Corporate Governance Report

Asia Pacific 4Q 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.

Q4 2019 Voting Activity on Behalf of Clients in the Asia Pacific ex-Japan Region

	Oct-Dec 2019	%	Oct-Dec 2018	%
Total votes cast	4,715	100.0	5,736	100.0
For	4,147	88.0	5,106	89.0
Against	541	11.4	539	9.4
Abstain	27	0.6	63	1.1
Did not vote	0	0.0	28	0.5
Number of meetings	184		215	

Seasonally, the fourth quarter tends to be one of the quieter quarters in the corporate calendar. Nevertheless, the meeting cycle is changing as our exposure to China A-shares increases, and as Chinese companies hold more Special Meetings to seek approval for one-off financing arrangements and other authorizations. Under China's governance codes, related-party transactions, the provision of intra-group loans and guarantees, and amendments to Articles of Association all require specific shareholder approvals. Of the 184 meetings at which we voted during the quarter, almost 40% (72) were Special Meetings convened by China-domiciled companies. Elsewhere, with most Australian companies operating on a June year-end basis, last quarter was the peak of the AGM season in Australia, and we voted at 27 Australian AGMs.

The commentary below provides some examples where we voted **against** management at shareholder meetings during the quarter:

Australia

The governance framework in Australia is considered best-in-class in Asia Pacific and generally provides strong protection for minority shareholders. However, there is one area that requires particular scrutiny, and that is executive compensation. Under Australian governance 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, there can be no "one size fits all" approach.

As a general 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.

In this vein we voted against the Remuneration Report resolutions at**: Westpac Banking Corp, Wesfarmers, Goodman Group** and **Ramsay Health Care.** The shareholder meeting at Westpac was particularly contentious with a substantial minority of shareholders voting against the Remuneration Report for the second consecutive year. Despite having been cited by Australia's Royal Commission (into Misconduct in the Banking, Superannuation and Financial Services Industry) as having "material governance and risk" failings, Westpac's Remuneration Report still sought shareholder approval for generous executive bonuses, where the justification given was that performance measures relating to "customer, culture and capability targets" had been achieved. Given that Westpac has set aside AUD1.5 billion to address remediation and compliance issues associated with the Royal Commission's findings, this seemed particularly egregious. In addition, there appeared to be overly generous sums set aside to meet the claims of terminated executives associated with these failings. This provided ample justification for our vote against the adoption of the Westpac Remuneration Report.

Elsewhere, shareholder resolutions are an increasingly common feature at Australian shareholder meetings. Depending on a company's Articles of Association, such resolutions may be put to a general vote if the sponsor secures enough support, either in terms of the aggregate percentage of shares owned (usually 5%), or the number of shareholders (more than 100?) who agree with the proposal. At the same time, we note that these proposals can often be initiated by activists, seeking a platform for their personal agendas.

Our stance here is clear: whilst we recognize that qualifying shareholders should have the right to submit proposals to general meetings, we will not support those which are frivolous, or which may otherwise fall within a management's general remit. But where such proposals demonstrably enhance shareholder rights, or are in the long term interest of all shareholders, they will receive our support.

During the quarter, we voted **against** shareholder resolutions (and therefore **in favor of** management) at the following meetings**: Westpac Banking Corp, ANZ Banking Corp, National Australia Bank, BHP, Insurance Australia Group** and **Qantas Airways.** Most resolutions did not meet our standard of working to enhance shareholder rights, and could mostly be handled within the existing remits of managements.

China

As our exposure to China domiciled companies rises in line with the increased number of China listings (both A and H shares), China now dominates in terms of the number of voting decisions that we make each quarter. In part, this is because of the large and growing number of Special Meetings called to seek shareholder consent for financing approvals. But it also reflects the increased exposure to China A shares within our Asia Pacific portfolios. Special Meetings of China domiciled companies accounted for almost two fifths of the total number of meetings at which we voted during the quarter.

Related-Party Transactions are a common source of resolutions, since shareholder approvals are required when intra-group transactions take place. Elsewhere shareholders are required to sign off on the provision of various financing commitments requested by group subsidiaries and affiliates. Approvals, for example, are required when a company makes deposits to, obtains loans from, or provides guarantees to entities within the same business group.

