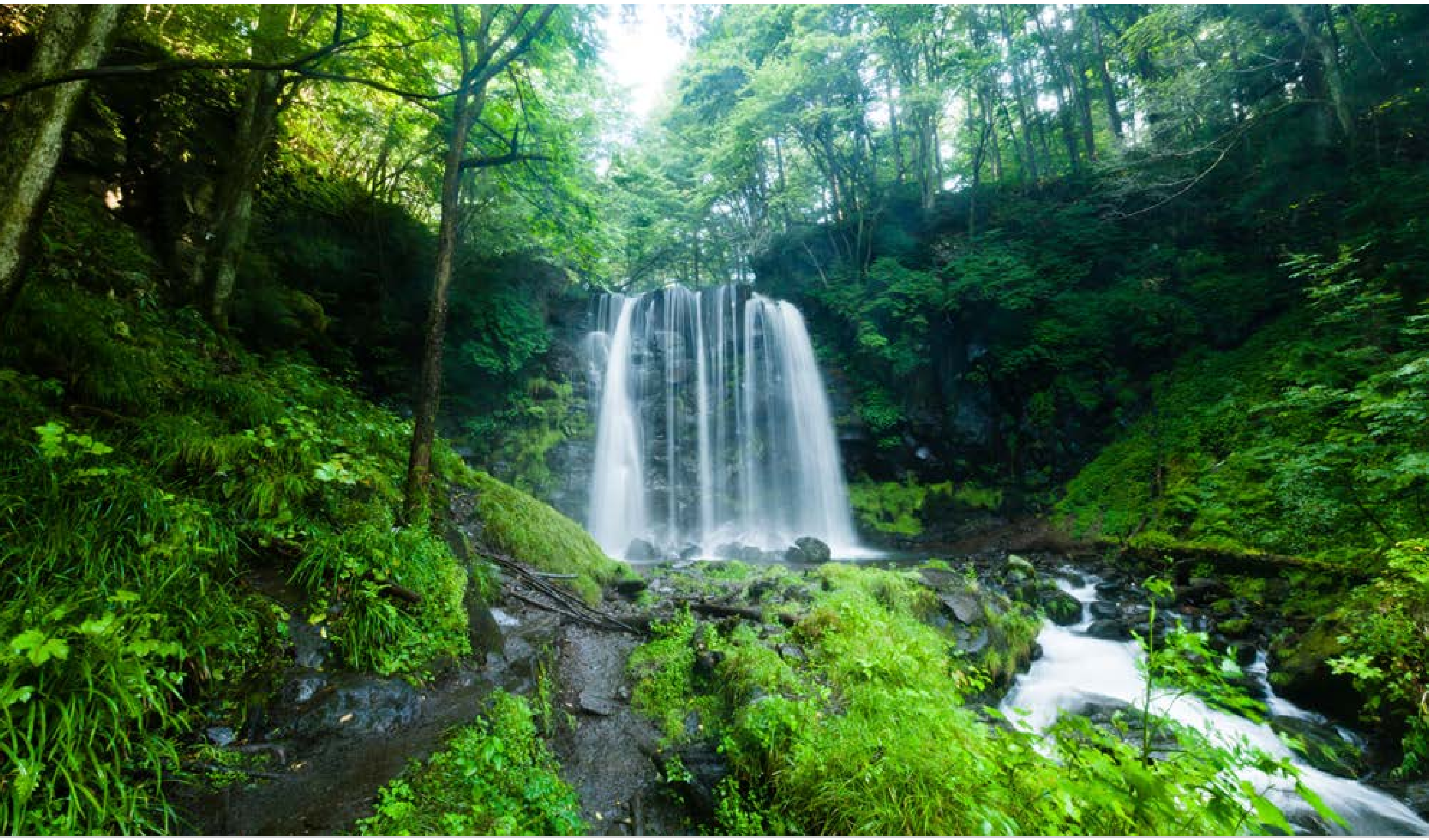
**We believe that our thorough management of conflicts of interest helps to maintain the trust of both clients and investee companies and allows us to conduct our stewardship activities more effectively.**

We believe that our thorough management of conflicts of interest helps to maintain the trust of both clients and investee companies and allows us to conduct our stewardship activities more effectively. Our everyday stewardship activities such as proxy voting are governed by the management framework and supervision functions described above, including our policy for managing conflicts of interest.

Whilst there were no actual conflicts of interest in 2021, we identified a number of new scenarios that may cause potential conflicts:

- where our investment management and investment advisory operations have a strategy that is the same or similar;
- where the firm purchases investment instruments for clients issued by the same firm that also acts as broker for us in making the transaction;
- where the firm purchases for one client or group of clients investment instruments that are issued by another client, potentially unduly favouring the issuer.

Existing processes such as order placement committees and allocation policies already address these potential conflicts, but we are planning further improvements to the systematic processes that we use to identify such potential conflicts.



# Principle 4:

## Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

### Activity

As an asset manager, we are reliant on our ability to invest in liquid, transparent and functional markets. Market-wide and systemic risks directly affect the value of the assets that we invest in, therefore, as a fiduciary, one of our key responsibilities is to manage these risks in order to improve outcomes for our clients. As long-term investors it is in our interest to support and advance initiatives that aim to reduce market-wide and systemic risks and, as responsible stewards, we recognise both the responsibility – and the opportunity – we have to promote well-functioning, stable markets in the interest of the wider economy, environment and society.

A core part of our philosophy is that our investment professionals are best positioned to identify market-wide and systemic risks through their research and engagements. The natural corollary of this is that they then have the freedom to follow their own high-conviction approaches in dealing with these risks, supported by the infrastructure and resources of the wider organisation.

Our fundamental research is supplemented by external sources which enhance our overall understanding of the investment landscape. External sources include contacts with market-makers and related participants, dialogue with companies, sell-side research, independent research vendors, roadshows, presentations, conferences and rating agencies.

Research is shared globally through informal information-sharing platforms, as well as more formal regular meetings to discuss views, build synergies, debate and refine ideas. Research notes are recorded and distributed across geographies and asset classes. Our teams also share unique and timely analysis on important macroeconomic and political issues, especially those that may not always be covered in the media. Ad-hoc meetings may also be organised between offices to discuss urgent market news and/or important developments.

Emerging systemic risks and their impact on companies or industries are discussed at regular investment meetings. For instance, our global fixed income team holds monthly meetings to review the foreign exchange and interest rate outlook as well as quarterly "horizon-scanning" meetings which consider long-term market issues without being distracted by the immediate focus of products or issuers. The purpose of these meetings is to address fundamental challenges to the smooth functioning of global fixed income markets and what we can do to mitigate those challenges for our clients.

Specific challenges to the functioning of markets during the year have included the pandemic and upheavals in the Chinese property market, alongside changes in interest rates, while in the background is the ever-present threat of climate change. We look at how we tackled each of these issues in the following examples.

**A core part of our philosophy is that our investment professionals are best positioned to identify market-wide and systemic risks through their research and engagements.**

## Global Fixed Income and the Pandemic

In 2020 our investment teams faced an unprecedented situation as the COVID-19 pandemic significantly raised risks in markets. The shutdown in March 2020 led to an extreme reduction in market liquidity and wider challenges caused by the low level of global interest rates. Our Global Fixed Income team closely monitored portfolio risk throughout the period, but remained resolute in maintaining our long-term perspective. As we entered calmer market conditions in April 2021, external forces lost their dominance and the investment team was able to return to managing our portfolios with more emphasis on fundamental, bottom-up, factors.

We feel that the fact that our fixed income portfolios were able to come through this difficult period so successfully was a good test of our risk-management processes. The team uses a portfolio dashboard to help monitor systemic risk from a quant level to give an understanding of the ranges of risk in the market from a number of angles, including regions, countries, maturity buckets, capital structures, currency, ratings and sectors as well as the concentration of risks and portfolio limits. This process provides a high-level picture of global fixed income markets, with each region being assessed against macroeconomic, microeconomic, technical and valuation factors, helping us to navigate the current environment for global risk.

Detailed below is an example of how these scorecards changed over the 12 months from April 2020, when pandemic fears were at their height and causing turmoil in markets, to April 2021, when more normal conditions returned. The colour coding – red for "risk off", green for "risk on" – provides a clear visual indication of how regional risks changed between the two periods.

### Regional Scorecard April 2020

| Region | Macro | Micro | Technicals | Valuation | Overall Assessment |
|---|---|---|---|---|---|
| Europe | OFF | OFF | OFF | ON | OFF |
| North America | OFF | OFF | OFF | OFF | OFF |
| Asia | OFF | OFF | ON | OFF | OFF |
| Japan | OFF | OFF | OFF | OFF | OFF |
| South America | OFF | OFF | ON | OFF | OFF |
| Australia | OFF | OFF | ON | ON | OFF |

Source Nikko AM, as at 1 April 2020

### Regional Scorecard April 2021

| Region | Macro | Micro | Technicals | Valuation | Overall Assessment |
|---|---|---|---|---|---|
| Europe | OFF | ON | ON | ON | ON |
| North America | ON | OFF | ON | ON | ON |
| Asia | ON | ON | ON | OFF | ON |
| Japan | OFF | OFF | OFF | OFF | ON |
| South America | OFF | OFF | ON | OFF | OFF |
| Australia | ON | ON | ON | ON | ON |

Source Nikko AM, as at 1 April 2021

This scoring process provides the portfolio management team with a gauge of risk and risk appetite in the market, while also providing a one-month forward-looking view. The portfolio managers meet regularly to discuss information and research on the current condition of credit markets. These regional scorecards provide background for these discussions, along with our currency and interest rate views, helping to determine whether any changes are needed to be debated at our investment strategy meetings.

Once we have undertaken our analysis from a regional perspective, the team will then perform a country analysis. Amongst the many factors we look at, close attention is paid especially to central banks' policy stance, governments' fiscal positions, financial stability, and domestic and geopolitical developments. Each country is scored and the investment team's views are subsequently checked against market consensus and central bank projections to gauge the extent of risk within the market.

# Principle 4:



**Global Equity and the Pandemic**

As long-term stock pickers who carefully assess the bottom up influences on the companies we invest in, our focus on profitability and balance sheet quality over the long term helps safeguard our clients' assets. Our allocation of capital to businesses that we feel can stand the test of time from a quality point of view also contributes to the efficient functioning of the market overall as businesses with these quality characteristics are rewarded over time.

As explained above, in 2020 we faced an unprecedented situation. From the spring of 2020 and throughout 2021 as lockdown restrictions developed and changed around the world, our Global Equity team was confronted by the scenario that many companies in the portfolio faced a zero or dramatically reduced revenue situation. To ensure the smooth functioning of the system and maintain confidence that each business had sufficient capital to manage through these circumstances, a comprehensive review of company balance sheets was undertaken for all portfolios. This analysis gave a clear understanding of the businesses which were most affected and which would need access to additional funding to trade through an extended period of earning no income and extremely negative cash flows. Only one investee company required additional equity funding during 2020 and 2021, a testament to the strength of our fundamental research and understanding of liquidity requirements which protect our clients' assets in times of stress but also ensure the efficient working of the system overall.

**Fixed income: China Real Estate Contagion**

Another serious systemic risk faced by our investment managers last year was the difficulties that emerged in the China real estate market in the second half of 2021. A change in regulations in China limited the ability of real estate companies there to take on additional debt. This raised investor alarm about the sector, which was exacerbated in August 2021 when one of the largest Chinese property companies, Evergrande Group, revealed that it was experiencing cash-flow issues, prompting a sharp fall in the share price. Rumours of financial difficulties had already surfaced during the summer, when the company was downgraded by rating agencies and the company started to sell assets to generate cash. Even so, it subsequently missed several debt payments. This series of events sparked fears of contagion in the sector and had an impact on global markets, leading to a significant slowdown in foreign investment in China in the autumn of 2021.

We were exposed to the Chinese real estate sector in several portfolios and early on realised that the seriousness of the situation would require collaboration between a number of teams. Noting the likely global ramifications arising from the deterioration in the sector, the developments were highlighted and discussed on multiple occasions in 2021 as part of the monthly Nikko AM Global Credit Committee meetings, attended by fixed income teams globally and the head office investment risk team. In addition, dedicated discussions on the topic were organised and held in June and November, attended by investment teams from a number of asset classes, including equities.

As a result of our rigorous analysis and cooperation between our teams across Japan, Asia and the UK, the systemic risks arising from the China real estate sector were identified early. The Asia fixed income team reduced exposure to the segment and moved its portfolios up the credit quality curve during the second half of the year, successfully avoiding the many defaults that occurred in the sector. This multi-asset, multi-disciplinary collaboration also armed other investment teams with early warning of how the situation might unfold, allowing them to reduce exposures in good time.

**Money Market Funds: Pandemic-Induced Interest Rate Changes**

Money market funds are characterized as low-risk, low-return investments which aim to provide investors with a safe way to invest in secure and highly-liquid, cash-equivalent or short-term debt instruments. Returns from the underlying holdings – and hence the funds – are more than usually dependent on interest rates.

During 2020 and 2021, in the period when central banks around the world sharply reduced interest rates in response to the COVID-19 pandemic, we closed three of the money market funds we managed to protect the investments of our Japanese clients. On all three funds during this period, interest rates were moving towards zero or even negative levels. It was clear that it was highly likely that we would not be able to fulfil our clients' objectives for these funds and recommended that the funds be closed.

For two of the funds, in order to ensure that 100% of clients' capital be returned to them, we recommended a course of action that would deviate in some respects from the funds' applicable legal documentation. In this case, we saw the higher fiduciary duty to our clients being to protect their investments as much as we could, rather than stick to the letter of the funds' legal documentation. In the event, we were able to ensure a smooth closure of all three funds, with clients being repaid without loss and the Japanese regulator in full understanding and agreement with the approach that we had taken.

We believe that this is a good reflection of our approach to stewardship. By taking pre-emptive action, we closed three funds where clients' interests would not have been best served by continuing to invest.

# Principle 4:

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## Climate Change

We recognise climate change as one of the greatest challenges the global community faces. It is a prime example of a market-wide, systemic risk to the assets in which we invest and, as such, we consider it our fiduciary duty to address it in managing our clients' assets. We adopt a two-pronged approach to climate risk:

1. **Collaboration with other stakeholders:** We work with other stakeholders to help develop solutions and support global initiatives to address the issue, such as the UN's Paris Agreement to limit carbon emissions and the UN's Sustainable Development Goals. We are involved in Asia with other fund managers seeking to collaborate to address the issue of climate change. We are signatories to, and participants in, a large number of environmental initiatives, both globally and locally. Our involvement in these several bodies is discussed in more detail under Principle 10.
2. **Addressing climate-related portfolio risks:** We see climate-related factors as both a key ESG risk and a potential opportunity for the companies in which we invest. Climate change is therefore factored into the investment processes of our teams across asset classes in order to ensure our investments are aligned to properly address both the risks and opportunities.

Our investment approach focuses on ESG integration. We therefore continually strive to recognise, understand, and improve our methodologies for assessing the risks and opportunities of climate change in our clients' portfolios. This includes appreciating the scientific implications of those methodologies, as well as the structural changes likely to affect the business environment of the investee companies we analyse.

Climate change is an issue that is likely to affect all sectors, albeit on different timescales. Some impacts are direct, such as carbon taxes, while others are indirect, such as the effects on ecosystems and biodiversity. Beyond known effects, we also acknowledge that systemic changes may arise from the increased instability of physical systems as global temperatures rise. Below we list some of the impacts we consider:

- the regulatory and operating environment, which influences the degree of adaptation and vulnerability of companies to climate change;
- the physical impact on business activities, which will differ across industries and locations;
- the social pressures on stakeholders, which may influence consumers' product selection and supply-chain management.

To assess these impacts, we use climate-related research tools and analyses, such as carbon footprinting, shadow pricing and identifying our exposure to assets considered to be at higher risk of being "stranded" by the move towards a low-carbon economy. More detail on our approach to climate change can be found in our Position Statement on Climate Change, our TCFD Report and the discussion under Principles 7 and 10.

As a firm, we have been certified as carbon neutral since 2019 by Carbon Footprint Ltd, a UK-based consultant. We use the consultant for carbon assessments and offsets: it purchases carbon credits and retires them on our behalf to balance our emissions.

## Collaboration to promote well-functioning markets

An important way in which we promote well-functioning financial markets is through our participation in industry bodies and forums, which help us to identify and address market and systemic risks and ensure that our processes, policies and procedures remain relevant. (See below case study for an example of how we collaborate to improve the function of debt markets.) Each of our subsidiaries is a member of the applicable local regulatory and industry bodies, for example the Investment Association in the UK. Some of the members of our subsidiaries take an active role in these industry bodies. These are outlined in more detail under Principle 10.

## Managing Climate Change Risk in our Japanese Equity Portfolios

While we take account of climate change considerations in our portfolios, we recognise that climate-related impacts are complex and uncertain. Unless directed to do so by our clients, our approach is to actively engage with our investee companies and exercise our voting rights rather than applying blanket exclusions of investments based on climate change factors. As described under principle 7, we believe this is more effective in upholding ESG and stewardship standards for our clients, the broader economy and the environment.

In our Japanese Equity portfolios, our investment research incorporates Creating Shared Value (CSV) evaluations (more information on this can be found under Principle 7) to integrate factors related to competitiveness, ESG and financial strength. During 2021 we made a number of enhancements to this process, including adding carbon intensity and resilience factors to the ESG themes. As a result, each of our Japanese Equity portfolio managers now receives data on the carbon intensity of the portfolios that they manage versus the respective benchmark, as well as carbon intensity data at the sector and underlying stock level. This enables them to identify very clearly where the contributions to the carbon intensity of their portfolios are coming from, giving them the ability to adjust engagements with investee companies accordingly.

In line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), we encourage our investee companies to identify material climate change risks and opportunities in a range of scenarios, integrate material climate change risks and opportunities into their overall business strategy and risk management, and disclose their management policies and processes toward meeting the goals – and resulting performance – that emerge from these above activities. Trends such as decarbonisation may put companies at risk of potential cost rises, yet their brand power may be damaged if they fail to take sufficient action. At the same time, this process gives us the ability to capture the future potential of companies to respond to the transition to a low-carbon economy as such shifts are creating growth opportunities for companies with environmentally-friendly technologies. We use our engagement to urge firms to address these changes, for example by allocating business resources to related fields and preparing for the associated risks.

