# Passive Fund Providers Take an Active Approach to Investment Stewardship

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## Executive Summary

As assets continue to flow from actively managed to index-tracking strategies, the largest index asset managers[1] are becoming increasingly influential, often ranking among the largest investors of public companies. Despite this fact, little research has been done to understand how index managers carry out their investment stewardship responsibilities.

It is legitimate to assume that devoting resources to monitor investee companies is not as high a priority for an index manager as it is for an active manager. After all, index managers tend to compete on fees, and their overriding objective is to match the performance of indexes. But, unlike active managers, index managers can't sell poorly run companies. They must either put up with poor governance or encourage positive change through voting and engagement. The former is not an option. These managers have a fiduciary duty to their investors to push for changes that will increase shareholder value. As large, permanent owners of a wide swath of public firms, they have the clout to advance their agendas. Being active owners is also a means for these managers to galvanize their reputation as investor advocates.

To better understand the stewardship activities of index managers, we surveyed the largest providers of index funds and exchange-traded funds—12 in total—across three regions, the U.S., Europe, and Asia. These include not only global asset managers such as BlackRock and Vanguard but also smaller firms that are key passive fund providers in their local markets, such as Schwab and Lyxor. Most of the surveyed firms also operate an active fund business that in some cases is much larger than their passive one. Collectively, the firms surveyed have over $20 trillion of assets under management.

In this paper, we share our findings and highlight what managers have in common and areas where they differ. We also provide a list of best practices that investors can use to assess how asset managers stack up.

### Key Findings

- The shift to index investing hasn't led to an abdication of stewardship responsibilities. On the contrary, index managers like BlackRock, Vanguard, and SSGA are increasingly taking an active role in the oversight of investee companies. That said, we observed a range of stewardship practices among index

1 Throughout the study, we use the term "index managers" to refer to asset managers who provide index-tracking investments, including traditional index funds, ETFs, and segregated mandates.

managers based on their scale, predominant investment style (passive or active), philosophy, region, and history.

- The data we have captured indicates that index managers are increasingly committed to using the tools at their disposal—proxy voting and engagement—to improve environmental, social, and governance activities of their holdings. This has coincided with increasing demands from investors for more focus on responsible investment and increased pressure from regulators to exercise strong corporate oversight.

- Nearly all the firms we surveyed apply the same principles to all their holdings irrespective of whether they are in active or passive portfolios. Consolidating all holdings for voting and engagement allows asset managers to leverage their full scale.

- All but one of the surveyed firms indicated they were stepping up engagement efforts, despite the associated costs, the difficult-to-quantify prospective benefits, and the fact that any fruits from these efforts are bound to be shared with competitors. Schwab was the only firm to indicate that it has no plans to carry out company-engagement activities.

- Index managers, especially in the U.S. and Japan, appear increasingly willing to voice concerns, and in some cases directly challenge corporate management, like European managers have tended to do for years, notably in areas such as board composition and climate risk.

- Investor scrutiny of stewardship practices is intensifying. While voting and engagement disclosure is improving, more can be done. Enhancing transparency and communication will improve public awareness and understanding of index managers' stewardship activities.

## Introduction

The rise of index investing has raised questions about the impact of index managers on corporate governance and how far they go to ensure that the companies they hold are acting in investors' best interests. It may be tempting to assume that index managers are passive owners and have little incentive to devote resources to monitoring companies; after all, they tend to compete on fees and their primary objective is to match the performance of indexes.

But, as this paper will show, the shift to index investing hasn't led to an abdication of stewardship responsibilities. The world's largest index managers have expanded their stewardship or corporate-governance teams and, based on the data we have collected, are increasingly committed to improving the ESG practices of their holdings through proxy voting and engagement.

This proactive approach to stewardship makes sense as, unlike active managers, index managers can't vote with their feet. Their funds must hold whatever stocks the underlying indexes and prudent portfolio management dictate, even stocks of poorly run companies. In that regard, they are the ultimate long-term investors. Many index managers are among the largest shareholders in the firms they own. This puts them in a strong position to drive change to benefit their shareholders, which — irrespective of their scale — is their fiduciary obligation.

There is also reputational and regulatory pressure for asset managers to provide strong corporate oversight. Vanguard, BlackRock, and SSGA, the world's largest index fund and ETF providers, have come under intense public scrutiny. These firms are now large common owners of competing companies in the same industries. This has spurred a myriad of concerns. Some academics have claimed that common ownership has resulted in consumer price inflation[2]. Others have alleged that it has inflated executive compensation[3]. Also, these asset managers' voting records are being dissected on topics as varied as board composition, gender diversity, and climate risk. At the same time, the adoption of stewardship codes in many countries is pushing for more active ownership across the board. Facing mounting pressure from a variety of stakeholders, asset managers have little choice but to increase their level of engagement with the companies they invest in and better demonstrate their commitment to driving change for the better to a diverse group of stakeholders around the globe.

2 Azar, José and Schmalz, Martin C. and Tecu, Isabel, Anti-Competitive Effects of Common Ownership (March 15, 2017). Journal of Finance, Forthcoming. Available at SSRN: https://ssrn.com/abstract=2427345 or http://dx.doi.org/10.2139/ssrn.2427345

3 Anton, Miguel and Ederer, Florian and Gine, Mireia and Schmalz, Martin C., Common Ownership, Competition, and Top Management Incentives (October 19, 2017). Ross School of Business Paper No. 1328; European Corporate Governance Institute (ECGI) - Finance Working Paper No. 511/2017. Available at SSRN: https://ssrn.com/abstract=2802332 or http://dx.doi.org/10.2139/ssrn.2802332

## How We Conducted the Study

To better understand the stewardship activities of index managers, we surveyed the largest providers of index funds and ETFs — 12 in total — across three regions, the U.S., Europe, and Asia. It should be noted that most of these firms also operate an active fund business, which — in some cases — may be much larger than their passive one. Collectively, the surveyed firms have over $20 trillion of assets under management.

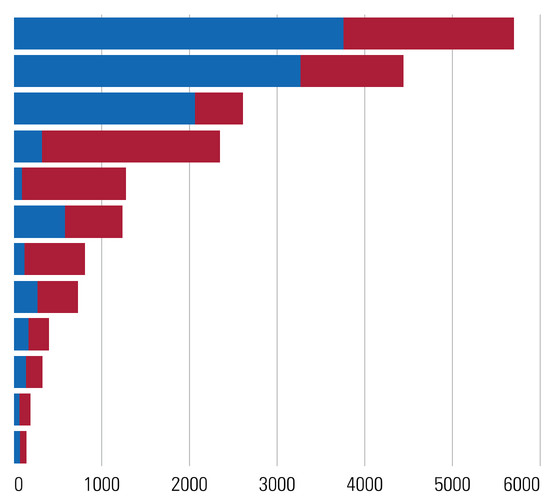
**Exhibit 1** Surveyed Asset Managers

| Asset Manager | Country | Total AUM ($ Billion) |
|---|---|---|
| BlackRock | United States | 5,700 |
| Vanguard | United States | 4,440 |
| SSGA | United States | 2,610 |
| Fidelity Investments | United States | 2,346 |
| Amundi | France | 1,274 |
| LGIM | United Kingdom | 1,235 |
| Deutsche AM | Germany | 808 |
| UBS AM | Switzerland | 730 |
| Nomura AM | Japan | 395 |
| Schwab | United States | 322 |
| Nikko AM | Japan | 184 |
| Lyxor | France | 141 |

Source: Asset managers. Data as of 30 June 2017.

**Exhibit 2** Surveyed Manager AUM Split Into Passive and Active ($ Billion)

| Asset Manager | Passive | Active |
|---|---|---|
| BlackRock | 3,762 | 1,938 |
| Vanguard | 3,270 | 1,170 |
| SSGA | 2,062 | 548 |
| Fidelity Investments | 319 | 2,027 |
| Amundi | 89 | 1,185 |
| LGIM | 580 | 655 |
| Deutsche AM | 121 | 687 |
| UBS AM | 270 | 460 |
| Nomura AM | 162 | 233 |
| Schwab | 139 | 183 |
| Nikko AM | 61 | 123 |
| Lyxor | 71 | 71 |




Source: Asset managers. Data as of 30 June 2017.

We sent these firms a comprehensive questionnaire covering aspects ranging from the size and structure of their investment stewardship teams to voting and engagement activities, disclosure thereof, and the management of conflicts of interest. We subsequently had face-to-face meetings or conference calls with each of the surveyed firms.

It's clear from the responses to our questionnaire and our interactions with the firms that practices vary significantly. In the first part of the report, we share our observations, examining commonalities and differences between managers' practices. We also provide a list of best practices that investors can use to assess how asset managers stack up. In the second part, we provide individual manager profiles that detail each firm's resources and approaches to voting and engagement.

Corporate governance isn't a black-and-white topic. While all asset managers strive to ensure that their investee companies act in the best interest of long-term investors, there isn't always agreement about what that looks like in practice. In principle, most firms we surveyed try to promote board independence and equal voting rights for each share and discourage excessive compensation and measures to entrench corporate insiders. Those are all laudable positions that, if properly executed, should benefit investors.

But it isn't always easy to trace those positions to individual votes and engagements. Some firms (for example, SSGA and LGIM) do a better job than others at disclosing how they vote and engage with holdings on core themes. Asset managers also differ in the extent to which they engage with their investee companies. In theory, more engagement should foster better corporate behavior, but it requires resources and the benefits are difficult to quantify.

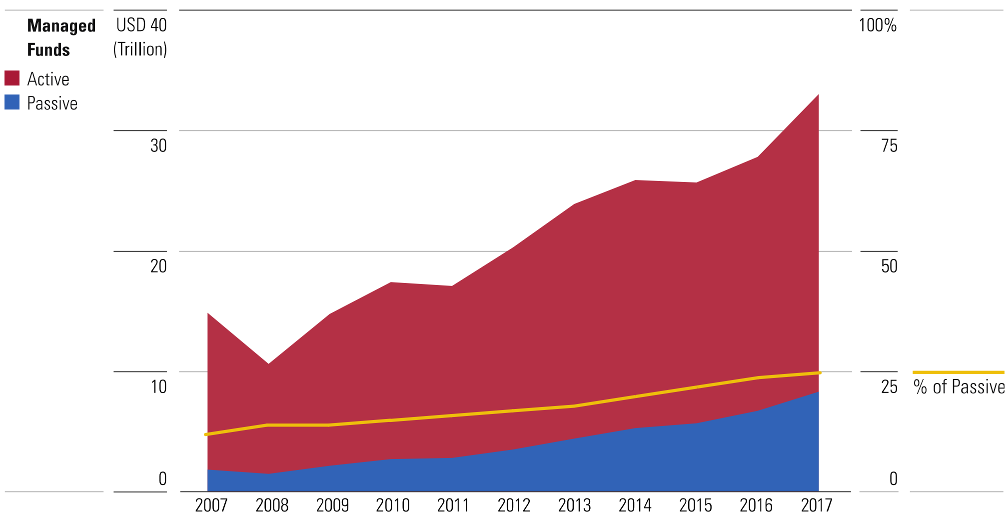
This report doesn't attempt to define the optimal way for index managers to approach corporate governance. Rather, it outlines current industry practices, highlights some of the better ones, and makes a case for greater transparency.

## The Rise of Passive and Responsible Investing

### The Rise of Passive Investing

Passive investing has become a global phenomenon and now accounts for a larger share of publicly traded assets. Assets under management in traditional index funds and ETFs have grown to $8.1 trillion globally, from $1.8 trillion 10 years ago, and now represent 25% of all fund assets, up from 12% a decade ago (Exhibit 3). This tremendous growth has been primarily driven by investors' growing cost-consciousness and active managers' difficulties in beating their respective benchmarks on a consistent basis.

**Exhibit 3** Global Fund Assets Split Into Active and Passive ($ Trillion)




Source: Morningstar Direct. Data as of 30 September 2017, excluding money market funds and funds of funds.