We will support such proposals where we receive adequate details of the nature of the transaction, and are convinced by the rationale for the commitment and the fairness of the terms. But where disclosures are lacking or where we perceive the risks assumed to be too high, we will vote against. During the quarter, we voted against financing and / or related party transaction proposals at: **Huaneng Power International** and **Datang International Power Generation.** We also voted against proposed employee share purchase plan (ESPP) arrangements at: **Zhongji Innolight, Midea Group** and **Yangzhou Yangjie Electronic Technology.** Our votes against were determined either by the lack of information provided; or by the potential dilution implied by the incentive payment grants, which we deemed to be excessive.

Japan

Given the rising demographic headwinds impacting the Japanese economy, policy makers have long sought to mitigate these by putting policies in place to improve corporate efficiency and force structural reforms. The hope is that by boosting micro-level returns, this will help raise Japan's overall macro growth rate. Strategy so far has been two pronged: the first phase was to introduce changes to Japan's Corporate Governance Code, to focus on improved governance standards in the expectation that this would lead to better capital allocation decisions; the second phase has been to develop a more demanding Stewardship Code, whereby Japan's asset owners and asset managers are obliged to hold boards to publicly account for their actions.

Among the provisions of the Corporate Governance Code is a requirement to include at least two independent board members on company boards, to provide for enhanced oversight of corporate strategy. Progress is being made, but the pace of this is slow, and is being applied inconsistently. As a result of this uneven progress, we voted against a number of director election resolutions, either because of the slow pace of compliance with the Corporate Governance Code, or the perceived lack of independence of the nominated candidates. Votes against nominated directors were exercised at the **Fast Retailing** and **GMO Payment Gateway** annual shareholder 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:

Swire Properties (Hong Kong)

We recently attended Swire Properties' ESG Investor Day. Not only was this Swire Properties' first ESG Investor Day, it was the first ESG specific company event that we can recall being held in Hong Kong. The novelty of this can be seen from the large number of attendees (in excess of 70) from both buy-side and sell-side. And this despite the fact that Swire Properties is only a mid-cap property company (USD19 bill market cap) with a limited free float (less than 20% of total shares outstanding). There is clearly a pent up demand in Asia for these kinds of events.

In hosting such a high profile meeting, Swire Properties clearly has a good story to tell. Indeed in setting out its narrative, the company was not embarrassed to list out the third party accolades it has received over the past 12 months:

- Number one ESG performer in Asia, as ranked by Dow Jones' Sustainability World Index, and the eighth strongest performer globally;
- The number one ranked company in the Hang Seng Corporate Sustainability Index
- A Global Sector Leader by GRESB (Global Real Estate Sustainability Benchmark)
- A 2018 constituent of MSCI's ESG Leaders Indexes, with an AAA rating.

As a corporate mission, it has set itself the goal of being "the leading sustainable development performer in our industry globally by 2030".

How is it structuring itself to achieve this objective? The company has set out a road map in its "Sustainable Development (SD) 2030 Strategy", where it has identified five key pillars (People, Partners, Places and Environmental / Economic Performance) each with their own Working Groups. These groups report quarterly to a SD Steering Committee, which itself reports directly to the Board. Each pillar has quantifiable targets to achieve and around 80 measurable KPIs have been identified, which are integrated into employee performance reviews. Clearly by linking the achievement of targets to performance reviews and employee compensation, the company is more than just "talking the talk" of sustainable development.

From our perspective, we give Swire Properties a "Trading" classification with an average number of red flags (21 – derived from our Strategic Classification process) for a similarly classified company. From a governance perspective the company is held back by its controlling shareholder structure, although compared to other similarly controlled companies in Hong Kong, we consider the Swire group to be more respectful of minority interests than many of their peers. At the same time, in terms of the level of detail provided, and metrics set to measure the progress of, and compliance with, their self-identified E and S goals, we acknowledge the company is setting a high standard. In this respect it is no surprise that Swire Properties has become one of the first Hong Kong companies to embrace the recommendations of the Taskforce on Climate Related Financial Disclosures (TCFD), and will be publishing future disclosures using the TCFD reporting framework.

