Building stronger portfolios

Investment stewardship

Promoting sustainability through investment-led stewardship

Annual report 2020

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

Contents

4 Foreword

6 Our investment stewardship philosophy

7 Our 2020 stewardship activities

Summary of engagement activity

8 PRIORITY I – GOVERNANCE

Theme in focus: Board and management diversity

– Case studies and outcomes

Theme in focus: Capital allocation

– Case studies and outcomes

13 PRIORITY II – STRATEGY ALIGNMENT WITH THE LONG TERM

Theme in focus: Executive remuneration

– Case studies and outcomes

16 PRIORITY III – HUMAN CAPITAL MANAGEMENT

Theme in focus: Diversity in the workplace

– Case studies and outcomes

Spotlight on Emerging Markets and Asia-Pacific

Showcasing diversity at the board level and diversity in the workplace

23 PRIORITY IV – STAKEHOLDER ENGAGEMENT

Theme in focus: Cybersecurity

– Case studies and outcomes

27 PRIORITY V – CLIMATE RISK

Theme in focus: Climate risk disclosure

Spotlight on the Task Force on Climate-related Financial Disclosures

– Case studies and outcomes

Investor-led engagement

ESG-aligned transportation investing

36 Summary of voting activity

42 Glossary

Foreword

Amid the difficulties of 2020, it was a busy and exciting year for stewardship and sustainable investing.

A wide spectrum of sustainability issues were thrust into the public consciousness – from human rights to societal inequality to the impact of corporate diversity strategies to cyberattacks – leading many to begin to demand change.

This increased visibility also led many more investors to consider the risks these issues posed to their portfolios and ask what we, as responsible stewards of capital, were doing to address them.

In 2020, regulators around the world also started to seriously address the risk climate change poses to investment portfolios. Increasing numbers of our clients must now disclose how they are addressing environmental, social and governance (ESG) risks, while we face our own requirements around the world. For example, the UK's Financial Reporting Council set out new requirements on how asset managers must report on their strategy and activities as part of its 2020 UK Stewardship Code.

Our firm takes a long-term, active approach to investment management that is designed to address both the risks and the opportunities of all these issues. In this respect, we have created a formal stewardship structure that is designed to identify risks and understand our portfolio companies' activities, in order to enhance value and mitigate risks associated with them.

At the start of the year, we identified five main investment stewardship priorities we believe have universal applicability and will stand the test of time: governance; strategy alignment with the long term; human capital management; stakeholder engagement; and climate risk.

Within each priority area, we identified related themes we are seeking to address over a shorter time frame. These themes will evolve as we engage with companies to understand issues and promote best practice.

This combination of long-term priorities and evolving, shorter-term themes provides us with a structured and targeted framework to guide our investors and investment stewardship teams globally as we engage with investee companies around the world.

This report illustrates not just that we are engaging with a wide range of companies, but how we are doing it. It shows the importance of engagement – but also how change can often take time and significant effort to achieve.

We are not claiming credit for the positive changes made by many of the companies with which we have engaged, but we are pleased to have either initiated discussions or added our voice to the existing dialogue on issues we believe are important to long-term performance.

This year, we also reported on our stewardship activity in the context of our reporting against the United Nations-supported Principles for Responsible Investment.[1] This demonstrated how we, as a signatory to the institution since 2007, have been engaging with companies all around the world on a range of important, long-term issues. It also showed our commitment to transparency and accountability around sustainability.

[1] For UN PRI results, refer to the Sustainable Investing section of the J.P. Morgan Asset Management website.

Similarly, we have also committed to report more widely on our activities through this annual report, the first of many to come. Over time, we will move our focus, within our five key priorities, to center on issues that we believe will make an important, material difference to our long-term investment goals.

In the last 12 months, we also became signatories to Climate Action 100+, reflecting our increasing focus and engagement with companies on the critical issues they face on climate risk.

We hope you find our report useful, interesting and helpful in understanding our investment-led stewardship approach to sustainability. It helps us, as investors, not just to identify risks within portfolios but to find opportunities that should generate better long-term returns for our clients, too.

We look forward to sharing more with you.

Jennifer Wu
Global Head of Sustainable Investing
J.P. Morgan Asset Management

Our investment stewardship philosophy

As a fiduciary of our clients' assets, we understand that performance is paramount. We believe that understanding the sustainability of investments is vital to that goal.

We have worked to create an investment stewardship approach that aims to improve long-term, sustainable value. We believe that the companies in which we invest should be focused on responsible allocation of capital and long-term value creation.

For us, investment stewardship is not about adhering to one set of norms or limiting our scope to one collection of standards. Nor is it about arbitrarily extending the time horizon of our portfolios. Rather, we strive to understand how factors impacting sustainability are financially significant to companies over time, understanding that the regions, cultures and organizations in which we invest differ greatly.

Identifying whether a risk or opportunity is substantial enough for us to act upon it is a key element in our approach to investment stewardship. Due to the global breadth of our investment universe, we cannot apply the same metrics or standards across the board. Instead, we need to judge securities, assets and situations in context, and decide how significant a particular event or circumstance may be, given that context. This allows us to gauge the financially material elements of a sector, industry or business model from a sustainability perspective, now and into the future. Our focus is on future cash flows or duration of business. We view purposeful leadership at the top of a company, supported by strong corporate governance, as the key to achieving these goals. Where such attributes are discovered lacking, we aim at actively engaging with investee companies to improve governance.

We integrate financially material ESG factors into our active investment frameworks across asset classes. Combining our ESG research capability with the experience and skill of our investment teams and the expertise of our investment stewardship specialists gives us a deep understanding of the risks and opportunities facing different sectors, industries and geographies. By integrating this expertise onto a global common platform, we seek to maintain a consistently high standard of engagement, considering the myriad nuances a responsible investor needs to embrace. Our approach provides for broad flexibility as data, regulations and outlooks change, while focusing on the best prospects for sustainable financial returns.

Please find some of our engagement and voting activity from 2020 on the following page. The sample of engagement reports and voting activity presented here aims to illustrate our approach to investment stewardship.

Our 2020 stewardship activities

This report covers some of our engagement and voting activity for calendar year 2020.

Over that time, our investment stewardship specialists undertook several hundred engagement discussions with portfolio companies around the world. This was in addition to the several thousand company meetings undertaken by our investors. We also met with regulators, exchanges, nongovernmental organizations and other industry bodies to understand a wide range of region- and sector-specific issues and promote best practices.

Summary of engagement activity

Over the year, we recorded a total of 500 investment stewardship engagement discussions with 402 portfolio companies globally. Of those 500 meetings, some 427 were specifically focused on governance issues, 110 on environmental issues and 166 on social issues. We engaged on more than one of these issues with 96 companies.

Our integrated approach to stewardship involves active participation between the investment and stewardship groups, with shared meetings and collaboration on issues. In addition to the stewardship meetings mentioned above, our investment teams conducted thousands of meetings with companies that often included ESG issues.

However, as we are long-term investors, it is important to note that many of these engagements were not single conversations. Rather, they formed part of long-running discussions covering months or, in some cases, years.

This ongoing activity shows our commitment to long-term stewardship, which has been enhanced this year by the publication of our five key priorities, which we outlined in February, and specific areas of focus within them.

The examples are detailed below.

Governance	Strategy alignment with the long term	Human capital management	Stakeholder engagement	Climate risk

500
ENGAGEMENT DISCUSSIONS

427
GOVERNANCE ISSUES

110
ENVIRONMENTAL ISSUES

166
SOCIAL ISSUES

96
MULTIPLE CATEGORY ISSUES

PRIORITY I – Governance

Companies that get their governance right tend to get other sustainability issues right.

In 2020, we engaged with companies on wide-ranging governance issues. Among these, we tackled board strategy and independence, succession planning and ensuring appropriate diversity of skills, background and experience on the board and among senior executives. We also focused on bribery and corruption risk, as well as culture and conduct issues, as they can have material adverse regulatory and reputational impacts for companies and our clients.

THEME IN FOCUS: BOARD AND MANAGEMENT DIVERSITY

Good governance needs challenge in the boardroom, and we believe this is best achieved by a diversity of views. When governance is good, it benefits the organization, CEO, shareholders and all other stakeholders.

We believe gender, race and ethnicity, age, nationality, sexual orientation, disability and religious background as well as different perspectives and skill sets, promote stronger thinking and enhance decision-making. It is also becoming increasingly clear that diversity is a material economic factor when assessing long-term company performance.[2] We believe diversity at board and management level can contribute to generating revenues and risk-adjusted returns.

Best practice for the diversity of board composition is still evolving, but big changes in recruitment call for modern governance practices and board management solutions.

Case studies and outcomes

CASE STUDY 1

WHY DID WE ENGAGE? Case study 1 is a German multi-national food retailer held in our equity and fixed income strategies. We believed improved diversity at both the board and management levels, and in particular an increase in the proportion of women, would benefit the company and its long-term performance.

HOW DID WE ENGAGE? We engaged with the company to understand its board dynamics and sustainability program. We asked the company whether, as a retailer with a diversified customer base, it had an appropriate gender balance on its board. We were interested to find out if the board was expanding its search to source suitable candidates. Finally, we wanted to know how the company was addressing the lack of diversity in the management team.