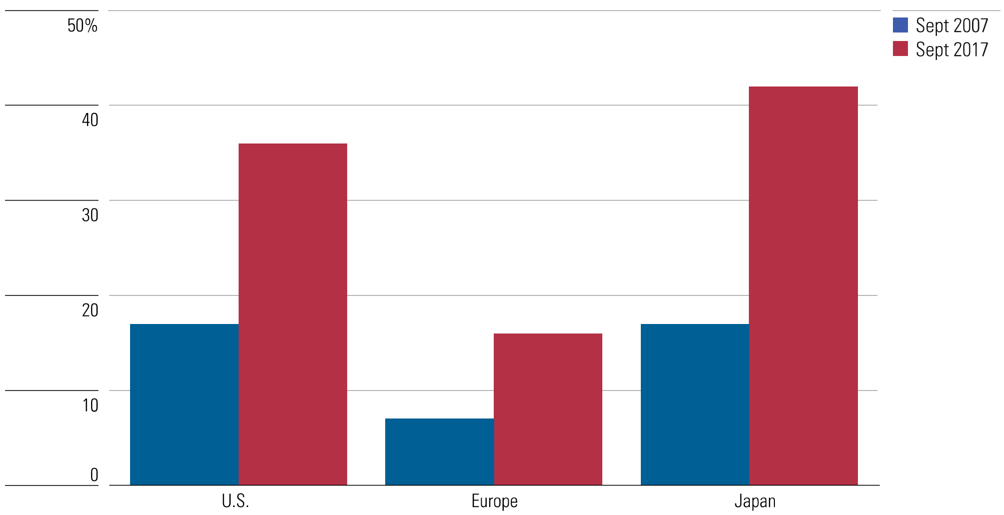
The ongoing shift toward indexing has been especially pronounced in the United States, where inflows into passive funds have outpaced those into active funds and 36% of fund assets are now passively managed[4], up from 17% 10 years earlier (Exhibit 4).

In Europe, growth has also been strong, albeit from a much lower base, and passive funds now account for 16% of total fund assets, up from 7% a decade earlier. By contrast to the U.S., where the growth of passive investing has been driven by both institutional and retail investors, the European passive fund client base remains largely institutional. Fund distribution networks in Europe are dominated by large commercial banks that have shown little interest in the commercialization of low-cost investments to retail investors. Besides, up until now, European financial advisors had never been incentivized to promote funds such as ETFs that do not pay retrocession fees. This may change with the implementation

4 Passive fund assets include only assets invested in traditional index funds and exchange-traded funds.

of MiFID II regulation, which includes a ban on commissions and is expected to create a level-playing field for the distribution of passive funds to European retail investors.

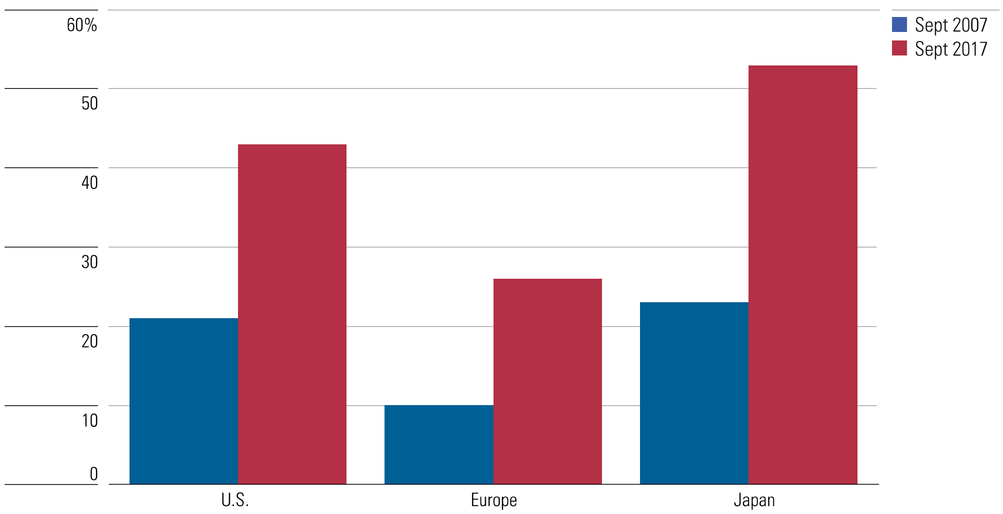
**Exhibit 4** Passive Market Share in All Funds in the U.S., Europe, and Japan




Source: Morningstar Direct. Data as of 30 September 2017, excluding money market funds and funds of funds in the U.S. and Europe, but excluding only money market funds in Japan.

In Japan, where 42% of fund assets are now in index funds and ETFs, up from 17% 10 years ago, the shift to indexing has been primarily driven by the Bank of Japan's ETF purchases under its quantitative-easing program. As of September 2017, the BOJ held an estimated 58% of total ETF assets in Japan. Another key driver of passive funds' growth in Japan has been the high adoption of indexing by large asset owners. For instance, the Government Pension Investment Fund, one of the world's largest pension funds, established by the Japanese government, had 77% of its assets managed passively as of March 2017.

**Exhibit 5** Passive Market Share in Equity Funds in the U.S., Europe, and Japan




Source: Morningstar Direct. Data as of 30 September 2017, excluding money market funds and funds of funds in the U.S. and Europe, but excluding only money market funds in Japan.

When considering only equity funds, the market share of index funds and ETFs is even higher (Exhibit 5), at 43% in the U.S., up from 21% a decade ago. Providers of passive funds are now among the largest owners of U.S. companies. In Japan, the figure has grown to 53%, up from 23% 10 years earlier. This is because the BOJ's ETF purchases were entirely in equity ETFs, predominantly tracking the TOPIX, Nikkei 225 and JPX-Nikkei 400 indexes.

**The Rise of Responsible Investment**

Concomitant with the rise of index investing, responsible investment has become more prominent. There is a growing consensus among investors, particularly large asset owners, that the integration of ESG factors into an investment process and active ownership practices—through voting and engagement—reduce risks and lead to superior long-term performance.

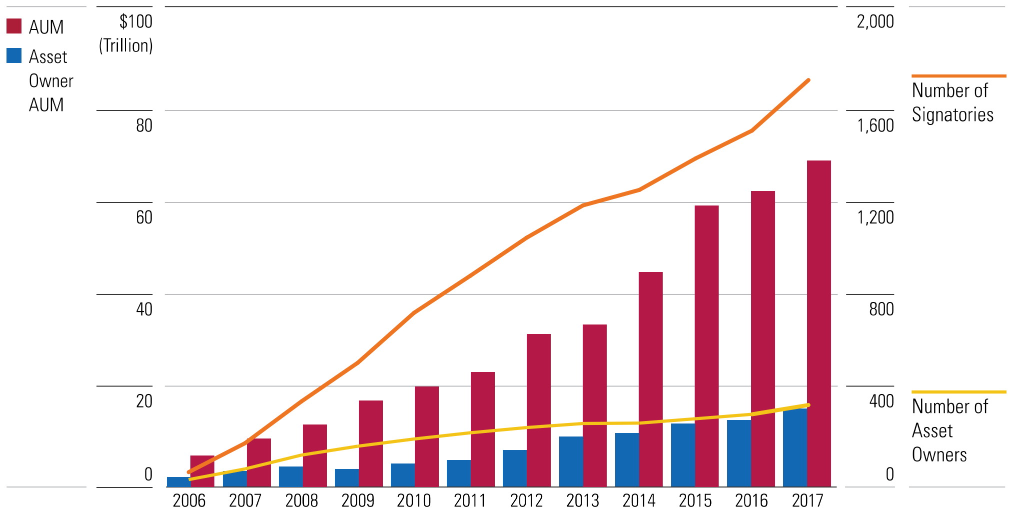
Perhaps the strongest evidence of this trend is the adoption of stewardship codes in many countries, including the U.K., Switzerland, and Japan, in addition to the creation of the U.S. Stewardship Framework for Institutional Investors[5], and more recently the adoption of a new European Union Shareholders' Rights Directive aimed at strengthening shareholders' engagement[6].

At the same time, the number of signatories to the Principles for Responsible Investment is continuously rising (Exhibit 6). PRI are a voluntary and aspirational set of investment principles supported by the United Nations that encourage investors to use responsible investment to generate sustainable returns and better manage risks.

5 https://www.isgframework.org/stewardship-principles/

6 http://www.consilium.europa.eu/en/press/press-releases/2017/04/03-shareholder-rights-eu-companies/

**Exhibit 6** Growth of PRI Signatories




Source: UN Principle for Responsible Investments. Data as of April 2017.

All the asset managers we surveyed, with the notable exception of Schwab, are PRI signatories. Signing the PRI allows investment organizations to publicly demonstrate their commitment to responsible investment. Among other principles, PRI signatories commit to be active owners and incorporate ESG issues into their ownership policies and practices.

This rise of sustainable and responsible investment and the importance of sound stewardship have not gone unnoticed by Morningstar. We have committed to providing investors with the tools they need to assess the ESG credentials of individual companies and funds. In 2016, we launched the Morningstar Sustainability Rating[7] to help investors measure how well the holdings in a portfolio are managing their ESG risks and opportunities relative to their Morningstar Category peers. We've also long emphasized the importance of partnering with responsible stewards as evidenced by our Equity Stewardship ratings for stocks and Parent ratings for funds. This report builds upon a broad body of work that underscores the importance of partnering with responsible agents.

7 http://www.morningstar.com/content/dam/morningstar-corporate/Company/Trends/Sustainability/Detail/Documents/Morningstar-Sustainability-Rating-Methodology-0916.pdf

**Index Managers' Corporate-Governance Philosophy**

Unlike active portfolio managers, index managers can't sell poorly run companies. They must buy every stock in a given index (to the extent that it is cost-efficient to do so) and keep it as long as it stays in the index. As a result, index managers typically own a broad swath of the market and often hold those stocks indefinitely. This encourages them to focus on issues that could have a bearing on shareholders' outcomes over the long-term, such as board composition, management compensation, and effective oversight and disclosure of relevant risks. The approaches to these issues can vary by index manager, but all the firms we surveyed share a common commitment to encouraging good governance of investee companies.

In fact, like their active counterparts, providers of passive funds have a fiduciary duty to act in the best interests of their clients. Besides, it should not be overlooked that most of the world's largest passive players are part of larger organizations that operate an active fund business, and most do not differentiate between active and passive when it comes to stewardship activities.

All the surveyed managers establish independent voting policies that reflect their views of how companies should be governed and that they use to exercise their clients' voting rights at annual general meetings. To amplify their impact, most managers also engage with a subset of their portfolio companies, prioritizing engagements with firms that face material risks or employ very different ESG practices from their peers. As large, long-term shareholders, index managers are in a unique position to establish strong relationships with investee companies and influence their behavior. As owners of virtually every security in the market, they are also well placed to engage with regulators, policymakers, and other stakeholders to improve market standards.

At the same time, a growing number of investors are also concerned about ESG issues and expect asset managers to address these matters directly with the companies they own. Virtually all surveyed managers have reported an increase in client inquiries about stewardship activities, while investee companies themselves are increasingly paying attention to demands from their largest investors, regardless of whether their shares are held in active or indexed portfolios.

## Voting Activities

### Surveyed Managers' General Approach to Voting

Voting is the most visible tool for shareholders to hold companies to account and an essential part of any asset manager's stewardship activities.

We found that among firms offering both passive and active strategies, the voting policy is nearly always the same—the voting interests of active and passive strategies are represented identically. The only exception was Fidelity, which delegates the full management and voting responsibilities of its index funds to subadvisor Geode. Therefore, Geode's proxy voting policy and activities are separate from Fidelity's. In our view, this setup has the disadvantage of duplicating efforts and limiting the benefits of scale with respect to proxy voting.

Most surveyed firms adopt a pragmatic approach to voting, although some are more systematic. For example, BlackRock, which is global in nature and has a sizable active business, follows different voting guidelines in different regions to better address local corporate-governance concerns and norms. It also assesses non-routine votes, such as takeover offers, say-on-pay votes, and proxy contests, on a case-by-case basis. By contrast, Schwab, which offers only passive and quantitative active strategies, has opted for a more scalable and systematic voting approach.