In one example during 2021, a portfolio manager identified a holding that accounted for less that 1% of the financial weight of their strategy yet accounted for 11.5% of its carbon intensity. The investment team already had a sound understanding of the company's environmental policies and goals, such as emission reduction targets, however following subsequent engagement meetings the company disclosed that it had formulated a long-term vision based on the premise of a transition to a carbon-neutral society. It has established a sustainability policy and structure, identified climate-related risks and opportunities, conducted climate-related financial impact assessments using internal carbon pricing, and undertaken climate scenario analysis. It also disclosed further details of initiatives to invest in net-zero technology in the next three years, including Carbon Capture Utilization and Storage (CCUS) and renewables. We are pleased with the progress that the company has been making but will continue to monitor this against future targets.

**Case Study: collaboration with the World Bank**

We have long experience of working with wider industry bodies to improve the functioning of markets. The World Bank is both an active market participant as a debt issuer and is also a key agent in determining the shape of market innovations. We have been collaborating since 2007, when we launched a Green Bond fund with the Bank, and have maintained a continuing dialogue ever since. In 2021, the key topics we discussed were:

1. World Bank market intervention

   In the context of our Green Bond Fund, we discussed the size of new issues or taps in currencies where there is little or no secondary market inventory in certain maturities. This discussion covered minimum issuance size and target maturity bands for tapping existing issues and also issuing new bonds in a range of currencies to improve portfolio diversification and market liquidity. The difficulties associated with tapping existing bonds from the issuer's perspective were discussed, as well as the possibility of the World Bank reducing its minimum issue size in order to match demand.

2. The EU's Sustainable Finance Disclosure Regulation (SFDR) and EU taxonomy

   This discussion centred on how to ensure that bonds issued by the International Bank for Reconstruction and Development (the lending arm of the World Bank) are appropriate for one of the EU's new so-called SFDR article 9 funds, which are defined as funds that have either sustainable investment or a reduction in carbon emissions as their objective. We also wanted to know how the Bank was proposing to meet the challenges of the forthcoming EU taxonomy, a classification system to establish what economic activities can be officially recognised as "sustainable". We discussed how legacy bonds would fit with these regulations and how the Bank would ensure environmental objectives, for example, greenhouse gas emissions, were met. We agreed to continue this dialogue as more information and understanding emerges from these regulations in 2022.

3. Products for Japanese investors

   A key part of our dialogue with the Bank is developing product ideas that will be suitable for our Japanese investors. In 2021, we explored the idea of a new fund that would include collaboration with the International Development Association (IDA), a subsidiary of the World Bank. We will continue exploring this idea and others in 2022.

## Managing portfolio risks

One of the key defences we have against systemic risks is our Group Investment Risk Management Department. It operates independently of the investment management division, with a separate reporting line to the Chairman via the Chief Risk Officer. The department oversees our risk management framework, keeping track of our exposure to a number of risks, including market risk, counterparty risk and liquidity risk in order to ensure our portfolios are aligned to meet the best interests of our clients.

**Group Risk Management Framework**


A number of measures, such as scenario analysis and stress testing, are used to monitor exposure and the resilience of our portfolios to market shocks. In addition to these regular measures, ad-hoc stress tests are run in response to developing market risk. These scenarios may cover short- or long-term time horizons using various macroeconomic and firm-specific assumptions. Historical scenarios include the Global Financial Crisis, while hypothetical scenarios may look at market shocks resulting from a single risk, such as an oil supply shock.

The Group's Risk Oversight Committee reviews the firm-wide stress-test and scenario analyses and their impact on the firm's business at its quarterly meetings. Once risks are identified, we have a responsibility as an active manager to mitigate them in order to achieve the best outcomes for our clients. During periods of market upheaval, we might also increase liquidity in our portfolios, either by increasing cash balances or by switching into more liquid instruments. This might be to provide a buffer to market volatility or to give us the ability to deploy cash when buying opportunities emerge, or both. We must also remain alert to the need to ensure liquidity is sufficient to meet client redemptions.

We have a particular interest in Danish mortgages, as further described under Principle 7, where we see ourselves as gatekeepers to a particularly attractive market for Japanese investors. We regularly assess the liquidity of the market, the local yields available and how they appear for Japanese investors after currency hedging. We also regularly review the effectiveness of our analysis, including using models of prepayment risk, as well as market liquidity and counterparty risk. A key risk for any fixed income asset is that of default and the negative impact that would have on the price.

## Outcome

We believe that the examples we have outlined show that our investment teams were effective in identifying and responding to market-wide and systemic risks during 2021. Our risk management framework and active management style meant that it was not necessary to invoke liquidity measures in our portfolios in response to periods of market volatility, such as the emergence of the Omicron and Delta variants of the COVID-19 virus, and we were able to effectively reduce exposure to the Chinese real estate market at an early stage of the crisis.

Due to the long-term nature of the risks that climate change poses, it is not yet possible to determine whether the measures we are putting into place to address this risk will be effective. Nonetheless, we will continue to enhance our strategies and methods to monitor and calculate the climate effects of our investment strategies, while developing approaches that minimise global warming. In doing so, we will continue to engage with other stakeholders in our effort to promote well-functioning markets.

We are an active member of a number of industry collaborations, particularly those aimed at climate change. Several announced significant advances or initiatives towards reaching their goals during 2021. These are discussed in detail under Principle 10.

# Principle 5:

## Signatories review their policies, assure their processes and assess the effectiveness of their activities.

### Activity

All of our policies and processes, including our stewardship policies, are subject at least annually to a review and assurance process to ensure that they remain appropriate and effective. The review process varies depending on the substance of the policy, but in principle the process is as follows: creation and drafting (for new policies) and revision by the applicable department, if relevant subsequent review by the appropriate committee, then review by either the subsidiary board, in the case of local policies, or the GEC and Group Board, in the case of global policy.

The key policies that are applied to stewardship activities are listed below, with any changes made during 2021 detailed in the Outcome section. (We have not detailed policies less directly related to stewardship, but they follow the same review process described above.)

- Group Code of Ethics and Business Conduct
- Group Commitment to Responsible Investing
- Group Conflict of Interest Control Regulations
- Group Engagement and Stewardship Strategy
- Group Proxy Voting Policy
- Group Best Execution Policy
- Group Trading Policy
- Group Environmental Policy
- Regulations on Engagement and Compliance Regarding Fiduciary ESG Principles

In terms of audit and assurance, we have a number of internal checks and balances provided by, for instance, oversight committees that have a majority of independent non-executive directors, as well as our compliance department. Various stewardship activities are audited by outside bodies, including the PRI and our external auditors. Our policy is to audit each division every two years, with a follow-up to ensure implementation of any corrective action identified as a result of the audit. There were no major audit issues raised during 2021.

### Risk Governance and Oversight

At a group level, responsibilities for our risk governance and oversight are split according to the "three lines of defence" model:

- **First Line of Defence:** Front office business units and individuals identify and manage risks in their business function that could threaten the achievement of their objectives. They undertake risks within assigned limits of risk exposure and are responsible and accountable for identifying, assessing and controlling the risks of the business.
- **Second Line of Defence:** The support functions, such as, but not limited to, risk management and compliance, assess and oversee risk at the firm level, developing and maintaining risk frameworks, including firmwide policies. Each of these support functions, in close relationship with the business, ensures that the risks of the business have been appropriately identified and managed.
- **Third Line of Defence:** The Internal Audit function provides independent and objective confirmation regarding the design and effectiveness of internal controls, i.e. it independently assesses the effectiveness of the processes created in the first and second lines of defence and provides assurance for these processes.

**External assurance**

In its 2020 assessment of our adherence to its principles, the PRI gave us top scores on a wide range of stewardship-related activities, including our responsible investment policy, coverage and objectives, conflicts of interest policy, governance and human resources, performance management and rewards, personal development and training, collaboration and promoting responsible investment.

On every measure, we came out in the top two categories (A or A+) by comparison with our peers. Overall, we received an A+ rating in all areas where we had any investment business involvement. The firm was audited by our external auditor to measure our compliance during 2020 with reporting standards SSAE18 (for the US) and during 2021 with reporting standards ISAE3402 (for the rest of the world), which cover control procedures and their adequacy, service delivery, information security and controls over data privacy. No significant matters were raised.

Our extensive collaboration with industry organisations ensures that we stay up to date on the range of issues which are important to investors and the wider market and keeps our policies and processes up to date. These organisations include, but are not limited to, the PRI and the regulatory investment initiatives that our subsidiaries are members of as set out in Principle 10.

**Ensuring reporting is fair, balanced and understandable**

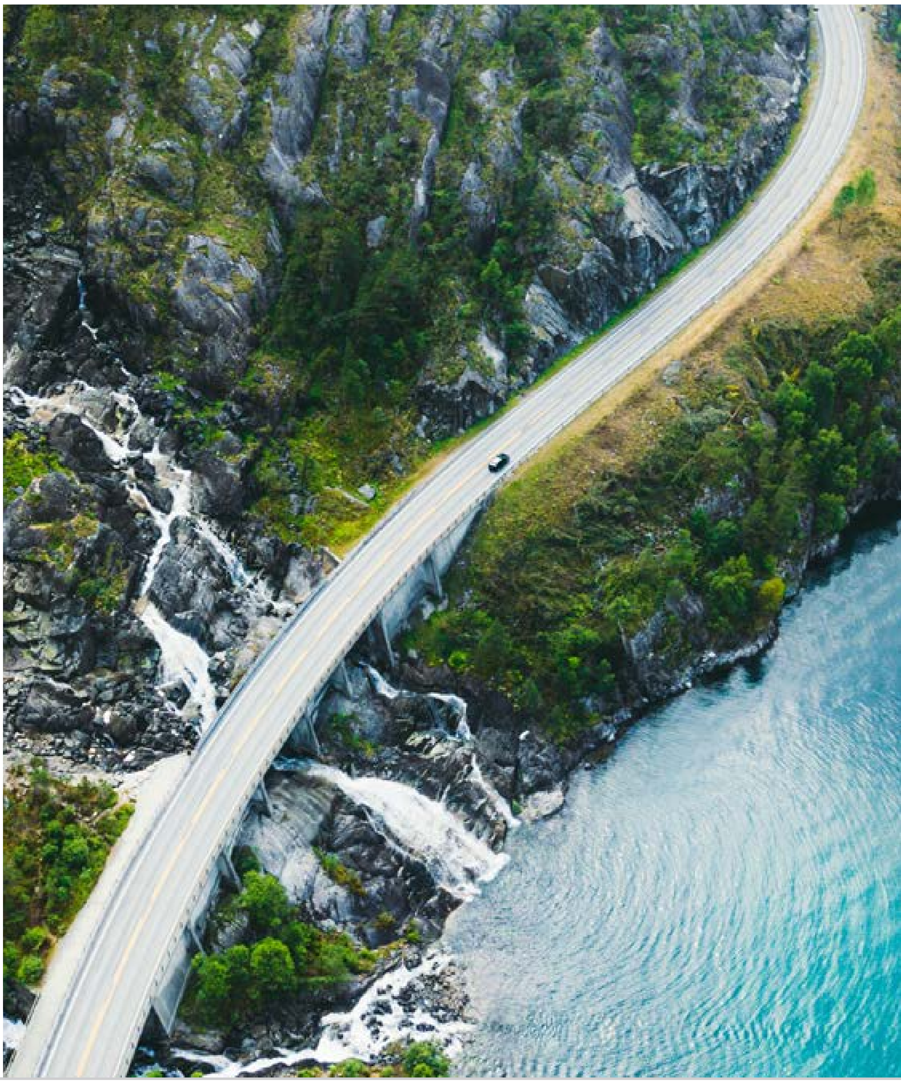
All external material, including regular reports to clients, our annual Sustainability Reports and stewardship reporting to meet the requirements of local codes, is produced locally and reviewed by the local compliance team. However the ultimate judges of whether our reporting is fair, balanced and understandable are our clients, with whom we work closely. This includes institutional clients with whom we have had relationships spanning decades. Reporting has evolved over time, not only in line with market norms – including an increased emphasis on ESG – but also as a result of our knowledge of clients' specific requirements. Further detail on how we communicate with clients and the process with which they assess our reporting is included under Principle 6.

Stewardship reporting to other codes such as Japan and Singapore are produced and reviewed by the relevant Group companies.

**Review and sign off process for our reporting under the UK Stewardship Code**

We have brought together a number of internal teams from across the firm, including Client Services, our Active Ownership Group, ESG specialists, operations and members of our global investment teams to produce this report. To make it informative and accessible, we have used both internal and external resources to prepare the report. It has been reviewed by our UK Stewardship Oversight Committee, as well as being reviewed and approved by the UK and Group Boards, and has been signed off by our Group Non-Executive Director and Chairman. The process of collating information for the report has also led us to reflect on areas that may need to be developed further.

**The ultimate judges of whether our reporting is fair, balanced and understandable are our clients, with whom we work closely.**



# Principle 5:

HOME

## Outcome

We believe our combination of internal checks and balances, external assurance and auditors and our widespread involvement in industry and regulatory bodies ensures that our policies, procedures and processes are subject to continuous and rigorous review. To be effective, such review has to result in action to ensure that our policies, procedures and processes are kept up to date and effective. During the year, therefore we made a number of changes as a result of our review and assurance processes:

- Group Code of Ethics– the policy was updated to include statements on diversity and inclusion.
- Group Conflict of Interest Control Regulations – we identified one new potential conflict which was added to the global register along with details of consequent control methods. We added six companies to the appendix of related group companies.
- Group Engagement and Stewardship Strategy – this new global strategy was developed during 2021, and reviewed and approved in early 2022. The strategy formalises our engagement and stewardship activities, ensures unity across regions and allows us to share with the market our global engagement commitments.
- Group Proxy Voting Policy – as stated in Principle 2, subsidiaries may add local addendums to the policy; local addendums during 2021 were:
  - our Global Equities team updated its local proxy voting policy to reflect the importance of ESG.
  - the Stewardship and Proxy Voting Oversight Committee approved the updates to the Standards for Exercising Voting Rights on Japanese Stocks to strengthen the criteria for the selection of directors, a change that will come into effect in April 2022. Specifically, the ratio for independent outside directors was increased, the absence of gender diversity on boards was agreed as a possible trigger to vote against members' re-election (to be applied in 2023), and the standards for the independence of outside directors were clarified and reinforced. Additionally, insufficient measures to manage and address climate change and sustainability were added as issues that could trigger votes against directors.
- Group Environmental Policy – the policy was revised with a new framework that aligned the way our subsidiaries consider environmental factors when conducting business and we set a new goal of reducing greenhouse gas emissions by 40% by 2030.

**We believe our combination of internal checks and balances, external assurance and auditors and our widespread involvement in industry and regulatory bodies ensures that our policies, procedures and processes are subject to continuous and rigorous review.**

Other changes as a result of reviews that took place during 2021 included:

- approval by the ESG Global Steering Committee to join the Net Zero Asset Managers Initiative (see Principle 10);
- establishment of a groupwide Diversity and Inclusion policy (see Principle 1);
- creation of a working group in our Singapore subsidiary to build capacity and address improvements in our processes and policies that address environmental risks in response to guidelines issued by the local regulator.

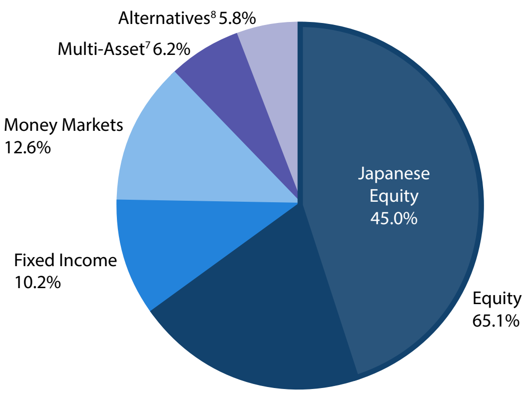
# Principle 6:

## Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

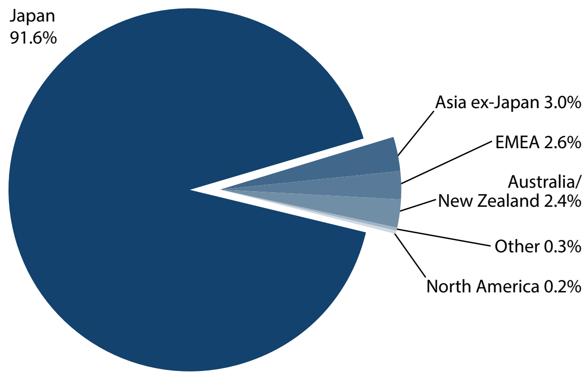
### Context

A breakdown of our AUM by asset class and client domicile is shown in the following charts.

**Assets Under Management by Asset Class[6]**




**Assets Under Management by Client Domicile[6]**




Keeping in touch with clients is a basic duty of any asset manager and is a vital part of good stewardship. However, different clients have different requirements. By far the largest segment of our client base is in Japan, mainly investing in equities and buying through third-party distributors. We generally do not directly manage any assets on behalf of private clients. As a result, we have to adopt a different approach when talking to our retail investors compared to our institutional investors. The former require easy-to-digest material that is simple, brief and well presented. The latter expect more direct, personal and frequent communication, with the amount and timing determined by our contractual relationships.

[6] Totals may not sum due to rounding of data at source.
[7] 'Multi-Asset' funds are made up of Equity and Fixed Income assets; the stewardship of each of these assets is addressed individually in this report.
[8] 'Alternatives' constitutes REITs, Equity Long/Short and Infrastructure funds. Infrastructure represents 0.2% of group AUM and is managed by external managers. These managers are subject to Nikko AM's external manager due diligence process, which includes a review of ESG policies.
Data as at 31 December 2021.

We believe most of our clients are best served taking a medium- to long-term view of their investments. For retail investors, we would argue this fits their need for long-term savings and best allows them to ride out the fluctuations in financial markets, thus maximising the value they can obtain from investing in securities. The same considerations apply to the majority of our institutional strategies, which are typically aimed at pension funds, insurance companies, banks, and sovereign wealth funds, which have long-term horizons. These perspectives are reflected in our communications with clients, which tend to focus on trying to explain long-term economic and market trends, including, but not limited to, demographic shifts and the fate of globalisation in a less open world. They are reflected too in our policy of integrating climate change and other ESG considerations into the investment processes.

We manage a number of money market funds, which hold more immediately liquid investments. These funds are typically invested for short periods, normally no longer than a few months.

We believe that this combined range of products and strategies aligns well with the needs of our clients.

