Environmental, Social and Governance report

Japanese Equities
Emerging Market and Asia Pacific Equities Team (EMAP)

Fourth Quarter 2020

ESG INTEGRATED FUND

J.P.Morgan
Asset Management

“We believe effective investment stewardship can materially contribute to helping build stronger portfolios over the long term, for our clients.”

George Gatch

CHIEF EXECUTIVE OFFICER
J.P. MORGAN ASSET MANAGEMENT

Our aspirations for engagement

When it comes to corporate engagement, being one of the world's largest investment managers brings advantages but also challenges.

The starting point from which we engage with the companies in which we invest is strong. We are typically large shareholders, we have a reputation for being long term partners and our engagements are underpinned by the in depth research that comes with a large, well-resourced analyst team.

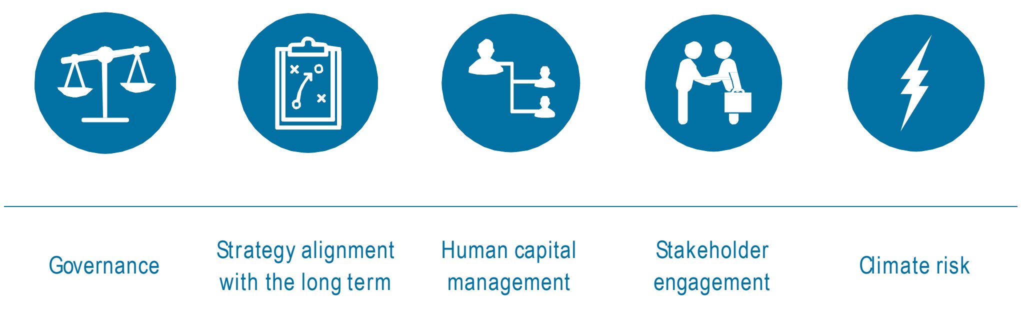
The challenge is to bring together our sizeable internal resources - from research to a specialist sustainability function - to ensure we pursue a coherent agenda based on consistent principles. In particular it is important that we understand the relationship between sustainable goals and financial outcomes, as it is engagement at this intersection which drives the greatest long term value for our clients.

The purpose of this report is to explain how we are setting about achieving these aspirations and to share examples of progress as we continue on our journey towards ever more productive and impactful corporate engagement.

Our frameworks for engagement

There are two frameworks that you will see referenced in this document:

- Our **Five Investment Stewardship Principles** are the highest level statement of universal priorities that we have. They are set by our Global Sustainable Investing Function and are principles we believe will have universal applicability and stand the test of time.



- Our **Research Frameworks** come entirely from the opposite, bottom up perspective. Across global equity we have **a 40 question ESG Checklist** which ask the same questions of every company under global coverage to establish a baseline of their ESG credentials. In Emerging Markets and Asia Pacific we also have a **Materiality Framework**. This sees our specialist sector analysts determine which are the most important Environmental, Social and Governance issues within individual industries, and score companies on those in order to identify leaders and laggards.

We hope the case studies and data contained in the following pages help illustrate how these principles and frameworks work together to create a coherent and effective approach to corporate engagement.

Shoichi Mizusawa,

Head of Japanese Equities Team

Engagement: Environmental, Social & Governance

J.P. Morgan Asset Management believes that companies should act in a socially responsible manner. To this end, we are signatories to the United Nations-supported Principles of Responsible Investment (PRI), which commits participants to six Principles, with the aim of incorporating Environmental, Social and Governance (ESG) criteria into their processes when making stock selection decisions and promoting ESG disclosure. As a firm, we prefer to invest in companies that engage in social and environmental behaviours likely to enhance their reputations, rather than compromise them. We believe that such factors are key determinants of sustainability and, ultimately, can have a material impact on share prices over time.