### Scope of Voting Activities

The largest asset managers tend to exercise shareholders' voting rights for all portfolio holdings where possible and as long as the potential benefit of voting outweighs the cost of exercising the right. For example, BlackRock and Vanguard exercise voting rights for close to 100% of their equity portfolio assets. Other firms will focus on their home country or region or on their largest holdings. For example, Amundi has a policy to vote for all French holdings and for international companies where it holds more than 0.05% of the capital, which in practical terms adds up to 91% of its equity holdings. Meanwhile, Deutsche Asset Management works with a "watchlist" of around 700 companies, which typically represents just over 60% of its equity fund AUM.

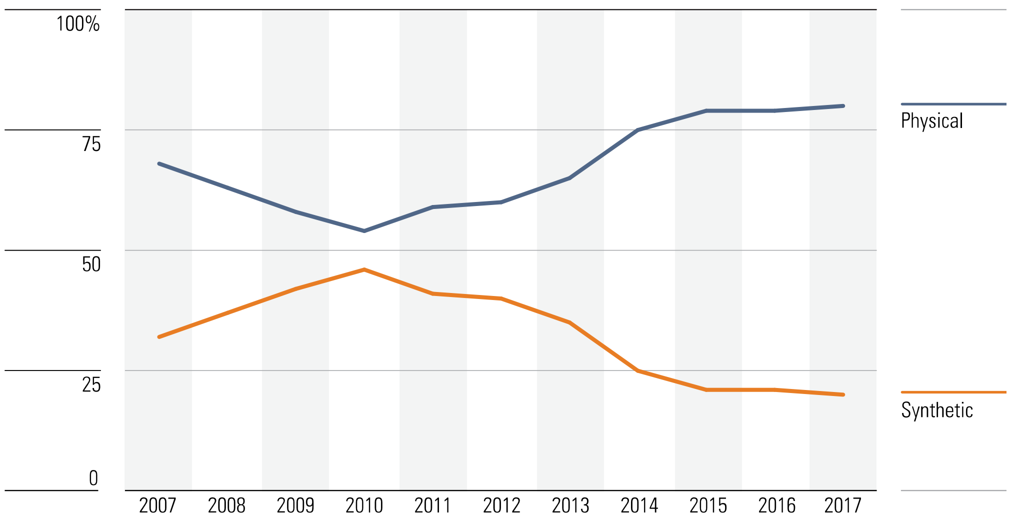
It must be noted that in the case of the European asset managers, none of the voting figures include synthetic ETFs, for which voting rights cannot be exercised[8]. As of this review, assets in synthetic equity ETFs ranged from 20% of total assets under management in equity ETFs in the case of Deutsche AM and UBS to around 50% and 75% in the case of Lyxor and Amundi, respectively.

Synthetic ETFs, which at one time were nearly at par with physically replicated ones in terms of assets under management, have rapidly lost ground over the past five years (Exhibit 7). Responding to client demand, and in some cases for efficiency reasons, European providers have switched many synthetic

8 Synthetically replicated funds are designed to track an index through a performance swap. To mitigate risk, the swap counterparty delivers a basket of securities to the fund. Because the "substitute basket" or collateral can change composition every day and does not match the economic exposure of the fund, voting rights are not exercised.

ETFs to physical replication[9]. This is a trend that seems well entrenched and one that leads us to believe that a higher proportion of equity ETF holdings will see their voting rights exercised in the future.

**Exhibit 7** Europe-Domiciled Equity ETF AUM by Replication Method (%)




Source: Morningstar Direct. Data as of September 2017.

Equity funds employing synthetic replication are not the only case where an asset manager may forfeit its right to vote. Many physically replicated index funds and ETFs engage in securities lending[10]. When a stock is on loan, the right to vote is temporarily transferred to the borrower. Borrowers, which tend to be short sellers, generally commit not to vote on these shares.

In this regard, our research revealed a contrasting picture between Europe and the United States. European managers are less inclined to forgo voting rights, especially for shares in domestic markets, and will more systematically recall stocks or restrict securities lending before the voting date. By contrast, U.S. managers tend to recall shares only in rare cases where the impact of the vote can be material and the benefit of voting shares outweighs the forgone lending income.

9 http://media.morningstar.com/uk/MEDIA/ETF/AGuidedTouroftheEuropeanETFMarketplace2017.pdf

10 http://media.morningstar.com/uk/media/ETF/SecuritiesLendinginPhysicalETFs.pdf

**Voting Behavior**

The starting position for all surveyed asset managers is to be supportive of company management and boards, as most votes are linked to routine administrative matters. Nevertheless, as voting records show (Exhibit 8), some firms tend to back management more often than others. BlackRock, Vanguard, and Fidelity's index subadvisor Geode reported the highest percentages of "For" votes in the past three years.

**Exhibit 8** Voting Statistics

| | 2014 / 2015 | | | 2015 / 2016 | | | 2016 / 2017 | | |
|---|---|---|---|---|---|---|---|---|---|
| Asset Manager | # Votes | % For | % Against | # Votes | % For | % Against | # Votes | % For | % Against |
| Amundi | 31,237 | 83 | 17 | 32,396 | 82 | 18 | 32,771 | 83 | 17 |
| BlackRock | 147,400 | 92 | 8 | 158,965 | 92 | 8 | 163,461 | 91 | 9 |
| Deutsche AM | 4,984 | 83 | 17 | 5,754 | 79 | 21 | 7,735 | 77 | 23 |
| Geode (Fidelity) | 74,484 | 91 | 9 | 78,184 | 91 | 9 | 77,039 | 91 | 9 |
| LGIM | 42,631 | 89 | 11 | 44,823 | 89 | 11 | 44,332 | 88 | 12 |
| Lyxor | 0 | 0 | 0 | 0 | 0 | 0 | 461 | 81 | 19 |
| Nikko AM | 23,117 | 91 | 9 | 23,657 | 91 | 9 | 22,956 | 83 | 17 |
| Nomura AM | 8,816 | 87 | 13 | 8,819 | 82 | 18 | 7,709 | 78 | 22 |
| SSGA | 130,840 | 89 | 11 | 143,540 | 88 | 12 | 158,053 | 86 | 14 |
| Schwab | 81,811 | 84 | 16 | 83,838 | 84 | 16 | 86,925 | 85 | 15 |
| UBS AM | 74,655 | 93 | 7 | 87,348 | 91 | 9 | 97,670 | 90 | 10 |
| Vanguard | 119,130 | 92 | 8 | 153,768 | 93 | 7 | 170,974 | 94 | 6 |

Source: Asset managers. Data as of Dec. 31, 2016, except for BlackRock, Vanguard, Schwab, and Nikko, for which data is as of June 30, 2017. Geode is Fidelity's index subadvisor. Deutsche AM data is for funds of legal entities domiciled in Europe only. Nomura and Nikko disclose votes on Japanese equity-related proposals only. “Against” votes include “Abstain” and “Withhold” votes.

Our collected data also suggests that asset managers in Europe tend to report higher - and in some cases increasing - percentages of "Against" votes than their U.S. counterparts.

Meanwhile in Japan, in a sign that changes to the domestic corporate culture may be gathering pace following the adoption of Japan's Stewardship Code in 2014, Japanese asset managers are now opposing management more. For example, by applying more-stringent voting criteria in areas like election of directors and auditors for Japanese companies, Nikko’s votes against management have doubled in two years, reaching 17% in 2017.

Our research also revealed key differences in the way votes against management are deployed. For some, voting against management remains a last-resort option. For example, BlackRock will first try to effect change by engaging management teams and will only cast a negative vote if management is unresponsive or takes too long to address BlackRock’s concerns. At the other end of the spectrum, Europe’s largest asset manager, Amundi, makes a strict application of its voting policy and does not hesitate to swiftly vote against management when a proposed resolution fails to comply with its principles.

In addition to the data collected, we found anecdotical evidence that points to a higher disposition to become more vocal about the instances where a negative vote is cast. This is particularly so in the case of U.S. asset managers, who, relative to their European counterparts, have been historically more reluctant to challenge the status quo, especially in relation to environmental and social issues.

One recent high-profile case is Exxon Mobil. In May, BlackRock and Vanguard supported a shareholder proposal seeking greater disclosure of climate-related risks, against the recommendation of Exxon's board. This was the first year Vanguard supported a climate-risk disclosure resolution. Other asset managers, including SSGA, Amundi, and LGIM, had already voted in favor of the Exxon shareholder proposal in 2016.

SSGA also made headlines this year with its opposition to the re-election of directors at 400 companies for failing to appoint more female board members.

**Use of Proxy Advisors and Role of Active Portfolio Managers**

Given the large number of companies in which they invest, most surveyed managers rely on proxy voting advisors like Institutional Shareholder Services and Glass Lewis to provide data as an input to their voting process. However, the managers do not follow the advisors' voting recommendations. Instead, they follow tailored recommendations that the advisors provide based on the managers' own voting policies, though many also ask the advisors to flag non-routine votes for in-house review. Some firms, including Amundi and LGIM, use proxy advisors for research only.

Asset managers with an active fund business are also able to draw on the knowledge of their investment teams and ESG analysts. Active portfolio managers are normally consulted as part of the voting decision-making process, although the extent to which their recommendations are followed varies from firm to firm.

For example, at BlackRock, Amundi, and UBS, the policy is for active fund managers to vote consistently across all funds, but they retain the authority to vote differently from the house view. This contrasts with the approach at Vanguard, SSGA, and LGIM, where the stewardship teams have ultimate authority on the final voting decisions. This is to ensure consistency and efficacy, as well as to minimize potential conflicts of interest. Conflicts of interest arise when views of internal portfolio managers differ between each other and with the stewardship team.

Index portfolio managers, meanwhile, have no say in the voting of their portfolio holdings. Index portfolio management is a highly automated process whereby delivering the index performance is the overriding mandate. That said, index portfolio managers can be consulted in some organizations for policy-level decisions and informed of certain votes.

## Engagement Activities

### Increased Commitment to Engagement

Our research shows that index managers are intensifying their engagement efforts. Of the 12 surveyed firms, nine reported that they currently engage with investees and expressed a willingness to reach more companies in years to come. They also, and perhaps more importantly, intend to improve the quality of their interactions.

Of the three that do not currently engage, two, namely Fidelity's index subadvisor, Geode, and Lyxor, have plans to formalize an engagement strategy in the coming months, in line with their commitment to the UN PRI[11]. These principles require signatories to be active owners and incorporate ESG issues into their ownership policies. By contrast, Schwab was the only firm to see no compelling reason to set up an engagement program, citing cost and what it sees as a lack of solid evidence on the benefits of direct engagement.

While it is difficult to quantify the benefits of direct engagement, these activities allow managers to build trust and create a dialogue with the management teams at their portfolio companies, which can help them more efficiently drive change. A recent article in the *New York University Journal of Law & Business* cast engagement as a middle ground between shareholder activism and deference to boards' recommendations. It suggested that engagement may help foster better communication that can help improve accountability and influence change[12]. Other academic studies[13,14] have documented outperformance following ESG engagements.

Despite the emphasis placed on direct engagement among nearly all the surveyed firms, it is difficult to compare engagement activities across them. This is because there is no standard definition of what constitutes an engagement. While for some, a fact-finding meeting or call with a company is enough to be recorded as an engagement, others apply a more stringent definition, only classifying meaningful interactions with companies as engagements, specifically those aimed at bringing about change. As a result, our research shows a wide range in the number of engagements disclosed in 2016—from 37 by Deutsche AM and 120 by UBS to around 1,000 by Nikko and 1,480 by BlackRock (Exhibit 9).

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11 https://www.unpri.org/download_report/6309 Active ownership for listed equities includes engagement and (proxy) voting activities.

12 Mallow, Matthew and Jasmin Sethi, "Engagement: The Missing Middle Approach in the Bebchuk-Strine Debate. New York University Journal of Law & Business. Volume 12, Number 2, Spring 2016.