## Activity

Accountability to our clients is at the heart of our fiduciary principles and communication is therefore crucial. For all clients, this means providing easy-to-understand materials that explain our investment approach, product risk characteristics and fees, as well as tools that help them understand their investments and the risks involved. As is stated within the Context section above, a large segment of our assets are managed for retail investors via intermediaries and, in terms of geographic location, the majority of our clients are based in Japan. In this section we have therefore provided particular focus on our communication with this segment of our client base.

The COVID-19 pandemic changed the way we communicate with our clients. It made holding traditional face-to-face seminars and meetings difficult during large parts of 2021, but we acted ahead of industry competitors in Japan to implement initiatives to communicate with the market. We have received positive feedback from our clients about our efforts to provide customer support – including support for our distributors by publishing market information aimed at retail investors – despite the difficult circumstances. Working with distributors and others, we quickly established the infrastructure needed to handle events remotely during the pandemic by setting up digital seminars and training sessions. This enabled us to provide customer support without in-person meetings. We were also able to help distributors in their efforts to service their retail customers by supplying them with information quickly, accurately and concisely through a wide range of media. As a result of our active promotion of remote seminars and training sessions since lockdown began, we have built up a hybrid communications strategy using both traditional in-person and on-line approaches that is both robust in the face of widespread disruption and allows greater flexibility and breadth of content in our interactions with clients.

### Retail investors

We have a large number of mutual funds which are sold through banks and other distributors to retail as well as institutional investors in Japan. We therefore put a great deal of effort into timely, understandable and accessible communications with Japanese retail investors. As we do not sell directly to them, our communications efforts are in part directed at our distributors: banks, brokers and, increasingly, internet-based groups.

We provide a wide range of information to distributors and Japanese retail buyers of investment funds, not only concerning the specific funds in question but also related to broader themes, such as the economy and wider markets. Our aim with our communications aimed at retail investors is to ensure they understand what is happening with their own investments and the reasons, while fostering a deeper understanding of markets and investment trends.

Realising that there are wide differences in the level of financial sophistication amongst our retail investors, we tailor our communications to our differing audiences. Thus we provide videos on our website aimed at both distributors and end investors. For example, we might support a particular fund with:

- videos that explain the concept of the fund;
- videos aimed at first-time viewers to promote the fund;
- regular videos and other materials that keep the clients up to date with performance and underlying factors that affect the fund

We also put a great deal of effort into webinars, online educational courses and training for distributors and end investors, an effort we have stepped up since the onset of the pandemic. Under our Nikko AM Fund Academy brand, we provide what we deem to be essential fund-related knowledge and information for our retail investors and distributors and also for non-customers.

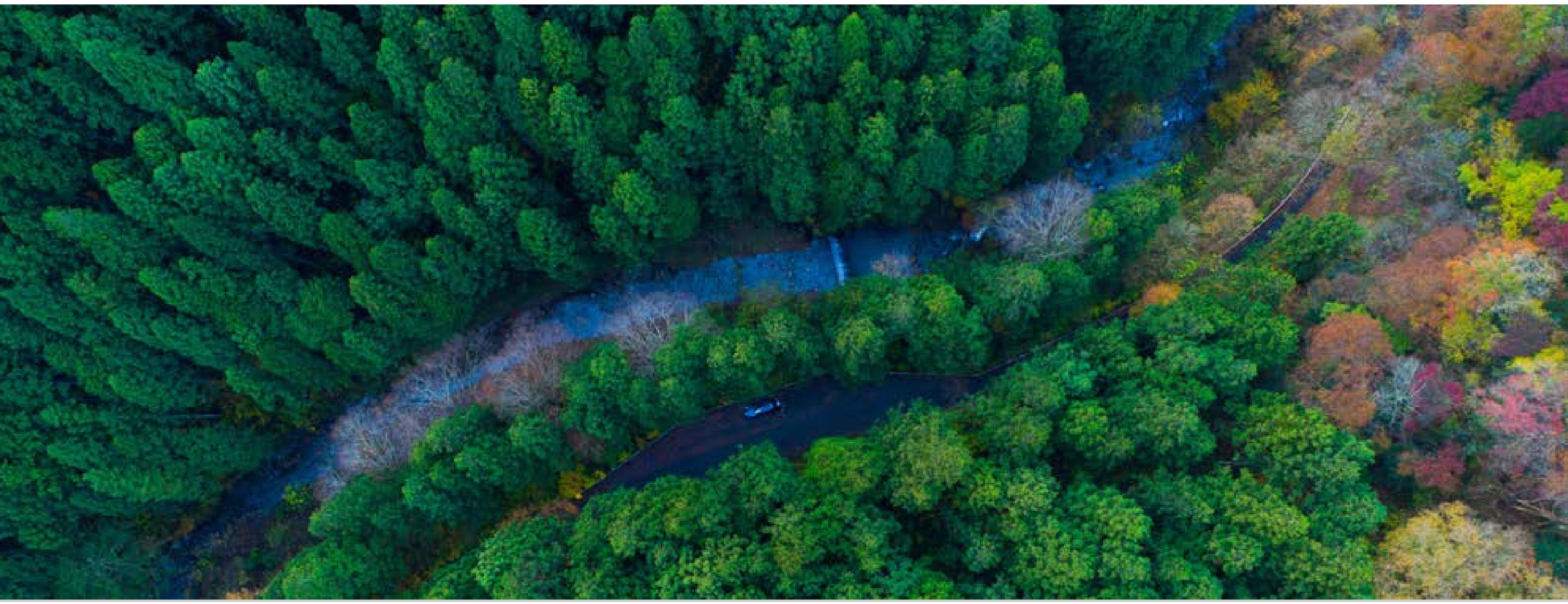
**Regular Material produced under the Nikko AM Fund Academy brand**

| | Frequency | Additional Information |
|---|---|---|
| Rakuyomi (Easy 5 Minute Briefing) | Twice weekly | 110 released in 2021 |
| Koyomi (Quick Soundbites) | Monthly | |
| Gokuyomi (Deep Dive) | Monthly | |
| Market 5 Minutes | Monthly | |
| Weekly Market | Weekly | |
| Date Watch | Weekly | |
| Follow-up Memo | Ad-hoc | 3 released in 2021 |
| Global REIT Weekly | Weekly | |
| Monthly Market | Monthly | |
| Japan in Motion | Quarterly | |
| Global Equity Overview | Ad-hoc | |
| Nikko AM Newsletter | Ad-hoc | 3 released in 2021 |
| China Insight | Ad-hoc | 13 released in 2021 |
| Kamiyama Reports (Market update reports by our Chief Strategist, Naoki Kamiyama) | Ad-hoc | 23 released in 2021 |
| Kamiyama Seconds! (Quick updates by Naoki Kamiyama) | Ad-hoc | 49 released in 2021 |
| Why should we invest? | Ad-hoc | 7 released in 2021 |

Our retail communications efforts regularly receive favourable endorsement from third parties:

- The latest distributor survey conducted by Greenwich Associates, a leading financial services benchmarking company, showed Nikko AM as number one in Japan in relationship management and marketing. Overall, we were rated either number one or within the top three by distributors, whether banks, brokers or internet banks and brokers.
- For the third year in a row, we were placed first in the latest mutual fund company satisfaction survey by Rating and Investment Information, Japan's largest rating agency.
- We were similarly ranked number one in last year's branding survey by Nikkin, the Japanese news agency, the third year we have taken top position.
- We were also placed first last year in the latest asset manager branding survey by MaDo, a major financial publication in Japan.

We believe the results of these surveys represent a weighty vote of confidence from intermediaries and commentators in the quality of our customer support, as well as how and what we communicate to the market.



### Institutional Investors

Our communications with institutional investors are, by necessity, much more sophisticated and individual than those with retail investors. It is our policy as a group to tailor the frequency and method of communication with institutional clients to meet their specific requirements. These are typically discussed and agreed as part of negotiations when the investment management agreement is set up, but the heart of our communications with institutional clients is our direct discussions. Our sales directors and client services teams work with clients to confirm the required content and timing for all regular client reports. In addition, we schedule investment reviews at least annually, and can arrange ad hoc meetings as required by the client.

Outside of a client's regular performance reviews, we take a proactive approach to ensuring clients are kept up to date with important information affecting their portfolios, including any changes to their mandates or significant market events which may affect performance.

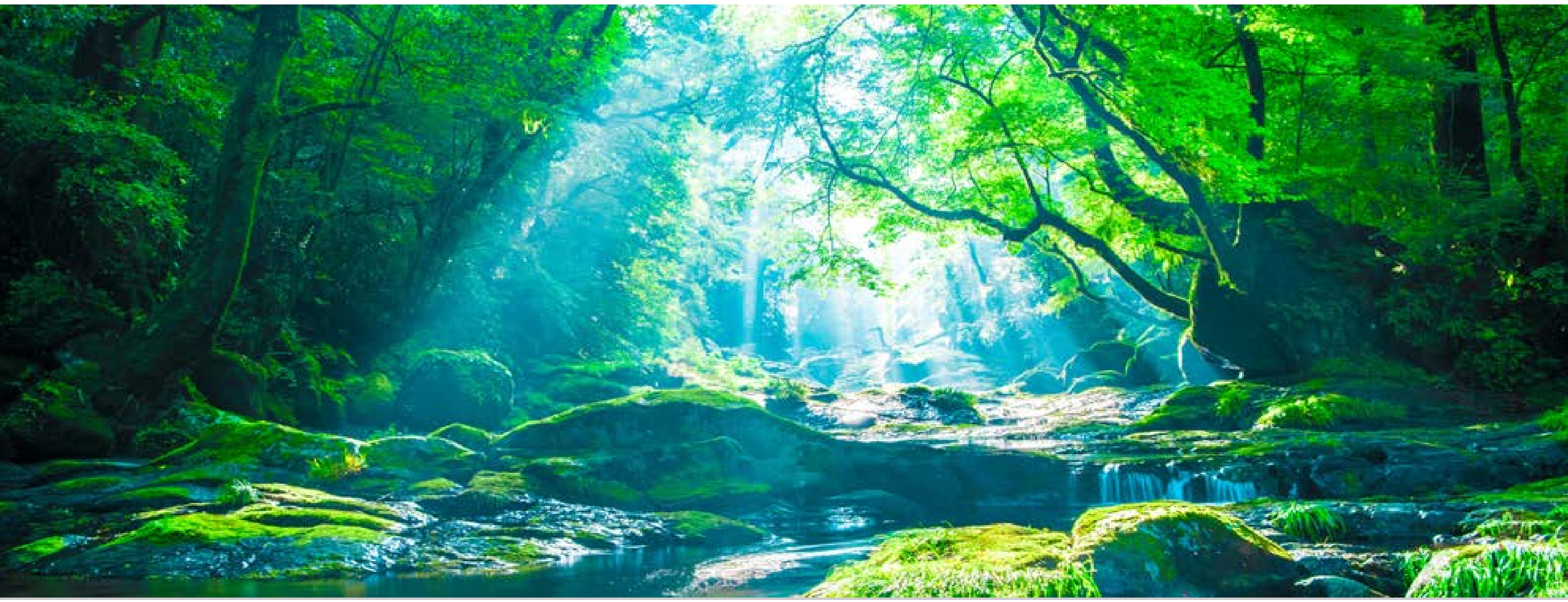
Regular meetings with our institutional clients are a two-way process. As well as the normal discussions and reports on performance, we provide explanations of a wide range of investment-related topics in answer to client queries.

With most of our institutional clients, we hold dedicated stewardship meetings once a year, although we may report on proxy voting, company engagement and other stewardship activities more frequently as clients require. Before these meetings, we typically submit information on a range of topics, including our stewardship policy, implementation framework, company engagements and their effect, and third-party assessments of our ESG integration and stewardship activities (for example, the latest United Nations' Principles for Responsible Investment Assessment). To meet clients' requirements, we are also able to provide reports on carbon intensity and other carbon-related disclosures, ESG scores, and other related information, for the companies in which we invest.

This allows us to focus our stewardship discussions on topics that may be of particular interest to those clients. We explain our voting decisions in some detail, including how we dealt with specific proposals and, in particular, where we voted against management proposals. We also discuss occasions where views within the firm differed and how internal consensus was reached. (How we cast our proxy votes and the number of company engagements we undertook during the year are disclosed on our website.)

In addition, we hold corporate sustainability meetings with clients, typically on an annual basis, to report on our broader sustainability initiatives that encompass not only investments but also other activities at the corporate level. Such discussions often involve an exchange of ideas as to what asset managers and asset owners can and should do to fulfil their fiduciary responsibilities and contribute to the betterment of the society.

We are always keen to understand the investment and stewardship principles our clients wish us to adopt when managing their assets and in return we explain the firm's policies and approach to implementation. Should there be any misalignment between the two views, we try to reconcile the differences with the aid of the Stewardship and Proxy Voting Committee's secretariat or other relevant specialists. Our aim is to be flexible when making any necessary amendments to the policy. For instance, when required by equity clients, we will adopt their policies on proxy voting or engagements. For segregated mandates, where possible we are happy to implement client-supplied lists of investments to be restricted or excluded and will tailor our investment approach to meet their specific requirements.



**Tailoring our engagement to client needs**

An example of where we responded to client demands arose last year when one of our UK pension fund clients in our global equity strategy told us they intended to become a signatory to the UK Stewardship Code. To better understand how we could help the client meet the requirements of the Code, our investment and Client Services teams discussed with them the key ESG themes that they prioritise under their stewardship and responsible investment policies. As a result, we provided them with information on our company engagements related to those themes that had taken place during the year, with a view to this information being incorporated in their submission. The investment team has also decided to focus on these specific themes in future engagements with investee companies in order to ensure that we continue to be able to meet the needs of this pension fund client.

Through such discussions, we confirm that both we and our clients understand each other on the topics raised and subsequently try to ensure that their views are shared with all the relevant people within the firm, particularly the investment team. In order to maintain close communication with our clients, we focus on face-to-face interaction via on- or off-line meetings, although we also use other methods of communication. Our client-facing personnel spare no effort in seeking detailed feedback, confirming whether our explanations given at meetings were sufficient and generally ensuring that clients' expectations and requirements have been met.

Our compliance department provides an independent check on whether investment portfolios are adhering to clients' investment policies and the relevant guidelines. Where necessary, it will discuss its review findings and any operational issues that need to be addressed with the investment teams, local management and head office.

Our non-Japanese investment teams maintain an active dialogue with our Japanese clients via our Tokyo-based client service team. We supply monthly investment positioning and performance reports, as well as market outlook updates. The client service team offers the first response to client requests about their portfolios and many of these are subsequently fed through to the teams on the ground for a further response. Portfolio managers typically visit Japan on a regular basis and, in addition to updating clients on their portfolios during investor meetings, they will also offer educational workshops. For example, our Global Fixed Income team offers seminars on European markets and the Danish mortgage bond market to clients and prospective clients. Some clients have also sent their representatives to London as a means of learning about the market and its day-to-day workings. These contacts strengthen our dialogue with clients and our understanding of their needs.

## Outcome

Given that our core client base is in the intermediary segment, it is harder for us than some other asset managers to assess the effectiveness of our communications with the retail market. However, we take comfort in the high rankings we regularly receive in the three most influential independent industry surveys in Japan, described above. Similarly, we feel our high rating in the Greenwich Associates Japan survey is testimony to our success in getting our message across to retail clients.

In terms of institutional clients, we make it a regular point at our client meetings to ask whether clients feel that they still understand the investment strategy we adopt for them and whether it continues to meet their needs. Beyond that, we are constantly seeking clients' comments on the scope and quality of the services we provide, as well as their degree of satisfaction with our investment results. This can be through separate feedback sessions or during the course of our regular communication with clients – portfolio and operational review meetings conducted by our client services teams are another important feedback point. Some of our institutional clients formally evaluate their third-party managers, such as ourselves, and assign scores. We always value such feedback from clients as it enables us to more objectively evaluate the effectiveness of the service we provide and highlight areas where we can improve.

In the light of clients' views, we are very ready to make changes to the strategies we employ, for instance, by strengthening our ESG integration or using additional investment techniques (e.g. derivatives) to better meet clients' needs. By the same token, we constantly strive to enhance our regular reporting on our investment or stewardship activities to meet clients' demands.

There were only very rare instances during the year when there were breaches of clients' investment policies. Breaches sometimes occurred when, for instance, instruments were reclassified during the holding period so that they no longer fell within the original category, or the classification was ambiguous so that the definition was not clear enough to avoid different interpretations, or due to external factors outside of our control, such as market movements or brokers' allocation of new issuance securities. In all such instances, we immediately addressed the situation by clarifying the cause, taking the necessary remedial steps, and implementing preventive measures. In such cases, we provide a full explanation to our clients, in line with regulatory requirements and best practice and, if necessary, make additional efforts to eliminate any future ambiguity in the interpretation of clients' investment policies.

# Principle 7:

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

## Context

As we stated under Principle 1, we strongly believe that stewardship, including fiduciary and ESG considerations, are inherent to long-term corporate value creation and contribute to the realisation of sustainable economic growth. We therefore see ESG issues as an integral part of our fiduciary duty to clients and incorporate ESG principles in all our investment processes.

We do not adopt a one-size-fits-all approach to integration. The main responsibility for implementing our fiduciary duties falls on our investment teams and they are given a remit to act in the best interest of our clients within the global and local governance frameworks provided by the Group. This means that our ESG integration and engagement processes are bespoke to each investment team, ensuring each chooses the methods most appropriate and effective for them. Where appropriate to the asset class, investment strategy and client requirements, certain investment teams may maintain specific ESG policies and procedures pertaining to their investment philosophy and process.

Allowing for asset class and regional differences, our Global ESG Steering Committee is responsible for monitoring and improving the investment teams' implementation of stewardship principles. Whilst the approaches may differ, the process ensures there is consistency across the firm. We believe that this structure enables us to serve the best interests of our clients.

ESG issues are rarely the only consideration when making investment decisions, but an understanding of these issues informs the investment process, gives our investment teams a more rounded view of companies and may help identify companies with improving ESG practices. Individual investment teams tailor their ESG policies and procedures according to their investment philosophy and process, asset class, investment strategy and client requirements. Relevant ESG factors include (but are not limited to) those related to environment, climate change, human rights and labour standards, talent management, product safety, diversity, board structure and independence, alignment of remuneration, transparency of ownership and control, and accounting.