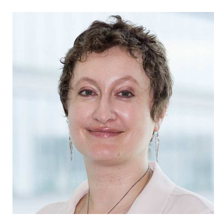
J.P. Morgan Asset Management also recognises its wider stewardship responsibilities to its clients as a major asset owner. To this end, we support both the Japanese and UK Stewardship Codes, which sets out the responsibilities of institutional shareholders in respect of investee companies. We believe that regular contact with the companies in which we invest is central to our investment process, and we recognise the importance of being an 'active' owner on behalf of our clients.

We have significantly advanced our ESG and Sustainability research in Emerging Markets and Asia Pacific by establishing a materiality framework which now covers over 1,000 companies. The basis of "materiality" is to identify the Environmental, Social or Governance issues that are most likely to have a material negative financial impact on the company were they to be mismanaged, or potentially a material positive impact if they are managed well. Using the sector expertise of our global network of 100+ research analysts, we identified the five most material issues across 54 sub-industries and then scored each company 1-5 with the rating backed up by detailed research commentary. The implementation of this research framework has deepened our understanding of what best practice looks like for sustainability and we used this template to engage with companies.

Komatsu

Stewardship Priorities : Climate Risk

In December our industrials analyst Polina Diyachkina met Komatsu, one of the largest construction machinery companies globally. In addition to general construction machinery where the US, Japan and EU are the main markets, the company generates roughly over a half of its profit from mining machinery, where it has exposure to the coal industry. The meeting was part of a broader ESG seminar where the company set ambitious targets for CO2 reduction, and built on ESG discussions we had with the company in March 2020.



Polina Diyachkina
Other Basic Industries
Experience: 14/1

Climate risk

The key points discussed were targets to reduce emissions through driverless trucks and mine truck electrification, potential to replace demand from coal mines with alternatives, and corporate culture. Over the medium term Komatsu believe one quarter of their trucks will be driverless with cost savings of 15% and 40% improvement in the life of tires. Electrification of vehicles will be more challenging with just the cooling system changed in the current phase, followed by hydraulic and air-conditioning systems. No time frame was given for the shift to hybrid and fully electric vehicles. As a result, we are skeptical that they can reach their target of a 50% CO2 reduction by their clients by 2030. On a positive note, ESG targets are included in management key performance indicators (KPIs), and after a slow start, employees are more receptive to environmental and TFCD goals.

Engagement: Environmental, Social & Governance

Hikari Tshushin

During the quarter we met Hikari Tsushin to discuss their first sustainability report and their supply chain management. Hikari Tsushin supports small & medium-size enterprises with services such as the provision of distribution networks, telecommunication lines and office automation equipment. The company has strong economics, generating robust recurring revenues and free cash flow, and good governance, with just 6 red flags in our ESG focused Checklist. That said, the company has an average score in our materiality framework when compared with other business service companies in Japan. The company published its first Sustainability report in June 2020 which is just 7 pages long and lacks detail in important areas. Management acknowledged that there was scope to improve and were receptive to our suggestions, but we will monitor their actions.

In terms of its supply chain, Hikari Tshusin works with close to 1000 agencies but they do not a have a formal process for conducting due diligence or monitoring their suppliers social standards. Their primary focus is on economic performance of the agencies, although they do conduct training to enforce compliance and monitoring of any suspicious activities. We will continue to engage with Hikari Tsushin, seeking better disclosure and better supply chain management.

Shizuko Ohmi
Japan Head of
Investment Stewardship

Michiko Sakai
Portfolio Manager
Experience: 11/7

Tokio Marine

Stewardship Priorities : Stakeholder Engagement, Climate Risk

Tokio Marine is a non-life insurer and one of the few financial companies in Japan to be rated as quality by our analyst. Having voted against the appointment of two directors we felt were not sufficiently independent in the June 2020 AGM, our analyst and Investment Stewardship head, Shizuko Ohmi, met the company in October to address a broad range of sustainability issues.

As the company's business is focused on Property and Casualty, it has high exposure to climate risk and cyber risks. Tokio Marine has been carbon neutral in its operations for seven consecutive years, and we believe they are a leader in climate related disclosure. They were an initial member of TCFD and a signatory to Principles of Sustainable Insurance (PSI). As part of PSI, the company is now working with 22 global insurers to create methodologies that insurers can use towards implementing the TCFD recommendations. In September, the company announced their climate strategy whereby they will stop providing new underwriting and financing to coal fired power generation. However, we have asked Tokio Marine to limit exceptions and consider bringing existing contracts in scope.