OUTCOME We believe the company has made improvements on diversity and is traveling on a positive trajectory. In Germany, by law, the supervisory boards of certain large corporations are composed of 10 shareholder-elected members and 10 employee representatives. The supervisory board oversees and appoints the members of the management board and must approve major business decisions. The company's supervisory board set an objective to have at least one female on the management board by June 2022. The company has targeted 20% women in its tier 1 management level and 35% within its tier 2 management level.

[2] https://hbr.org/2020/06/how-diverse-is-your-board-really

To establish a diverse and inclusive corporate culture and gain better access to more talent, it has developed a company-wide diversity approach. The company wants an open working environment in which individual differences are respected, valued and encouraged, as it believes diversity and inclusion lead to better business results. It has established a dedicated contact person for its diversity and inclusion strategy, which is monitored by the board using key performance indicators.

We believe the company has embedded its diversity and inclusion strategy within its culture, and this has acted as a catalyst to promote further diversity on the management board. We believe diversity in senior management will help the company better address the needs and concerns of a diversified customer and employee base, thus putting it in a better position to deliver better long-term value.

NEXT STEPS We will continue to engage with the company on governance and its broader sustainability program.

CASE STUDY 2

WHY DID WE ENGAGE? The second case study is a Japan-headquartered company that specializes in human resources and employee services. We started to engage with the company to discuss gender diversity because its board had no female director.

We believe boards have a responsibility to reflect the interest of all company stakeholders, and recruiting them from diverse backgrounds is a fundamental part of strengthening a business. However, boards in Japan fall far behind their global peers on gender diversity. As of August 2020, only 6% of the directors of listed Japanese companies were women.

As the company creates its value by connecting people all over the world, we felt a diverse voice on the board was vital to its continued growth.

HOW DID WE ENGAGE? In our engagement with the company, we recommended female representation on the board. We said that while the nomination of female executive directors is still rare in Japan, companies should take adequate steps to promote gender diversity within their organizations.

The company explained it was seeking female board representation among its existing staff. We discussed how Japanese companies are increasingly appointing female directors from outside the organization, often from pools of academics, accountants and lawyers.

OUTCOME The company nominated an internal female director, and we subsequently encouraged it to further enrich its internal pool of female candidates, as well as take diversity into consideration from various angles.

The company emphasized that it places value on diversity, not only in terms of gender but also in ethnicity and across age, which we welcome. The company's efforts to increase the number of female managers is not limited to regular, ongoing initiatives to develop internal resources. It also has a special program to promote talent, providing employees with opportunities to take on a new challenge outside their career path and conduct a fair evaluation of their accomplishments. These improvements allowed the board to appoint a young female director.

NEXT STEPS We will continue to monitor board diversity and will keep engaging with the company.

THEME IN FOCUS: CAPITAL ALLOCATION

As an active investor, we demand high standards from company directors, particularly around their interaction with investors, and encourage a strong corporate culture to foster long-term value. We require candid and open communication, access to independent directors as well as executive management and a clear articulation of the board's thinking on long-term strategy.

The board of directors plays an important role in providing oversight of the capital allocation process over competing priorities and multiple time horizons. Capital allocation has increasingly come into investor focus in recent years, becoming one of the leading drivers of activist campaigns against boards. As long-term investors, we encourage company leadership to consider extended time horizons when approaching capital allocation and other strategic business decisions. Planning needs to be long-term and should take into consideration the views of a wide variety of stakeholders as well as the possibility of economic, societal and regulatory change, given the potential implications of these factors on company performance.

Case studies and outcomes

CASE STUDY 3

WHY DID WE ENGAGE? This U.S.-based company proposed to make a significant acquisition, which raised our concerns around social, regulatory and governance risks. Given the very public nature of these ESG concerns, we expected the board to have taken them into account before approving this deal. As these risks unfolded, the acquisition fell well short of targets, which led to a multi-billion-dollar write-down to the original investment. We were disappointed by the lack of board oversight. We expect boards to conduct due diligence on mergers and acquisitions, employ their expertise in understanding ESG risks and challenge management's assumptions around them.

HOW DID WE ENGAGE? The deal, and the almost immediate fallout, validated our concerns. JPMAM voted against the reelection of several board members to reflect our concerns around M&A due diligence. We also voted against executive compensation, as we believed there had been a lack of management accountability.

We engaged with senior officers and the company's board before and after the annual meeting, explaining the rationale behind our decisions. We encouraged the board to enhance its oversight around M&A due diligence and provide more disclosure of the risks to the process.

NEXT STEPS We will monitor the company's disclosures in its upcoming proxy statement. In particular, we will monitor how the board has responded to investor concern on executive remuneration to ensure executives are held accountable for capital allocation decisions.

CASE STUDY 4

WHY DID WE ENGAGE? We were concerned with this company's assumption of significant legal liability arising from the use of controversial chemicals by a business it acquired.

HOW DID WE ENGAGE? In 2019, we voted against releasing directors from their liability for the policies the company pursued during the 2018 financial year. This formally signaled our disapproval with the board and its actions. Our JPMAM investment stewardship team then continued to engage with senior management, which undertook several roadshows to meet and listen to a range of shareholders' views.

OUTCOME The company has taken several steps to restore investor trust and confidence in the board. The supervisory board agreed to a voluntary special audit of due diligence procedures for evaluating major M&A transactions. The company has also taken a more serious stance on addressing sustainability as a long-term issue, with its board chair now the company's chief sustainability officer and responsible for achieving its ambitious targets by 2030.

Changes to the board's leadership, along with the addition of new directors, has resorted our confidence. The board has also been strengthened by the appointment of a director who has expertise in the company's specific field. A skills matrix will inform its ongoing board refreshment process going forward.

The company has redesigned its remuneration system to reduce complexity and better align with its go-forward strategy, which includes incorporating sustainability factors. A clawback mechanism has been introduced that forces board members to pay damages if they breach their duties. Additionally, the CEO is now required to hold shares for two years beyond service.

CASE STUDY 5

WHY DID WE ENGAGE? This South Korea-based company is engaged in the manufacture of specialist industrial parts. Its board had traditionally been filled by executives who were close to the founders and proprietors.

The appearance of activist investors on the shareholder register prompted the company to overhaul its governance practices and bring international independent directors onto the board.

HOW DID WE ENGAGE? We met with management to discuss the company's shareholder value maximization policies. We focused on recent changes to governance, particularly the selection of independent nonexecutive directors.

OUTCOME While the total number of directors stayed at nine, two international independent directors with experience in the industry and capital markets, respectively, have joined the board. The remaining independent nonexecutive directors hail from either academia or the financial sector. We believe that board evaluation and acknowledgment of governance problems by the board are often the first step to meaningful changes in board practices.

We see clear positives in the board placing emphasis on value maximization and recognizing the need for independence and diversity. For example, it has created a remuneration committee to ensure senior management's incentives are properly aligned with those of shareholders.

NEXT STEPS With a more diversified board, we are looking for initiatives from the company that would improve transparency and augment shareholder value.

CASE STUDY 6

WHY DID WE ENGAGE? We believed several capital management improvements could be made at this Japanese listed property company. First, it needed a clearly defined and well-articulated capital management strategy. Second, risk-adjusted returns on net asset value should be the primary driver of property share price returns rather than simple return on equity. Third, share buybacks should be considered as growth investment options. Finally, using third-party capital to fund the company's development pipeline could allow it to both lift return on capital and improve shareholder returns.

HOW DID WE ENGAGE? We have been engaging with senior management to present our views on the company's strategy and suggest capital management improvements. We engaged directly with management and presented our four key messages to the corporate strategy leadership team.

OUTCOME Disclosure has significantly improved on capital management strategies and balance sheet valuations. The company is implementing strategies to improve returns.

Priority II – Strategy alignment with the long term

We believe long-term thinking leads to sustainable business models.

THEME IN FOCUS: EXECUTIVE REMUNERATION

We expect the businesses in which we invest to be managed towards long-term outcomes.

As a long-term investor, we see the importance of incentive awards that are designed to encourage management to perform at the highest levels. These programs need to align with appropriate performance criteria that are both challenging and reflect the company's strategy and objectives over the long term. We also take issue with programs that reward executives for short-term gains rather than long-term value.

We engage with boards and management to appropriately align remuneration packages. We are not prescriptive in our evaluations and recognize that boards need flexibility when formulating a compensation plan. We believe this flexibility is crucial, given the rising pace of innovation, disruption, and uncertainty. We also acknowledge that some discretion is needed when evaluating management performance towards realizing long-term outcomes.

Over the past year, we have engaged with a range of companies on executive remuneration issues, voting against committees and their plans where we had concerns regarding executive compensation.

Case studies and outcomes

CASE STUDY 7

WHY DID WE ENGAGE? Following an extended period of poor business performance, this global food and beverage producer was subject to growing shareholder activism. This was manifested in poor "Say on Pay" support for executive compensation packages in previous years.