In addition to our own policies and considerations, certain issues may be given priority as a result of client feedback from our institutional clients, either at the inception of a mandate or as the mandate evolves over time. We continue an active dialogue with our service providers, making clear to them our ESG priorities. For example, during our annual review with ISS, who provide us with analysis on proxy voting resolutions, we share any updates to our responsible investment and voting policies. Further information on how we interact with and assess service providers can be found in our response to Principles 8 and 12.

**The main responsibility for implementing our fiduciary duties falls on our investment teams and they are given a remit to act in the best interest of our clients within the global and local governance frameworks provided by the Group.**

**Allowing for asset class and regional differences, our Global ESG Steering Committee is responsible for monitoring and improving the investment teams' implementation of stewardship principles.**

## Climate Change

Firmwide, we recognise climate change as one of the greatest challenges the global community faces and consider it a fiduciary principle that we must address when managing our clients' assets. We reinforced our commitment to this principle and outlined our approach to climate change in 2019, when we published our Position Statement on Climate Change. The statement contains the four building blocks of our strategy:

1. develop internal capacity;.
2. collaborate with the investment community;
3. active stewardship;
4. report on our activities.

While these are the outlines of our approach, we do not seek to regulate how each investment team puts principle into practice in their own investment processes. However, in all cases we do believe that active dialogue and exercising voting rights on climate change, where appropriate, can lead to positive outcomes for the investee companies, our clients and our firm. We participate in relevant corporate engagement activities, such as the Climate Action 100+, to communicate our expectations to investee companies (see Principle 10 for more on our collaborative engagement activities). In line with the recommendations of the Task Force on Climate-Related Disclosures (TCFD), we encourage our investee companies to take the following steps:

- identify material climate change risks and opportunities in a range of scenarios (including where the global temperature rise is kept below 2°C) over appropriate time horizons;
- integrate material climate change risks and opportunities into their overall business strategy and risk management;
- disclose their management policies and processes toward meeting the goals – and resulting performance – that emerge from the above activities.

We are also actively exploring research tools to monitor the resilience of our portfolios under a range of climate-related scenarios. Whilst there has been significant progress on improving data, there are still some limitations with data quality and coverage, especially for emerging markets. Nevertheless, we will continue to work on improving data, exploring relevant tools and evolving our disclosures.

We generally do not apply blanket exclusions of investments based on climate change factors, unless directed by our clients. We prefer active engagement and the exercise of voting rights, which we see as more effective in upholding ESG and stewardship standards, whether it be for our clients, for the broader economy or for the environment. We believe that exclusions based on formulaic filters to determine climate risks can be inflexible and fail to capture the future potential of companies to respond to the transition to a low-carbon economy.

We believe that thorough research and vigorous debate within the teams, as well as direct engagement with companies to get a first-hand appreciation of the issues, are still the best ways to evaluate ESG factors and judge their impact on investment outcomes. We also recognise that climate-related impacts are complex and uncertain, so we need to keep abreast of scientific findings and information, and how regulators and stakeholders are responding to them.

While we take account of climate change considerations in our portfolios, we also work with clients to provide low-carbon investment solutions aligned with their specific investment beliefs. For example, our Green Bond fund is a low-carbon collective investment that invests in securities that finance climate change mitigation and adaptation projects, ensuring the highest level of transparency for investors who want to avoid "greenwashing". Launched in 2010, the strategy targets global AAA-rated sovereigns, supranationals and agencies with the strongest sustainable development credentials, such as bonds issued by the Asian Development Bank and European Investment Bank. In 2021 we also launched a Hydrogen Fund managed by our UK-based Global Equity team, which enables our clients to participate in the financing of the green hydrogen economy and the transition away from fossil fuels. More detail on our consideration and management of climate risk can be found in our TCFD Report on our website.

**We believe that thorough research and vigorous debate within the teams, as well as direct engagement with companies to get a first-hand appreciation of the issues, are still the best ways to evaluate ESG factors and judge their impact on investment outcomes.**

## Activity

The investment teams in our actively-managed strategies identify attractive stocks through in-depth bottom-up research, based on their own philosophy and approach. ESG factors and the risks and opportunities they present for the stock or bond are integrated into this process, providing additional considerations in stock selection.

ESG factors are thus rooted in our investment philosophies and processes and not treated as being part of a separate exercise. We strongly believe that attention to ESG is just a part of good investment discipline – core to any business and inherent to its long-term value creation, while contributing to the realisation of wider sustainable economic growth. Given this view, we endeavour to incorporate ESG considerations across all asset classes and geographies.

Having said that, different asset classes have different dynamics, with varied geographies and industry sectors adding to the complexity. Each of our investment teams is therefore allowed to view ESG implementation through its own lens, leading to diverse approaches across the organisation. Whatever the approach, we strive to apply all ESG policies to the highest standard, continually seeking improvement and innovation.

ESG risk analysis is integrated within the investment research function rather than outsourced to a separate team. Each investment team is responsible for the assessment of risks that may affect the success and long-term sustainability of holdings in the portfolio. Our detailed process – including stress-testing investment candidates, stock selection and portfolio construction – also helps to ensure that the whole investment team is engaged in managing ESG risks.

ESG specialists support the investment teams as part of our aim of having all investment professionals integrate ESG into their investment processes to the fullest extent. They also build relationships with various ESG-focused organisations and regularly share information with the ESG Global Steering Committee on developments such as ESG-related legal changes in countries around the world. In addition, each of our regional offices is required to present its ESG implementation activities to its respective board.

The table below gives a brief overview of the approach taken to ESG integration as applied across the various asset types and geographies that we manage.

| Asset class | How we integrate ESG and stewardship responsibilities within the investment process |
|---|---|
| Japanese Equities | • ESG factors incorporated within the "Creating Shared Value (CSV) evaluations" performed during initial and ongoing company due diligence.<br>• Engaging constructively with company management in relation to our key themes (E: Action for a Decarbonized Society, S: Human Capital and Productivity, G: Effective Governance).<br>• Exercising voting rights, including voting against director appointments where the firm faces serious climate-change-related risks or sustainability issues, its initiatives to address them are deemed insufficient and the situation is not deemed to be improving.<br>• See the "How we integrate ESG in Japanese Equity portfolios" case study for more on our approach to Japanese Equities.<br>• Proxy voting is executed in the interest of our clients in line with our proxy voting guidelines. |
| Global Equities | • ESG analysis is undertaken by each portfolio manager and fully integrated into the stock-picking process to ensure we can robustly evaluate the materiality of each factor and its potential impact in the future.<br>• Our four-pillar "Future Quality" analysis includes in-depth evaluations of ESG factors to determine their effect on the company's risks and returns.<br>• Research includes an analysis of a company's corporate governance, social practices, the environmental sustainability of its products or services and its capacity to fund its growth and ESG commitments.<br>• Our investment team engages with investee companies to help promote better ESG practices if we believe there is room for standards to improve. This includes ESG controversies identified by the Global Equity team.<br>• MSCI validates our ESG analysis by scoring our Global Equity portfolio, which is rated AAA as at the end of December 2021.<br>• Proxy voting is executed in the interest of our clients in line with our proxy voting guidelines. |

| Asset class | How we integrate ESG and stewardship responsibilities within the investment process |
|---|---|
| Asia ex-Japan Equities | • ESG materiality matrix applied to company using ESG factors from the Sustainability Accounting Standards Board and MSCI<br>• ESG analysis incorporated in company research, security selection and portfolio construction.<br>• Our ESG "Materiality Map" focuses on the material issues and opportunities for each of the companies we cover (see "Case study: improving ESG factors in a palm oil producer").<br>• ESG-focused research is used to identify areas for company engagement and improvement.<br>• An acceptable ESG standard is not the sole determinant for investment, however where negative ESG issues are identified with little or no evidence that corrective measures are being taken, the company is excluded from investment consideration.<br>• For existing holdings, an indication of material deterioration in ESG factors may lead to a rating downgrade and subsequent sale from the portfolio.<br>• Proxy voting is executed in the interest of our clients in line with our proxy voting guidelines. |
| New Zealand Equities | • The team seeks to understand how industry and company ESG factors may impact investments and ultimately client portfolios.<br>• ESG factors are considered as one aspect of the overall analysis to build a picture of the risks and opportunities faced by a company.<br>• Portfolio companies with low ESG scores are targeted for engagement in an effort to lift the bar in weak areas or where improvement would be beneficial to stakeholders.<br>• Proxy voting is executed in the interest of our clients in line with our proxy voting guidelines |
| Global Fixed Income | • The majority of fixed income assets managed by the investment team are in AAA-rated bonds. Particularly in the case of corporate credit, ESG factors are considered to the extent that they are deemed material to the investment case and in line with our Japanese clients' risk appetite and perspectives on ESG investing.<br>• In relation to our holdings in sovereign entities and major banks, we maintain an active dialogue on ESG themes as a means of building our insight and market intelligence. |
| Asian Fixed Income | • ESG materiality matrix applied to company using ESG factors based on the Sustainability Accounting Standards Board and MSCI but enhanced to reflect conditions in Asia<br>• ESG analysis incorporated into all company research and portfolio construction. ESG-focused research is used to identify areas for company engagement.<br>• An acceptable ESG standard is never the sole determinant for investment, however where negative material ESG issues are identified and we do not believe that corrective measures will be taken, the company is excluded from investment consideration.<br>• For existing holdings, an indication of material deterioration in ESG factors may lead to a rating downgrade and potential subsequent sale from the portfolio. |
| New Zealand Fixed Income | • The team seeks to understand how industry and company ESG factors may affect investments and, ultimately, client portfolios.<br>• ESG factors are incorporated into the due diligence process to provide an overall picture of the risks and opportunities faced by issuers.<br>• The team engages with portfolio companies with low ESG scores in an effort to seek improvements that would be beneficial to stakeholders. |
| Money Markets | • ESG and stewardship considerations are considered within the issuer selection process to the extent that they are deemed material to the investment case and in line with our underlying clients' risk appetites. See "Money Market Funds: Pandemic-Induced Interest Rate Changes" within principle 4 for information on our approach to fiduciary duty to our clients. |

### How we integrate ESG in Japanese Equity portfolios

Our largest asset class in terms of assets under management is Japanese Equities. ESG is integrated into all investment decisions in these portfolios through the use of a selection process which uses Creating Shared Value (CSV) evaluations.

CSV evaluations use the work of Harvard University Professor Michael Porter which found that the creation of social value leads to economic value. We have used CSV evaluations of firms as part of our investment process since 2013, incorporating the ESG factors of diversity, management ability to execute, contribution to the environment and society, and threats to business continuity. These are integrated with Porter's original Five Forces (which fall within the "competitiveness" category) – barriers to entry, threat of substitutes, bargaining power of customers and suppliers and competitive rivalry – together with an evaluation of financial strength and returns to shareholders ("financial strength"). Our CSV evaluations currently comprise 12 factors grouped into three categories: competitiveness, ESG, and financial strength. We have most recently updated the factors, increasing from four ESG factors to five (new factors include human capital, carbon neutrality, and resilience). We use the CSV evaluation factors to determine whether a stock is at a premium, neutral or at a discount relative to the sector.

In March 2017, we launched the Active Ownership Group, a body devoted to promoting better corporate and shareholder value in the Japanese companies in which we invest, including our passive strategies. These initiatives have further improved our ability to engage with firms and exercise our voting rights in our efforts to maximise the corporate value of firms. During 2021, the AOG engaged a total of 4,104 times with 1,111 firms.

In March 2021 the AOG established three ESG priorities (published on our web site as "Nikko AM's Key ESG Themes") for engagement with our Japanese equity investments which we believe will contribute to better investment returns in the medium- to long-term. They are listed below with the background to each one:

**Environment – Action for a decarbonised society:** The shift toward a decarbonised society is creating growth opportunities for companies with environmentally-friendly technologies. At the same time, decarbonisation and other such changes put companies at risk of potential cost rises, while their brand power may be damaged if they fail to take sufficient action. This is making decarbonisation increasingly important as a driving force behind future corporate value. We use our engagement to urge firms to address these changes, for example by allocating business resources to related fields and preparing for the associated risks. Our analyses of companies' actions in this area are pivotal to our assessments of their corporate value.

**Social – Human capital and productivity:** The way companies use human capital is clearly important to their medium- to long-term earnings and corporate value, and it will become increasingly crucial as populations age further and birth rates continue to fall. Following the COVID-19 pandemic, reconsiderations of working styles and the need for flexible responses to similar environmental changes have also driven improvements in corporate sustainability. Deepening our engagement and analyses with a focus on companies' personnel strategies and systems, as well as their labour productivity, is another way in which we are helping to enhance corporate value.

**Governance – Effective governance:** Thanks in part to the Corporate Governance Code, Japanese companies have made great strides in developing their governance frameworks. We continue to urge companies to increase their corporate value even further through sustained development and enhancement of their governance frameworks. Our engagement covers the appropriateness of their long-term visions and management strategies, their ability to put these plans into practice, and the effectiveness of their oversight and advisory functions.

### Outcome

We think the best way to demonstrate the practical outcome of the way we integrate stewardship into our investment activities, and particularly ESG issues, is through some examples. Therefore, we have included a number of case studies that illustrate how information gathered through engagement and active ownership during 2021 has helped inform investment decisions.

**Case study: improving ESG factors at a palm oil producer (Asia ex Japan Equity)**

We aim to identify companies where ESG factors are improving, as there is scope for an uplift in valuation as the improvements become evident to the market. An example is the history of our investment in Wilmar International, a Singapore-based agribusiness which is held within our Asia ex-Japan Equity portfolios.

**Issue:** As a leading palm oil plantation owner, refiner and distributor, the company operates in a highly controversial sector. It faces a number of material ESG issues, including carbon emissions, land conservation and labour practices. The diagram below illustrates the investment team's ESG Materiality Map for the company.

**Engagement:** We have been engaging with the company directly and as a member of the PRI's investor working group on sustainable palm oil since 2018. In the intervening years, we have seen big improvements in the company's engagement with ESG. These have included addressing deforestation, winning certification from the Roundtable on Sustainable Palm Oil (a stakeholder industry group), ensuring traceability in its supply chain and aiding development in the communities from which its labour is sourced. We have also witnessed a substantial improvement in the company's attempts to improve food safety and nutrition practices, which we had previously highlighted as an area where there was an opportunity to improve sustainability.

Independent endorsement for the company's efforts – and the success of our engagement – came when Wilmar was included in the Dow Jones Sustainability Index as a sustainability leader in 2020. At a meeting in 2021, we spoke further with company representatives about their sustainability practices, ESG journey and their continuous efforts in engagement and transparency that has contributed to their inclusion in the Dow Jones Sustainability rankings. We also discussed their efforts in social opportunity in food safety and sustainability.

**Outcome:** During the meeting in 2021, Wilmar addressed some of our previous concerns which led to an upgrade to the investment thesis under the "Social" pillar of our ESG matrix. Their progress in certain ESG-focused areas, particularly in Social (food safety) gives us confidence that there will be further improvements on these fronts. As a result of this, we increased our position in the stock.

**ESG Materiality Map**

| Environmental Pillar (50%) | | | | Social Pillar (30%) | | | Governance Pillar (20%) | | |
|---|---|---|---|---|---|---|---|---|---|
| Climate Change | Nature Capital | Pollution & Waste Management | Environmental Opportunities | Human Capital | Product Liability | Social Opportunities | Corporate Governance | Corporate Behaviour | Governance Opportunities |
| Emissions & Energy Management | Water | Toxic Emissions & Waste | Clean Tech | Labour Management & Development | Product Safety & Quality | Access to Basic Services (Food, Healthcare, Finance, Power, Communications, Education) | Beneficial Ownership Assessment (Individual, SOE or Capital Market) | | Ownership & Management Change |
| Product Emissions Footprint | Land | Packaging Material & Waste | Green Building | Equal Opportunities | Customer Welfare | | Treatment of Minorities | Business Ethics | Minority interest Alignment |
| Financing Envionmental Impact | Biodiversity | Electronic Waste | Renewables | Health & Safety | Privacy & Data Security | Opportunities in Health & Wellbeing | Board | Anti-Competitive Practices | Principal-Agency Alignment |
| Climate Change Vulnerability | Resource Management | | | Supply Chain Management | Responsible Investment | Community Development | Pay | Corruption & Instability | |
| | | | | | Financial System Instability | | Accounting Practices | Past Transactions | |
| | | | | | | | | Transparency & Disclosure | |

| | |
|---|---|
| Primary Risks | Issues which can put a company out of business |
| Secondary Risks | Issues which can have a material impact on shareholder return |
| Opportunities | Issues which can lead to a material enhancement in shareholder returns |

## Case study: a palm oil producer that is destroying value with poor ESG standards (Asia Fixed Income)

We hold IOI Corp bonds in our Asia Fixed Income portfolios. Based in Malaysia, it is one of the largest palm oil producers in the world, with operations encompassing plantations, mills, refineries, specialty fats and oleochemical operations. The company's plantation business is in both Malaysia and Indonesia and has a land bank of more than 230,000 hectares. Last year, the company announced a bond issue. Our Asia Fixed Income team had to decide whether we wanted to participate.

From a financial point of view, IOI has a robust credit profile and is rated BBB-. It has a long track record of strong cash generation, with high interest coverage ratios. These financial strengths are partially offset by the company's high earnings correlation with commodity cycles.

**Issue:** IOI Corp has periodically been embroiled in ESG-related controversies surrounding its palm oil plantations and the health and safety standards of its workers. The company was recently accused of using forced labour by an activist group, an allegation which remained unresolved at the time of last year's bond issue.

In March 2016, IOI lost its certification from the Roundtable for Sustainable Palm Oil (RSPO), a stakeholder industry group. RSPO ruled that IOI was not meeting the certificate's standards by ensuring adequate protection for areas of peat in the forested areas it owns. The ruling resulted in large multinationals dropping IOI from its approved list of suppliers (for example, Kellogg's, Unilever and Mars). IOI responded swiftly by carrying out remediation work to rectify its processes and restore its full compliance with RSPO standards. RSPO subsequently reinstated IOI's licence in August 2016.

**Outcome:** Despite the remedial action taken by the company and its strong balance sheet, our Asia Fixed Income team was worried that the RSPO suspension would have a lasting impact on the company's reputation, affecting both its operations and credit profile. We did not feel our concerns were properly reflected in the pricing of the bonds in 2021's new issue. This was reflected in our ESG evaluation and we decided not to participate.

