Corporate Governance Report

Asia Pacific 2Q 2019

Introduction

J.P. Morgan Asset Management is committed to delivering the highest possible risk-adjusted returns to its clients. We believe that one of the key contributors to strong investment returns is a full understanding of the corporate governance principles and practices of the companies in which we invest. We expect all our companies to demonstrate the highest standards of governance in the management of their businesses, as far as is reasonably practicable.

Central to our investment approach is regular engagement with our investee companies in order to better understand their operating, strategic and governance issues. As a fiduciary, we recognize the importance of active ownership on behalf of our clients, and we have an obligation to maintain a dialogue with the companies in which we invest, to ensure that our clients' interests are represented and protected. We therefore meet routinely with the senior executives of our investee companies, in order to exercise our ownership responsibilities. Where a governance issue is material, we will engage with the company in order to better understand the issue and seek to promote best practice. Our analysts and portfolio managers take these issues into account as part of their investment processes.

Proxy Voting

It is our policy to vote all shares held in portfolios in a prudent and diligent manner, based on our judgment of what is in the best interests of our clients. We have documented the principles, which underpin our voting policies, in our "Corporate Governance Principles and Proxy Voting Guidelines". Copies of this policy document can be accessed from our web-site. Our voting activity in all markets during the most recent quarter is summarized below.

Q2 2019 Voting Activity on Behalf of Clients in the Asia Pacific ex-Japan Region

	Apr-Jun 2019	%	Apr-Jun 2018	%
Total votes cast	44,148	100.0	45,307	100.0
For	38,048	86.2	37,953	83.8
Against	5,795	13.1	7,083	15.6
Abstain	230	0.5	143	0.3
Did not vote	75	0.2	128	0.3
Number of meetings	1,008		919	

All listed companies are obliged to hold an annual shareholder meeting once a year. For the Asia Pacific region, the April – June quarter sees with the peak of the AGM meeting cycle, and is by far the busiest time of the year in terms of numbers of resolutions voted and proxies cast. As the above table shows, we exercised proxies at over 1,000 shareholder meetings during the quarter.

We review all resolutions tabled at shareholder meetings to ensure that the votes we cast are in the best interests of our clients. Most resolutions are relatively uncontentious, and will receive our support.

Routine resolutions cover, inter alia: the acceptance of financial statements and statutory reports; the approval of dividends; the election and re-election of directors and auditors; the fixing of director and auditor remuneration; the approval of issuance of new equity, generally without pre-emption rights (the so-called "general mandate"); and the approval of share repurchases. All these resolutions require shareholder votes to allow basic governance functions to continue.

We will vote against specific resolutions, where we believe this is to be in the best interests of our clients. We have retained the services of Institutional Shareholder Services Inc. (ISS) to assist us in the processing of proxies and to provide us with recommendations based on our voting policy guidelines. At the same time, we are under no obligation to accept the recommendations of our provider, if we believe our clients' interests are best served by voting differently. Our sole objective is that we should act in the best interests of our clients.

The commentary below provides some examples where we voted **against** the recommendations of incumbent management during the past quarter.

China A Share Listings

An increasing proportion of the meetings at which we vote concern companies listed on the A share market in China. This throws up a number of challenges since under China's Corporate Governance code the proposals tabled for shareholder approval tend to be granular and specific, while the information provided to shareholders can be patchy at best. Related-party transactions are a common source of resolutions, since shareholder approvals are required when intra-group transactions take place. Another source of resolutions concerns the provision of financing to group subsidiaries and affiliates. Shareholder approval is required when a company makes deposits to, obtains loans from, or provides guarantees to entities within the same business group.

While we acknowledge that there are benefits to shareholders from this level of oversight, there are also potential risks. Guarantees significantly increase the degree of concentration risk assumed by financing entities since the risk exposures are, by definition, not diversified. Moreover, transactions are related-party in nature, which give rise to conflicts of interest. Finally the lack of transparency associated with many of these transactions are a source of concern. In many cases, there is insufficient disclosure surrounding these proposals for shareholders to be able to adequately assess the full extent of the risks assumed.

Given the limited disclosures provided, or concerns that the risks assumed were not proportionate to the underlying exposure to an entity, we voted against group financing resolutions at the following companies: **BTG Hotels, China CYTS Tours, Hangzhou Hikvision, Han's Laser, Inner Mongolia First Machinery** and **Shenzhen Inovance Technology.** Elsewhere, a number of resolutions were tabled to seek authorization for investment in third party financial products. Again the lack of disclosure on the potential risks of such investment led us to vote against these resolutions at: **Foshan Haitian Flavouring, Spring Airlines, Midea Group, Venustech Group, Focus Media Information Technology, Yuanda Holding** and **China Yangtze Power.**

China H Listings / Hong Kong

Proxy resolutions for Hong Kong listed companies tend to be more straightforward, in that the level of disclosure required is more rigorous and the authorizations sought are more routine. But this does not necessarily mean that we support each and every resolution. A significant number of resolutions at each Annual shareholders' meeting relate to the election or re-election of Directors, and we focus on this closely, since we believe that this one of the main areas where shareholder votes can have a durable impact on the future direction of the company. In particular, we believe that a strong independent board is essential to the effective running of a company, and we will vote against resolutions to elect or re-elect individuals who cannot be deemed to be truly independent. Equally we will vote against election resolutions where the nominees concerned have poor past attendance records or sit on an excessive number of boards.