At the same time, the company was undergoing significant boardroom changes.

The new executive management and reconstituted board revamped the company strategy to focus on sustainable value creation by driving profitable revenue growth across its global and local brands. This could lead to higher gross profits and therefore high quality earnings growth.

HOW DID WE ENGAGE? We engaged with the board on its executive compensation program and linkage to the new strategy. The board took feedback from JPMAM and other shareholders on the matter.

The board reduced the high weight given to personal goals and increased the weightage toward objective measures of annual performance. It also added volume growth as an annual metric, as directors considered it an important indicator of underlying performance. Gross profit margins were replaced by gross profit dollars to emphasize the company's goal of growing cash flow. The board introduced an overlay of market share to the annual incentive, consistent with its objectives.

OUTCOME The company made important changes to its annual executive incentive plan, creating a program that demonstrates accountability and transparency at the top of the company. The changes have been received well within the company because management now better understands their linkage to strategy and its role in and responsibility for managing them. The plan also aligns incentives with aims to create long-term shareholder value by incorporating strategic elements of growth and execution, as well as culture.

In addition to linking executive compensation with elements of business strategy, the company has implemented several features that improve the plan. For example, by prospectively disclosing target levels against performance metrics, the company offers greater transparency than many.

The board has also built in further alignment by subjecting all vested awards to an additional year of withholding. Options make up a small proportion of long-term awards, and the company is also judicious in its valuation of options.

Retaining key performance indicators related to sustainability initiatives in the company's annual incentive plan will drive better long-term outcomes.

CASE STUDY 8

WHY DID WE ENGAGE? We had concerns around the pension provisions a European food producer was making for its executive officers. For example, the CEO had received a much higher proportion of his base salary in pension contributions than the wider workforce. While pensions may have retention value for executives, they have little linkage with corporate performance and are therefore scrutinized by investors. Outsized pension benefits to senior managers who are responsible for driving shareholder returns not only fail to align pay and performance, but also create the impression of inequity in the workplace. This can be deleterious to morale and company culture.

As part of UK best practice, companies must set a credible plan to pay all executive directors the same level of pension contribution as the majority of their workforce by the end of 2022. This sentiment is echoed in the UK Corporate Governance Code. Executive remuneration, of which pension contributions are a significant part, is a reputational issue for companies with potential adverse impacts on their long-term value. In addition, we had concerns around some long-term and short-term metrics.

HOW DID WE ENGAGE? The board had told investors these payments were obligatory under the CEO's employment agreement, under contract law. Our concerns were echoed by the broader investor base, noted by low support at the 2020 annual meeting.

OUTCOME The company pledged that new executives would receive the same pension contribution as the wider workforce. Incumbent executives also agreed to cap future pension contributions for the CEO and CFO. However, we believed contributions for executives were still high.

NEXT STEPS We will continue to engage with the company and encourage it to improve remuneration practices.

CASE STUDY 9

WHY DID WE ENGAGE? As a long-term shareholder, we were concerned about the company's compensation program. In our opinion, there was a disconnect between shareholder returns and management compensation, and the compensation plan did not hold management accountable for its past strategic decisions. We believe the company had allocated a significant amount of capital toward questionable acquisitions, compromising long-term returns.

Although the company had to take significant charges related to these acquisitions, executive compensation remained relatively unaffected because such charges were excluded from adjusted earnings. This resulted in skewed key metrics being used to drive the compensation plan. Consequently, performance share units have paid out at very high levels, and even after the underperformance period of 2017-19, executives earned above-target rewards.

HOW DID WE ENGAGE? The JPMAM investment stewardship team and analysts held several discussions with company representatives to share our concerns around the problematic features of the compensation program. At the 2020 annual shareholder meeting, we voted against the compensation program and some members of the board's compensation committee. The "Say on Pay" received low support, reflecting investors' concerns. The company then reached out to its large shareholders, including us, seeking feedback and suggestions.

NEXT STEPS We will review the compensation discussion and analysis presented at the next shareholder meeting to determine if problematic practices have been corrected. While we do not want to micromanage the compensation plan, the board should do a better job of exercising its judgment to ensure metrics are evaluated in a manner that drives management accountability.

PRIORITY III – Human capital management

Effective management of human capital is critical to an engaged and productive workforce.

THEME IN FOCUS: DIVERSITY IN THE WORKPLACE

Purposeful leadership is critical to defining and creating the conditions to drive workforce productivity growth that will support long-term performance. We believe the recruitment, development and retention of the right personnel are critical to the successful execution of a company's overall strategy – and there is growing evidence a diverse workforce is key to achieving it.

Studies have demonstrated that a diverse workforce brings innovation and is in tune with a broader range of customers' changing demands, both of which can lead to better financial performance.[3] Different perspectives and skill sets can also ultimately improve decision-making for long-term value creation.[4]

Therefore, we have highlighted workforce diversity as a critical aspect of a business's model, approach and outlook that can also give a strong indication of its corporate culture. The recognition of any lack of diversity in talent pipelines should encourage leaders to address the issue in a holistic manner.

While we believe remuneration policies and pay equity reporting are important tools to further these objectives,[5] discussions should be expanded to encourage disclosure on a broader scale of diversity across more levels of an organization. Through our investment-led stewardship approach, we engage with management and encourage it to create an environment in which employees at all levels feel valued and can bring their own diverse experiences and perspectives to their workplace.

In 2020, we engaged with a range of companies on human capital management, including discussions focused purely on diversity issues in the boardroom and workplace.

Case studies and outcomes

CASE STUDY 10

WHY DID WE ENGAGE? This UK utilities company is held in several of our equity and fixed income strategies. Over recent years, the company has had a good track record of protecting its balance sheet and ratings. However, since appointing a new management team in 2019, and with the changes a new board introduced, we engaged to discuss how it was also promoting diversity in the workplace.

HOW DID WE ENGAGE? We held a virtual meeting in which we asked what initiatives were in place to increase the female workforce, and how the company retained its staff and created an inclusive culture. We also noted that many companies were focusing on promoting their work on diversity and inclusion, and said we were keen to understand what approach it was taking.

3 https://www.bcg.com/en-gb/featured-insights/winning-the-20s/embrace-business-imperative-of-diversity
4 https://www.weforum.org/agenda/2019/04/business-case-for-diversity-in-the-workplace/
5 https://hbr.org/2020/11/how-to-identify-and-fix-pay-inequality-at-your-company

OUTCOME The company believes diversity will drive better results, and its board has set an ambitious ESG strategy despite experiencing challenging operating performance. By 2030, the company wants to have attracted and developed 100,000 people with essential science, technology, engineering and mathematics (STEM) skills, and aims to have women make up 40% of its workforce.

Year to date, the company has around 17% female representation within the STEM program. In 2020, the board elected a female director, bringing female representation on the board to 33%.

The company has also rolled out several other projects to address diversity issues. These included unconscious-bias training for people in leadership positions and for other employees. The company has introduced a support scheme for workers with caring responsibilities, helping them balance their jobs with time spent supporting family members. It has also offered further training through specialist learning academies, apprenticeships and a career development hub.

Mentoring has empowered staff to amplify their personal and professional development. This spanned cross-sector mentoring via the 30% Club, a global campaign that seeks to increase gender diversity at board and senior management levels, to in-house “reverse mentoring,” which empowers staff at different levels to learn from one another. These actions are all having a positive impact on employees.

NEXT STEPS We will continue engaging with the company to monitor how it will achieve its ambitious target to have a 40% female workforce. We believe the company has a model to build the workforce for its future, helping staff develop vital skills and creating a more inclusive workforce to ensure the company delivers for its customers.

CASE STUDY 11

WHY DID WE ENGAGE? We engaged with this U.S. oil and natural gas company to improve diversity across management, the board and the general workforce. Historically, the board had no female or minority representation. Executive management has acknowledged the energy industry is not highly diverse and has had challenges with attracting female talent.

HOW DID WE ENGAGE? We asked the company to review its initiatives on diversity, inclusion and its board refreshment process. We also encouraged the company to disclose more granular data on the gender and ethnic makeup of its workforce.

OUTCOME The company has made progress on diversity. The composition of the eight-member board has improved, with the recent addition of two women and one ethnic minority. The percentage of women across the company has fluctuated around 30%, while the percentage of women in management had climbed above 25% before dropping under 20% in 2019. The percentage of minority employees has climbed from a little over 10% in 2016 to around 20%. Minority representation in management positions has similarly climbed from 15% to 25% over that time.

Given that its professional ranks are almost entirely sourced from on-campus recruiting, the company had three focus areas for 2020. It is widening its intern outreach, adding colleges with more diverse student populations. The company has supported organizations including the National Society of Black Engineers, the Society of Professional Women in Petroleum to promote name recognition.

To have a broader reach, the company has placed advertisements in national magazines. It has completed internal reviews to assess how its two main offices compare with the local population regarding minority and female representation. Any shortcomings are flagged as areas for improvement.

We commend the company for acknowledging where it can improve and for its actions on diversity in the workforce. We believe diversity and inclusion are integral to a company's culture as they can improve decision-making and lead to better long-term performance. It is encouraging to see senior management and the board setting the tone at the top.