### Key ESG factors considered in the investment process of our Asia Fixed Income team

**Environment**

- Carbon Emissions
- Product Carbon Footprint
- Financing Environmental Impact
- Climate Change Vulnerability
- Water Stress
- Biodiversity & Land Use
- Raw Material Sourcing
- Toxic Emissions & Waste
- Packaging Material & Waste
- Electronic Waste
- Opportunities in Clean Tech
- Opportunities in Green Building
- Opportunities in Renewable Energy

**Social**

- Labour Management
- Health & Safety
- Human Capital Development
- Supply Chain Labor Standards
- Product Safety & Quality
- Chemial Safety
- Financial Product Safety
- Privacy & Data Security
- Responsible Investment
- Insuring Health & Demographics
- Controversial Sourcing
- Access to Communication
- Access to Finance
- Access to Healthcare
- Opportunities in Nutrition & Health

**Governance**

- Board
- Pay
- Ownership
- Accounting
- Business Ethics
- Anti-Competitive Practices
- Corruption & Instability
- Financial System Instability
- Tax Transparency
- Ownership & Mgmt Change
- Minority Interest Alignment
- Principal-Agency Alignment
- Regulator Track Record

(Reference: Sustainability Accounting Standards Board, MSCI)

### Case study: giving credit for active engagement in ESG (Asia Fixed Income)

Our Asia Fixed Income portfolios hold bonds issued by Reliance Industries, a large Indian conglomerate with a presence in the refining and marketing, petrochemical, digital services and retail businesses.

**Issue:** As part of the research process carried out for our Asia Fixed Income portfolios, we identify the ESG issues most relevant for the company while taking account of the nature of the business and the materiality of the issues for the overall sector. In our analysis, we will tend to favour companies that are proactive in managing ESG issues and are implementing changes that encourage longer-term growth. We will tend to be cautious about those at risk of falling behind.

Reliance Industries is an example of a company making progress on ESG. The key ESG factor applicable to the company is greenhouse gas emissions (which fall under our "Environment pillar") as a result of its involvement in the fossil fuel industry. This exposes the company to risks from the transition to greener energy.

Following our analysis, we found that Reliance has been actively diversifying its business by building a sizeable presence in retail and digital services. The company now boasts a diversified business with a large presence in the Indian domestic market and has gradually reduced its reliance on the oil refining business. In 2021, the company also announced a $10 billion capital spending programme in clean energy investments to be rolled out over the next three years and an ambitious target to be carbon neutral by 2035. The company also improved its ESG reporting by announcing that it would adhere to international reporting frameworks, such as the Task Force on Climate-related Financial Disclosures.

With its good track record in business execution and strong balance sheet, we are optimistic that Reliance will be successful in its plans to mitigate energy transition risks. The company is also capitalising on new business opportunities with large investments in the renewable and clean energy sectors. These will help to sustain the company's long-term financial performance and enhance its overall ESG profile, whilst playing an important role in supporting energy transition in India. External validation of these improvements came when the company's MSCI ESG score was upgraded by one notch in 2021.

**Outcome:** The positive ESG assessments were factored into the quantitative and qualitative components of our Internal Credit Rating, improving the overall credit rating and corresponding risk premium, and thereby justifying further investment in the company.

### Case study: Nikko AM as gateway to a greener Danish mortgage market (Global Fixed Income)

The Danish mortgage bond market dates back to the end of the 18th century. It is unique in its age and size, being significantly larger than the Danish government bond market. It is typically AAA-rated and has no high-yield or sub-prime sectors. Local market practices provide high levels of security amongst individual bonds, whilst the market has proved to be robust and resilient in both favourable and difficult market conditions. The market takes great pride in the fact that no bond has ever defaulted throughout its history.

**Issue:** As stewards of our clients' capital, we see ourselves as a bridge between Japanese investors and this very attractive market. While investors' main concern is to ensure that their Danish portfolios help improve diversification and income relative to their Japanese holdings, they also need confirmation that their holdings have been well managed in the context of the local opportunity.

Our Global Fixed Income investment team has built extensive experience in the market, having researched and invested in it for over five years. We were instrumental in encouraging Nycredit, a Danish bank, to design an index of Danish bonds hedged back into Japanese yen as a benchmark for Japanese investors with holdings in this market. We continue to maintain a dialogue with the index provider on behalf of our clients. We have also engaged in extensive discussions with Japanese financial institutions about the opportunities that the Danish bond market offers overseas investors. Despite the fall in yield in recent years, we have still been able to construct portfolios for our Japanese clients that offer diversification in terms of duration, coupon and mortgage originators, as well as a desirable income stream over the periods being sought.

Our investment team has regular communication with Danish market participants, as well as the central bank and other market commentators to understand ongoing developments in the market. We are in regular contact with the originators of mortgage bonds and market regulatory officials to understand the current issuance of mortgage bonds and how it might impact the market. Similarly, we maintain constant contact with domestic Danish investors and brokers to follow the demand side of the market. As part of our discussions with the banks last year, we suggested that they might offer incentives through their mortgages that would encourage their customers to improve the insulation and energy efficiency of their homes. We also discussed how these "green mortgages" might be segmented to identify them as a sub-sector of the market.

**Outcome:** We will continue to be actively involved in the Danish mortgage market in 2022, maintaining our contacts with all participants. We will be paying particular attention to our green initiatives and will be monitoring the extent of their take-up and engaging in further discussions to encourage their more widespread adoption.

# Principle 8:

Signatories monitor and hold to account managers and/or service providers.

## Activity

We use a number of outside service providers as part of our stewardship of the assets we manage. These include MSCI, Bloomberg, ISS, Good Bankers and IR Japan for ESG information and analysis. We also have regular meetings with external ESG analysts to improve our understanding of how they engage with companies and thereby enhance the quality of the research we receive. Quality and depth of reports and insights are considered, as well as the effectiveness of the vendor in providing us with the necessary insights to fulfil our stewardship obligations on behalf of our clients.

Although there is value in the data provided by our third-party providers, we treat it as supplemental to our own analyses and believe any enhancement depends on how the information is incorporated into the investment process. A large portion of our assets are in Japanese and Asia ex-Japan equities, as well as fixed income assets, all of which are asset classes not well covered by third-party providers. We find that there are gaps and data delays while, at times, we disagree with the analyses or ratings even when they are available. We therefore do not rely exclusively on these services. We conduct all engagement with investee companies ourselves and the decisions on how we vote are ultimately made internally.

One example in 2021 where we disagreed with the data provided by a third-party provider occurred when an MSCI Social Controversy Score downgrade resulted in engagement with MSCI to understand the rationale for the downgrade. Further details can be found in the case study that follows.

**Case study: querying third-party ESG scoring**

Deere & Company manufactures and distributes a range of agricultural, construction, forestry, commercial and consumer equipment.

**Issue:** Last year Deere suffered a major strike by its US workers over pay and benefits. The strike resulted in a significant downgrade by MSCI in Deere's Social Controversy Score. We noted the downgrade as part of our regular monitoring. We asked MSCI to confirm that the strike was the reason for the downgrade and, if so, why it had taken so long to feed through to the rating. We also questioned why the company had received such a severe downgrade when the issue had been resolved.

MSCI confirmed the downgrade was related to the strike. It explained that each company receives an overall score based on the assessment of performance under the three headings of environmental, social and governance. The overall score is then driven by the lowest scoring of the three. MSCI assessed the scale of the impact of the strike to be extremely widespread, although the nature of the impact was only assessed as medium (as with most labour strikes). Nonetheless, using MSCI methodology these scores added up to a "severe controversy".

Although MSCI had determined that this matter had been concluded, it did say that its report took account of controversies over the previous three years. On timing, it acknowledged that news of the strike had been received in October, with its conclusion following in November, yet the downgrade was not reflected in its scores until December. MSCI assured us that its Controversies Team was continuing its efforts to enhance its news collection and monitoring processes to ensure timely processing of relevant controversies.

**Outcome:** No change in our investment was made as a result of this engagement as it did not result in any change in our research thesis. We will continue to monitor MSCI's Social Controversy Score for Deere in future years to see how it accords with our own research.

# Principle 8:

When engaging with any external service provider, we undertake an initial due diligence analysis, after which the provider is subject to ongoing monitoring and due diligence. Each outsourcing department that owns the relationship with the applicable external service provider undertakes an annual review of the cost, effectiveness and usage of the services received. Vendors are also subject to anti-money-laundering and adverse media screening checks. Monitoring includes maintaining appropriate levels of regular contact and may include regular performance assessment. The areas covered in the initial due diligence are illustrated in the diagram below.

**How we monitor service providers**

- Internal control system
- Information security system
- Management stability, industry standing, corporate culture, organisational structure
- Public accreditations, licences, certifications by private certification bodies
- Quality, technical capabilities, environmental friendliness and track record in consigned business or similar business and reputation thereof
- Outsourcing fees and payment conditions
- Emergency measures, Business Continuity Managment (BCM), Business Continuity Plans (BCP)

In 2021 we also enhanced our annual vendor due diligence questionnaire for strategic service providers to include a section on ESG and sustainability. For example, we request that vendors provide copies of any ESG/sustainability policies or procedures which govern integration of ESG considerations within their business activities. We also ask (amongst other things) for details of how the company identifies and manages material ESG-related risks, uses ESG factors to create value and how the firm promotes ESG/sustainability awareness within their organisation. We are in the process of rolling this out more widely across our service providers during 2022.

An example of a service provider we use extensively for our stewardship activities is ISS. We use ISS to carry out proxy voting on our behalf. Upon receipt of any advisory research and voting recommendations from ISS, the portfolio manager or analyst responsible for the security in question looks at the report and conducts further research where any issues have been flagged.

ISS has benchmark policy guidelines which are regularly updated. It is part of our annual review process to combine the review of these guidelines with the annual review of our own proxy voting policy. We then liaise with ISS if their guidelines do not match our expectations. Our interaction with ISS and our voting process is further detailed in our response to Principle 12.

## Outcome

We have experienced no material issues with any of our external service providers during 2021.

As illustrated by our case study, there are instances where we disagree with the analysis provided. This is fed back to the data provider as part of our day-to-day operations but does not always result in reports being reissued (in the case of, say, MSCI or ISS). We are confident that our monitoring of service providers has ensured that services have been delivered to meet our needs.

# Principle 9:

Signatories engage with issuers to maintain or enhance the value of assets.

## Activity

As a leading asset manager, we recognise that engagement and stewardship are part and parcel of our fiduciary duty. Active engagement with our companies is built into our investment processes and plays an integral role in fulfilling our commitments as a good steward of the capital that our clients have entrusted us with. While the general approach outlined here applies to all discretionary accounts, it will be adapted to circumstances. For example, Japanese culture may approach engagement from a different perspective than Western societies. Our strategy as outlined here should be read in conjunction with our Commitment to Responsible Investing and the Group Proxy Voting Policy.

### Engagement Objectives

We engage with our companies on their strategy, operations and financial decisions, as well as their performance and management with respect to material environmental, social and governance (ESG) issues. The purpose of our engagements is to help them attain and sustain high returns and create value, while becoming and remaining good corporate citizens. In carrying out our purpose, we seek to understand managements' stance and strategy on material issues, monitor their performance on these issues and set milestones, where appropriate, and shape corporate behaviour and influence positive change by encouraging policies such as enhanced ESG disclosure and performance in line with best ESG practice.

Our discussions with managements often seek the rationale for their decisions and policies and, where appropriate, commitments to address any issues raised. Three overarching principles guide our engagements:

- Materiality: our engagements are driven by material factors, including ESG factors;
- Intentionality: we establish clear objectives and expectations for our engagements;
- Effectiveness: we engage in a constructive, positive and pragmatic manner.

### Engagement Methods and Execution

Our engagement methods vary, based on the needs of the situation. These methods include:

- one-on-one company dialogues, including on-site visits;
- management calls and roadshows;
- written communication;
- collaborative engagements.

In some parts of Asia, one-on-one engagements are often the most constructive and culturally appropriate way to build trust, on the basis that confidentiality can bring better results than open confrontation. Mindful of these important regional nuances and our commitment to constructive, positive and pragmatic engagements, we carefully select our engagement methods, whilst being committed to supporting collaborative engagements where appropriate. For more on collaboration, see Principle 10.

Regardless of the method of engagement, we always seek to have a dialogue with the key decision makers, including founders, chairs, independent directors and executive directors, and particularly chief executives, chief financial officers and others whose duties include sustainability and investor relations. If these more consensual approaches fail to achieve our desired ends, or there are more serious failings by a company, we may escalate the matter. This could involve collaboration with other investors. These approaches are discussed in more detail under Principles 11 and 10 respectively.

**We engage with our companies on their strategy, operations and financial decisions, as well as their performance and management with respect to material environmental, social and governance (ESG) issues.**

# Principle 9:



As discussed under Principles 1, 2, 6 and 7, ESG is integrated into our investment process, with investment teams engaging with our companies on relevant ESG issues both before and during the period of investment. We do not separate or outsource the engagements as we believe our own analysts and portfolio managers are best placed and should be responsible for assessing ESG issues and engaging with the companies they cover. As a result, ESG risk and opportunity are factors that form part of our buy and sell decisions. Our active engagement makes it clear to issuers that ESG is one of our priorities.

We use several factors to decide how to prioritise companies for engagement, which can differ by region and asset class. The factors that may be considered for prioritisation are:

- the size of holding and/or our influence,
- a poor ESG score or the scope for improvement,
- the nature of the issue and/or the severity of the breach,
- materiality,
- a voting event,
- our ESG thematic priorities,
- the client's priorities,
- the company's openness to dialogue.

The results of our engagements supplement our investment analysis, risk management frameworks and, consequently, our investment decisions. Our principal objective, however, is to seek commitments from company managements that they will address any material concerns raised by investment teams as a result of our engagement. The results are logged and revisited as we monitor companies' progress.

## Engagement by Asset Class

The type of engagement undertaken depends in part on the asset class in question, as well as its geographic location. Below we outline the approach adopted in the main asset classes we manage.

### *Japan Equities*

Our Japanese equity investment teams have a deep understanding of local markets and the intricacies of Japanese corporate culture, which helps us develop relationships with the companies in which we invest. Sources of information extend beyond written forms, such as financial statements, sell-side research and local news flow, with managers placing an emphasis on direct contact with company management, including site visits. Our local presence in Tokyo, where we are one of the largest asset managers in Japan and where the market generally tends to be under-researched by non-domestic peers, helps facilitate dialogue with companies. Over the years, we have been able to establish strong local relationships, providing us with unique insights, investment opportunities that might have otherwise been overlooked and allowing us to provide unusually far-reaching stewardship.

To supplement the research undertaken by our specialist Japanese equity investment teams, we set up the Active Ownership Group (AOG) in 2017 to enhance the firm's ability to decide how to exercise voting rights, carry out our stewardship activities and conduct engagement with companies held in our Japanese equity portfolios. As a result, even stocks which are only held in passive portfolios became subject to engagement. Since August 2021, a key focus of the AOG has been to work with portfolio managers and analysts in our research teams to engage with large and mid-sized firms specifically on ESG issues.

The AOG's priorities when deciding which firms to engage with are based on several stewardship considerations, including, amongst other things, ESG, corporate earnings, asset efficiency and shareholder return. After each engagement, a report is created to track progress and is shared internally. Feedback is also provided to active investment portfolio managers.

In March 2021, the AOG group established three key ESG themes in relation to Japanese equity investments. These are covered in more detail under Principle 7. Guided by these themes, our assessment and dialogue with investee companies enhances corporate value and contributes to better investment returns in the medium to long term.

We view the improvement of our engagement policies as an iterative process and as a result of reviews conducted during 2021, we will be rolling out further enhancements to our Japanese Equity engagement policies during 2022.

# Principle 9:

### *Global Equity*

When appropriate, our Global Equity investment team will engage with investee companies to help us understand how their ESG opportunities and risks are managed. These meetings can occur at any point in the investment process – from initial research, through to portfolio inclusion and beyond. These discussions provide us with an opportunity to develop our knowledge of each business and industry, and to take a view on the quality of management teams and their strategies. We will also engage to help promote better ESG practices, if we believe there is room for standards to improve.

Clients in the UK and Europe are increasingly engaging with us on matters of stewardship. During 2021, we had discussions with UK institutional and wholesale clients on the impact of the revised UK Stewardship Code. Certain clients of our Global Equity strategy have also requested greater focus on specific ESG themes, which has resulted in increasing emphasis on these areas during investee company engagements and other regular activity, such as client reporting. Taking into consideration clients' engagement themes where possible is included in our new Group engagement strategy.

### *Global Fixed Income*

In relation to corporate credit, our Global Fixed Income portfolio managers and research analysts regularly engage with companies in which we invest. These discussions cover the firms' corporate earnings and financial strategies, but also other non-financial information, including their management policies, business strategies and ESG matters, as part of an assessment of corporate value that ultimately informs our investment decisions. Where we have identified company-specific or systemic risks, we may raise these concerns through meetings, site visits, conference calls or correspondence in order to gain assurance that risks are being managed. We prioritise engagements based on our holding, the issue and our exposure, rather than whether we expect change and will be able to demonstrate outcomes. However, the level of engagement depends on the asset class and the geographic region. Given our relatively small exposure to corporate bonds and emerging markets as part of our global AUM, we are realistic about the practical limits to our influence and we avoid situations where we might end up in corporate actions which would tie-up disproportionate resources and time.

In our Global Fixed Income portfolios, most of our assets under management are in sovereign or other AAA bonds and money market instruments. We also hold small shares of issuance by major banks and some leading corporates. While we maintain an active dialogue, we see this as a means of building our insight and market intelligence as much as a form of influence that might change the behaviour of these issuers.

# Principle 9:

Nonetheless, despite the AAA-rating of Danish mortgage bonds, we recognise our position as a "gateway investor" for Japanese investors in this market. We therefore believe it is important to regularly engage with the mortgage banks in respect of their lending practices, securitisation methods and issuer programmes. In 2021, we discussed with them how their lending process might support house insulation and energy efficiency amongst their borrowers and how this might be reflected in bond issuance. We have also held initial conversations with Danish institutions to see whether they can segment loans based on the energy efficiency of the borrower to create green mortgage bonds. We will revisit that conversation in 2022. For more on this subject, see our case study under Principle 7.

## Outcome

The best way to describe the outcomes of our engagement in the past 12 months is by a series of examples and case studies.

### Case Study: addressing climate change at a large financial institution (Japanese Equity)

A large financial services group whose business lines include banking, trust services, securities brokerage, credit cards, and leasing. The shares are held in our Japanese Equity portfolios.