13 https://studylib.net/doc/13021910/active-ownership--abstract – pp. 3225-3268

14 https://workspace.imperial.ac.uk/business-school/public/people/srossi/Becht-Franks-Mayer-Rossi-2009-RFS.pdf – pp. 3093-3129

**Exhibit 9** Number of Disclosed Engagements

| Asset Manager | 2014 | 2015 | 2016 |
|---|---|---|---|
| Amundi | 529 | 598 | 481 |
| BlackRock | 1,293 | 1,522 | 1,480 |
| Deutsche AM | — | — | 37 |
| Geode (Fidelity) | — | — | — |
| LGIM | 589 | 545 | 500 |
| Lyxor | — | — | — |
| Nikko AM | 1,000 | 1,000 | 1,000 |
| Nomura AM | 200 | 200 | 200 |
| Schwab | — | — | — |
| SSGA | 610 | 636 | 611 |
| UBS AM | 115 | 160 | 120 |
| Vanguard | 617 | 685 | 817 |
| **Total** | **4,953** | **5,346** | **5,246** |

Source: Asset managers. Data as of September 2017. Geode is Fidelity's index subadvisor. Nikko and Nomura provided an approximate number of engagements per year.

However, irrespective of the definition, our collected data revealed an increase in the aggregate number of engagements in recent years, with BlackRock and Vanguard reporting the most significant growth. And while some expect their number of engagements to rise even further in the years ahead, others were quick to point out that the focus should remain on quality, rather than quantity. At the same time, most surveyed firms reported that companies are increasingly eager to reach out to them to exchange opinions on ESG issues.

### Various Forms of Engagement

Initiating the process of direct engagement can take many forms. The simplest relates to expressing views about voting intentions ahead of an investee company's annual general meeting. In effect, this is a two-way communication and can be initiated by either asset managers or investee companies. We found that some managers contact companies regarding a contentious vote as a way of triggering a long-term process of engagement.

Another common reason to seek direct engagement is for the purposes of information gathering, particularly when concerns arise following a market event. Other engagements can be aimed at discussing broad thematic issues.

We found that most surveyed firms that have a structured program of direct engagements seek the support of their investment teams to facilitate a dialogue with investee companies. In fact, in some cases, especially in firms where active management dominates (for example, Amundi and UBS), the portfolio managers and ESG analysts primarily drive the engagement process.

Some (for example, SSGA) also draw on client input to identify potential targets for direct engagement, while others, namely Fidelity's subadvisor Geode and Nomura plan to use a third-party service provider to facilitate their engagement efforts.

Meanwhile, new ways of engaging investee companies have emerged in recent years. BlackRock[15], Vanguard[16], SSGA[17], and Deutsche AM[18] are now sending annual "open letters" to investee companies. They consider this type of engagement as a way around the fact that they can't possibly engage in direct dialogue with every firm on every issue. These letters allow asset managers to communicate their core governance expectations to a large number of companies. These public declarations also attract the attention of the media, investors, and other stakeholders, with the potential benefit of increasing pressure on companies to address specific issues.

When it comes to the issue of joining forces with other investors, including activist investors, the views are split. Given their size, the largest asset managers (for example, BlackRock, Vanguard, and SSGA) have a clear preference for one-to-one engagements, ideally behind closed doors. Others, typically smaller firms, are keener to work with peers and share resources, especially in cases when individual engagements would have a low likelihood of success. All, however, are subject to regulatory constraints. In some countries (such as the United States and Germany), engagement is at risk of being seen as a collusive practice, which could potentially violate antitrust law.

Despite the crucial role of company engagement, good investment stewardship practice also involves collaborating with regulators, policymakers, and other stakeholders (for example, proxy voting service providers and index providers) to help improve market standards. All surveyed firms, including all those currently not directly engaging with investee companies, reported participation in industry forums such as those from the International Corporate Governance Network, Council for Institutional Investors, and the Investor Stewardship Group.

**Effecting Change and the Challenges of Measuring Success**

Surveyed firms agreed that the ultimate objective of direct engagement is to effect positive change, while stopping short of micromanaging investee companies. Interestingly, we found differences among the surveyed firms with regards to their willingness to wait to see change take place. Some take the view that changing corporate culture can only come about after a long process of direct engagement and are willing to give companies the benefit of the doubt (that is, withhold voting against management as a means of furthering the engagement process). Others, by contrast, strive to see change happen as quickly as possible and will use their voting rights to send a clear message of dissatisfaction. Irrespective, all surveyed firms acknowledged that any engagement strategy should take into account local customs.

15 https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter

16 https://about.vanguard.com/investment-stewardship/governance-letter-to-companies.pdf

17 https://www.ssga.com/investment-topics/environmental-social-governance/2017/Letter-and-ESG-Guidelines.pdf

18 https://deutscheam.com/contentassets/e009be87415c43648c3b13a7d7bed99a/engagementletter-2017-english.pdf

One of the main challenges of direct engagement is measuring its success. This is highly subjective and difficult to assess quantitatively. All surveyed firms agreed that it is difficult to attribute a change in company behavior to their specific engagement efforts. This is mainly because engagements may take years to bear fruit, and companies are often engaged by a variety of investors all at once. It is even more difficult to measure the impact of engagement on stock performance.

## Resources and the Issue of Cost

### Growth of Stewardship Teams

Perhaps the best evidence of the increased importance of stewardship responsibilities for index managers is the recent growth of their stewardship or corporate-governance teams (Exhibit 10).

For example, BlackRock expanded its team to 33 members today from 20 in 2014, Vanguard's team went to 21 today from 10 in 2015, and UBS will employ 11 dedicated professionals by the end of 2017, up from four in 2015.

Most firms stated that increased capacity will allow them to undertake more and/or better-quality engagements.

**Exhibit 10** Number of Stewardship Team Members

| Asset Manager | 2014 / 2015 | 2017 |
|---|---|---|
| BlackRock | 20 | 33 |
| Vanguard | 10 | 21 |
| LGIM | 9 | 11 |
| SSGA | 8 | 11 |
| UBS AM | 4 | 11 |
| Amundi | 5 | 5 |
| Nomura AM | — | 5 |
| Geode (Fidelity) | 3 | 4 |
| Nikko AM | 0 | 4 |
| Schwab | 2 | 3 |
| Deutsche AM | 0 | 3 |
| Lyxor | 0 | 2 |

Source: Asset managers. Data as of October 2017. Data excludes ESG analysts/portfolio managers of investment teams. Geode is Fidelity's index subadvisor.

At the same time, there has been an increase in the degree of specialization and sophistication within stewardship teams, as evidenced by the hiring of more thematic and sector analysts, as well as local/regional experts.

The increased specialization of stewardship teams is most evident at Vanguard, where passive and quantitative active strategies are managed internally, while traditional security selection is mostly outsourced to third-party managers. Even though the stewardship team at Vanguard uses input from its subadvisors for its voting and engagement activities, it doesn't seem to be able to leverage their expertise as effectively as stewardship teams at other firms that have in-house fundamental research and investment teams.

With that in mind, it is important to note that the numbers of stewardship team members provided in Exhibit 10 don't include ESG analysts of investment teams. This means that the figures may not truly reflect the full resources that some firms are allocating to their stewardship activities. A good case in point is Amundi, which reported that its team of five governance specialists had remained unchanged since 2011. But this team sits alongside 12 ESG analysts with whom it shares research and engagement responsibilities.

**The Issue of Cost**

The additional human and technological resources allocated to voting and engagement activities have come at a cost for the surveyed asset managers. And as their ESG-dedicated teams continue expanding and developing their expertise, the related expenditure will continue to rise. This raises the question of whether these firms will be able to absorb the extra cost without increasing their fees.

While large asset managers with economies of scale should be able to absorb the additional costs, it might be more of a challenge for the smaller firms. To remain competitive, these will have little choice but to either do the minimum required or go down the outsourcing route.

Direct engagement is particularly resource-intensive, and index managers must balance the costs and benefits associated with it.

The benefits of building dialogues with individual companies seem more evident for firms that also have an internal active stock selection business, as portfolio managers typically use engagement to inform their investment decisions. In fact, a number of surveyed firms said that they see a larger stewardship team as an added resource benefiting not only their passive funds but also their active funds. Portfolio managers are hoping to leverage the stewardship team's expertise and engagement activities to identify attractive alpha opportunities for their funds.

The benefits of direct engagement seem less evident for those surveyed managers whose mandates are limited to passive and/or quantitative active strategies, as is the case for Schwab and Fidelity's subadvisor Geode. Schwab, which doesn't engage with any investee companies, argued that it would be difficult to engage with companies in a consistent and scalable way and that there isn't a clear benefit to investors that would justify the expense. As for Geode, which has so far only occasionally and reactively engaged with portfolio companies, the firm expressed a preference for the less costly route of outsourcing the engagement function by hiring the services of ISS' Ethix.

All in all, it is fair to say that most index managers have no intention to free-ride with respect to engagement. All but one of the surveyed firms have plans to intensify their efforts in this area and bear the associated costs. This is because they see engagement as an important and integral part of their stewardship responsibilities and increasingly as something that clients expect from—in the words of one surveyed manager—a "grown-up" asset-management organization.

## Disclosure—An Area Needing Improvement

Transparency of voting and engagement activities is an essential part of an asset manager's stewardship duties. Yet, the variety of national regulatory requirements and customs means that disclosure practices differ greatly between managers and countries.

Most surveyed asset managers publish voting records for their funds on their websites in countries where the regulator or a stewardship code require them to. But too often—with the exception of the U.S.—these records are hard to find, and, where disclosure isn't a requirement, they may not exist. Also, very few explain the rationale behind important votes (that is, votes against management, abstentions, and contentious votes). This is certainly an area for improvement. Indeed, providing reasons behind a vote allows stakeholders to assess whether the asset manager has voted in line with its policy and in the best interest of shareholders.

Meanwhile, with respect to disclosure of engagements with investee companies, differences are even more pronounced. Some managers, including BlackRock, Vanguard, and UBS, are averse to disclosing the names of the companies with which they engage. They believe that in order to build trust and develop constructive long-term dialogues with company management and boards, conversations need to be kept confidential. Some commented that naming and shaming could be potentially damaging for the relationship. This, however, doesn't seem to be a concern for Amundi, which publishes a formal annual engagement report detailing nearly every action it had with companies during the year. SSGA also discloses the names of all the companies with which it engages each year, although it only provides full details on a selected number of successful engagements.

In the future, we would welcome increased disclosure of voting and engagement activities. Already, there is investor pressure on asset managers to share more details on voting decisions with the public. Equally, more companies will be publicly identified when engagement has failed, as in the case of Exxon Mobil's disclosure of climate-change risks. This year, BlackRock started publishing—on a very limited basis—statements on its engagements and votes in relation to certain proposals.

We also would encourage asset managers to better articulate their stance on important ESG topics through public statements on their websites, opinion pieces in major publications, speaking engagements, and interactions with the media. Ultimately, this may also influence their product offerings. In fact, it already has. The SPDR SSgA Gender Diversity ETF provides a good example of a fund created not only in response to client demand but also to advance a manager's cause—gender diversity in business leadership, in this case.

Given the growing importance of responsible investment, asset managers' stewardship practices will inevitably be more closely scrutinized. Index managers won't escape that scrutiny. In fact, they may continue to be singled out.

## Best Practices

Corporate governance isn't a black-and-white topic. While asset managers strive to ensure that the companies in which they invest act in the best interest of long-term investors, there isn't always agreement about what that looks like in practice.

Similarly, it would be ideal to have one set of global standards for responsible stewardship. But this is unlikely to happen, not least because of cultural and legal differences across countries. That said, it is legitimate for investors to expect their asset managers to meet the highest standards.