NEXT STEPS We will review disclosures for progress on diversity and will continue to engage with the company.

KEY CONCLUSIONS

- Companies must continue driving the agenda of diversity in the workplace, as broad-based diversity of gender and ethnicity can augment the range of talent and experience within an organization. There are company-specific to having a good balance of gender and ethnic diversity at all levels. We believe greater diversity through a broader range of views, backgrounds, and values leads to improved group decision making, more innovation, and greater ability to serve a diverse customer base.

- In 2020, we saw growing numbers of companies starting to make public statements of intent regarding workforce diversity targets, including on gender pay and racial equality. Workforce diversity is an integral part of corporate culture, as we believe it can help drive better long-term performance, and we expect companies to provide more disclosure on the composition of their workforces. These disclosures may be driven by regulations and shareholder needs for more data pertaining to human capital management.

- We recognize some companies and sectors face more challenges than others to attracting a diverse group of employees. In some cases, improvements will take several years. However, to develop a diverse pool of talent, companies need to examine their efforts across different levels within their organizations without delay.

SPOTLIGHT ON EMERGING MARKETS AND ASIA-PACIFIC

This year, our Emerging Markets and Asia-Pacific equity team launched a research initiative to deepen its understanding of corporate sustainability practices within its universe. The result was the Fundamental Materiality Framework. Within this framework, global research analysts for each industry identify the five ESG issues that are most financially material to companies in their sector. Each company is scored 1-5 on each issue to identify industry leaders and those with transgressions or room to improve.

Our analysts have identified clear industry leaders and best practice from assessments of more than 1,000 companies. Aside from aiding portfolio construction, this research database informs our engagement and helps us share best practice with companies earlier in their sustainability journey. Within the field of human capital management, our enhanced sustainability research has highlighted examples of best practice from across the emerging markets equity universe.

COMPANY 1

INDUSTRY Textile manufacturing

OUR ANALYSIS Employee health and safety in the workplace is a key part of management responsibility and shareholders run the risk of investment losses if a company is found to have been negligent. This company stood out from its peer group on everything from safeguarding checks when hiring employees to the quality of its dormitories. It was even a leader on creating a policy on toilet breaks.

This employee-first culture also saw it set industry standards on socially distanced working when COVID-19 first hit. This enabled its factories to stay open and continue to deliver value to shareholders while taking care of its employees, as others closed on health and safety grounds. It is a great example of how a culture of putting employees first can have economic benefits.

COMPANY 2

INDUSTRY IT services

OUR ANALYSIS This year, the company announced a new target to have women and nonbinary gender persons holding 50% of management positions by 2025. Given the software industry has tended to have lower historical levels of female participation, the company has also taken significant steps to build its own talent pipeline through various external programs. More broadly, the company has found that reflecting the values of its employees can lead to superior long-term financial outcomes. Its initiatives on employee welfare have seen steady improvements in its attrition rates, leading to higher customer satisfaction and stronger business growth.

COMPANY 3

INDUSTRY Food and drink manufacturing

OUR ANALYSIS Companies that are willing to codify, and be transparent on, their approach to human capital management give greater confidence to employees and shareholders that their commitment will be more than just words. We were impressed to see this Hong Kong-based beverage company produce a group-wide human rights policy that came into force this year. The document is based on the United Nations' Guiding Principles on Business and Human Rights and covers topics including diversity, workplace security and child labor. It also references the group's whistleblowing policies if employees feel these promises are not being kept.

FOCUS ON: PANDEMIC RESPONSES

Employee safety is the ultimate responsibility a company has to its staff, and shareholders run the risk of investment loss if it is found to have been negligent. The COVID-19 pandemic was a clear differentiator between those with the best and worst practices.

In Mexico, a food retailer sent home any employees aged over 60, giving them full financial support. A Brazilian pharmacy chain also allowed vulnerable employees, including pregnant women, to stay away from the workplace and rolled out a program to allow staff access to online medical consultations with private sector doctors.

In China, a restaurant operator enrolled all restaurant managers and their families in private insurance plans. During the early stages of the pandemic, it kept some outlets in Wuhan open but was aware that some staff might be unwilling to risk their health. It requested volunteers and within two hours had received 900 responses. This demonstrates the company's strong corporate culture but also reflects employees' desire to pursue activities that have a broader social impact.

SHOWCASING DIVERSITY AT THE BOARD LEVEL AND DIVERSITY IN THE WORKPLACE

Why diversity?

Embracing diversity and inclusion within companies is important to any business agenda, as it promotes stronger thinking and enhances decision-making at all levels within a company. This can help improve long-term performance.

We believe boards are at their best when there is diversity of culture, thinking and perspective, which can be drawn from a range of gender, sexual orientation, disability, ethnic and religious backgrounds.

Having a broad range of collective attributes, rather than overlapping or redundant qualities, significantly helps a board to fulfill its responsibilities of providing good corporate governance and strategic oversight. This structure can then be implemented into the entire business model and translated throughout the wider workforce.

We believe that harnessing all available talent could ultimately improve performance and lower risk for companies and investors. There is a growing body of research supporting the economic and business case for gender-balanced organizations.[6]

Being accountable

Diversity can be measured in several ways, but gender diversity is the metric that is most reliably reported and measured by companies.

We recognize that some companies and sectors face more challenges than others in attracting a diverse pool of employees. Looking at diversity at different levels within a company can help capture a pipeline of talent.

The type of analysis that can be promoted when reviewing diversity might be:

- Percentage of women and men on the board
- Percentage of women and men at management level
- Percentage of women and men at executive level
- Percentage of women in the wider workforce

We expect companies to break down their gender diversity disclosures and make them transparent from the outset.

DIVERSITY CASE STUDY: COMPANY X

WHY DID WE ENGAGE? Company X is a global leader in consulting, digital transformation, technology and engineering services. We wanted to understand how the company was attracting a diverse pool of candidates within its sector, and especially how it was marketing the technology and engineering industry to prospective female candidates. We also wanted to see what measures were being taken to diversify the board proportionately with the relevant skill sets and gender balance.

HOW DID WE ENGAGE? We held two engagement meetings with the company.

In the first meeting, to discuss board diversity and the evolution of the board, our technology analyst recommended more recent digital expertise should be brought into the group, as well as further female representation.

[6] https://hbr.org/2019/02/research-when-gender-diversity-makes-firms-more-productive and https://www.mckinsey.com/featured-insights/diversity-and-inclusion/women-in-the-workplace

In the second meeting, to discuss broader human capital management and diversity, we heard updates on measures to ensure the company retains female employees. We were also told about the introduction of employee satisfaction surveys and flexible working opportunities in some of the markets in which it operates. We stressed the importance of these measures. We heard that the company is placing a higher focus on diversity through specific initiatives to bring more women into management and the workforce. We have requested the company to provide evidence of this in future discussions.

OUTCOME Following our continued engagement, the company has introduced several initiatives to improve human capital management, as well as enhanced its disclosures. It has a talent pipeline strategy program, which focuses on graduate training programs, new hires, hiring needs and continued employee training programs.

It has been recognized by the *Financial Times* as one of the Top 50 Employers for Women for the fourth year in a row.

The company has 40% female representation on its board and in May 2020 announced a female Spanish national would join, bringing digital and data strategy experience.

This year, the company has decided to separate the chairman/CEO role after the 2020 annual general meeting (AGM). In light of this progress, we elected to vote in favor of management propositions at its 2020 AGM, and we will continue to engage with it on ESG issues.

PRIORITY IV – Stakeholder engagement

Generating long-term sustainable returns requires managing the interests of stakeholders.

THEME IN FOCUS: CYBERSECURITY

Cybersecurity is one of the top 10 risks to the global economy over the next decade, according to the World Economic Forum's Global Risks Report [7]. As the incidence of cyberattacks and the costs of security failures increase, we want to be alert and stay ahead when assessing portfolio exposure to them.

We are concerned by poor corporate disclosure in this area. Over the long term, a company's leadership needs to consider the broader network of relationships in which it operates, such as suppliers, customers and surrounding communities. In addition to direct impacts of business disruptions and fines for breaches, there are associated impacts to reputation as well as future business as cybersecurity is increasingly used as a criterion in vendor selection.

We believe boards should be accountable for key enterprise risks, such as cyber and data security issues, and should have clear oversight of technology, data security and privacy policies.

The number of cyberattacks continues to rise – as do the resulting losses. In particular, targeted cyberattacks have increased. While phishing and malware via email remain the most common types of attack, ransomware that targets user devices and cloud-based services can threaten infrastructure, also resulting in significant losses.

We have created a framework to identify key trends relating to cyberrisk reporting, and where we engage with companies we stress the importance of the following:

- Have oversight of cyberrisk strategy at a board level
- Ensure cyber resilience is integrated into corporate strategy
- Ensure that key personnel are accountable for cyberrisk strategy
- Disclose budgets and spending on cybersecurity
- Establish a framework for analyzing cyberrisk strategy
- Have a clear audit process for cyberrisk strategy
- Provide training to the board and wider workforce on cybersecurity and cyberrisk strategy

[7] Source: World Economic Forum, Global Risks Report 2020, http://www3.weforum.org/docs/WEF_Global_Risk_Report_2020.pdf

It is only prudent that companies take measures to secure against a possible threat, yet it is a challenge given the increasing sophistication of attacks. Companies should also consider physical aspects of cyberrisk, ensuring they have enough security on site to avoid the theft of data sources.