**Issue:** In May 2021, the firm published its Carbon Neutrality Declaration, which committed it for the first time to a long-term target of achieving net-zero greenhouse gas emissions within its loan and investment portfolio by 2050. The bank has also joined the Net-Zero Banking Alliance, an initiative that brings together those in the banking sector committed to moving their lending and investment portfolios to net-zero emissions. The company will unveil its interim carbon neutrality targets for 2030 this year and it will be important for investors to consider how ambitious these are and how they are to be achieved. Given that the company has said it will set interim targets in line with international frameworks and norms, we expect that it will declare highly ambitious and objective goals that align with the UN Paris Agreement.

**Engagement:** We recently held discussions with the chief sustainability officer of the company and said we would like to see more thorough disclosures in two areas: 1. the firm's policies, targets, and the results of its engagement with investee companies and borrowers as part of its plans to decarbonise its loan and investment portfolio; and 2. the firm's assessment of decarbonisation risks in investee companies and borrowers outside of the energy and utility sectors. At its annual general meeting, several environmental groups submitted a joint shareholder proposal requesting that the company develop and disclose a plan for investing and lending that is aligned with the goals of the Paris Agreement. Noting the company's recent significant commitments towards decarbonisation, we take a positive view of the company's approach to climate change and therefore opposed the proposal.

**Outcome:** The shareholder proposal failed to pass, with less than 23% of votes in favour. The actions the company has taken leading up to the proposal have been very close to meeting the demands of the shareholder resolution, which we believe explains why the resolution did not receive higher support. As a result, we view this as a successful outcome of joint investor action.

**Follow-up:** We plan to participate in a meeting with outside directors in the first half of 2022 and to continue our dialogue with the company. We have seen significant improvement in the company's response to climate change in recent years and its efforts are considered to be among the best in the Japanese banking sector and comparable to those of global financial groups. While we recognise that this is an area that requires long-term, continuous improvement efforts, climate change is not currently a negative factor in our assessment of the company, given its approach to sustainability and commitment to listening to shareholders and other stakeholders. In the light of that, we do not believe there is any need for escalation at this time.

### Case study: governance and board effectiveness at a medical device manufacturer (Global Equity)

LivaNova is a medical device manufacturer based in the UK in which our Global Equity portfolios own shares.

**Issue:** We had a number of concerns about the company, given management's lack of urgency over the poor share price performance, consistently poor communication with financial markets and insufficient focus on delivering adequate near-term financial performance.

**Engagement:** In the early part of 2021, we met the interim finance director and investor relations representative to discuss recent board changes, which were encouraging. We believed the addition of experienced members from very credible large medical technology companies would lead to better oversight of the executive management. In subsequent meetings with company personnel, we noted improved communication with the company, but stressed that there was more to do to restore investor confidence. We also made them fully aware of our priorities for any new permanent finance director. Following that, we noted the improvements in reporting and financial management once the interim incumbent had been appointed as permanent finance director

**Outcome:** We have seen improved communication from LivaNova's management while we have been actively engaging with it over the last year. The appointment of the new finance director has given rise to better communication and delivery of earnings guidance, resulting in less share price volatility. As a result of these improvements, we have made no change to our Future Quality thesis. We will continue to engage with management on a regular basis.

**Case study: Controversial sourcing policies at an IT company (Global Equity)**

Hexagon is a global provider of design, measurement and visualisation technologies held in our Global Equity portfolios.

**Issue:** MSCI had given it a low ESG score compared to rival companies on account of its sourcing policies and the lack of traceability of its raw materials.

**Engagement:** We discussed the issue in early 2021 with the Head of Investor Relations and Sustainability. Since then, the company has published its first annual sustainability report. This states that appropriate sourcing policies are now in place, with close to 50% of suppliers being covered by a new audit scheme introduced in 2020. Its Conflict Minerals Policy commits it to identifying products that may include minerals from countries where there is fighting – so-called "conflict minerals" – and extends its policy to suppliers, where possible.It is also enjoined to take reasonable efforts to avoid the use of raw materials that directly or indirectly finance armed groups which violate human rights. Amongst other things, Hexagon is also implementing a sustainability programme, a supplier qualification process and encouraging suppliers to adopt guidance from the OECD on responsible supply chains.

**Outcome:** The company has published a sustainability report including appropriate sourcing policies. We have left our investment recommendation unchanged as a result of our engagement, with no change to our Future Quality thesis.

**Follow-up:** We will continue to engage with management as part of our regular interaction with portfolio companies. We will particularly focus on the degree of progress by the company in auditing suppliers when it announces its 2021 annual report and sustainability review this year. Our belief is that these are sufficient and appropriate actions. The MSCI Report from August 2021 upgraded its "controversial sourcing" score for Hexagon to close to the industry average. MSCI also gave Hexagon a top score on its commitment to avoiding controversial materials.

**Case study: dealing with safety at a medical products group (Global Equity)**

Koninklijke Philips is a Dutch healthcare group held in our Global Equity portfolios.

**Issue:** In April 2021 , Phillips voluntarily recalled certain medical devices designed to help people with a sleeping disorder known as sleep-apnea, including its DreamStation 1 product, due to concerns about their safety.

The recall followed a rise in complaints about the device in the US and some humid parts of Asia, starting in 2020. The reports blamed sinus inflammation, coughs and other ailments on use of the devices. In the US, the complaints coincided with states where ozone cleaning products are often used. The machine operates using a type of foam, which may break down in hot and humid environments and/or through the use of certain cleaning products, causing users to breathe in possibly dangerous particles. The issue was identified by Philips' own post-market approval surveillance and that led to the voluntary recall.

**Engagement:** We met the investor relations team to find out more about the problems with the devices. The complaint rate had been just 0.03% of two to three million users. Nonetheless, the company believed it had learned lessons from previous product recalls and responded much more quickly this time.

In later discussions, the company said the move resulted from a change in US Food and Drug Administration (FDA) regulations requiring the foam used to be changed to silicone. There was little clinical evidence of meaningful harm to patients. We also met the finance director of one of the largest US distributors of Philips' sleep apnea products. He confirmed that they were happy with the way that Philips management had handled the issue and expected minimal long-term damage to its market position.

We also discussed with Philips the litigation that had resulted from the recall. The company had commissioned independent testing of the product to answer claims arising from class action lawsuits from people who claimed to have been injured by the devices. As well as testing, Philips is now distributing repair kits or replacements to affected buyers.

**Outcome:** We concluded that there was almost no clinical evidence of meaningful harm to patients and that the scope for litigation was limited in both scale and type. We felt that Philips' response was appropriate in the circumstances, a fact that seemed to be confirmed by doctors and distributors, who were also very positive about the company's reaction. It is worth noting that Philips' ESG team offered to meet MSCI to discuss its rating, but this offer was turned down.

The market capitalisation lost as a result of this recall far exceeds even the most bearish estimate of its financial impact. Nonetheless, management credibility needs to be restored, both with the investment community and the regulators – notably the FDA – before the shares can recover. Until we have greater confidence in this pillar of our Future Quality assessment, we will not be adding to our existing position.

We have kept in regular contact with Philips' investor relations team as events have unfolded, but we now need to engage with senior management to ascertain their appetite – and ability – to make good their damaged reputation.

# Principle 9:

**Case study: addressing board diversity and routes to net-zero carbon at an oil and gas company (Japanese Equity)**

This is a Japanese oil and gas company involved in the extraction, refining and wholesale of oil and natural gas in which our Japanese Equity portfolios hold shares.

**Issue:** The company's outside directors are all either from energy-related companies (such as trading companies, oil wholesalers and Japan Petroleum Exploration) or are former public officials.

In terms of climate change, the company has established a sustainability policy and structure, identified climate-related risks and opportunities, conducted climate-related financial impact assessments using internal carbon pricing, and undertaken climate scenario analysis. In this respect, the company's initiatives are considered to be advanced compared to other Japanese companies.

In 2021 the company announced its environmental policy for 2050 entitled "Towards a Net Zero Carbon Society in 2050". In it, the company set three targets for tackling climate change: 1. net zero absolute emissions by 2050 (Scope1+ and 2 emissions, defined as those directly generated or directly bought by the company); 2. 30% or more reduction in emissions intensity by 2030 compared to 2019 (Scope1+ and 2); and 3. reduction of Scope 3 emissions (which are defined as including, for instance, those created by suppliers, the distribution and use of products it makes and employee travel). In order to achieve these targets, the company said that its immediate focus would be on acquiring carbon credits through supporting forest conservation and giving priority to initiatives related to CCUS (carbon dioxide capture, utilization, and storage) and renewable energy.

**Engagement:** We recently held discussions with the director and general manager of the Corporate Planning Division about the firm's board policy and to better understand its environmental goals for 2050.

We urged the firm to bring more diversity to board discussions by appointing outside directors from fields beyond oil and gas and the public sector.

The firm told us it had recently commissioned the first independent assessment of its board and that the issue of board diversity had been raised. It indicated that it would look into how it could improve the make-up of the board.

Separately, the company has given a clear outline of its capital allocation for the next three years and has announced plans to invest in net-zero fields, such as renewable energy, CCUS and methanation technology. The company's long-term vision of where it wants to be in 2030 has also been presented more clearly than ever before.

**Outcome:** We are pleased to see that the company has formulated a long-term vision based on the premise of a transition to a carbon-neutral society, which is one area we have focused on in our engagement activities. Although the company has not set specific targets to reduce Scope 3 emissions, it is working with stakeholders to make cuts. We highly appreciate these moves and continue to have a positive investment evaluation of the company.

In December 2021 and February 2022, we met the executive in charge of the Corporate Planning Division to exchange views, mainly on future business development in the light of the transition to a net-zero society. The company indicated that it will promote this through low carbonisation of its mainstay LNG business and reiterated its commitment to focus on net-zero fields, such as renewable energy, CCUS and methanation. In addition, the Medium-Term Management Plan and Long-Term Strategy for 2030 clearly indicated that the company will allocate approximately 20% of its investment over the next nine years to the net-zero field.

Since addressing climate change is a long-term issue, we believe it is necessary to continuously monitor the company's efforts and engage in dialogue. However, we believe that the direction of the company's current efforts is the right one and that there is no need for escalation at this time.

# Principle 9:

**Case study: business strategy concerns at a metals, materials and parts manufacturer (Japanese Equity)**

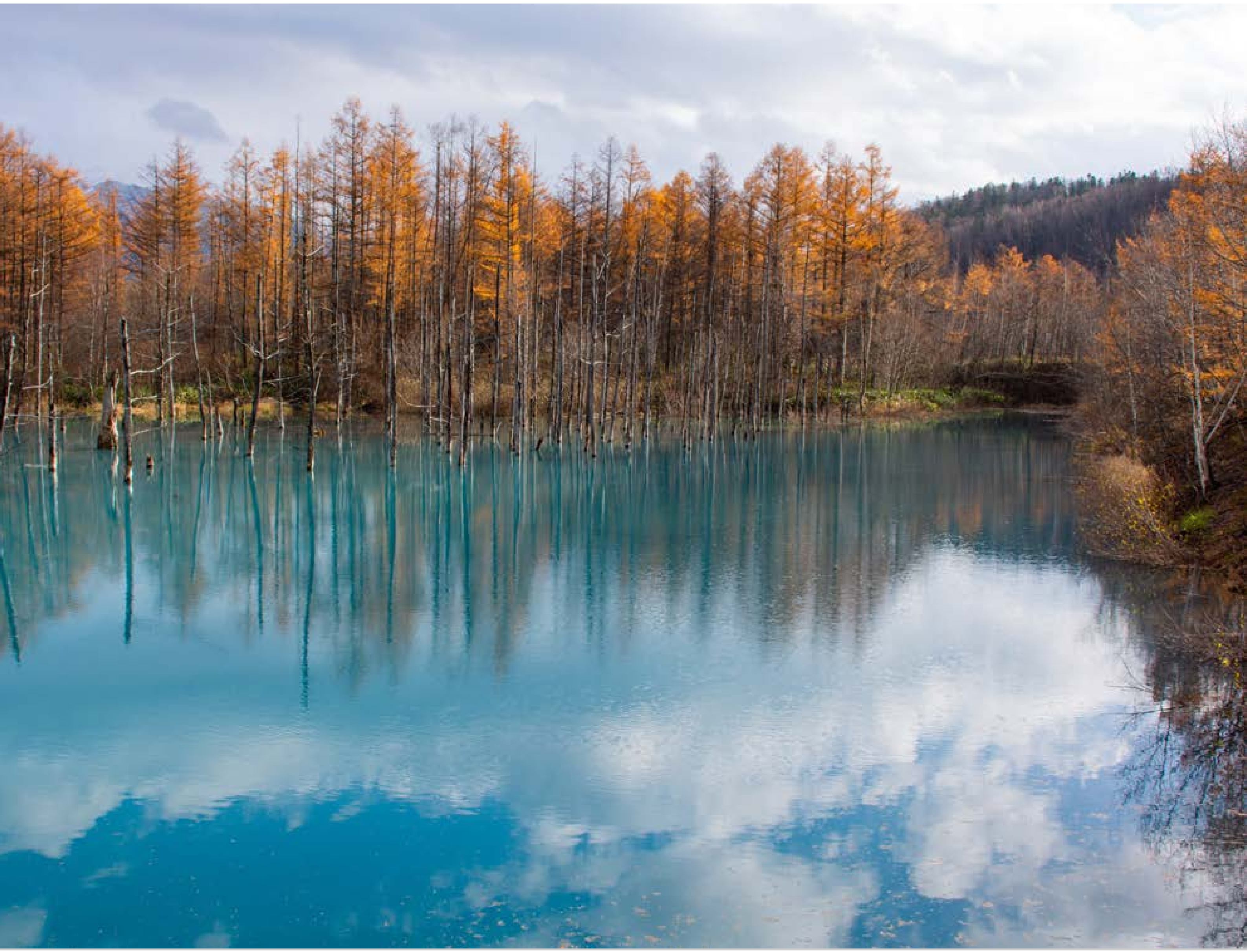
This is a company involved in metal smelting, electronic materials and automobile parts manufacturing held in our Japanese Equity portfolios.

**Issue:** As a mining and auto parts group, the company has a particular responsibility to address climate change issues arising out of its activities. We have also had concerns about its strategy, which seems to have resulted in inefficient investment and low margins.

**Engagement:** We have been engaging in stewardship-related meetings with the company's corporate social responsibility officer, investor relations officer, and executive directors since 2019. So far, we have exchanged opinions on climate change themes and on medium- and long-term management policies. Concurrently, we have had interviews with outside directors in order to voice our concerns about the company's business strategy. In particular, we have requested that the board improves its approach to business selection and concentration and that it should aim at making each business self-sustaining and self-driven.

In response, outside directors have told us they are seeking more thorough discussion at board level about the company's future direction and to gain more information from the executive directors.

**Outcome:** We are holding on to our investment for now. Progress is being made, including an ongoing transition away from unprofitable large copper mines and measures to address climate change in the mainstay metals business. We will monitor the situation using comparisons with other companies and review the company's mid-term plan scheduled for 2022 and its "2030 Vision". Specifically, we will be looking for quantitative and ESG evaluations, an improved strategy, better capital allocation and financial discipline and plans for the future direction of the automotive equipment division.



**Case Study: improving ESG rating not recognised by the market (Global Equity)**

Carlisle Companies is a US building products group held in our Global Equity portfolios.

**Issue:** Carlisle is divesting non-core segments of its business and allocating capital to higher-return products that aim to help meet customers' environmental and energy requirements. As part of this strategy, it has sold its Carlisle Brake & Friction brakes division and bought Henry, a rival building products company.

We believe this new direction for the company should benefit all stakeholders and lead to strong share price appreciation in time. It also makes sense from an ESG perspective, as buildings make up about 28% of greenhouse gas emissions globally and Carlisle's products help reduce heat and energy loss. Management has started to improve its ESG and sustainability communications, notably in its recently-published sustainability report.

Nonetheless, Carlisle's planned transformation remains misunderstood by market participants such as MSCI and company analysts. Although the company's ESG credentials are rated highly by ratings agencies, we believe that it is not yet perceived as a best-in-class provider. Its closest rival is Kingspan, which trades at almost a 50% premium to Carlisle, and is recognised by many as a sustainability leader.

**Engagement:** We engaged with management towards the end of 2021 and highlighted a number of ESG improvements management could make. Given its strengths in staff relations and climate-related products, we believed these steps were meaningful wins for the company. Specifically, our recommendations were:

- sign up to the UN Global Compact;
- disclose the gender pay gap as it already does for the gender make-up of the board;
- sign up to the Science Based Targets initiative (a collaboration between CDP, the United Nations Global Compact, World Resources Institute and the World Wide Fund for Nature), once it can measure its Scope 3 emissions.

**Outcome:** We remain long-term investors and will follow up on Carlisle's ESG developments throughout 2022 and beyond.

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# Principle 10:

## Signatories, where necessary, participate in collaborative engagement to influence issuers.

### Activity

We believe that in some instances where one-on-one company engagements deliver insufficient progress, collaborative initiatives with like-minded investors can increase shareholders' influence on companies' corporate behaviour and ESG performance. Whilst we are seeing increasing investor collaboration efforts across many regions, this engagement method is still in relatively uncharted territory in some parts of the world. For example, in parts of Asia, one-on-one engagements can be viewed as more constructive and culturally appropriate to build trust. In Japan (which accounts for the majority of our equity AUM) we are mindful about how we are involved in collaborative engagements due to local regulations on joint shareholdings and large shareholdings, whereby severe sanctions may be implemented for erroneous execution of reporting requirements.[9] We therefore participate in such engagements while after taking into careful consideration any potential ramifications.

Our involvement in collaborative engagements, often working with other stakeholders such as industry partners and academics, allows us to deepen our understanding of particular ESG topics, issuers' ESG performance and industry best practice. To date, most of our engagements have been restricted to a single asset class as there has been limited cross-over of equity and fixed income holdings and our engagements are typically conducted by asset-specific portfolio managers and analysts. However, in some regions we are exploring ways in which we could engage in a way that covers both equity and fixed income holdings if the need arose, for instance, where we had holdings of different asset classes in the same company.

Our regional investment offices select the most suitable and effective methods for their collaborative engagement. Generally speaking, however, we use the following criteria to determine whether to join common cause with other shareholders:

- whether the initiative is consistent with the particular issues we want raised and our responsible investment policy;
- whether the initiative is likely to be successful, taking account of, for instance, past results and other participants in the initiative;
- whether the cost, time and effort involved is commensurate with the anticipated effect; and
- whether the organisation sponsoring the initiative is one with which we want to be associated.