BHP (Australia)

In a similar vein, we attended a "Social Value Briefing" with Australian resources conglomerate, BHP. The purpose of this meeting was to highlight its CSR credentials and in particular its mission to create "social value" from operations, as opposed to simply maintaining a concession to operate. The Samarco tailings dam disaster in Brazil that occurred in 2015 appears to have impacted the company at multiple levels. It now recognizes that to operate mining projects successfully, it needs to move beyond being tolerated by the communities in which it operates, to active trust and partnership. Simply complying with today's social and environmental regulations and protocols is not sustainable long term, given the degree to which society's expectations are evolving. What is considered legitimate and acceptable today may be viewed as exploitative and illegal tomorrow.

Every business decision now includes a full assessment of social, as well as financial, benefits with each depending on the other for the decision to be effective. While this often involves trade-offs, the company claims it will only embark upon projects where it can quantify a positive social as well as financial impact. In the case of its nickel mining operation in Western Australia, it has managed to secure a long term land-use agreement with the indigenous Tjiwarli people precisely because of the benefits that the relationship promises to both parties. For BHP it secures access to high grade minerals over a long term horizon at a commercially acceptable price; for the Tjiwarli, it delivers opportunity for employment and procurement; it provides cultural security for places the community deems sacred; and it creates financial sustainability for the Tjiwarli people as a whole.

In terms of our Strategic Classification, we categorize BHP as a "Trading" stock with 22 red flags. Not surprisingly, most flags arise from negative "duration" factors, which are implicit in any natural resource company. At the same time, BHP is striving to mitigate many of the sustainability challenges that it faces. In particular, it should be commended for its Climate Investment Program, through which it will spend US$400 million over the next five years to reduce the effects of its carbon footprint. This is not just focusing on operational emissions (scope 1&2), but is working across its entire value chain to address scope 3 emissions as well. This ranges from promoting energy efficiency in its mining and transportation activities, to investing in renewable energy projects and carbon capture and storage programs. Investors – collectively - might be skeptical as to how much of an environmental offset such projects might bring. But we should not fault the company for trying.

Orange Life (Korea)

While companies in the Asia Pacific region are generally working hard to embrace higher ESG standards, not all jurisdictions are moving at the same speed. Korea remains a relative laggard, and confirmation of this was provided by the recent takeover of Orange Life Insurance by its majority shareholder Shinhan Financial Group. We have owned Orange Life, as a large minority holder, since its partial listing by its previous owner, ING Group. Since then, the company has been transformed, firstly by the sale of ING's remaining 59.2% stake to Shinhan Financial (at a price considerably higher than current levels – no equivalent terms were offered to minorities); and secondly by the agreement between Shinhan and Orange Life in November to absorb the rest of the company at a zero premium to the current market price.

We wrote to Orange Life to protest the terms on which this transaction has been concluded. In our view this transaction materially undervalued Orange Life, and was disadvantageous to minority shareholders. In particular we sought clarification on the following:

1. On what basis has the valuation of this transaction been determined? Why has no premium to acquire full control of Orange Life been considered?
2. Why no consideration has been given to pass on to minority shareholders their share in the value of Orange Life's surplus capital (which we note at the end of June 2019 amounted to KRW5.4 trillion – considerably in excess of the current market capitalization of KRW2.3 trillion)?
3. Why the board of Orange Life has agreed to such disadvantageous terms, and why it has demonstrably failed to protect the interests of minority shareholders?

Orange Life did provide a limp response, but unfortunately shed no light on the transaction terms, beyond noting that the intention of the transaction itself was to "encourage group synergies through a more stable and efficient management system. In addition the transaction would provide minority shareholders with exposure to a substantially larger financial services enterprise with much greater trading liquidity."

In our follow up, we reiterated that the terms of the transaction was significantly detrimental for minority shareholders of Orange Life and that we would be voting against the transaction in the deciding shareholder vote. Unfortunately this has changed nothing since 60% owner, Shinhan Financial, was eligible to vote and (not surprisingly) voted in favor of the set terms.

While this is just one example, it provides ongoing justification as to why "the Korea discount" (in relative valuation terms against other markets) continues to exist!

J.P. Morgan Asset Management

Asia ex-Japan Proxy Committee

February 2020