During the quarter we voted against director election resolutions at the following: **BOC Hong Kong, CK Hutchison, CK Infrastructure, China Mobile, China Merchants Bank, China Resources Land, Galaxy Entertainment Group, Hengan International, Minth Group, Nexteer Automotive,** and **Swire Properties.**

Executive compensation can be a controversial area, although in Asia not all remuneration plans are required to be signed off by shareholders. In Hong Kong, however, executive incentive plans require shareholder approvals since this generally involves additional equity issuance. The key objective of all remuneration plans is to attract, retain and reward key personnel who are fundamental to the long term success of the company. But a balance needs to be struck between incentivizing employees and protecting the interests of shareholders. Remuneration which encourages aggressive risk taking, rewards performance without sufficiently challenging hurdles or leads to excessive dilution from new issuance cannot be considered to be in the best interest of shareholders.

During the quarter we voted against incentive compensation arrangements proposed at the following: **Sands China, Minth Group, Tencent Holdings, Wuxi Biologics** and **IMAX China**.

Finally we voted against a number of proposals seeking approval for additional equity issuance. Hong Kong listed companies routinely ask shareholders to authorize the issuance of new equity and Listing Rules permit companies to issue up to 20% of outstanding equity capital at a maximum discount of 20%, provided that the appropriate approvals have been obtained.

While we acknowledge that companies should have the ability to tap the market for fresh capital, we believe that any new capital issued should first be offered to existing shareholders on a pre-emptive basis. The need for flexibility should be balanced with the need to protect against excessive dilution. Consequently we believe that any issuance arising from these authorizations should be limited to 10% of existing equity, at a maximum discount of 10% of the prevailing share price. We consider any request in excess of these limits to be overly dilutive, and we will usually vote against, unless strong mitigating arguments are provided.

During the quarter we voted against equity issuance resolutions at: **China Life Insurance, China Merchants Bank, China Mobile, China Resources Land, China Overseas Land, China Vanke, CK Infrastructure, CNOOC, Galaxy Entertainment, Hengan International, Petrochina, Ping An Insurance, Sands China, Sunny Optical Technology** and **Tencent Holding.**

Japan

Given the severe demographic headwinds impacting the Japanese economy, policy makers are seeking to mitigate these by raising the efficiency and profitability of the corporate sector. The hope here is that by boosting micro-level returns, this will help raise productivity and thereby increase Japan's overall growth rate. Executing on this has given rise to a two pronged strategy: the first phase has been to significantly tighten Japan's Corporate Governance Code, to focus on improved governance standards, in the expectation (hope?) that this will lead to better capital allocation decisions; the second phase has been to promulgate a more rigorous Stewardship Code, in which Japan's asset owners and asset managers are obliged to hold companies, and the boards which control them, to a higher level of accountability.

Most annual shareholder meetings in Japan are shoe-horned into a narrow window in June, and proxy voting results provide a means of demonstrating how shareholders are using their proxies to effect change in corporate behavior. One topic of frequent discussion in our engagement program concerns cross-shareholdings. The Japanese Corporate Governance Code is unequivocal in recommending that cross-shareholdings should be reduced, and we have made it clear that, unless a company provides a clear rationale for why it is tying up capital in this way, we will vote against director elections/re-elections in instances where the progress made in unwinding cross-shareholding relationships is too slow.

Elsewhere, we have tightened our policy around board independence. As a minority shareholder we expect to see strong external representation on company boards to better represent our interests, and we use our voting powers to reflect this view. The Corporate Governance Code recommends at least two independent non-executive directors on boards, but our own policy in Japan now proposes that at least one third of a board should be made up of fully independent external members, which is in line with minimum standards in most other jurisdictions.