As part of the evaluation of our ESG processes in 2021, collaborative engagements are an area in which we would like to more actively participate given (i) its growing acceptance, especially in Asia, and (ii) our expanding ESG team. Our dedicated ESG specialists are working with various investment teams to identify the most relevant investor initiatives and target companies for that purpose.

We participate actively in forums and events, publish thought leadership articles and engage with a wide range of stakeholders, including clients, members of the investment management industry, policy makers and civil society.

As alluded to under Principle 4, each of our subsidiaries is a member of the applicable local regulatory and industry bodies. Some of the members of our subsidiaries take an active role in these bodies. For instance,

- during 2021, Non-Executive Director and Chairman of our Group Board, Yoichiro Iwama, served as a member of The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code. Mr Iwama also acted as Chairman of the Japan Investment Advisers Association for seven years from June 2010, the self-regulatory body for the industry in Japan.
- The Chairman and CEO of our UK entity, John Howland-Jackson, was a regular participant in the Investment Association's CEO Forum.

[9] Further information on reporting obligations under Japan's large and joint shareholding rules can be found at www.uk.practicallaw.thomsonreuters.com.

**We participate actively in forums and events, publish thought leadership articles and engage a wide range of stakeholders, including clients, members of the investment management industry, policy makers and civil society.**

- Eleanor Seet, the CEO of our Singapore subsidiary, is Deputy Chair of the Executive Committee of the Investment Management Association of Singapore (IMAS), a representative body of investment managers spearheading the development of the industry in Singapore.
- Also in Singapore, our Joint Global Head of Operations is a member of the Environmental Risk Management Working Group, which was formed to co-develop the Monetary Authority of Singapore's MAS Guidelines on Environmental Risk Management for Asset Managers. In 2021, the working group was consulted on an e-learning module on "Sustainable Investing & MAS Guidelines on Environmental Risk Management" to provide further guidance to the industry.

During 2021, we joined a number of external initiatives, for example we became a signatory to the Global Investor Statement to Governments on the Climate Crisis. We also joined the Net Zero Asset Managers Initiative, and a group of 168 investors from 28 countries urging companies with a high environmental impact to disclose data through CDP, the global environmental disclosure platform. The 1,320 companies approached represented over $28 trillion in global market capitalisation and are estimated to collectively emit more than 4,700 megatonnes of carbon dioxide equivalent annually – more than the entire European Union. This initiative was part of Carbon Disclosure Project's 2021 Non-Disclosure Campaign, which aims to increase disclosure among companies that have either never disclosed, or stopped disclosing, environmental impact data through CDP.

Below is a list of these and other initiatives we participate in and their respective activity and goal.

| Initiative | Activity and Goal |
|---|---|
| Asia Investor Group on Climate Change | The goal of the Asia Investor Group on Climate Change (AIGCC) is to engage and cooperate with Asia-based asset owners, investors and the global investment community about climate finance and investment.<br>The group is a private forum of regional investors which uses peer-to-peer collaboration to increase understanding about the impact of the risks and opportunities of climate change presents in their portfolios.<br>Projects the group undertake aim to assist in facilitating dialogue and engagement with other Asian investors, companies and regulators in the transition to a low carbon global economy. |
| CDP (Carbon, forests, water) | CDP runs the global environmental disclosure system. Each year CDP supports thousands of companies, cities, states and regions to measure and manage their risks and opportunities on climate change, water security and deforestation. Over the last two decades it has created a system that has resulted in unparalleled engagement on environmental issues worldwide. |
| Climate Action 100+ | Climate Action 100+ has established a common high-level agenda for company engagement to achieve clear commitments to cut emissions, improve governance and strengthen climate-related financial disclosures.<br>Investors participating in Climate Action 100+ recognise that decarbonisation of the global economy is complex and will require unique strategies and approaches across different businesses, regions and sectors. However, signatories have agreed there should be a broad common engagement agenda across sectors, regions and business types.<br>An important component of company commitments on climate change is the formation of comprehensive business strategies that fully align with the goals of the Paris Agreement and reaching net-zero emissions by 2050 or sooner. Supporting this high-level agenda, investors identify and communicate with companies on more detailed company-specific expectations.<br>As part of CA100+, we started active collaborative engagements with United Airlines during 2021, aiming to help the company transition in line with the Paris Agreement. We will continue with this in 2022. |
| Task Force on Climate-related Financial Disclosures (TCFD) | The Financial Stability Board established the TCFD to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks.<br>The TCFD is committed to market transparency and stability. The task force believes that better information will allow companies to incorporate climate-related risks and opportunities into their risk management and strategic planning processes. As this occurs, companies' and investors' understanding of the financial implications associated with climate change will grow, empowering the markets to channel investment to sustainable and resilient solutions, opportunities, and business models. |

| Initiative | Activity and Goal |
|---|---|
| Global Investor Statement to Governments on the Climate Crisis | The updated 2021 Global Investor Statement to Governments on the Climate Crisis delivers the strongest-ever investor call for governments to raise their climate ambition and implement robust policies. The joint statement to all world governments urges a global race-to-the-top on climate policy and warns that laggards will miss out on trillions of dollars in investment if they aim too low and move too slow.<br>The statement also sets out five actions governments need to urgently undertake:<br>1. Strengthen Nationally Determined Contributions for 2030 in line with limiting warming to 1.5°C.<br>2. Commit to a mid-century net-zero emissions target with clear sectoral decarbonisation roadmaps.<br>3. Ensure ambitious pre-2030 policy action, including strengthened carbon pricing, phasing out fossil fuel subsidies and thermal coal-based power, avoiding new carbon-intensive infrastructure (no new coal power plants) and developing just transition plans.<br>4. Ensure COVID-19 economic recovery plans support the transition to net-zero emissions.<br>5. Commit to implementing mandatory climate risk disclosure requirements. |
| Net Zero Asset Managers | The Net Zero Asset Managers initiative is an international group of asset managers committed to supporting the goal of net-zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with net-zero emissions by 2050 or sooner.<br>The Net Zero Asset Managers initiative launched in December 2020 and aims to galvanise the asset management industry to commit to a goal of net-zero emissions. |
| International Corporate Governance Network | Led by investors responsible for assets under management in excess of $59 trillion, and bringing together companies and stakeholders around the world, ICGN advances the highest standards of corporate governance and investor stewardship worldwide in pursuit of long-term value creation, contributing to sustainable economies, social prosperity and a healthy environment. This is communicated by the ICGN Global Governance Principles and Global Stewardship Principles. |
| United Nations-supported Principles for Responsible Investment | The PRI is the world's leading proponent of responsible investment. It works to understand the investment implications of environmental, social and governance factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions.<br>The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.<br>The PRI is truly independent. It encourages investors to use responsible investment to enhance returns and better manage risks, but does not operate for its own profit; it engages with global policymakers but is not associated with any government; it is supported by, but not part of, the United Nations. |
| The Investor Agenda | The Investment Agenda, formed by underlying collaborative working groups, is a common leadership agenda on the climate crisis that is unifying, comprehensive, and focused on accelerating investor action for a net-zero emissions economy. With global reach and regional depth, this collaboration brings together and co-ordinates a number of investor and finance sector initiatives on the climate crisis.<br>The Investor Agenda draws on expertise from across the investor landscape to set out clearly joint expectations in four interlocking areas – corporate engagement, investment, policy advocacy and investor disclosure. |
| Women's Empowerment Principles | The Women's Empowerment Principles (WEPs) are a set of principles offering guidance to business on how to promote gender equality and women's empowerment in the workplace, marketplace and community. Established by the UN Global Compact and UN Women, the WEPs are informed by international labour and human rights standards and grounded in the recognition that businesses have a stake in, and a responsibility for, gender equality and women's empowerment.<br>WEPs are a primary vehicle for corporate delivery of the gender equality initiatives of the 2030 agenda and the United Nations Sustainable Development Goals. By joining the WEPs community, the CEO signals commitment to this agenda at the highest levels of the company and to work collaboratively in multi-stakeholder networks to foster business practices that empower women. These include equal pay for work of equal value, gender-responsive supply chain practices and zero tolerance of sexual harassment in the workplace. |

### Outcome

Throughout the year, a number of the industry collaborations of which we are a member announced significant advances or initiatives towards reaching their goals:

#### Climate Action 100+

In March, this major climate-related investor grouping released its first-ever benchmark evaluating the corporate ambition and action of the world's largest greenhouse gas emitters and other companies with significant opportunities to lead the world's shift to net-zero emissions. The Climate Action 100+ Net-Zero Company Benchmark offers the first detailed, comparative assessments of individual company performance against the initiative's three high-level goals: reducing greenhouse gas emissions, improving governance and strengthening climate-related financial disclosures.

As outlined in Principle 7, under Climate Action 100+ and as per the recommendation of TCFD, we are committed to engage with investors bilaterally and in collaborative efforts with target companies to integrate climate change in their forward business planning. In 2022, as our dedicated ESG resources are further expanding, we are looking to more actively participate in the collaborate engagements of this important initiative.

#### International Corporate Governance Network (ICGN)

We were shortlisted for one of the ICGN Global Stewardship Disclosure Awards in the large asset manager category (>£60 billion AUM). The awards were established to recognise investors who provide genuine insight into their stewardship policies and how they are implemented, and whose approach to disclosure provides a model that others might follow.

**The Climate Action 100+ Net-Zero Company Benchmark offers the first detailed, comparative assessments of individual company performance against the initiative's three high-level goals: reducing greenhouse gas emissions, improving governance and strengthening climate-related financial disclosures.**

#### PRI investor working group on sustainable palm oil

**Issue:** We recognise that commercial deforestation is a severe threat to the climate, a fact that was emphasised in the Intergovernmental Panel on Climate Change's 2019 special report highlighting the protection and restoration of forests as a critical mitigation measure. The production of palm oil, a very widespread food ingredient, is a key factor in deforestation, particularly in Asia. But palm oil companies face big challenges in promoting sustainability, not just in the plantations they own but in the wider palm oil supply chain. Encouraging engagement and compliance is a particular concern for palm oil refiners and traders, as much of the raw material originates from numerous independent suppliers, which makes it very difficult to trace its origins and the sustainability practices associated with its production.

We have engaged the palm oil industry through two channels. The first is individual engagement with companies and the integration of the results into our investment process and ESG risk assessment framework. The second is through our historic participation in and support for the PRI's investor working group on sustainable palm oil. We became a member of the working group in 2018, taking part in a collective effort by investors to engage in palm oil matters and accelerate sustainability. Due to restructuring of the working group in 2021, we were not able to play an active role in the working group, however we continue to take our own initiatives and engage with palm oil companies on a bilateral basis.

**Outcome:** Since participating in the working group, we have seen positive changes in the industry. Palm oil companies are making greater efforts to promote the benefits of sustainable palm oil and large palm oil merchandisers are exerting greater influence to drive sustainability.

For example, one large palm trading company we engaged in 2021 estimated that about 10-15% of its suppliers still do not meet sustainability criteria, such as the Certified Sustainable Palm Oil standard mandated by the Roundtable on Sustainable Palm Oil, an industry grouping. As a result, it has stopped its business with non-compliant suppliers. The company also estimated that as much as a quarter of palm oil produced in Indonesia and Malaysia may not be fully compliant with so-called "No Deforestation, No Peat, No Exploitation" (NDPE) commitments. It has therefore implemented a formal sanction policy against non-compliant suppliers. The company hopes to bring the NDPE industry to 100%, and we see this as a welcome sign that large palm merchandisers are using their greater influence and bargaining power to initiate ESG-related change and improve sustainability standards.

We see such transparency as crucial in improving ESG compliance in the sector. Companies that have taken a public lead in setting clear sustainability targets have raised the bar for ESG compliance and helped act as drivers of positive change. This has been reinforced by ESG ratings and rankings accorded by index providers, such as MSCI and DJI Sustainable Index, which encourage disclosures by palm oil companies. This helps create a virtuous circle as we often take a positive view from an ESG perspective of companies that take leading roles in transparency and disclosure. However, we will continue to take every opportunity to talk directly to senior management on these issues. Combined with collaborative efforts, we continue to believe that high quality engagements with companies are vital to good stewardship. (See our case studies on Wilmar International and IOI Corp under Principle 7 and 11 for examples of our direct engagement with palm oil companies.)

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# Principle 11:

## Signatories, where necessary, escalate stewardship activities to influence issuers.

Where we engage with companies to shape corporate behaviour and influence positive change we may escalate the discussions.

The escalation methods vary across asset classes and regions, but broadly comprise:

- additional meetings and engagement, including meetings with more senior management, where appropriate;
- collaborative engagements, where like-minded shareholders jointly seek change from a company;
- voting at general meetings and/or supporting shareholder resolutions (in our equity holdings);
- reducing or divesting our holdings.

Our investment teams have the discretion to escalate in the most appropriate way, given the nature of the issue. Some might want to follow up, others divest.

Escalation timelines may also differ, depending on the region. A good example is the Climate Action 100+ (CA100+), the collective engagement group referred to under Principle 10. CA100+ provides recommendations based on companies progress in moving towards net-zero carbon and this is incorporated into our voting considerations in Japan.

When an incident raises concerns about ESG performance of a portfolio company, we may take a dual approach. On the one hand, we put the company through our evaluation frameworks to determine whether we should continue to hold it in the portfolio. On the other, we may engage with company management to urge where appropriate.

The length of this process depends on the issue in question. While many engagements touch on topics that are inherently long term and require time for improvement, some issues need to be reviewed quickly. These considerations are taken into account when we select the method of escalation.

Our engagement, escalation and voting decisions are fed back into our investment analysis, providing more information on which to base our investment decisions. Depending on the severity of the issue and the broader context (for example, the outcome of previous engagements), we may reduce our holdings or divest where we have the discretion and where such an outcome would be in the best interest of our clients.

Within our Japanese Equity holdings, the initial assessment will be made by our Active Ownership Group (AOG) analysts, who are responsible for proxy voting and engagement. The AOG analyst will work with the relevant portfolio manager and sector analyst to engage with the company according to priorities based on the gravity of the issue, the company's response and the portfolio weight of the holding. They will open a dialogue with management with the initial aim of trying to avoid any loss of shareholder value.

If no improvement is observable and it is determined that there is a high likelihood of long-term damage to the company, the AOG analyst may remove the stock from the investment universe. Any such evaluation will be made independently of any investment decision by the portfolio manager. In addition, when governance issues are revealed by this evaluation process, we will in principle seek to express our opinion through our proxy voting activity.

**Our engagement, escalation and voting decisions are fed back into our investment analysis, providing more information on which to base our investment decisions.**

## Outcome

As we have suggested under earlier principles, our general policy in our Asian businesses is to rely, where possible, on one-on-one engagements. Particularly in Japan, escalation involving a group of investors is rare, given the complications associated with large and joint shareholdings as described under principle 10. Having said that, we are not afraid to be robust with companies where we think there are failings, both in financial performance and stewardship. And we will escalate where we think that we can improve the outcome for our investors. The case studies that follow gives a flavour of how we escalate issues when they occur. Other examples can be found throughout this document.

### Case study: governance and product safety issues at a building products group

Kingspan is an Irish supplier of insulation and building cladding products held by our Global Equity portfolios.

**Issue:** As a cladding supplier, Kingspan has been caught up in the controversy surrounding the cladding that contributed to the Grenfell Tower fire in London in 2017. The subsequent public inquiry raised governance concerns about the testing of products and the culture at the company.

Kingspan's K-15 insulation product was identified as having been used in the refurbishment of the Grenfell Tower which preceded the tower block's devastating fire in 2017, killing 72 people. The second stage of the Grenfell Tower Inquiry identified faults with Kingspan's internal fire safety procedures and a culture of cover-up by some employees. Sales of K-15 were not significant and its use in the Grenfell Tower refurbishment work was limited to 5%. However, the inquiry identified a conflict between product safety and sales targets as a serious problem, and one which is completely at odds with Kingspan's mission: "to accelerate a net zero emissions future with the wellbeing of people and planet at its heart".

**Engagement:** In December 2020, we had a meeting with Kingspan's finance director and investor relations team to highlight our concerns about governance at the company in the light of criticisms at the public inquiry. The meetings gave us confidence that management was taking the issue extremely seriously and acting accordingly. This included improving its processes and getting them independently reviewed, as well as recruiting a new senior head of technical specification who reports to the internal audit committee.

At a subsequent meeting in February 2021, we had discussions with the chief operating officer to find out what further action was being taken. The company told us that improvements to product safety and traceability were being made, a new product technical officer reporting to the chief executive had been appointed and the terms of reference of the audit committee widened to include oversight of fire and safety and compliance at the product level.

In September, we had another update from Kingspan's investor relations department in the wake of a review by Eversheds Sutherland, the solicitors, into its insulation boards business. We were told that all the Eversheds recommendations had been adopted. The company continued to emphasise that the issue at Grenfell was a system-related issue and not to do with the K-15 product itself. However, the conduct and culture of the company had been called into question and management had been quick to act.

Following our discussions, we felt we needed to escalate the issues by making a statement that change was needed at Kingspan and our proxy votes would be cast accordingly. At the annual meeting in April, we therefore chose to abstain on the re-election of the chief executive and voted against the majority of the non-executive directors seeking re-election. We also voted against the approval of the remuneration report.

**Outcome:** The public inquiry will probably not make its recommendations until late in 2022 or in 2023.There remains a class action outstanding and media attention will not disappear but, in the meantime, Kingspan has done everything it can and has implemented all the Eversheds recommendations.

The actions identified during the inquiry have highlighted the need for change at Kingspan. Senior management recognises this need and is making changes. In our view, these changes will make Kingspan a better business and, on balance, we are prepared to give management the time to make the improvements. Without trivialising the issues, we believe on this occasion this is the best approach to take as long-term investors.

We added to our holdings in the first quarter of 2021 but subsequently reduced it due to the outperformance of the shares and our view that the valuation is stretched. We continue to engage with management and will keep up our pressure to ensure that there is no backsliding on governance.

# Principle 11:

### Case study: governance issues at a China-based property development company (Asia Fixed Income)

Hopson Development Holdings is a China-based property developer whose bonds we held in our Asia Fixed Income portfolios.

**Issue:** Governance concerns were raised about the company following the announcement that it had engaged in multiple related-party transactions whose merits and rationale were unclear. While the overall transaction size was not material to the credit profile of the issuer, the transaction was seen as favouring the related party, calling into question the independence and credibility of the management.