Cyber security brings risks as well as opportunities as Tokio Marine provides cyber insurance, a market that at a double digit rate in recent years. To prevent the group from risks, it has a group policy with initiatives led by the Chief Information Security Officer (CISO) who is also Chief Information Technology officer (CITO). When asked for greater disclosure on this topic the company was not aware investors focused on this, but is willing to improve disclosure in future.

Shizuko Ohmi
Japan Head of
Investment Stewardship

Hiroyuki Hanaoka
Major Banks/ Regional Banks/
Financials excluding Banks
Experience: 28/20

Stakeholder engagement

Climate risk

Proxy Voting

J.P. Morgan Asset Management exercises the voting rights of shares held in client portfolios, where entrusted with this responsibility. We seek to vote in a prudent and diligent manner, based exclusively on our reasonable judgement of what will best serve the financial interests of our clients. So far as is practicable, we will vote at all of the meetings called by companies in which we are invested.

A summary of key voting statistics and activity in Japan for the period is detailed below:

Meetings voted	**19**	
Votes with management	**124**	(82.7%)
Votes against management	**26**	(17.3%)
Abstentions	**0**	

Source: JPMorgan Asset Management . Data is for fourth quarter 2020. The second quarter is traditionally the busiest n terms of proxy voting volumes in Japan with a heavily concentrated annual general meeting season in June.

The number of annual general meetings held outside of the May/June season remains relatively low. Amongst the 19 meetings we voted during Q4, two were special meetings which relates to the reorganization, one from Sawai Pharmaceutical to form the holding company, and another from OSJB Holdings to dissolve the holdings structure. There was no shareholder proposals nor contentious votes.

The percentages of votes cast in favour of management by J.P. Morgan Asset Management in Japan was 82.7% during Q4 2020, up from 78.9% in the same period in 2019. This is largely due to the decline in votes against director in this quarter as a result of improvement in proposed board structure as is shown in the case of Cyber Agent as below. We noted the increase in proposals asking to raise aggregate compensation ceiling for directors, and albeit the amount per capita does not bring much concerns compared globally, we felt that the lack of transparency in remuneration schemes should be addressed in engagement.

Major reasons for votes being cast against management included the following:

- candidates for external directors lacking in independence
- boards with less the one third independence
- stock options without sufficient vesting period or that bring excessive dilutions

Cyber Agent

We voted against the nomination of CEO, Susumu Fujita at the 2018 and 2019 AGM, due to the lack of board independence, as the board was composed of only three outsiders out of fifteen directors, and not fulfilling our requirement of one third outsiders. In addition, we voted against outside director Koichi Nakamura, who could not be regarded as fully independent as he served as the vice president of Recruit Holdings although he retired in 2016, with which Cyber Agent has transactional relationships that exceeds 3% of its revenue. Subsequently, we had been engaging with the company to enhance board independence. Listening to our request and of many other investors as well, at the 2020 AGM, the company proposed to reduce significantly the size of the board to eight and to add one independent director to make the board composed of half outsiders.

We welcomed the change and confirmed that the founder CEO has previously used director positions as incentives but now introduced new executive officer system and separated monitoring and management. At the same time, the company increased numbers of executive officers to motivate and reward achievements, based on evaluations that are results-oriented and transparent. Among twenty four executives, there are numbers of executives in their twenties and thirties and the average age is somewhere in late thirties. There are two female executives.

We also confirmed that this change in the board composition was brought about by the contribution of Koichi Nakamura, who served as the chair of the nomination committee that has been established last year so as to enhance transparency of the nomination process. Taking this into consideration, we decided to vote for his appointment despite our previous concern over his independence.

On the other hand, we note that two other outside directors and audit members have problem over their independence, as their terms of office exceeds twenty years. We urged to nominate outside candidates who can be regarded as independent at their re-election in the 2021 AGM.