As a result of the failure of companies to reduce their cross-shareholdings, the relative lack of external representation on boards, or the inability of boards to meet our standards of independence, we voted against nominated directors at the following meetings: **Daikin Industries, FP Corp, Hino Motors, Keyence, Komatsu, M3 Inc, Murata Manufacturing, Nidec, Nitto Denko, OBIC, Recruit, Shinetsu Chemical, Sony, Suzuki Motor** and **Tokyo Electron.**

The Corporate Governance Code also calls on companies to set out their long term strategy and capital allocation policies. While some companies release detailed mid-term plans and targets, others have paid limited attention to communicating strategy in a bid to boost returns. In particular, we remain dissatisfied with the low levels of return on equity at many companies, and their poor dividend payout policies. As a result, we voted against the dividend resolutions at the following: **Daikin Industries, Keyence, Murata Manufacturing, Nitto Denko, OBIC, Suzuki Motor, Takara Bio** and **Tsumura.**

SE Asia

We voted at a number of shareholder meetings throughout South East Asia during the quarter. The majority of proxies cast were exercised in support of management, but in a number of instances, we voted against specific resolutions, mainly because of the lack of information provided to make an informed voting decision. This included resolutions to change Articles of Association and approve board changes in Indonesia, resolutions to "Approve Other Matters" in the Philippines, and resolutions to support “Other Business” proposals in Thailand. Unfortunately, in ASEAN’s smaller markets, local governance standards continue to lag behind international best practice.

At the same time, the ability to influence corporate behavior through the proxy votes of minority foreign shareholders is limited. The shareholding registers of most large corporations in the region tend to be dominated by controlling family or state backed entities, and they are relatively impervious to the governance concerns of minorities. **CP All** in Thailand, for example, still employs three executive directors on its board, who were convicted of insider trading offences in 2013. While foreign institutional investors have routinely voted against these individuals at subsequent elections, the fact that they still obtained between 60% and 75% support from proxies cast at last year’s meeting, shows the extent to which controlling shareholders can just shrug off legitimate governance concerns. This year two members of the Nominations and Remuneration Committee were proposed for re-election and we voted against their re-election accordingly.

During the quarter we voted against proposals to elect directors and amend the Articles of Association at a number of meetings in Indonesia: **PT United Tractors, PT Astra International, PT Semen Indonesia, PT Bank Negara Indonesia, PT Telkom Indonesia** and **PT Indah Kiat Pulp and Paper.** In the Philippines we voted against Director Election resolutions, and /or the “Approve Other Matters” resolution at: **Ayala Land, Globe Telecom, Metropolitan Bank and Trust, SM Investments, BDO Unibank, Manila Electric, Jollibee, JG Summit** and **Metro Pacific.** And in Thailand we voted against the ill-defined “Other Business” resolution at**: PTT Global Chemical, Thai Oil, PTT Corp, Bangkok Expressway, Srisawad** and **Indorama Ventures.**

Corporate Engagement

We hold a number of meetings with our investee companies each quarter to review the company’s business activities and discuss the future outlook. Such meetings are integral to our investment process. At these meetings, we seek to:

- Keep updated with the main drivers of operating performance
- Question senior management on their strategic priorities
- Remain fully briefed on the risks which may affect a company's outlook
- Ensure that any issues that we may have with the company's environmental, social and governance practices are discussed and if necessary escalated to a higher level.

The commentary below provides an example of a recent engagement meeting where sustainability issues were discussed.

New World Development

We recently met with the Head of Sustainability of Hong Kong’s New World Development (NWD) for an update on the group’s approach to ESG and the challenges it faces in implementing policy. NWD is a broadly diversified conglomerate centered on property development and investment, but with interests ranging from construction and infrastructure to hotels and department stores, transportation and telecommunications. Purely in terms of sustainability reporting, we consider NWD to be one of the more forward-thinking companies in Hong Kong. Interestingly the meeting was arranged at NWS’s request in reaching out to the investment community to gather feedback and help identify areas of improvement. In our experience this degree of engagement by corporates in Hong Kong on ESG is unusual.

The fact that this is taking place comes down to the importance that the new generational leadership at NWD is placing on sustainability. This is being led by Group CEO and Vice Chairman, Adrian Cheng, son of the current Chairman and grandson of the Group's founder. Adrian Cheng chairs the Sustainability Committee, which is one of two board level committees reporting directly to the board.

In terms of its environmental and social policies NWD knows it has a good story to tell. Compared to key competitors the group has well-defined and well-structured policies covering climate change risks, water resource utilization risks and waste management and disposal risks, with plenty of metrics to back this up. The group has sought third party validation for these activities and is rated 81/100 on the GRESB sustainability rating and ranks third among eight listed diversified listed businesses in East Asia. It is rated Grade A by GRESB for the transparency and comprehensiveness of its sustainability disclosures.

Where it ranks less well is in terms of its overall governance scores. This is partly down to the presence of a large single controlling shareholder (44% controlled). Given the presence of an executive Chairman, and an entrenched board with a high proportion of long serving directors, the board's composition only meets minimum standards of independence under Hong Kong's Listing Rules; we doubt whether the current structure provides much in the way of effective challenge to the executive leadership. Lack of diversity and the over-boarding of directors are also areas where the board lags best practice. In view of these challenges, NWD does not rank highly on third party assessments of governance. Both the Head of IR and the Head of Sustainability recognized these concerns and promised to reflect our views. Although we do not anticipate any rapid change in this area, we should give credit to NWD for its willingness to engage.

J.P. Morgan Asset Management

Asia ex-Japan Proxy Committee

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