

# Corporate Governance Report

## Asia Pacific 2Q 2020

### Introduction

J.P. Morgan Asset Management is committed to delivering the highest possible risk-adjusted returns to our 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 downloaded from our web-site. Our voting activity in all markets during the most recent quarter is summarized below.

### Q2 2020 Voting Activity on Behalf of Clients in the Asia Pacific ex-Japan Region

	Apr-Jun 2020	%	Apr-Jun 2019	%
Total votes cast	34,362	100.0	44,148	100.0
For	29,568	86.0	38,048	86.2
Against	4,658	13.6	5,795	13.2
Abstain	77	0.2	230	0.4
Did not vote	59	0.2	75	0.2
Number of meetings	769		1,008	

We review all resolutions to ensure that votes cast are in the best interests of our clients. Most resolutions raised are uncontentious, and we typically vote in support of incumbent management. However, in a number of instances, we either abstain from voting or vote against specific resolutions on the instructions of our portfolio managers, or on the recommendation of our proxy voting adviser. In the Asia Pacific region, we have appointed Institutional Shareholder Services Inc. (ISS) to assist us in the processing of proxies and to provide us with recommendations based on our Proxy Voting

Guidelines. At the same time, we are under no obligation to accept these recommendations if we believe that client interests are best served by voting differently.

The commentary below provides some examples of how we voted during the quarter.

## Australia

The governance framework in Australia generally provides strong protection for minority shareholders. However, there is one area that requires particular scrutiny, and that is executive compensation. Under Australian governance and listing codes, remuneration reports and incentive plan arrangements require approval from shareholders. But given the uniqueness of each company's operating circumstances, and the bewildering variety of remuneration structures on offer, this can be a complex area for shareholders to navigate.

As a matter of policy, we support incentive compensation schemes with stretch hurdles and challenging performance criteria. Conversely, we will vote against remuneration arrangements where we believe the payments promised, or the potential dilution implied, to be excessive, or where the required performance criteria that would trigger such payments, are undemanding or insufficiently disclosed.

Given these considerations, we voted against the Remuneration Report resolutions at **Scentre Group** and **Woodside Petroleum**, and we also voted against the incentive compensation resolution proposed for **Scentre's** CEO, Peter Allen, due to limited transparency surrounding the performance targets to be achieved.

Elsewhere, shareholder resolutions are an increasingly common feature at Australian company meetings. This can present some challenges, in that the shareholder threshold required to sponsor such resolutions is relatively low, and they can often be co-opted by activists seeking publicity for personal agendas. But at the same time, it is a legitimate channel for investors to express concerns about the long term direction of a company.

In Q2, the Australasian Centre for Corporate Responsibility initiated shareholder resolutions at both **Woodside Petroleum** and **Santos**, seeking improved disclosures on limiting GHG emissions, and their compliance with the goals of the Paris Agreement. In particular the resolutions requested annual disclosures on targets to reduce Scope 1, 2 and 3 emissions, details of how future oil and gas reserve replacement spending can be aligned with the Paris Goals, and details of changes to remuneration policies to encourage progress towards meeting emissions targets. In this instance we felt the disclosures requested to be legitimate information for investors to help assess future climate related risks. As such, we were happy to vote with the proponents and against the recommendation of incumbent managements.

## China A Listings

An increasing proportion of the meetings at which we vote relate to 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, and /or approvals to invest idle funds with related or third parties.

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, many transactions are related-party in nature, which give rise to conflicts of interest. Finally the lack of transparency associated with these transactions are a source of concern. In many cases, there is insufficient disclosure 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, we voted against group financing and other resolutions at the following companies: **BTG Hotels Group, Poly Developments and Holdings Group, Wuxi App Tec, China Merchants Shekou Industrial Zone, Contemporary Amperex Technology, Shanghai Baosight Software and VenusTech Group** . Elsewhere, a number of resolutions were tabled by investee companies to seek authorization for investment in third party financial products. Again the lack of disclosure on the potential risks of such investments led us to vote against these resolutions. This included resolutions proposed at: **Foshan Haitian Flavoring, Beijing Kingsoft Office Software, Pharmaron Beijing, Shenzhen Sunway Communication, Guangzhou Haid Group, Luxshare Precision and China Yangtze Power**.

### China H Listings / Hong Kong

Proxy resolutions for Hong Kong listed companies tend to be less granular and in most cases the level of disclosure is higher to allow shareholders to make an informed decision. As a result the resolutions seeking approvals tend to be more routine. At the same time, a significant number of resolutions at each AGM 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 strategic 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: **China Mengniu Group, CK Asset, CK Hutchison, China Resources Land, Galaxy Entertainment Group, Guangdong Investment, HKT & T Trust and Shenzhou International**.