Below is a list of what we consider best practice, based on our survey and various stewardship codes. Our aim in providing this list is to help investors assess the stewardship practices of the asset managers they partner with. An asset manager should:

- Have a comprehensive responsible investment policy and make it publicly available on the firm's website.
- Cast votes on the shares held by all funds, including passive funds.
- Make the voting policy and voting records of all funds—including passive funds—publicly available on the firm's website. This is an area where regulators could help by making public disclosure of voting records a requirement where it is not yet mandatory.
- Publicly disclose rationales for key votes (that is, votes against management, abstentions, and contentious votes). Providing reasons behind a vote allows stakeholders to assess whether the asset manager has voted in line with its policy and in the best interest of shareholders.
- Consider recalling lent stocks or restricting lending for important votes and when it is believed the benefit of voting shares outweighs the forgone lending income.
- For those relying on third-party governance providers for voting and/or engagement activities, monitor and audit recommendations and services closely to ensure they comply with the asset managers' policies.
- Be an active owner and engage with investee companies either directly or collaboratively, or ideally both. Emphasis should be put on the quality of engagements, not the quantity.
- Disclose the number, topic, and outcome of direct engagements with companies, as well as the full list or a sample of companies engaged with over the year. Providing names of companies engaged will allow index managers to improve public awareness and understanding of their engagement activities.

- Do not limit company dialogues to governance matters alone, and address environmental and social issues because they are a source of reputational and regulatory risk that can affect a company's bottom line.

- Engage with regulators, policymakers, index providers, and other stakeholders to help improve markets, and disclose the parties to and topics of some or all of these conversations.

- Use the firm's scale by consolidating active and passive equity portfolios for voting and all asset classes, including fixed income, for engagement.

- Communicate with clients and stakeholders through regular investment stewardship reports.

**Conclusion**

As assets continue to flow into passively managed strategies and responsible investment becomes increasingly important, one can only expect the scrutiny of index managers' stewardship activities to intensify. As our research shows, the largest index managers in the world have stepped up their efforts in the areas of voting and engagement. They are looking to influence investee companies and help improve ESG standards across the board. Many plan to carry out more and better-quality engagements, despite the associated costs, the difficult-to-quantify prospective benefits, and the fact that any fruits from these efforts are bound to be shared with competitors.

It is now incumbent upon these managers to enhance disclosure and communication to improve public awareness and understanding of their activities. At Morningstar, we will be monitoring these developments.

# Manager Profiles

## 1. Amundi

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|---|---|
| **Manager Description** | ► Amundi is the largest European-headquartered asset manager, with $1.28 trillion in AUM worldwide as of end of June of 2017, of which 7% are managed passively.<br>► Amundi is the fifth-largest ETF provider in Europe with $40 billion in AUM, 75% of which are in synthetic ETFs. The firm also manages a suite of traditional index funds.<br>► Socially Responsible Investment has been one of Amundi's strategic pillars since 2010. |
| **Industry Codes and Frameworks** | ► Amundi was among the first signatories to UN PRI in 2006.<br>► The firm has also signed the EFAMA Code for External Governance and observes several governance-related industry codes (including the U.K. and Japan's Stewardship Code). |
| **Investment Stewardship Team** | ► Amundi has a dedicated corporate-governance team with a global scope.<br>► The team is made up of four specialists located in Paris and one in Tokyo. The team's size has remained unchanged since 2011.<br>► The Paris-based team is part of Amundi's Equity department and sits alongside the ESG Analysis team, which consists of 12 analysts. Amundi also established an ESG Analysis team in Tokyo in 2015 to meet the specific needs of the Japanese market.<br>► The corporate-governance team is focused on analysis, engagement, and voting. Each analyst is in charge of a geographical area. The team is in charge of coordinating internal expertise (fund managers, financial analysts, ESG analysts) to reach the most informed voting decision. |
| **Proxy Voting** | **Process**<br>► The voting process is internal, centralized, and implemented by the corporate-governance team.<br>► Amundi's voting principles are universal and underpinned on the basic assumption that long-term financial performance cannot be achieved without considering sustainable development and social responsibility challenges. However, the voting principles can be adapted to the specificities of different geographical areas.<br>► Active portfolio managers are consulted during the voting decision-making process and can vote differently from the view adopted by the corporate-governance team, as long as they are authorized by a voting committee headed by the CIO or the global head of equity. However, divergent votes by portfolio managers happen only on very rare occasions. |
| | **Scope**<br>► Amundi votes for all holdings in France-domiciled companies and for international companies where it holds more than 0.05% of the capital. This represents 91% of its equity holdings.<br>► Amundi does not execute voting rights on stock holdings in substitute baskets of synthetic ETFs. |
| | **"Against" votes**<br>► The team's standard policy is to cast a negative vote on any proposal that goes against Amundi's policy principles. |

## 1. Amundi

| | |
|---|---|
| | **Use of proxy advisors**<br>► Amundi uses proxy advisors—including ISS, Glass Lewis, and ECGS—for general research only and does not rely on their voting recommendations. |
| | **Stock lending**<br>► The corporate-governance team aims to exercise the voting rights of all lent stocks and will typically recall them ahead of a vote. |
| **Engagement** | **Number of direct engagements**<br>► Amundi has a target of 300 companies to engage with every year. In the period 2014-16, the target was surpassed. |
| | **Reasons for direct engagement**<br>► Amundi carries out three types of engagements:<br>► related to AGM voting<br>► engagements for influence<br>► to gather information for ESG rating purposes<br>► The corporate-governance team engages with companies for issues related to AGM agenda and to discuss controversies linked to governance failures.<br>► The ESG Analyst team conducts engagements aimed at influencing companies' practices and for the purposes of deciding in-house ESG ratings, which grade companies from A to G. G-rated stocks are divested from active portfolios but can remain in index-tracking funds. As a consequence, any engagement with G-rated companies focuses on addressing existing controversies. |
| | **Collaborative engagement**<br>► Amundi prefers one-to-one engagement with investee companies. However, collaborative initiatives can be carried out in certain circumstances; often in situations where Amundi's holding in a company is too small or when a prior individual engagement has been unsuccessful. |
| | **Other forms of engagement**<br>► Amundi contributes to the development of regulatory policy with other asset managers and participates in industry events and relevant working groups. |
| **Disclosure on Website** | ► Amundi publishes a proxy voting policy document that details voting principles in subjects such as board composition, remuneration, capital structure, and market control measures (for example, mergers and acquisitions).<br>► The firm also publishes its principles of dialogue with issuers, as well as an annual engagement report, which details its interactions with investee companies, including measures implemented to address concerns and an assessment of the achieved results. The report discloses the name of the vast majority of companies it has engaged with during the year.<br>► Amundi also publishes a semiannual proxy voting report listing all the shareholder meetings voted during the period and signaling the companies against which negative votes were cast. Amundi has plans to start publishing the details of all voted resolutions.<br>► The ESG Analysis team publishes SRI discussion papers on the website. |

## 2. BlackRock

**Manager Description**

- BlackRock is the world's largest asset manager, with $5.7 trillion in AUM, at the end of June 2017.
- Almost two thirds of its assets are in ETFs and index mutual funds, making it the largest manager of passively managed funds in the world.
- Because of its large scale, BlackRock is often among the largest investors in many of its holdings.
- The firm's strategies span active, passive, multi-asset, cash management, and alternatives.

**Industry Codes and Frameworks**

- UN PRI signatory since 2008.
- The firm is compliant with major industry corporate-governance codes and frameworks, including the U.K. and Japanese Stewardship Code, the Framework for U.S. Stewardship and Governance, and Eumedion Best Practices for Engaged Share-Ownership.

**Investment Stewardship Team**

- The BlackRock Investment Stewardship team has grown to 33 professionals from 20 in 2014.
- It is spread across New York, San Francisco, London, Tokyo, and Hong Kong. The analysts on the Americas' team specialize by sector, while those in the EMEA and Asia-Pacific regions specialize by country.
- The team is responsible for voting proxies and engaging with portfolio companies.
- Three regional stewardship advisory committees, consisting of the firm's senior investment professionals, oversee the Investment Stewardship team in each market.

**Proxy Voting**

**Process**

- Proxies are voted according to BlackRock's market-specific guidelines. It directs routine votes to ISS (a third-party proxy advisor), which votes in line with the instructions outlined in BlackRock's policy. The team flags high impact, non-routine votes for in-house review.
- Among the principles it attempts to advance, BlackRock expects each firm to follow the accepted corporate-governance standard in its market or explain why not doing so is in investors' best interests. It asks for clear reporting on governance structure and expects the board to put a compensation structure in place that aligns managers' interests with long-term shareholders'.
- The firm does not make value judgements on social, ethical, and environmental issues on behalf of clients, outside of ESG-mandated strategies. But it does expect its holdings to report on their exposure to business risk in these areas and how they are managing them.
- While the Investment Stewardship team has centralized voting responsibilities for all index-based assets across the firm, active portfolio managers can vote proxies on the holdings in their funds, if they choose. They may vote differently from the stewardship team, but this happens very seldom.

**Scope**

- The firm's policy is to vote proxies for any holding where it is feasible to do so.

**"Against" votes**

- BlackRock will not vote against management until it has a chance to share its concerns directly with the management team (or tries to do so) and gives it a chance to address the issue. The governance team prefers to engage in private dialogue to build trust and constructively effect change. But it will vote against management if it is unresponsive, does not make sufficient progress addressing BlackRock's concerns, or does not act in the best interests of long-term shareholders.

**Use of proxy advisors**

- The team subscribes to research from ISS and Glass Lewis, but it does not rely on their voting recommendations.
- Routine votes are directed to ISS, which votes in line with BlackRock's policy.

**Stock lending**

## 2. BlackRock

| | |
|---|---|
| | ► BlackRock only recalls securities on loan for material proxy votes to have the maximum impact. |
| **Engagement** | **Number of direct engagements**<br>► In 2016, the team had a total of 1,480 in-person meetings. In recent years, the number of engagements has fluctuated between 1,300 and 1,500 per year. |
| | **Reasons for direct engagement**<br>► BlackRock prioritizes engagements based on its level of concern and the likelihood that the engagement will lead to positive change.<br>► It identifies candidates for engagement based on whether:<br>► Prior to a vote, there are concerns about the company's performance or governance or insufficient disclosure of information<br>► There has been a material event that may affect the company's long-term value<br>► The company is in a sector where there is a material thematic issue<br>► BlackRock prioritizes engagements based on its level of concern and the likelihood that the engagement will lead to positive change. |
| | **Collaborative engagement**<br>► The team doesn't generally do collaborative engagement on company-specific situations. Given BlackRock's size, direct engagements are considered more effective.<br>► Nevertheless, the team collaborates with other investors on policy-level issues. |
| | **Other forms of engagement**<br>► Since 2012, BlackRock has sent an annual letter to the CEOs of over 1,300 companies on stewardship issues and trends that are important to BlackRock.<br>► It also sends private letters to companies outlining its position on issues such as disclosure of climate-change risks and diversity to encourage better practices.<br>► Members of the Investment Stewardship team participates in industry events and relevant working groups. |
| **Disclosure on Website** | ► BlackRock outlines its Global Corporate Governance Guidelines & Engagement Principles and Investment Stewardship Priorities on its website.<br>► Quarterly and annual voting and engagement statistics reports are also available. Engagement activities are broken down by region, area of focus (environmental, social, governance) and resource level (basic, moderate, extensive).<br>► BlackRock does not disclose the names of companies it engages with. However, in 2017, the firm started publishing on a very limited basis statements on its analysis, engagements, and votes in relation to certain high-profile proposals at company shareholder meetings.<br>► Like all U.S. fund providers, BlackRock discloses the proxy voting records of its U.S.-listed funds. But it does not publish its voting record for funds listed in markets where it isn't a regulatory requirement.<br>► Position papers are also regularly published on the website. |