We are keen to develop a better understanding of the scope of these risks and the potential impact on portfolio companies. We recognize that existing cybersecurity regulations cover different aspects of business operations. Additionally, rules relating to data privacy can vary among countries and regions, posing additional challenges for compliance.

In this context, governance of cyberrisks can be a proxy for the strength of resilience to these risks within a company. It is important to obtain disclosure around governance of cyberrisk to demonstrate that regulations are being followed. It also helps ensure companies have the appropriate policies, controls, frameworks, levels of accountability and strength of oversight to validate their cybersecurity procedures.

Over 2020, we met with a broad range of companies to discuss their approach to wider stakeholder engagement as well as cybersecurity and data privacy issues.

Case studies and outcomes

We engaged with four focus companies to learn about their security programs and compared them on six key metrics.

	FOCUS COMPANY			
GOVERNANCE AND OVERSIGHT	COMPANY A	COMPANY B	COMPANY C	COMPANY D
Does the company have a cyber budget?	✓	✗	✗	✓
Does the company have an internal/external framework that it follows on cyberrisk analysis?	✓	✓	✓	✗
Does the company have a CIO or equivalent to take accountability of cybersecurity?	✓	✗	✓	✓
Does the company have board training on cybersecurity?	✓	✗	✓	✓
Does the company have employee training on cybersecurity?	✓	✓	✓	✓
Does the company have an audit process on the cyberrisk framework?	✓	✗	✓	✓

COMPANY A

WHAT DID WE FIND OUT? We engaged with an Italian bank and established that it uses NIST, a U.S. external framework, to assess its cybersecurity maturity. It also reports cyberrisk to senior management using key performance indicators. However, it was not transparent regarding the key personnel responsible for cybersecurity strategy, or whether there was an audit process.

Following a second engagement, the company has confirmed it has an internal and external audit process on cybersecurity risk. It also has appointed a chief security officer, who is accountable to the board for execution of its cyber strategy. The board of directors has two members with cybersecurity expertise.

In response to our specific questions the company said it provides ongoing training to its cyber experts so they may develop in their roles to meet the ever-changing nature of cybersecurity risk. The company confirmed that in 2020 it had allocated 5% of its total security budget to cybersecurity, which is in line with other European banks. The company is also working on its talent pipeline by recruiting directly from universities.

NEXT STEPS We will continue engaging to understand internal accountability.

COMPANY B

WHAT DID WE FIND OUT? We engaged with Company B, a Spanish bank, and established it has a cybersecurity incident response team. It collaborates with external entities, including government security agencies and different security providers. All employees receive training on cybersecurity. However, it was unclear who was responsible for the strategy in this area and what the company's cybersecurity budget was. In addition, the board had not received specific training on the management of cyberrisks.

NEXT STEPS We will continue engaging to understand internal accountability, board training on cyberrisk and whether the bank has an audit process for its cyberrisk strategy.

COMPANY C

WHAT DID WE FIND OUT? We engaged with a UK insurer, which together with its subsidiaries provides personal and commercial general insurance products in various countries. We found out that the company is a member of the Information Security Forum and has group policies and guidelines based on its Standard of Good Practice. These policies aim to ensure a consistent expectation of the cyber controls in place across the regions in which the company operates. The chief information security officer is responsible for the cybersecurity strategy and communicating to management.

Company C also provides annual privacy refresher training and regular updates to all employees.

There is appropriate training on cyber and data security for all employees and the board. Occasionally, it carries out spot checks to ensure compliance with policy and procedures. Lastly, key controls are in place for an annual external audit, and the independent risk function conducts real-time and periodic assurance. The internal audit department's information security is in line with the company's audit plan.

NEXT STEPS We will continue to engage with Company C to understand its cybersecurity budget.

COMPANY D

WHAT DID WE FIND OUT? We engaged with a hotel services provider that was one of the first companies to disclose its cybersecurity budget. This accounts for around 5% of its total IT spend. However, the company confirmed that, due to the impact of COVID-19, this budget would not be spent in full during 2020. We were pleased to hear the company was preserving its capital expenditure.

The company also confirmed it will provide more disclosure on its training programs for data sharing. We were told the executive board receives training on cyber, data security and phishing, in addition to monthly reports about IT risks in the group. The executive board also has personal direct access to IT teams when members are not sure about the quality of an email. This company participates in a cybersecurity conference every year and has access to the online training platform and one-off on-site training. It also has a cyber surveillance program, which is managed by an external provider.

In our view, the company lags its peers because it has yet to consider external assessment frameworks. However, it does adhere to a four-tier internal process. The chief information security officer is responsible for setting the company's cybersecurity strategy.

NEXT STEPS We will continue to engage with Company D and follow its journey of adopting new policies and setting a cyber strategy by the newly appointed chief information security officer.

KEY CONCLUSIONS

- Companies must continue to invest in technology, as cyberrisks will evolve to create a burden for all business sectors.
- Boards are still exploring processes to enhance their business models and protect them from cyberrisks. Privacy-enhancing technologies are emerging as a crucial method of overcoming the challenge of information security.
- Cybersecurity is complex, and public disclosure is intentionally lacking in detail, as it could compromise the program itself. However, this should not stop companies from having clear frameworks, budgets, and accountability.
- Companies should assume that a cyber breach will happen. Therefore, the presence of a robust cyber incidence response plan, including the role of the board in providing oversight of the response, is paramount.

PRIORITY V - Climate risk

Climate change is a global challenge that investors cannot afford to ignore.

THEME IN FOCUS: CLIMATE RISK DISCLOSURE

Every business is in a constant state of transition. This transition is usually rapid, often sector specific, with increasing visibility into shifting market preferences or the changing nature of competition. In our role as asset managers, this visibility can provide us with the information and evidence we need to take appropriate oversight of any associated risks that may occur within the investment horizon.

Climate change, however, is a unique transition that has been unfolding over decades and impacts multiple sectors and industries in a complex way. This transition has been urged by changing public awareness and customer preferences, and is now demanded, in some jurisdictions, by a broad regulatory response. It has also been shaped by new energy sources and technologies, leading to a wide range of possible paths and outcomes.

This unique and ongoing transition therefore has the potential to significantly impact individual securities, industries and even the global economy. As long-term investors, we understand it will continue to influence company strategies well beyond the tenures of their current managements and boards. Thus, creating a framework to encourage and facilitate long-term reporting is vital.

SPOTLIGHT ON THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURE

In 2015, the Financial Stability Board created the Task Force on Climate-related Financial Disclosures (TCFD) to increase and improve company reporting of the issue, by adapting the board's existing processes. Under this framework, the task force made a range of recommendations around how and what each organization should report. These were:

- Reporting the organization's governance around climate-related risks and opportunities
- Reporting the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy and financial planning
- Reporting the processes used by the organization to identify, assess and manage climate-related risks
- Reporting the metrics and targets used to assess and manage relevant climate-related risks and opportunities

The task force said its recommendations would help create a foundation for immediate adoption and were flexible enough to accommodate evolving practices and promote board and senior management engagement on climate-related issues. The framework would also bring the future nature of issues into the present through scenario analysis. The recommendations also support understanding of the financial sector's exposure to climate-related risks and solicit decision-useful, forward-looking information on financial impacts.

How we use the Task Force on Climate-related Financial Disclosures recommendations

As users of fundamental research, we recognize that climate transition risk cannot be easily distilled into simplistic metrics. How a company responds to climate risk will depend on the industry in which it competes, as well as the countries and regulatory frameworks within which it operates. The range of strategic response, and therefore the right metrics and targets, would be determined by a company's natural advantages relative to peers and the core competencies it may have or develop to manage the transition.

Therefore, we do not prescribe what metrics or targets should be chosen to generate the best risk-adjusted returns. However, we do expect companies to be able to articulate how they will manage the transition risk and demonstrate the competencies needed to execute that transition plan. Similarly, we believe targets should be set for a reasonable time horizon that drives accountability and transparency.

The task force's recommendation to conduct scenario analysis to test resilience of strategy is particularly useful for our fundamental research. It involves using a set of scenarios that covers a reasonable variety of future outcomes that are both favorable and unfavorable. The framework recommends organizations use a 2° Celsius or lower scenario in addition to two or three others that are the most relevant or challenging.

However, in its 2020 status report,[8] the task force noted only one in 15 companies disclosed information on the resilience of its strategy.