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 issuance resolutions which, if exercised, would permit excessive dilution at (among others): **China Mobile, China Resources Land, China Unicom, China Vanke,**

**CNOOC, Galaxy Entertainment, Hang Seng Bank, Meituan Dianping, Minth Group, Ping An Insurance, Sunny Optical Technology, Swire Properties, Swire Pacific and Tencent Holding.**

## Japan

As a result of Japan's severe demographic headwinds, policy makers have sought to mitigate the effects of this by encouraging the corporate sector to boost its efficiency and profitability. The hope is that by boosting micro-level returns, this will help raise productivity and thereby improve Japan's long term potential growth rate. 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 subject companies, and the boards which control them, to greater scrutiny and higher 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 stronger external representation on boards to better represent minority 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 elsewhere.

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 (or their failure to refresh otherwise entrenched boards), we voted against nominated directors at the following meetings (among others): **Daikin Industries, FP Corp, Hino Motors, Keyence, Komatsu, M3 Inc, Nidec, Nitto Denko, Ono Pharmaceutical, Ryohin Keikaku, Shinetsu Chemical, Softbank Group, Tokyo Electron and Toyota Motor Corp.**

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 this area. 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, Daiichi Sankyo, Keyence, Murata Manufacturing, Nihon M&A Center, Ono Pharmaceutical, Shinetsu Chemical, SMC Corp and Tsumura.**

## South East Asia

We voted at a number of shareholder meetings throughout South East Asia during the quarter. The majority of proxies were cast in support of management, but in a number of instances, we voted

against resolutions, where insufficient information was given to allow for an informed voting decision, or where local governance standards failed to offer suitable protection to the interests of minority investors. As elsewhere in Asia, the influence of controlling shareholders often rides roughshod over minorities.

In **Indonesia**, for example, resolutions were put to shareholders to approve changes to the board composition, without giving details on the nominated candidates proposed. Given the lack of information provided, we voted against such resolutions at the **PT Perusahaan Gas Negara**, **PT BFI Finance Indonesia** and **PT Telekomunikasi Indonesia** shareholder meetings. In **Thailand**, it is common to include a bundled “Other Business” resolution on the agenda, at which a range of issues may be discussed and potentially approved without the knowledge of shareholders submitting votes by proxy. We advocate that all resolutions should be presented so that they may be voted upon clearly, distinctly and unambiguously. We therefore voted against this resolution at the **Hana Microelectronics PCL**, **Kasikorn PCL**, **Bumrungrad Hospital PCL**, **Thai Oil PCL** and **PTT Global Chemical** meetings. In **Malaysia**, we voted against the incentive award scheme proposals recommended for non-executive directors at **Tenaga Nasional Bhd** and **Public Bank Bhd**, in view of the potential conflicts of interest raised. And finally in **Singapore**, we voted against a number of equity issuance resolutions in view of their potential dilution effects. This included votes cast at the **First Resources Ltd**, **Wilmar International**, **Jardine Cycle and Carriage** and **BOC Aviation Ltd** meetings.

## 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 some examples of meetings held during the quarter, or communications initiated where governance of other ESG issues were discussed:

### JD.Com (China)

We met with the senior management of China based e-commerce company, **JD.Com**, ahead of its recent secondary listing in Hong Kong. Since listing its ADRs on Nasdaq in mid-2014, JD.Com has had a chequered history. During its first four years as a listed entity, it suffered from some significant operating challenges, a serious data security breach, and rising governance concerns; and the share price suffered accordingly. But since reaching a nadir in early 2019, the company has enjoyed a spectacular renaissance as top line growth has resumed, margins have recovered, and investors have come to appreciate its superior logistics operating model. Unlike many competitors, the company provides an integrated logistics service, combining both warehousing and delivery.

Since 2017's data security breach (in which a former employee stole customers' personal data and transactional information), the company has significantly upgraded its cyber-security and data protection framework. The company is now able to evidence extensive data protection policies and practices, including certification to external security management standards. It has also introduced robust compliance programs to ensure these are adhered to throughout the company. Third party validation places the company's data protection and privacy policies as among the most rigorous in its sector.

At the same time, corporate governance continues to be a concern, particularly as it relates to the company's ownership structure. JD.Com is a controlled company where the founder shareholder controls the majority of votes outstanding, and therefore has effective control of the board. Although his direct economic interest is equivalent to only 14% of the shares outstanding, the CEO and Chairman, Richard Liu, controls more than 75% of the voting power, thanks to disparate voting rights. This clearly gives rise to potential conflicts with ordinary shareholders, not least in terms of related party transactions. Given this structure, our Strategic Classification approach assigns 18 red flags to its risk profile, which places it firmly in the "Trading" category.