## 3. Deutsche Asset Management

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|---|---|
| **Manager Description** | ► Deutsche Asset Management is one of the largest Europe-headquartered asset managers, with $808 billion in AUM worldwide as of the end of June 2017, of which 15% is invested in passively managed strategies.<br>► As of this review, the firm is the second-largest ETF provider in Europe with $74 billion in AUM across most asset classes. For some years now, the firm has been switching its ETFs to physical from synthetic replication, and as of this review, only around 20% of the equity ETF range uses synthetic replication. |
| **Industry Codes and Frameworks** | ► UN PRI signatory since 2008.<br>► DeAM also adheres to many local corporate-governance-related industry codes (for example, U.K. Stewardship Code) and frameworks (for example, ICGN, Ceres). |
| **Investment Stewardship Team** | ► DeAM has had a dedicated Corporate Governance Centre since 2016 as part of the chief investment office. The team, based in Frankfurt, is currently made up of three members and is responsible for engagement and voting for funds domiciled in Europe only.<br>► The team's areas of focus are board composition and independence, executive pay, shareholder rights, and transparency in reporting.<br>► The CGC is part of a dedicated ESG team of 10 individuals focused on supporting the integration of ESG into DeAM's investment process.<br>► DeAM also has a team in the U.S. that handles voting for U.S.-domiciled funds following its own voting policy. Up to now, there has been no formal collaboration between the European and U.S. teams. However, a harmonization of processes between the two teams has been initiated and should be implemented in 2018. |
| **Proxy Voting** | **Process**<br>► DeAM's voting process is articulated around an internal "watchlist" of companies representing the most relevant equity holdings. Until 2011, the watchlist only included German companies, but now it has a global scope.<br>► Voting decisions are made using recommendations issued by proxy advisors in line with DeAM's voting policy. The CGC team cross-checks for potential conflicts and carries out additional analysis.<br>► Active portfolio managers are involved in the voting decision-making process.<br>► The CGC team and/or active portfolio managers can propose votes deviating from the DeAM policy. These votes need the approval of the Proxy Voting Group.<br>► DeAM's voting principles are universal, but the detailed guidelines are adapted to the specificities of different geographical areas. |
| | **Scope**<br>► DeAM's policy is to vote only for the companies included in the watchlist. As of this review, the watchlist consisted of 700-750 firms, representing more than 60% of AUM in equity funds. The plan is to extend it to 1,000 in 2018.<br>► In the case of passive equity holdings, the firm establishes a lower market-capitalization threshold for inclusion in the watchlist.<br>► DeAM does not exercise voting rights on stock holdings in substitute baskets of synthetic ETFs. |
| | **"Against" votes**<br>► The team's standard policy is to cast a negative vote on any proposal that goes against DeAM's policy principles. |
| | **Use of proxy advisors**<br>► DeAM uses proxy advisors ISS and IVOX Glass Lewis, who provide custom research with voting recommendations based on DeAM's own policy.<br>► ISS is used for non-German holdings, while IVOX Glass Lewis is responsible for German holdings. |

## 3. Deutsche Asset Management

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| | **Stock lending**<br>► The team's standard policy is to exercise the voting rights of lent stocks. Rather than recalling stocks, which can jeopardise the relationship with borrowers, the firm prefers to place restrictions on lending four to six weeks ahead of a vote. |
| **Engagement** | **Number of direct engagements**<br>► In 2016, the Corporate Governance Centre started to conduct governance-focused meetings and carried out 37 engagements. In the January-October 2017 period, the number of engagements totaled 65.<br>► Although not tracked as engagements, ESG analysts also have discussions on environmental and social topics at around 1,500 company meetings per year. |
| | **Reasons for direct engagement**<br>► The Corporate Governance Centre carries out proactive engagements to address important governance-related concerns or in relation to major M&A transactions.<br>► In addition, the CGC responds to investee companies who approach it; this is normally done ahead of AGMs to enquire about voting intentions but also increasingly to seek opinions on ESG issues. |
| | **Collaborative engagement**<br>► DeAM does not carry out collaborative engagements with other asset managers and/or activists because of regulatory constraints ("acting in concert" issue). |
| | **Other forms of engagement**<br>► Since 2015, DeAM has sent annual letters to investee companies detailing its main expectations for governance as well as policy changes for the upcoming voting season.<br>► DeAM contributes to the development of regulatory policy with other asset managers and participates in industry events and relevant working groups. |
| **Disclosure on Website** | ► DeAM publishes a Corporate Governance and Proxy Voting policy document that details voting principles in subjects such as board composition, remuneration, capital structure, and market control measures (for example, mergers and acquisitions). It also outlines its engagement approach.<br>► The firm also publishes an annual governance engagement report featuring high-level statistics on voting activities. However, the report does not contain specific examples of interactions with individual companies.<br>► DeAM discloses distilled voting records for all companies included in retail funds domiciled in Germany and Luxembourg only.<br>► DeAM's dedicated ESG Thematic Research team publishes reports on ESG issues. |

## 4. Geode Capital Management (Fidelity's index subadvisor)

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|---|---|
| **Manager Description** | ► Fidelity founded Geode Capital Management in 2001 and it began managing index strategies in 2002. Fidelity spun the firm off in 2003, and Geode has since served as the subadvisor for all of Fidelity's index mutual funds. Fidelity accounts for the vast majority of Geode's assets, though it has some other institutional clients.<br>► At the end of June 2017, Geode managed $304 billion in assets, 96% of which was in passively managed strategies. |
| **Industry Codes and Frameworks** | ► UN PRI signatory since the second quarter of 2017.<br>► It is not a signatory of any other industry stewardship codes. |
| **Investment Stewardship Team** | ► Four members of the compliance team are responsible for voting proxies. The firm's proxy voting policy is set by the compliance team in collaboration with a newly created ESG Committee. Policy changes are approved by the firm's board of directors.<br>► Members of the team are all generalists. |
| **Proxy Voting** | **Process**<br>► Geode's proxy voting policy and activities are totally separate from Fidelity's.<br>► Geode executes its votes through a third-party proxy advisor (ISS) in accordance with its voting policy, which may differ from its proxy advisors' recommendations.<br>► Geode regularly audits these votes to ensure that they comply with its policy and manually reviews votes that fall outside of its standard voting policy.<br>► Portfolio managers cannot vote independently on behalf of their fundholders.<br>► Geode applies the same voting policy globally, but in some cases, it may adapt the application of that policy to reflect differences in local market norms.<br>► Among its guiding principles, Geode votes to promote independence on the board and discourage antitakeover provisions. Geode may also vote for shareholder proposals that require greater disclosure of key environmental and social issues confronting its holdings. |
| | **Scope**<br>► The team votes proxies wherever it is feasible to do so. |
| | **"Against" votes**<br>► Geode may vote against members of the board if it has serious concerns about the company's ESG practices. |
| | **Use of proxy advisors**<br>► Geode subscribes to research from ISS and Glass Lewis but does not solely rely on their voting recommendations. |
| | **Stock lending**<br>► The team generally does not recall shares on loan to vote. |
| **Engagement** | **Number of direct engagements**<br>► Geode has not proactively engaged with its portfolio companies. However, Geode recently hired ISS's ETHIX service to facilitate its engagement efforts. |
| | **Reasons for direct engagement**<br>► ISS ETHIX determines whether an engagement is appropriate and gives Geode the option to participate. |
| | **Collaborative engagement**<br>► N/A |

## 4. Geode Capital Management (Fidelity's index subadvisor)

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| | **Other forms of engagement**<br>► N/A |
| **Disclosure on Website** | ► Geode's proxy voting policy is included in the Statement of Additional Information filings for its subadvised U.S.-listed funds, which is also available on Fidelity's website.<br>► The policy outlines the firm's framework for proxy voting, including its approach to electing directors, voting on antitakeover proposals, say on pay, stock compensation, and environmental and social proposals, among others.<br>► Like all U.S. fund providers, Geode discloses the proxy voting records of its subadvised U.S.-listed funds on Form N-PX, which it files with the SEC. These records are also available on Fidelity's website. |

## 5. Legal & General Investment Management

**Manager Description**

- LGIM is one of Europe's largest asset managers. The company manages close to GBP 900 billion in assets globally in a variety of investment vehicles. Over 80% of the assets in its range of funds are managed passively.
- The firm is a key player in the U.K. investment fund market, both in its capacity as one of the largest pension fund managers and via the sale of traditional index-trackers.

**Industry Codes and Frameworks**

- UN PRI signatory since 2010.
- LGIM adheres to many local corporate-governance-related industry codes (for example, U.K. Stewardship Code) and guidelines (for example, ICGN).

**Investment Stewardship Team**

- LGIM has a dedicated corporate-governance team with a global scope based in London. The team is made up of 11 specialists, having increased in size by two members since 2015.
- The director of corporate governance reports directly to LGIM's CEO and is on the board of LGIM.
- In addition, there is a corporate-governance board that oversees the evolution and implementation of LGIM corporate-governance policies and plays a key role in the resolution of conflicts of interest. Two independent nonexecutive directors sit on the board.

**Proxy Voting**

**Process**

- The voting process is internal, centralized, and implemented by the corporate-governance team.
- LGIM's voting principles are universal and underpinned on the belief that companies that demonstrate good corporate governance and properly address sustainability and environmental concerns will deliver enhanced shareholder value. However, the principles can be adapted to the specificities of different geographical areas.
- The team uses proxy advisor voting recommendations for general information purposes but does not necessarily follow them. Each voting decision ultimately lies with the corporate-governance team.
- LGIM consistently votes the same way across its portfolios, so as not to dilute the effectiveness of the vote.
- Index portfolio managers are kept informed of voting decisions.

**Scope**

- LGIM votes proxies for all holdings where feasible.
- The number of holdings for which LGIM does not vote represent around 5% of the total.

**"Against" votes**

- LGIM's standard position is to cast a negative vote on any proposal that goes against its policy principles.
- In the period 2014-16, there has been an increase in the number of companies for which LGIM has voted against in at least one resolution.

**Use of proxy advisors**

- LGIM uses proxy advisor ISS for general research, supplemented with IVIS research for U.K. meetings. ISS also issues LGIM with voting recommendations tailored to LGIM's policy, but these are used for information purposes only.

**Stock lending**

- In the U.K., LGIM does not engage in securities lending, but it does so in other geographies.
- LGIM does not recall securities or impose restrictions to lending ahead of a vote, except in cases where the impact of the vote can be materially important.

**Engagement**

**Number of direct engagements**

- The decision to engage directly with investee companies is made by the corporate-governance team without the

## 5. Legal & General Investment Management

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| | interference from investment teams. In the period 2014-16, LGIM carried out 500-600 company meetings per year. |
| | **Reasons for direct engagement**<br>► The corporate-governance team engages with companies directly both for information-gathering purposes as well as to discuss ESG-related concerns. The ultimate objective of these engagements is to foster a beneficial long-term relationship that facilitates effective change in investee companies.<br>► The team prioritizes engagement with large companies in a sector or industry. The premise is that engaging with large companies – particularly if the engagement triggers effective change – redefines industry best practice and can generate peer pressure in medium and smaller companies. |
| | **Collaborative engagement**<br>► LGIM undertakes collaborative engagement with other asset managers and with asset owners.<br>► Whenever an activist reaches out to LGIM with a shareholder proposal, the corporate-governance team is open to study it and potentially collaborate, as long as it favors the long-term interests of LGIM fundholders. |
| | **Other forms of engagement**<br>► LGIM contributes to the development of regulatory policy with other asset managers and participates at industry events. |
| **Disclosure on Website** | ► In addition to LGIM's General Voting Policy, LGIM publishes six separate proxy voting policy market supplements (U.K., North America, Brazil, France, Spain, and Japan) detailing key principles in subjects such as board composition, remuneration, capital structure, and market control measures (for example, mergers and acquisitions). LGIM also publishes a Climate Change Policy and a stand-alone Conflicts of Interest Policy for its engagement activities.<br>► The firm publishes an annual report with high-level voting statistics and generic examples of engagement activities with investee companies. It also publishes full voting records monthly.<br>► Thought pieces and topical pieces are also regularly published on the website. |