**Outcome:** These concerns led us to change our ESG assessment and this was factored into the quantitative and qualitative components of our Internal Credit Rating, thus reducing the overall credit rating and raising the risk premium required to justify an investment in the company. As a result the decision was made to divest the bonds.

Recently, in January 2022, the company's auditor, PricewaterhouseCoopers, abruptly resigned as it was unable to obtain information from the company for its audit procedures, bringing to the fore the governance concerns at the company and resulting in a sharp sell-off in the company's bonds.

### Case Study: Turkish lira collapse

One area of stewardship where we are constantly alert is protecting our clients from political risk, particularly when we are investing in emerging or frontier markets. This may require proactive communication with the client, not least because providing adequate protection may require us to agree amendments to legal documentation. A case in point during 2021 was the political and economic problems of Turkey.

**Issue:** President Erdogan has for some time been centralising control around the presidency, eroding the constitutional separation of powers and weakening other state institutions. During the year there was a notable loss of faith by international investors in the central bank, whose recent conduct has gone against conventional macroeconomic thinking and is closely aligned with President's Erdogan's stated belief that low-interest rates can lead to lower inflation. Political pressure to cut interest rates resulted in sharp declines in the Turkish currency and increased uncertainty about the outlook for monetary and exchange rate policy.

As a result of these developments, the international investment community has increasingly disregarded the country as a viable investment proposition and Turkey has lost its status as a key emerging market. However, the specific circumstances of the country mean that there is deemed to be limited risk of contagion to the wider EM universe.

**Outcome:** Having begun the year underweighted to Turkey across all our bond funds or with the Turkish lira hedged out of the portfolios – depending on the nature of the investment mandates – the decision was taken to exit both the market and currency completely on investment grounds. Our concerns were deemed sufficient to trigger a stewardship intervention. We were concerned that the long-term loss of foreign exchange reserves and the impact on the economy of a falling currency and rising inflation would ultimately put pressures on other areas of economic policy, such as taxation. This could in turn lead to social and political tensions. We discussed these concerns with our clients and in some cases requested a change in investment guidelines to effectively exclude future investment in Turkey. We believed that, as stewards of our clients' capital, it was important to build in protection from these events by removing Turkey from our benchmark and investible universe.

### Case study: getting to grips with governance at a European banking and financial institution (Global Fixed Income)

Our Global Fixed Income portfolios hold bonds in this large European banking and financial institution.

**Issue:** The way the company was dealing with long-standing governance issues was raising unease amongst investors. We got in touch with the company's treasury team to check on the progress of a year-long investigation into allegations of impropriety. We were concerned that the matter had still not been settled and that further investigation was deemed necessary. We were also keen to discuss the overall ESG profile of the company. We were not sufficiently reassured by the company's response. Although financial performance had been good in recent quarters, the investigation was creating uncertainty that was affecting the subordinated bonds in our Global Credit UCITs portfolio.

**Outcome:** As a result of our discussions with the company, the decision was taken to replace the holding in this portfolio with the bonds of a rival institution with similar economic characteristics and a more favourable ESG profile.

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# Principle 12:

Signatories actively exercise their rights and responsibilities.

## Context

In our equity portfolios, proxy voting is one of the major elements of our stewardship activity, and we take great care to ensure that our voting serves the interests of both companies and clients. Where we invest through passive strategies, we strive to incorporate stewardship through the voting of proxies and the engagement process, where appropriate.

In our fixed income investments we do not have the voting rights that are available to shareholders, however we aim to be active owners of assets by utilising other stewardship tools such as issuer engagement. We hold a small allocation (approximately 0.2% of our group AUM) in infrastructure investments via sub-advised managers who are subject to an annual ESG evaluation (a process that was initiated in 2020). We do not currently manage private equity assets.

The NAM Group Proxy Voting Policy establishes our company-wide approach to proxy voting decisions. This policy establishes the principles we use for determining the exercise of voting rights at the group level. Implementation of the groupwide policy is actioned locally according to the attributes of the local market and freedom to interpret the rules to suit local conditions. This gives our regional investment teams the ability to tailor their approach to stewardship according to the attributes of the local market.

As a result, there are some variations in how stewardship activities, including voting, are implemented across the group. For example, our UK entity has a supplemental proxy voting policy addressing environmental and social principles as it relates to our Global Equity strategy.

The full text of our group Guidelines on Exercising Voting Rights policy (as well as our supplemental Standards for Exercising Voting Rights on Japanese Stocks) are available here, with a summary of the main detail listed below.

The groupwide policy underscores our focus on ESG in proxy voting decisions and also covers the following non-exhaustive list of considerations:

- shareholder return;
- the separation of executive and supervisory functions;
- the size and composition of the company's board of directors;
- the auditors;
- executive compensation systems;
- Company control and takeover defences: We are generally opposed to resolutions aimed at preventing change of control. On the other hand, takeover defences may be assessed positively if the acquisition risks are clear and existing shareholder value would not be damaged.
- new share issuance.

We regularly vote and when doing so take account of groupwide policies, advice from proxy voting advisers as well as other considerations like past engagements and local policy.

Our voting principles are applied with full consideration of a company's circumstances and each corporate governance principle to which we hold our investees is considered. Upon receipt of any advisory research and voting recommendations, the team responsible for the security in question is able to analyse the report and conduct further research where any issues have been flagged.

**Our voting principles are applied with full consideration of a company's circumstances and each corporate governance principle to which we hold our investees is considered.**

# Principle 12:

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We aim to cast our votes on the same resolution consistently across all vehicles that we manage unless specifically directed not to do so by clients in respect of their own accounts. We consider requests from clients to override a house policy on a case-by-case basis. In a small number of instances, segregated account clients have their own policies, which we supplement with ours where appropriate. We also have segregated account clients who make their own voting decisions. It is not possible for clients in pooled funds to direct our voting.

For Japanese Equities (which account for almost three quarters of our firmwide equity AUM), our supplemental Standards for Exercising Voting Rights on Japanese Stocks establish detailed decision criteria. The Active Ownership Group (AOG) is responsible for confirming all proposals for holdings in both actively-managed and passive portfolios, and making a comprehensive decision on whether to approve or disapprove after taking into account the content of past engagements with investee companies. Advice from ISS based on our proxy voting guidelines is one of the inputs in the decision-making process, but this advice is used for reference only. The Investment Support & Planning (ISP) team is responsible for exercising voting rights for non-Japanese stocks, where the investments are held via Japan-domiciled feeder funds on behalf of Japanese investors. In some cases, when there are important resolutions the ISP team takes account of the opinions of the overseas investment management subsidiaries who are closest to the market where the investee company is based. We also note, in some cases, the overseas team may also conduct engagement with local companies for stocks held in Tokyo, in coordination with ISP. Execution is outsourced to ISS.

For equity strategies not managed in Japan, ISS may provide analysis of individual proposals and customised proxy voting recommendations based on our proxy voting guidelines, however the local Nikko AM entity makes the ultimate decision on how to exercise these voting rights, which are then executed by ISS.

One example in 2021 where we disagreed with the voting recommendation from ISS occurred as a result of a vote on an independent board chair. This did not require engagement with ISS as we understood the rationale for their advice, but we disagreed with it and voted against their recommendation. See our Case Study "voting against recommendation from our proxy voting advisers" for more detail.

**Case Study: voting against a recommendation from our proxy voting advisers**

Abbott Laboratories discovers, develops, manufactures, and sells healthcare products and services.

**Issue:** ISS recommended we vote against the proposal to elect an independent board chair, in view of the benefits of keeping the existing incumbent, Miles White. Those cited included his ability to provide guidance for the new chief executive, Robert Ford, given his long experience of running the company. We also recognised that the shareholder proposal for an independent chair that had been tabled did not demand immediate change. The aim was to allow adequate time for Mr Ford to gain from Mr White's presence until he settled into his new role.

Similar proposals have appeared on the company's ballot eight times since 2005, receiving between 20-30% shareholder support on these occasions. Our general policy is to use our votes to support independent board chairs as we believe this most effectively ensures the protection of long-term shareholder interests. Given that Mr White had been chief executive for 21 years, we did not believe he could offer genuine independent insight.

**Outcome:** In view of the previous shareholder proposals and Mr White's long-standing tenure, we saw this as a contentious issue that company management needed to address to protect shareholder interests and Abbott's reputation. As a result, we voted for the proposal and in opposition to ISS's recommendation to vote against.

# Principle 12:

### Recalling lent stock

We sometimes lend stock in accordance with our internal controls on lending practices. In those instances where we do, we may recall stock from the borrowers in order to vote in line with our proxy voting policies as there are cases where exercising voting rights is more desirable from the perspective of responsible stewardship than earning share lending income.

For example, in our Japanese Equity operations, if our voting guidelines signal a governance concern that would result in a vote against management or re-election of directors we would recall the stock in order to ensure that we are able to vote and therefore satisfy our stewardship responsibilities.

### Activity

We cast votes on all shares where there are no legal, client or technical constraints. Examples of where we may not be able to vote include where power of attorney has not been granted by a client, or in markets where share blocking is applied. These include bearer shares in the Swiss market, some stocks in the Norwegian and German markets and Egyptian market stocks.

Voting decisions for each of our group entities are executed by ISS. We use ISS to monitor our share and voting rights via a web-based platform. This shows us the accounts for which ISS votes, sends us notification of upcoming meetings, establishes voting decisions, tracks the status of votes and generates reports on voting activities. A record of all votes cast is also stored by ISS, allowing us to look back on historic voting records to ensure all service standards are being met and all votes are being cast as directed.

A summary of our firmwide voting records is listed in the table that follows. (This table is also provided within our annual Sustainability Report.)

**From Jan 2021 to Dec 2021**

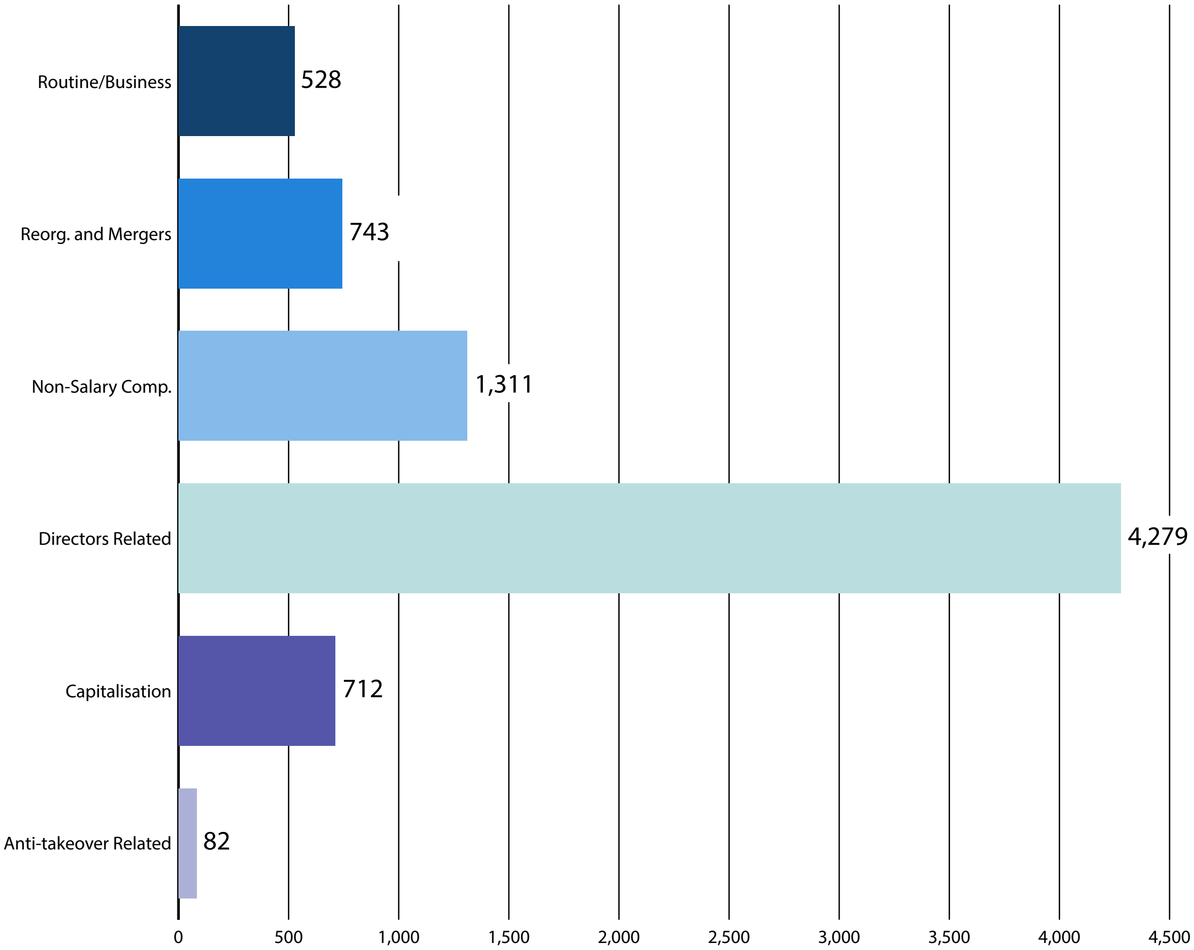
| Region | Number of meetings | Number of resolutions | Vote For management (%) | Vote Against management (%) |
|---|---|---|---|---|
| APAC ex Japan | 2,457 | 19,510 | 88% | 12% |
| EMEA | 1,213 | 17,536 | 91% | 9% |
| Japan | 2,465 | 23,772 | 88% | 12% |
| Latin America | 228 | 2,071 | 88% | 12% |
| North America | 1,077 | 11,368 | 91% | 9% |
| **TOTAL** | **7,440** | **74,257** | **89%** | **11%** |

# Principle 12:

Detailed voting records, including reasons for voting against specific proposals, are published on our website for the vast majority of our equity assets, notably Japanese Equities and Global Equities. For those voting records not publicly disclosed (US, New Zealand and Asian Equities), our policy is to release the information to clients on request.

As a result of implementing our guidelines on voting, 11% of our votes were cast against management. The reasons for voting fall broadly under the headings that were outlined within the context section above. A breakdown of the reasons for voting against resolutions across our firmwide voting activity during 2021 is shown in the chart below.

**Count of votes against management in 2021 and reasons**




## Fixed Income

In our fixed income allocations, we are not able to exercise the same level of influence as holders of equities since the instruments we hold do not confer proxy voting rights. Nonetheless, we aim to exercise our stewardship responsibilities through other means, such as by engaging with market participants and ensuring that our product offering is in line with the needs of our clients.

When participating in the primary bond issuance markets, our investment teams review prospectus and transaction documents (for example offering circulars) for every transaction as part of the due diligence process. Where possible the investment team engages with issuers and structuring advisors on the terms and conditions of issuances we are interested in, including providing feedback and, where applicable, seeking amendments to terms and conditions in legal bond documentation. In our experience, issuers accessing the bond market for the first time in particular tend to be more receptive to feedback on legal documentation and contracts. Specifically, for private companies' bond issuances we also ask for access to further details provided in trust deeds, for example, financial disclosures. It should be noted however that in the Japanese bond market this approach does not play a big role for publicly-traded corporate bonds.

# Principle 12:

## Outcome

The table that follows demonstrates examples of how our voting policies were put into practice during 2021.

| **Company** | Amazon | Amazon | Woodward | Keyence | HelloFresh SE | CIMC Group | Mitsubishi UFJ Financial Group | Toyo Engineering Corporation | Tatsuta Electric Wire Cable Company |
|---|---|---|---|---|---|---|---|---|---|
| **Proponent** | Shareholder | Shareholder | Shareholder | Management | Management | Management | Shareholder | Management | Management |
| **Date** | 26 May | 26 May | 27 January | 11 June | 26 May | 15 December | 29 June | 26 June | 18 June |
| **Resolution** | 6 | 8 | 5 | 2.1, 2.2, 2.3, 2.4, 2.6, 2.7 | 8 | 2.8 | 3 | 1-7 | 1-1 |
| **Title** | Gender Pay Gap | Community -Environment Impact | Company-Specific Board-Related | Elect Director | Approve Remuneration Policy | Elect Director | Revision to Articles of Incorporation | Elect Director | Elect Director |
| **Summary** | Report on gender/racial pay gap | Report on the impacts of plastic packaging | Adopt a policy to include non-management employees as prospective director candidates | Elect as directors Takizaki, Takemitsu, Nakata, Yu, Yamaguchi, Akiji, Miki, Masayuki, Yamamoto, Akinori and Taniguchi, Seiichi | Approve remuneration policy | Elect as director Iwasaki Masaru | Partial amendment to the articles of incorporation (disclosure of a plan outlining the company's business strategy to align its financing and investments with the goals of the Paris Agreement) | Elect as director Yamamoto Reijirou | Elect as director Miyashita Hirohito |
| **Voting Result** | Not approved | Not approved | Not approved | Approved | Not approved | Approved | Not approved | Approved | Approved |
| **NAM Vote** | Against management | Against management | Against shareholder | Against management | Against management | Against management | Against shareholder | For management | Against management |
| **Rationale** | We voted for this resolution as in line with a need for Amazon to improve disclosure around a range of issues relating to human rights, labour rights, environmental issues and a range of governance factors. | We voted for this resolution as in line with a need for Amazon to improve disclosure around a range of issues relating to human rights, labour rights, environmental issues and a range of governance factors. | We voted against this resolution as the company's current board framework and disclosures appear to be providing it with adequate oversight of workforce issues. | We voted against these resolutions due to the lack of independent directors which should be increased beyond the regulatory minimum of 2 and the ongoing lack of gender diversity on the board, albeit improved by the addition of one female director at the meeting. | We voted against this resolution due to the lack of specific performance criteria for incentives or explicit caps on pay-outs. The policy contains scope for discretionary adjustments and payments. We want to encourage better remuneration practice. | Failed to meet NikkoAM's independence criteria | Although there is room for debate about inclusion in articles of incorporation, focused decisions on whether proposal would help enhance medium- and long-term shareholder value. Voted against shareholder proposal based on the assessment of firm's initiatives and stance regarding climate related risks. | The director failed to meet NikkoAM's independence criteria. However, as he is a representative director of a company that invests in preferred stock, and he previously underwrote and saved the company when its survival was in jeopardy, we voted for the election of the director. | Not in conflict with performance and return criteria, but considering concerns with the company's use of capital resources, such as large loans to major shareholders in conjunction with insufficient dividends, we opposed the re-election of the CEO to the board. Opposed the reappointment of top management as there was no dividend proposal. |

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