Recommendation	Recommended disclosure	% Change 2017–19	Percent of companies that disclose information aligned with TCFD recommended disclosures		
			2017	2018	2019
Governance	a) Board oversight	8	16%	21%	24%
	b) Management's role	8	20%	24%	28%
Strategy	a) Risk and opportunities	1	40%	42%	41%
	b) Impact on organization	6	29%	32%	35%
	c) Resilience of strategy	3	4%	5%	7%
Risk management	a) Risk ID and assessment processes	11	14%	19%	25%
	b) Risk management processes	9	15%	21%	25%
	c) Integration into overall risk management	9	8%	11%	17%
Metrics and targets	a) Climate-related metrics	6	29%	32%	35%
	b) Scope 1, 2, 3 GHG emissions	5	22%	24%	26%
	c) Climate-related targets	6	27%	30%	33%

[8] https://www.fsb.org/2020/10/2020-status-report-task-force-on-climate-related-financial-disclosures/

Even if we manage to limit temperatures rising just 2° Celsius above pre-industrial levels – the so-called 2-degree scenario – the future is difficult to predict. The purpose of our engagement has therefore been multi-faceted. We have aimed to assess the soundness of a company's governance of these myriad risks, uncover the rigor of its processes to monitor and identify them, and gauge the candor with which the company approaches this uncertain future.

Over the past year, we engaged with companies across a wide range of industries and sectors on these crucial climate-related issues, using the framework outlined above.

However, for this report, we decided to highlight our engagement with several companies that have capital-intensive, long-life assets in the hydrocarbon sector to illustrate the difference in scenario analysis and how companies can improve their disclosure.

Each of these companies had recently completed and published TCFD-aligned reports, which provided a base for our engagement. Across a wide spectrum of companies, we found significant disparity in the approach each took to climate change, associated transition and physical risks, and how they might impact business and strategy.

Case studies and outcomes

CASE STUDY 12

WHY DID WE ENGAGE? As a long-term investor in the company, which produces and trades liquefied natural gas, we wanted to understand how the organization would manage risks related to its long-life assets under a 2-degree scenario.

HOW DID WE ENGAGE? We engaged with the company on its first report aligned with the TCFD framework to learn about its implementation process. This also provided us with the opportunity to give feedback and suggest additional disclosures that could make the report more useful.

OUTCOME The company has addressed all the task force's requirements. It has also attempted to focus on the resilience of its strategy under the International Energy Agency's (IEA's) Sustainable Development Scenario, which expects demand for liquefied natural gas to grow almost 80% by 2040 over 2018 levels. We believe the company is demonstrating proper oversight of supply chain risk by requiring suppliers to commit to a reduction in methane emission – a key risk illustrated on page 33.

NEXT STEPS While we recognize this resilience, we still advocate the company use a scenario pathway that is less conducive to demand, assess the vulnerabilities in its investment plan and develop strategies to mitigate them.

We noted that the company does not provide the metrics it uses to assess the resiliency of its assets, nor does it provide any benchmarking data to assist investors. We have also encouraged it to discuss how scenario analysis feeds into capital allocation decisions.

CASE STUDY 13

WHY DID WE ENGAGE? This petrochemical refining company is sensitive to changes in consumer and regulatory activity around climate change and therefore faces a range of associated long-term risks.

In 2019, the company published a sustainability report; in 2020, it added a section dedicated to the task force's disclosure framework in its publication. The company provided a full response to some elements required by the task force, especially around governance and the resilience of assets to adverse climate events. It also provided some information on how it is mitigating risks to its strategy by increasing its exposure to biofuels.

However, its resilience analysis lacks any discussion of how it may be impacted under the IEA's Sustainable Development Scenario.

HOW DID WE ENGAGE? We noted to management that the company provides only a description of what oil demand would look like under the above scenario. It does not discuss the impact this would have on its business or how it would take that risk into account in strategic capital allocation decisions.

OUTCOME We encouraged the company to conduct this analysis and provide a discussion in its next report.

CASE STUDY 14

WHY DID WE ENGAGE? This refining, transportation and U.S.-based vending company operates in a sector that is already being impacted by regulatory pressure to act on climate change.

HOW DID WE ENGAGE? Since the company published its first stand-alone TCFD-aligned report, we have been engaging with it on climate-related issues as a long-term investor.

OUTCOME We found the company has made remarkable progress since the first report, especially the detailed work it has produced on the IEA's Sustainable Development Scenario, its impact on the global refining market and its resilience relative to its peers. We found this to be one of the more comprehensive discussions on resilience.

Yet we concluded a more detailed discussion on the impact on the company's business, such as on the crude supply chain and refinery closures, and the impact on enterprise value, may require disclosing competitive information, which could be problematic. We also note that while the company does not explicitly use a carbon price or discuss the absolute impact it may have on enterprise value, it effectively incorporates it in capital allocation projects by using higher hurdle rates for carbon-intensive projects.

The company has established a business-wide goal to reduce its greenhouse gas emissions per barrel of oil equivalent processed to 30% below 2014 levels by 2030. It has also linked this to its executive compensation program and certain employee programs. The company was able to link the choice of metric as well as the target level with the narrative provided in its TCFD report. It has also provided some discussion on how those targets will be achieved by expanding its energy efficiency program, reducing methane emissions and increasing the use of renewable energy.

KEY CONCLUSIONS

Based on our findings and engagement with these companies and others as a long-term investor, we make the following recommendations:

- For industries that have direct and significant exposure to climate risk, it may be advisable to have a stand-alone report that is aligned with the framework set out by the task force. This would encourage more detailed and complete reporting by companies, allowing investors to assess how they are responding to investor inputs, along with regulatory and technology developments and other important factors.
- A complete scenario analysis requires a company to assess how resilient its strategy might be to the large number of possible pathways that may be taken as the world responds to climate change. This remains one of the weakest areas of reporting for most companies. In particular, when we engage on specific climate risk-related reporting, we expect management teams to explain how the company's strategy would evolve if transition pathways proved to be more challenging than base case expectations.
- We believe it is important for a company to discuss its choice of metrics as well as targets when creating a framework for climate risk oversight. The issue of target setting is complex, and metrics will depend on multiple factors that relate to the specific sector in which the company operates. Likewise, targets could be absolute or relative, depending on the industry and the company's starting point.
- We advise active investors to conduct their own fundamental analysis to become comfortable with the assertions of climate disclosure reports that aim to adhere to the guidance and framework set out by the TCFD. Long-term analysis presented in these disclosures is inherently challenging, and any reporting can be biased by management's optimism or constrained by its need to protect competitive and confidential information.

INVESTOR-LED ENGAGEMENT

J.P. Morgan Asset Management research analysts play a pivotal role, not only in conducting the proprietary research and due diligence that support our investment but also in driving our stewardship effort. The increasing flaring of methane in the prolific Permian basin poses a serious environmental risk to the investment thesis in such companies. Our oil and gas investors have been actively engaging with companies, industry experts and other organizations to understand operating practices and advocate for better management of this issue.

Below is a foreword, written by our oil and gas analysts for recently published industry-leading research prepared by GaffneyCline for the Environmental Defense Fund, that demonstrates these efforts.

Tackling flaring: Learning from leading Permian operators

At J.P. Morgan Asset Management, creating value for our clients is central to everything we do. As fiduciaries, sustainability factors, including those related to environmental, social and governance practices are an important component of our investment decision-making process.

The oil and gas sector produces social, environmental and economic costs that must be evaluated and measured. Decarbonizing the global economy is a priority but will take time.

There are a variety of technologies and operational practices that can be applied today at reasonable cost to significantly reduce the environmental and social costs of extraction. The Permian basin represents an opportunity for substantial emissions reductions with the potential to deliver one of the oil and gas industry's smallest comparative environmental footprints.

Carbon dioxide combustion of flaring and methane from unlit and partially burning flares contribute unnecessarily to greenhouse gas emissions without economic benefit. Societal and economic costs manifest themselves in foregone revenue streams to federal and state governments and private mineral owners because gas been not been captured and sold. Operators must preserve their social and regulatory license to operate.

Flaring is a problem with multiple solutions and a compelling long-term economic proposition. Several industry participants – including those profiled in this report - have begun to differentiate operating practices, delivering substantial emissions reductions. Some have delivered flaring intensity as low as 1% (versus others greater than 20%) because of more deliberate planning and the adoption of widely available technologies and equipment.

Voluntary operator actions to reduce routine flaring, while necessary, have proven insufficient to deliver on the industry's full potential. Government and policymakers are well-positioned to ensure successful achievement of zero routine flaring. J.P. Morgan Asset Management supports policymakers developing regulations to achieve the objective of zero routine flaring by 2025. With related policies, regulations and enforcement mechanisms, zero routine flaring by 2025 represents an important and achievable goal.

Our ongoing engagement with operators emphasizes the importance of establishing suitable objectives to reduce their environmental footprint through deliberate, practical business plans supported by enhanced emissions transparency — and we will hold companies accountable. The changing climate needs to be placed high on every corporate agenda, as it poses both wide-ranging risks and opportunities that could impact company operations and investment valuations.

ESG-aligned transportation investing

As environmental considerations become increasingly prevalent in the way businesses operate, it is only natural that many corporations, investors, financiers and end users have become more proactive, too.

In the transport industry, a number of positive strides have been taken to become more environmentally sustainable, presenting investors with an opportunity to create return rather than simply manage risk.