## 6. Lyxor

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| **Manager Description** | ► Lyxor is a wholly owned subsidiary of Societe Generale, with $141 billion in AUM worldwide, of which around 50% is managed passively, almost entirely in ETFs.<br>► Lyxor is the third-largest ETF provider in Europe with $71 billion in AUM. The firm has a pragmatic approach to replication methodology and uses physical replication whenever it brings additional value to the end investor. As of this review, just over 50% of Lyxor's ETF range employs synthetic replication. |
| **Industry Codes and Frameworks** | ► UN PRI signatory since December 2014.<br>► Lyxor also adheres to many local corporate-governance-related industry codes. |
| **Investment Stewardship Team** | ► Lyxor has had a dedicated Socially Responsible Investment team in place since 2015. The team, based in Paris, is set up under the responsibility of the General Secretariat of Lyxor.<br>► The team has two members, including an analyst hired in 2016 to develop ESG expertise on, and potentially engagement with, small and medium-size enterprises.<br>► In addition, there is a governance committee that oversees the formulation and implementation of the voting policy and manages conflicts of interest. The committee is composed of SRI team manager, CIO, head of risk, head of legal affairs, and chief compliance officer. |
| **Proxy Voting** | **Process**<br>► Lyxor's voting decisions are made using recommendations issued by proxy advisor ISS in line with Lyxor's voting policy. Starting in 2018, the SRI team will start analyzing sensitive information delivered by ISS to identify potential conflicts, but as of now it votes in line with ISS' recommendations.<br>► The key principles of Lyxor's voting policy revolve around the independence and diversity of boards, fair remuneration policies, transparency of reporting, and integration of environmental and social responsibility targets. |
| | **Scope**<br>► Prior to mid-2016, Lyxor did not exercise voting rights for its equity holdings.<br>► As of this review, Lyxor votes for all French and MSCI Europe Index companies included in its France- and Luxembourg-domiciled equity funds for which Lyxor holds a minimum of 0.10% of the capital. This represents 18% of its equity holdings.<br>► Lyxor does not execute voting rights on stock holdings in substitute baskets of synthetic ETFs. |
| | **"Against" votes**<br>► Lyxor follows the voting recommendations provided by proxy advisor ISS and in line with Lyxor's voting policy. The SRI team is aware that whenever its voting scope is expanded, there will be more instances where they will disagree with ISS. However, the SRI team has yet to establish a protocol of how to act in these circumstances. |
| | **Use of proxy advisors**<br>► Lyxor uses proxy advisor ISS to provide voting recommendations tailored to Lyxor's own policy. |
| | **Stock lending**<br>► Lyxor systematically recalls French and German stocks ahead of a vote.<br>► For the remainder, the firm follows a case-by-case approach and will only recall if the matters involved have a material effect on the funds holding the stocks. |
| **Engagement** | **Number of direct engagements**<br>► Lyxor does not currently carry out engagements with investee companies. |

## 6. Lyxor

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| | ► As a potential first step, Lyxor would consider engaging with large-cap companies—maybe from 2018. In addition, Lyxor hired an analyst for the SRI team in 2016 with a view to developing a ESG strategy—potentially involving engagement—with small and medium-size companies. |
| | **Reasons for direct engagement** ► Lyxor has yet to formulate a formal strategy on engagement. |
| | **Collaborative engagement** ► Lyxor has yet to formulate a formal strategy on engagement. |
| | **Other forms of engagement** ► Lyxor contributes to the development of regulatory policy with other asset managers and participates at industry events. |
| **Disclosure on Website** | ► Lyxor publishes a SRI policy document detailing the firm's general vision on corporate governance and broad voting guidelines on subjects such as board composition, remuneration, and social/environmental shareholder proposals.<br>► The firm also publishes an annual voting report with high-level statistics on voting patterns by country and broad governance theme. The report also includes a distilled breakdown of the factors behind negative votes and, separately, a list of the companies against which negative votes were cast.<br>► Lyxor reports online the carbon footprint for its equity ETFs at index level. |

## 7. Nikko Asset Management

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| **Manager Description** | ► Nikko Asset Management is one of Asia's largest asset managers, with over $184 billion in assets under management globally, as of the end of June 2017.<br>► Around 33% of total AUM is invested in passive strategies, or around 45% when only considering the firm's investment fund range, as of 30 June 2017.<br>► Nikko AM is the second-largest ETF provider in Japan. Most of Nikko ETFs are domiciled in Japan. Nikko AM also has a presence in the Singapore ETF market. |
| **Industry Codes and Frameworks** | ► UN PRI since October 2007.<br>► Nikko AM is also a signatory to Principles for Financial Action for the 21st Century and CDP (Formerly Carbon Disclosure Project).<br>► It has also accepted and complies with Japan's Stewardship Code. |
| **Investment Stewardship Team** | ► The Active Ownership Group was created in March 2017 in Tokyo. Prior to that, the head of Equity Fund Management and one of the Equity Research Group's analysts were in charge of proxy voting and engagement.<br>► The Active Ownership Group, which includes four members, is responsible only for Japanese companies.<br>► Regional research teams execute the voting rights based on firm's policies. |
| **Proxy Voting** | **Process**<br>► Nikko AM refers to customized recommendations provided by ISS based on Nikko AM's proxy voting guidelines.<br>► ISS' recommendations are reviewed and discussed by the Active Ownership Group, with the involvement of sector analysts and active portfolio managers. Only one voting decision will be made. |
| | **Scope**<br>► The Active Ownership Group votes for all 2,000 companies within the TOPIX index. |
| | **"Against" votes**<br>► Nikko AM would vote against a resolution if the resolution is regarded as being against the interests of the beneficiary or client.<br>► The increase in percentage of votes against management in the past two years is a result of Nikko increasing the threshold of ROE and dividend-payout requirements and to put pressure on companies for change. |
| | **Use of proxy advisors**<br>► Third-party research is used, including, but not limited to, environmental reports from investment advisory firm the Good Bankers, MSCI ESG Research, ISS, and investor relations services company IR Japan. |
| | **Stock lending**<br>N/A |
| **Engagement** | **Number of direct engagements**<br>► Nikko AM reports conducting around 2,800 engagements, including multiple meetings with the same company, every year.<br>► If multiple visits are omitted, Nikko Asset Management engages about 1,000 companies a year. |
| | **Reasons for direct engagement**<br>► Engagements are initiated by analysts and active portfolio managers, and as such are proactive instead of reactive to certain events.<br>► Nikko AM views engaging with Japanese companies as essential to promote international standards as it pertains to increasing corporate and shareholder value. |

## 7. Nikko Asset Management

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| | **Collaborative engagement**<br>► Nikko AM does not have collaboration agreements with other firms because of the regulation in Japan, which may prevent collaborative engagement. |
| **Disclosure on Website** | ► Nikko AM publishes on its website its fiduciary and ESG principles, views on Japan's Stewardship Code, guidelines on exercising voting rights, voting decisions by proposal, as well as a summary of voting decisions.<br>► Details of its engagement activities are disclosed only to clients on a quarterly basis. |

## 8. Nomura Asset Management[19]

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| **Manager Description** | ► Nomura Asset Management is one of the largest asset managers in Japan, with $395 billion of assets under management, at the end of June 2017.<br>► Around 41% of the firm's total AUM is in passive investment strategies.<br>► The firm is the largest ETF provider in Japan, with a 45% market share.<br>► Most of Nomura ETFs are domiciled in Japan. |
| **Industry Codes and Frameworks** | ► UN PRI signatory since March 2011.<br>► The firm also complies with Japan's Stewardship Code, the U.K. Stewardship Code, and Principles for Financial Action for the 21st Century. |
| **Investment Stewardship Team** | ► Nomura AM has been gradually expanding the team and currently has five ESG specialists in Tokyo.<br>► The firm has also appointed some investment specialists located in the overseas office for ESG functions.<br>► The main focus of ESG specialists was previously governance, but they now consider environmental and social issues.<br>► The team's main responsibilities are proxy voting, company engagement, integration of the investment decision making process, and collaborative activities. |
| **Proxy Voting** | **Process**<br>► The voting process is internal and the Responsible Investment Committee, located in Tokyo, is fully responsible for the proxy voting process.<br>► The Responsible Investment Committee is composed of senior managers outside of investment management and research operations.<br>► Portfolio managers cannot vote independently on behalf of their fundholders. |
| | **Scope**<br>► Nomura AM votes proxies for all holdings of Japanese stocks and for part of foreign stocks where feasible. |
| | **"Against" votes**<br>► The Responsible Investment Committee votes against resolutions deemed detrimental to shareholder value based on proxy voting guidelines. |
| | **Use of proxy advisors**<br>► Nomura AM uses MSCI ESG Manager, ISS, and Glass Lewis for research. |
| | **Stock lending**<br>► Securities are recalled if the benefits of voting the security are deemed to outweigh the costs of recalling the security. |
| **Engagement** | **Number of direct engagements**<br>► The firm engages with around 200 companies every year.<br>► Nomura AM expects this number to increase on the back of its contract with Global Engagement Services in April 2017 to support the global engagement activities. |
| | **Reasons for direct engagement** |

19 Please note that we relied on the completed comprehensive questionnaire from Nomura Asset Management and publicly available information to complete this section as subsequent face-to-face meetings or conference calls were unavailable.

## 8. Nomura Asset Management[19]

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| | ► Nomura AM believes that engagement should be held based on the deep understanding of investee companies and their business environment, including financial and nonfinancial information such as ESG issues and certain strategies and management philosophy.<br>► Engagements are triggered because of various reasons such as business scandal, law violation, low ROE, inadequate information disclosure, and other ESG issues. |
| | **Collaborative engagement**<br>► Nomura AM signed a contract with Global Engagement Services in April 2017 to support its global engagement activities. |
| **Disclosure on Website** | ► The firm publishes its stewardship approach, recommendations for the "Ideal Form of Business Management of Investee Companies, as well as basic policies for proxy voting and engagement.<br>► Nomura AM provides summaries and outcomes of proxy voting on each investee company for their respective proposals on the website, which are updated on a quarterly basis.<br>► In the U.K., Nomura AM publishes quarterly responsible investing reports. |

## 9. Charles Schwab Investment Management

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| **Manager Description** | ► Charles Schwab Investment Management is a subsidiary of The Charles Schwab Corporation, which also has a bank and brokerage arm.<br>► At the end of June 2017, CSIM had $322 billion in assets under management, including money funds. The firm's passively managed strategies represented the bulk of the firm's ETF and mutual fund assets (84% out of $166 billion)<br>► CSIM's fund lineup primarily consists of core portfolio building blocks with low fees, which are largely held by individual investors.<br>► Its fund business is used to support its core brokerage business, allowing the firm to price its products more aggressively than it might if it were a stand-alone asset manager. |
| **Industry Codes and Frameworks** | ► Unlike all of the firms Morningstar surveyed, CSIM is not a signatory of the UN PRI and hasn't signed any stewardship codes.<br>► However, CSIM is a member of the Council for Institutional Investors, International Corporate Governance Network, and the Harvard Institutional Investor Forum. |
| **Investment Stewardship Team** | ► The corporate-governance team includes three members.<br>► The team's responsibilities are divided into two functions: corporate-governance research, which includes the development of proxy policies, and proxy operation, which includes oversight of the firm's third-party proxy advisors. The director of proxy and governance is responsible for the former, while two additional employees focus on proxy operations.<br>► The CSIM Proxy Committee, which includes the chief investment officer, oversees the firm's proxy voting policy. |
| **Proxy Voting** | **Process**<br>► CSIM relies on Glass Lewis' proxy voting policies for guidance, but it develops its own guidelines on issues where it disagrees. It also relies on research from ISS on how to vote on executive compensation issues.<br>► Glass Lewis executes CSIM's proxy votes in accordance with CSIM's voting policy, which usually aligns with the proxy advisors' recommendations.<br>► Among its guiding principles, CSIM votes to promote independence on boards and alignment of manager compensation with shareholder interests.<br>► The Proxy Governance team focuses on corporate-governance issues, taking the view of a long-term investor, but it does not actively use its voting power to drive change on environmental or social issues. That said, CSIM may support proposals requiring greater disclosure of environmental and social policies when they are material to the business.<br>► CSIM takes local market context into account in its voting policy, so it won't necessarily apply U.S. standards to other markets.<br>► The portfolio managers at Schwab do not have any say on how their shares are voted, but they may provide feedback to the Proxy Governance Team on policy-level issues. |
| | **Scope**<br>► CSIM votes wherever it is feasible and cost-efficient to do so, including shares of non-U.S.-listed stocks. |
| | **"Against" votes**<br>► CSIM generally supports the board's recommendations unless specific concerns arise, such as the board's performance or potential conflicts of interest. |
| | **Use of proxy advisors**<br>► CSIM relies on Glass Lewis for advice on how to vote most issues. It relies on both Glass Lewis and ISS for advice |