Regarding remuneration scheme, fixed portion compose majority of the remuneration and only limited portion of stock incentives. We discussed the company to install the scheme that better rewards longer term success.

LITALICO

We voted against management on resolutions related to remunerations, such as approval of the restricted stock plan and the deep discount stock option due to excessive dilutions of plans of above 21.6% and because the deep discount stock options is exercisable in less than three years after the grant and there is no performance hurdles. Also voted against the retirement bonus for directors as it allows a payment to outsiders and could be discouraging to an effective monitoring of the board.

We voted For the increase in aggregate compensation ceiling for directors who are not audit committee members despite the extent is large, from JPY150 mil to JPY500, as the average amount per director is JPY250 mill and we thought it admissible taking into consideration the financial performance of the company.

We called the company in prior to the AGM that we think that the proposed increase in the aggregate compensation to directors is rather large, and although we appreciate the financial performance of the company, we recommend the company to be more transparent in the total system of director remuneration by setting clear performance hurdles and to have a good mix of short term and mid-long term portions in the remunerations. Also it is not considered a good practice to allow payment of retirement bonus to outside directors as it could demotivate effective board oversight. The company responded that our suggestion is reasonable and would like to work on to have more transparent remuneration framework going forward.

Spotlight on: Material Matters

Talking Materiality. In this Q&A, Japan real estate analyst, David Gleeson, reflects on his journey helping to build the materiality framework.

David Gleeson
Real Estate/Construction
Experience: 13/3

1) You recently built the materiality framework for the real estate sector, a considerable project. What were your key takeaways from completing this project?

The objective of the materiality framework is to identify the five most important ESG issues within a particularly sub-sector, and the global real estate sector is a broad and diverse industry, with many standards and systems of measurement. Dealing with these, and ensuring comparability between companies across different jurisdictions, required extensive collaboration between our analysts across the world. We were able to identify companies globally with a strong focus and competitive track record in areas related to the environment and climate change. In countries such as Japan, there were companies that have prioritized employee health and safety through their focus on business continuity and earthquake resistance. In governance areas such as capital management, we also found a significant spread in scores both within and across regions, informing both our stock selection and management engagement.

2) Can you talk about some of the examples of best practice that you saw, either in your coverage or amongst names your colleagues were working on?

Japanese homebuilders have had a strong focus on the environmental for several years. Companies such as Daiwa House place a high priority on lowering their impact on nature, with aggressive mid-term targets: zero net deforestation associated with timber procurement, zero waste emissions (recycling and reuse) through the life cycle of houses, and zero energy homes through renewable energy generation.

3) Having completed the project, how will the materiality framework shape your future conversations with corporates? Are there any specific themes that you will prioritise when engaging companies to promote sustainability of companies?

First, constructing the framework has helped us prioritize what really matters in the field of ESG for each company, giving us a template to ensure dialogue with management is productive for both sides. The scores also allow us to highlight acute weaknesses to address with the company. Second, using the framework as a basis for regular engagement with management teams, we have been able to identify a correlation between the willingness of management to engage and improve in areas of ESG and improvements in other areas of business management and strategy. This is allowing us to get ahead of the curve as investors and shareholders in terms of future improvements related to both ESG and broader strategic issues.

For example, productive engagement with Japanese developer Mitsui Fudosan in the area of transparency and communication two years ago gave us confidence that it was genuinely interested in improving across a variety of areas including capital management and shareholder returns. Since then, the company has made significant changes to how it distributes profits, including launching multiple share buybacks which we have been able to benefit from as shareholders.

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ACTIVELY VOTING

Across 80 markets around the world

Source: J.P. Morgan Asset Management; data as of December 31, 2019.

BUILDING STRONGER PORTFOLIOS

At J.P. Morgan Asset Management, collaborating with our clients in an effort to build stronger portfolios drives everything we do.

We are committed to sharing our expertise, insights and solutions to help make better investment decisions. Whatever you are looking to achieve, together we can solve it.

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