The past 20 years have seen shipping volumes more than double. However, as a result of fuel-saving technological developments, emissions have increased by just 40% during the same time period.[9] Today, ships produce only 2%–3% of total global CO2 emissions, even though over 90% of global trade is carried by sea.[10]

Regulation has played a key role – the International Maritime Organization (IMO), for example, is committed to reduce overall shipping emissions by 50% by 2050.[11] The International Civil Aviation Organization has implemented a performance standard that will mandate reductions in CO2 intensity in new aircraft beginning in 2028.[12]

Change is also being propelled by a shifting global energy mix. Fossil fuels have for a long time dominated the global energy landscape, with oil and coal supporting global power production during the 20th century.

Today, however, the growing political alignment around the reduction of greenhouse gas, combined with advances in technology and price declines, have helped speed up the move to alternative and renewable sources.

Capital markets, too, have played a role in reinforcing the need for change. Banks, asset owners and managers are becoming increasingly focused on reducing carbon emissions and promoting sustainability.

9 https://www.shell.com/energy-and-innovation/the-energy-future/greenhouse-gas-emissions-in-shipping.html
10 https://www.oecd.org/ocean/topics/ocean-shipping/
11 https://www.imo.org/en/MediaCentre/PressBriefings/%20Pages/06GHGinitialstrategy.asp
12 https://www.icao.int/newsroom/pages/icao-council-adopts-new-co2- emissions-standard-for-aircraft.aspx

The Poseidon Principles are a prime example. This global framework for responsible ship finance is aligned with the IMO's policies and ambitions. It has been adopted by 18 financial institutions that represent shipping lenders with a combined loan book of USD150 billion – more than one third of the global ship finance portfolio.[13]

Stakeholders are also demanding more from corporations on their ESG policies and strategies, driving players in the transportation industry to improve their ESG profiles and do more to mitigate the impacts of climate change. As a result, corporations have an increasingly strong preference to lease highly efficient assets from owners that demonstrate strong ESG track records.

As this continues to gain momentum across industries, profitability and growth prospects will undoubtedly become inextricably linked to sustainable operations. For investors, choosing to partner with ESG-aligned transportation players will provide attractive opportunities to achieve both their financial and their sustainability goals.

[13] https://www.poseidonprinciples.org/wp-content/uploads/2020/06/Poseidon-Principles-Reporting- Requirements_editable.pdf

Summary of voting activity

J.P. Morgan Asset Management voted on more than 83,400[14] proposals for the period under review and opposed management (either voting against or abstaining) approximately 10% of the time.

JPMAM voted with management on more than 75,800 proposals and voted against management on more than 7,300 proposals. An analysis of our voting activity shows the most common reasons for voting against include directors not meeting our independence criteria, executive compensation plans that are either poorly aligned or inadequately disclosed, and capital issuances that are either overly dilutive or not justified to shareholders. We also supported more than 1,200 shareholder proposals, including those related to social and environmental issues, such as climate risk, gender pay gaps and human rights. We abstained or withheld votes on more than 1,700 proposals.

Significant votes

JPMAM votes at nearly 8,000 shareholder meetings in more than 80 markets worldwide. Many of these relate to routine business at companies where we have not identified any material corporate governance concerns.

We define "significant" votes as those where we are a major shareholder in our portfolios, where the vote is likely to be close or contentious, or where there may be potential material consequences for our clients. We would also include certain categories of shareholder proposals and votes in relation to companies or issues identified on our focus list for engagement as potentially significant votes.

We have included examples of such votes below.

Voting examples

VOTING EXAMPLE 1

JPMAM supported a shareholder proposal at a major food processing company that called for a report on the deforestation impacts in its supply chain. In recent years, the company has expanded its operations in international markets, including Brazil, China and Southeast Asia. These markets have supply chain exposure to deforestation-related risks that are linked to the rearing of cattle and the production of soy. As predominant feedstock for poultry and livestock, the lack of oversight over these suppliers' practices could disrupt the sourcing of inputs and therefore the company's ability to operate profitably.

The company committed to develop and implement a no-deforestation policy and improve its reporting on the traceability and sustainability of forest-risk commodities in its global supply chain.

[14] All figures rounded to the nearest hundred – see voting section.

VOTING EXAMPLE 2

A major bank was targeted with a shareholder proposal related to fossil fuel lending in the context of the energy transition.

After a long-running engagement with the company was unsuccessful, shareholders were faced with two climate-related proposals at its AGM.

One of the resolutions was proposed by management in response to the shareholder resolution and called for the company to become a "net zero" emissions bank by 2050. It also called for the bank to give regular updates to shareholders on its progress.

The shareholder resolution called for the company to set and disclose targets to phase out financing to the energy sector completely and to report on progress from 2021. The proponents argued the company was far from being aligned with the Paris Agreement. The bank argued the shareholder resolution was too prescriptive and binding.

We noted the company's commitment to make progress in the management resolution. The proposal offered a strategy transitioning of its provision of financial services to align with the Paris Agreement.

Conversely, the shareholder proposal had not made any concessions. It was too prescriptive, as it required a phaseout. We also noted the shareholder resolution was expressed as binding on the company. We elected to vote for the management resolution and voted to abstain on the shareholder resolution.

VOTING EXAMPLE 3

During the June 2020 proxy voting season, a Japanese financial institution received a shareholder proposal related to climate change. It called upon the company to amend its articles to provide metrics and targets in its annual disclosures that aligned with the goals of the Paris Agreement.

While the company expressed support for the TCFD (see page 28), by early April detailed disclosures on scenario analysis were still not available. We also believed the company lagged the other megabanks in Japan in its climate reporting.

Subsequently, the company released its first TCFD report in April, providing disclosure on transition risk and scenario analysis following the appropriate recommendations. We found the disclosures provided meaningful content and enabled us to understand the company's transition plan.

Therefore, we decided the preferred approach would be to continue the dialogue with the company on issues such as broadening the scope of its analysis to encompass additional sectors and geographies. As a result, we decided to vote against the shareholder proposal.

VOTING EXAMPLE 4

JPMAM voted in favor of a shareholder resolution requiring a social media platform to adopt a policy that the chair of the board be an independent director. Given the structure of the board and significant controversies and regulatory issues facing the company, we believe shareholders would benefit from more oversight.

VOTING EXAMPLE 5

JPMAM voted in favor of a shareholder proposal at a health care company asking for a report on board diversity. There had been no women on the board for several years, and we could not identify any mitigating factors for the lack of diversity. We also expressed our dissatisfaction with the lack of diversity by voting against the members of the nominating and governance committee, who were up for reelection.

VOTING EXAMPLE 6

In 2020, JPMAM voted for the remuneration report at a large, UK-listed bank after the chair of the remuneration committee confirmed in an engagement meeting that the pension allowance for the CEO and CFO would be reduced and aligned with the wider workforce starting on January 1, 2020. In 2019, we had opposed the binding remuneration policy vote, due to the remuneration committee's refusal to incorporate our feedback over concerns around executive pension arrangements.

VOTING EXAMPLE 7

JPMAM voted against management compensation in the 2020 annual shareholder meeting at a petroleum company. This followed our vote against several board members in the 2019 shareholder meeting to reflect our disapproval of an acquisition.

After the transaction had introduced significant financial and operational risk to the company, JPMAM disagreed with the board's decision to modify the annual incentive award into two periods and reward management for deleveraging the balance sheet, which had been overextended following the costly financing of the deal. Moreover, in our view, it was unlikely that the ill effects of a long-term strategic capital misallocation decision would be undone by asset sales, especially given the uncertainties around closure.

VOTING EXAMPLE 8

JPMAM voted against the board chair and three other directors at this Korean financial services company due to concerns over corporate governance. In October 2018, the chairman was indicted on charges of recruitment malpractice at the company's subsidiary. The chairman was found guilty of recruitment malpractices and handed a suspended prison term. This led us to vote against not only the chairman but also all the members of the board's corporate governance and CEO recommendation committee.

VOTING EXAMPLE 9

This German company lost its board discharge vote, driven by shareholder concerns over the integration of an acquisition. German boards are required to seek shareholder approval each year to discharge them from liability for the decisions they have made in the previous year. The company was also flagged for multiple ESG issues. While the board discharge vote is largely a formality, it is symbolic and attracts a high degree of attention in Germany. JPMAM was one of the shareholders to oppose the board discharge in 2019, although we did agree to support it in 2020, following engagement with the company and progress on some of the issues raised.

VOTING EXAMPLE 10

JPMAM voted against the reelection of directors at a company in both 2019 and 2020. This was due to material concerns around the potential breach of fiduciary duties by directors and executives in the context of a significant event to hit one of the company's operations.

The company's auditors project that the eventual liabilities may be higher than projected by management. We were also disappointed that the two new members appointed to the company's board were former employees, raising questions around their independence. The move was contrary to our expectations and raised additional concerns as the company stated it was seeking to change its corporate culture.