While mindful of the limited governance protections that a Nasdaq listing provides, one of the advantages of a secondary listing in Hong Kong is that HK listing rules mandate annual shareholder meetings, and encourages boards to be appropriately sized. With an existing complement of just five (all male) members, the current JD.Com board, arguably, lacks the full range of skills able to provide effective oversight of management within an increasingly complex business. Hopefully, the secondary listing will encourage the creation of a larger, more diverse and appropriately skilled board, able to better represent the interests of all shareholders in providing the necessary strategic direction.

### Shenzhou International Group (China)

As part of our regular engagement we had a virtual meeting with the Chairman of **Shenzhou International**, one of China's largest integrated textile groups. Key clients include Nike, Adidas and Mizuno. It is involved in all parts of the production process from the spinning and dyeing of fabric to the cutting and sewing of finished garments. This is both a capital intensive and a labor intensive business and as a result, its operations have a sizeable impact on the environment and on how it organizes its labor force.

The name is widely held in JPMAM portfolios and we have engaged extensively with the company to better understand its business and its competitive / regulatory risks. We have been reassured, by the steady improvement in its environmental and labor management practices. In previous meetings the company has emphasized its commitment to environmental protection, and to providing the highest standards of employee protection and welfare. It has, for example, reacted quickly to the Covid 19 pandemic by introducing additional workforce safeguards to maintain the health and welfare of employees.

From an environmental perspective, the company continues to make progress in controlling its energy consumption and reducing carbon emissions. Its largest production facility in Ningbo is now fully powered by biomass, and investment in energy saving equipment has been accelerated to improve efficiency, reduce costs and lower its carbon intensity. Clear targets have been put into place to reduce GHG emissions, and the company has further improved its environmental disclosures.

In terms of labor management, the company has better labor force practices and a more comfortable working environment than most of its industry peers. As a result employee satisfaction is stronger,

employee turnover is lower, and labor relations are more stable than for the industry as a whole. In discussions with the Chairman, he has emphasized the importance of maintaining attractive working conditions for his workforce, which he regards as crucial to the company's long term competitive advantage. The textile industry will always be labor intensive, but he considers it imperative to continually upgrade the skills and quality of the workforce, if it is to further improve its efficiency and reduce per unit production costs.

Although Chinese textile manufacturers often receive mixed sustainability reviews compared with global peers, we believe Shenzhou's policies stand up well to global comparisons, and they certainly exceed the standards of immediate competitors in the Greater China region.

### Luxshare (China)

Finally, as our analysts complete our in-house ESG materiality project (in which they have been tasked to assess those ESG / Sustainability issues which are likely to impact the financial condition or operating performance of their companies under coverage), our technology analyst in Greater China noted the progress being made by some Chinese companies in improving ESG disclosures.

He writes ...” thanks to the ESG materiality project, I had the chance to review the ESG disclosures for all my covered companies. I was surprised to see **Luxshare** for the first time issued a thorough ESG report for FY19, which contained both solid qualitative and quantitative information. I found this particularly impressive after having read dozens of low-quality ESG reports within my A-share coverage (where many companies don't even publish ESG reports). I also did a quick exercise to compare Luxshare's ESG disclosure with other China listed companies with a market cap of over US\$ 10 bn, and found only a small number of them with a similar disclosure quality. While the company still has room to improve (for example, there are incomplete yoy comparisons, and there is no English version), I still find it worthwhile to highlight the company's ESG efforts as follows.

#### Environment

- Has set a long-term target to reduce carbon emissions by 40% by 2025 vs. 2017's level;
- Has recycled 34k tons of water in FY19, equivalent to the volume of 134 international standard swimming pools;
- Has decreased CO<sub>2</sub> emission intensity (CO<sub>2</sub> per million RMB revenues) by 25% yoy in FY19, even though total CO<sub>2</sub> emission (scope 1+2) still rose by 30% yoy;
- Followed RoHS 2.0 and REACH regulations on the usage of hazardous substances, with stricter internal maximum levels of hazardous material content than regulations required;
- Performed annual audits to its suppliers, especially relating to conflict minerals usage.

#### Social

- 15% of high-level management headcount are female in FY19 (no yoy comparison);
- 11% of its total employees have been promoted in FY19 (no yoy comparison);
- 0.17% of employees suffered from workplace injuries in FY 19 (no yoy comparison);
- Highlighted a few actions that the company took to enhance employee benefits, particularly for its Vietnamese workers.

#### Governance

- 3 out of 7 Board Directors are independent; 3 out of 7 are female;

- Increased priority given to anti-bribery and corruption efforts”.

As a key supplier to Apple, Luxshare is perhaps used to this degree of transparency. Nevertheless it is interesting how international pressure is impacting disclosures in areas such as China A listings where regulations have yet to force the issue.

**J.P. Morgan Asset Management**

**Asia ex-Japan Proxy Committee**

**August 2020**