VOTING EXAMPLE 11

JPMAM voted in favor of shareholder proposals at two petrochemical companies asking for reports on risks related to Gulf Coast investments by their joint venture. While each company had produced a TCFD-aligned report, they did not discuss the asset risk they faced. JPMAM believed these risks to be potentially significant, given the increasing severity of storms hitting the U.S. Gulf Coast. The proposal received 53% and 47% support, respectively, at each company.

In late 2020, the joint venture released a supplemental white paper focused on physical risks from storms, and its governance/oversight of those issues.

VOTING EXAMPLE 12

JPMAM voted in favor of a shareholder resolution at a waste management company requesting the company amend its compensation clawback policy to include disclosure of recoveries from senior executives. Executive misconduct has been one of the most significant factors in unexpected departures at U.S. companies, often without clawback. We believe recoupment policies are a powerful signal to employees and encourage strong risk oversight and compliance with a code of conduct. The company had multiple incidences of fines and settlement related to its business practices, prompting our concerns.

VOTING EXAMPLE 13

JPMAM supported shareholder proposals at two companies that requested each publish an annual report assessing its diversity and inclusion efforts. The proposals demanded they publish the process the board followed for assessing the effectiveness of its diversity and inclusion process, along with any goals, metrics and trends related to promotion, recruitment and retention.

While the companies acknowledged the significance of employee diversity on corporate performance, neither provided meaningful disclosures on employee gender, racial or ethnic diversity across data by job or management categories.

VOTING EXAMPLE 14

JPMAM voted against a shareholder proposal at an auto parts company that requested the company report on its targets and performance on material human capital risks in line with SASB guidelines on workforce diversity, inclusion and labor practice requirements.

We believe the voluntary public disclosure of competitive information requested by the proponents, such as average hourly wage and percentage of in-store employees earning the minimum wage, along with the voluntary and involuntary turnover rates for in-store employees, could put the firm at a disadvantage against peers that do not disclose such information.

For further information, please contact your Client Advisor (CA) or the investment stewardship team.

Voting examples

Table 1: Stewardship voting summary

	GLOBAL	%	EMEA	%	U.S.	%	JAPAN	%	ASIA EX-JAPAN	%
Number of meetings*	8,517	-	5,674	-	3,356	-	2,194	-	2,239	-
Number of meetings (voted)*	8,158	95.78	5,549	97.80	3,350	99.82	1,942	88.51	1,523	68.02
Number of proposals*	86,984	-	63,875	-	30,113	-	23,680	-	21,612	-
Number of proposals (voted)*	83,411	95.89	62,455	97.78	29,898	99.29	20,290	85.68	14,147	65.46
Number of shareholder proposals voted for*	830	43.85	681	46.39	234	33.24	170	29.16	138	23.12
Votes with management*	75,890	87.25	56,717	88.79	28,017	93.04	18,426	77.81	12,469	57.69
Votes against management*	7,312	8.41	4,937	7.73	2,271	7.54	1,884	7.96	1,678	7.76
Abstain and withhold	1,770	2.03	857	1.34	972	3.23	297	1.25	176	0.81

Source: J.P. Morgan Asset Management; data as of December 31, 2020.

* Please note some inconsistencies within the methodology, as regional totals may not sum to global totals due to some meetings being included in multiple regions. Similarly, vote categorizations within a region may not sum to the total number of votes due to individual proposals being voted in different ways by different funds, in some cases.

Table 2: Management and shareholder proposals

MANAGEMENT PROPOSALS	DIRECTOR RELATED	CAPITALIZATION	COMPENSATION	MERGERS/ACQUISITIONS
Total number of proposals voted	44,818	7,354	8,847	2,258
Votes against management	3,356	784	1,457	276
Votes against management %	7.49%	10.66%	16.47%	12.22%

SHAREHOLDER PROPOSALS	ENVIRONMENT	SOCIAL	GOVERNANCE
Total number of proposals voted	117	65	1,121
Shareholder proposal voted for	30	12	629
Shareholder proposal voted for %	25.64%	18.46%	56.11%

Source: Third party proxy service provider; data as of December 31, 2020. Details provided upon request.

Defined terms – as defined by a third-party proxy service provider

DIRECTOR RELATED Includes manager proposals defined as director related

CAPITALIZATION Includes manager proposals defined as capitalization

COMPENSATION Includes manager proposals defined as non-salary compensation

MERGERS/ACQUISITIONS Includes manager proposals defined as reorganizations and acquisitions

ENVIRONMENT Includes shareholder proposals defined as health and or environment

SOCIAL Includes shareholder proposals defined as social and society and/or human rights

GOVERNANCE Includes shareholder proposals defined as director related, corporate governance and compensation

Glossary

Voting and proposal terminology

VOTING

CAPITALIZATION Generally involves shareholder authorization for transactions related to raising capital, such as stock issuances, private placements and conversions of securities.

COMPENSATION AND REMUNERATION-RELATED PROPOSALS Generally involves shareholder approval of compensation arrangements for executive officers.

ELECTION OF DIRECTORS AND RELATED PROPOSALS A broad category that includes the election of directors and governance issues such as board declassification and implementation of majority voting, among others.

MERGERS, ACQUISITIONS AND REORGANIZATIONS Involves significant transactions requiring shareholder approval, including spin-offs and asset sales, as well as changes to company jurisdiction or structure.

SHAREHOLDER PROPOSAL - ENVIRONMENTAL Includes reports on climate risk and environmental impacts, policies and proposals asking for companies to reduce environmental impacts.

SHAREHOLDER PROPOSAL - GOVERNANCE Generally involves key corporate governance matters affecting shareholder rights and charter/bylaw amendments, such as requiring an independent chairman, as well as proposals on compensation, political spending and lobbying policies.

SHAREHOLDER PROPOSAL - SOCIAL Generally involves a range of social issues related to human capital issues, such as diversity and inclusion (reports on pay disparity, requests for enhanced anti-bias policies, reports on workforce representation) and human rights.

ENGAGEMENT

CLIMATE ACTION 100+ An investor-led initiative to encourage better climate disclosures and emission reduction strategies for a group of large greenhouse gas-emitting companies.

SUSTAINABILITY ACCOUNTING STANDARDS BOARD (SASB) A nonprofit organization with a mission to develop sustainability-related accounting standards.

TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD) Provides a framework through which companies can improve and increase the reporting of climate-related financial information.

UNITED NATIONS-SUPPORTED PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI) An official network of investors that works to promote sustainable investment through the incorporation of environmental, social and governance factors.

Priorities terminology

STRATEGY ALIGNMENT WITH THE LONG TERM

ANNUAL INCENTIVE COMPENSATION Compensation, typically in the form of cash, awarded to executives based on company performance in specific quantitative metrics and/or qualitative assessments over a one-year period.

CLAWBACK POLICY A contractual provision by which compensation already paid to an employee must be returned to the company under circumstances such as misconduct or scandal.

LONG-TERM INCENTIVE COMPENSATION Compensation, typically in the form of company stock although sometimes in cash, awarded to executives based on continued employment and/or company performance according to specific quantitative metrics over a time frame that is typically longer than one year.

PERFORMANCE SHARE UNITS Stock awards given to executives where the number of shares varies based on the company's achievement of goals, including financial metrics or total shareholder returns.

STOCK OPTIONS The right, but not the obligation, to buy a stock at a designated price over a designated period.

CYBERSECURITY

CYBERSECURITY FRAMEWORK Standards, guidelines and best practices to manage cybersecurity risk.

INFORMATION SECURITY FORUM (ISF) An independent not-for-profit organization dedicated to investigating, clarifying and resolving key issues in information security and risk management.

NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY (NIST) A physical sciences laboratory and nonregulatory agency of the United States Department of Commerce intended to promote U.S. innovation and industrial competitiveness by advancing measurement science, standards and technology.

CLIMATE RISK

GAS FLARING The combustion and disposal of unwanted natural gas that is produced along with oil and/or to avoid releasing flammable gas by overpressured safety valves.

INTERNATIONAL ENERGY AGENCY (IEA) SUSTAINABLE DEVELOPMENT SCENARIO (SDS)
The outline of a potential transformation of the global energy system that would achieve universal access to energy while reducing air pollution and limiting the global temperature increase consistent with the Paris Agreement.

THE PARIS AGREEMENT An agreement within the United Nations Framework Convention on Climate Change stating a global goal to keep the increase in global temperatures relative to pre-industrial levels to well below 2° Celsius while pursuing efforts to limit the increase to 1.5° Celsius.

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Acknowledgement

The investment stewardship team is grateful to all of our partners throughout the J.P. Morgan Asset Management network whose input has been incorporated into the Annual Report 2020. Express acknowledgement to Global Insights' Allison Schneider; our copyeditor Elizabeth Pfeuti, and Global Creative Services' Mark Virgo and Jay Lonie for design.

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RISK SUMMARY

Certain client strategies invest on the basis of sustainability/Environmental Social Government (ESG) criteria involves qualitative and subjective analysis. There is no guarantee that the determinations made by the adviser will be successful and/or align with the beliefs or values of a particular investor. Unless specified by the client agreement or offering documents, specific assets/companies are not excluded from portfolios explicitly on the basis of ESG criteria nor is there and obligation to buy and sell securities based on those factors.

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