## 9. Charles Schwab Investment Management

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| | on how to vote on executive compensation issues in the U.S. and Canada.<br>► CSIM uses Glass Lewis' system for vote execution, reporting, and record-keeping. |
| | **Stock lending**<br>► The Proxy Governance Team will recall securities on loan if an upcoming vote is material to magnify its impact. |
| **Engagement** | **Number of direct engagements**<br>► Schwab does not engage with any of its individual holdings. It believes that it would be difficult to engage with portfolio companies in a consistent and scalable way and that there isn't a clear benefit to investors that would justify the expense. |
| | **Reasons for direct engagement**<br>N/A |
| | **Collaborative engagement**<br>N/A |
| | **Other forms of engagement**<br>► Participation in industry forums. |
| **Disclosure on Website** | ► CSIM's proxy philosophy and voting policy is on its website. This policy outlines the firm's approach to proxy voting, including how it votes for directors, executive compensation, antitakeover provisions, and capital structure decisions, among others.<br>► Like all U.S. fund providers, CSIM discloses the proxy voting records of its funds on Form N-PX, which it files with the SEC. These records are also available on the firm's website. |

## 10. State Street Global Advisors

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| **Manager Description** | ► State Street Global Advisors is the investment division of State Street Corporation, which operates one of the largest custodial banks in the U.S.<br>► The firm is one of the world's largest asset managers with $2.6 trillion in assets under management at the end of June 2017, 79% of which was invested in passively managed strategies.<br>► Environmental, social, and governance strategies have become a bigger focal point for the firm in recent years. While these strategies still represent a small part of the firm's asset mix, they influence the way it thinks about corporate governance. |
| **Industry Codes and Frameworks** | ► UN PRI signatory since May 2012.<br>► The firm complies with the U.K. Stewardship Code, Japanese Stewardship Code, and the U.S. Stewardship Principles. |
| **Investment Stewardship Team** | ► There are currently 11 people on SSGA's Asset Stewardship Team, up from eight in 2014.<br>► The team includes four governance analysts, three ESG analysts, and four proxy operations analysts, located in Boston and London.<br>► Responsibilities are divided by region rather than sector.<br>► The team reports to the Proxy Review Committee, which is a subcommittee of the Investment Committee and includes senior investment and compliance personnel. |
| **Proxy Voting** | **Process**<br>► SSGA relies on ISS to apply the firm's voting policy for routine votes, but it reviews material, non-routine votes internally on a case-by-case basis.<br>► Through its voting policy, SSGA strives to promote independence and diversity on corporate boards, align manager compensation with long-term company performance, and encourage firms to manage environmental and social risks and take progressive stances on those issues.<br>► SSGA applies the same stewardship principles globally to guide its proxy votes, but it adapts the application of those principles to reflect differences in regional norms, but only to a point.<br>► In some cases, it may seek to drive change in local market practices where it feels that they do not adequately protect investors.<br>► Active portfolio managers can provide input, but ultimate voting authority rests with the Investment Stewardship Team. |
| | **Scope**<br>► The team votes proxies wherever it is feasible to do so. |
| | **"Against" votes**<br>► SSGA votes against proposals that are inconsistent with the principles it is trying to advance through its proxy voting and engagement guidelines. |
| | **Use of proxy advisors**<br>► The team uses ISS as a proxy voting agent and provider of research, but it does not rely on its voting recommendations.<br>► It also uses data and research from Glass Lewis, Bloomberg, Sustainalytics, and MSCI, among others. |
| | **Stock lending**<br>► SSGA can recall securities on loan ahead of material proxy votes to increase its voting power. |
| **Engagement** | **Number of direct engagements** |

## 10. State Street Global Advisors

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| | ► In fiscal 2016, the firm had 611 engagements with 558 companies, two thirds of which were with Canadian and U.S. firms. |
| | **Reasons for direct engagement**<br>► Each year, SSGA identifies key ESG themes and a few sectors where it will focus its attention and prioritize engagements.<br>► The team further prioritizes engagements with firms where it has concerns about governance or sustainability practices.<br>► SSGA's Asset Stewardship team engages with companies privately. |
| | **Collaborative engagement**<br>► The firm collaborates with other investors on engagements with individual holdings when appropriate. |
| | **Other forms of engagement**<br>► The firm periodically partners with other investors to voice concerns and propose solutions to marketwide issues and regulations.<br>► It also sends letters addressing thematic stewardship issues to over 1,000 companies. It sent the first letter in 2014 addressing director tenure.<br>► SSGA participates in industry events and relevant working groups. |
| **Disclosure on Website** | ► SSGA publishes Proxy Voting and Engagement Guidelines for each region where it operates on its website. These documents outline the firm's corporate-governance philosophy, as well as its framework for proxy voting on key issues and engaging with portfolio companies.<br>► Like all U.S. fund providers, SSGA discloses the voting record for its U.S.-listed funds on Form N-PX, filed with the SEC.<br>► SSGA also publishes an Annual Stewardship Report on its website, which summarizes its stewardship priorities for the year, aggregates voting data, discloses the names of all the companies it has engaged with during the year, and highlights some successful engagements.<br>► The firm publishes a Stewardship Compliance Statement, Quarterly Stewardship Updates, and thought pieces outlining its view on key governance and sustainability issues |

## 11. UBS Asset Management

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| **Manager Description** | ► UBS Asset Management is a business division of UBS Group with $730 billion in assets as of the end of June 2017, 37% of which is managed passively.<br>► UBS AM is an important player in the passive investment fund market in Europe. At present, UBS is Europe's third-largest provider of index funds with an AUM of $81 billion and the fourth-largest provider of ETFs with an AUM of $42 billion.<br>► As of this review, 20% of UBS' range of equity ETFs is in funds using synthetic replication, and the bulk is concentrated in two funds. |
| **Industry Codes and Frameworks** | ► UN PRI signatory since 2009.<br>► In addition, the firm adheres to many ESG-related industry codes, groups, and forums, including Stewardship Codes in the U.K. and Japan. |
| **Investment Stewardship Team** | ► UBS has a dedicated Sustainability and Impact Investing team with a global geographical scope.<br>► As of this review, the team consists of nine specialists located in London, New York, Zurich, and Chicago. It has grown from four in 2015 and will reach 11 by the end of 2017 and 14 by the end of February 2018.<br>► The SI team is supported by two ESG analysts and two ESG portfolio managers. |
| **Proxy Voting** | **Process**<br>► UBS has a centralized voting process implemented by the corporate-governance team in London.<br>► UBS relies on proxy advisor ISS to provide voting recommendations in accordance with UBS' own policy.<br>► UBS' SI team analyses every voting recommendation and doesn't always follow ISS' custom recommendations.<br>► The key principles of UBS' voting policy revolve around the independence and diversity of boards, fair remuneration policies, transparency of reporting, and integration of environmental and social responsibility targets.<br>► Active portfolio managers and equity analysts are consulted as part of the voting decision-making process. Where possible, UBS seeks to have a consistent approach to voting across portfolio holdings; however, portfolio managers retain the ability to vote differently from the house view.<br>► Passive portfolio managers are informed of controversial voting decisions. |
| | **Scope**<br>► The firm's policy is to vote proxies for any holding where it is feasible to do so.<br>► UBS does not execute voting rights on stock holdings in substitute baskets of synthetic ETFs. |
| | **"Against" votes**<br>► The SI team's standard policy is to cast a negative vote on any proposal that goes against UBS' policy principles. |
| | **Use of proxy advisors**<br>► UBS relies on proxy advisor ISS to provide voting recommendations in accordance with UBS' own policy. |
| | **Stock lending**<br>► The standard policy is not to recall loaned securities, but UBS recalls the securities to exercise its voting right if the matters involved have material effect on the funds holding the stocks. This, in practice, happens very rarely. In some cases, lending can also be restricted ahead of the vote. |
| **Engagement** | **Number of direct engagements**<br>► Engagement is undertaken by the investment teams with support from the SI team. The latter engaged with approximately 120 companies in 2016, while the investment teams has up to 5,000 investment meetings every |

## 11. UBS Asset Management

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| | year, many of which include discussions regarding governance and environmental matters. |
| | **Reasons for direct engagement**<br>► UBS seeks to adopt a more thematic and systematic approach to engagement, focusing efforts on issues that affect sustainability.<br>► The SI team's engagement activities are triggered by a variety of factors, including, but not limited to, the size of the holding, the significance of the issue for clients, its impact on the sustainability of the company, best practice standards, and the likelihood of success. |
| | **Collaborative engagement**<br>► UBS participates both formally and informally in collaborative initiatives, mostly through collective bodies rather than directly with other shareholders. UBS has so far played a more supporting role in these engagements but intends to play a more leading role going forward.<br>► Collaborative engagements are chosen on a case-by-case basis, more often when UBS' holding in a given company is too small or in cases when individual engagements would not have a strong likelihood of success. |
| | **Other forms of engagement**<br>► UBS contributes to the development of regulatory policy with other asset managers and participates in industry events and relevant working groups. |
| **Disclosure on Website** | ► UBS proxy voting policy is available on its website. The policy document details UBS' general vision on corporate governance and provides very specific voting principles in key subjects such as board composition, remuneration, capital structure, and market control measures (for example, mergers and acquisitions).<br>► UBS publishes voting records on its website. This includes comprehensive statistics by region and theme, as well as specific voting records pertaining to individual companies contained in the funds. It also sends clients quarterly and annual reports on voting and corporate-engagement activities.<br>► As from 2018, UBS intends to start publishing comprehensive stewardship reports on a yearly basis. Engaged companies will remain anonymous.<br>► The firm also published ESG-related thought leadership papers on its website. |

## 12. Vanguard

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| **Manager Description** | ► Vanguard had $4.4 trillion in assets under management at the end of June 2017, 74% of which was in passively managed strategies.<br>► Vanguard manages all its index and quant-active funds in-house, but it outsources traditional security selection to third-party managers, so most of its actively managed funds are subadvised. |
| **Industry Codes and Frameworks** | ► UN PRI signatory since 2014.<br>► Vanguard is also a signatory of the U.K. Stewardship Code, the Hong Kong Principles for Responsible Ownership, and Japan's Corporate Governance Code.<br>► Vanguard is a founding member of the Investor Stewardship Group (2017) and the Commonsense Corporate Governance Principles (2016).<br>► Vanguard is a member of the Investment Advisory Group for the sustainability Accounting Standards Board. |
| **Investment Stewardship Team** | ► Vanguard's Investment Stewardship team has doubled in size since 2015 to 21 people, all located at the firm's headquarters in Malvern, Pennsylvania.<br>► Members of the team specialize by sector to deepen their expertise.<br>► Vanguard's Investment Stewardship Oversight Committee and the funds' boards of trustees monitor the team's efforts.<br>► The Investment Stewardship Oversight Committee includes the firm's CIO and senior legal and compliance people. |
| **Proxy Voting** | **Process**<br>► Proxies are voted internally by the Investment Stewardship team, which attempts to promote four governance pillars: independence, diversity, and experience on the board; governance structures that empower shareholders; compensation practices that incentivize long-term outperformance; effective oversight of relevant industry- and firm-specific risks.<br>► Active portfolio managers can provide input when relevant, but ultimate voting authority rests with the Investment Stewardship Team. |
| | **Scope**<br>► The team votes proxies for all holdings, where feasible. |
| | **"Against" votes**<br>► Vanguard will vote against proposals that are not consistent with the core principles outlined in its proxy voting guidelines.<br>► In some instances, Vanguard may vote against management teams it is engaging with, but it considers the circumstances unique to each firm. |
| | **Use of proxy advisors**<br>► The team supplements its analysis with research from third-party providers, such as Institutional Shareholder Services, Glass Lewis, MSCI, and Equilar, among others. However, it does not rely on the recommendations of these firms. |
| | **Stock lending**<br>► The team doesn't typically recall securities on loan but will do so ahead of votes on material issues to increase its impact. |
| **Engagement** | **Number of direct engagements** |

## 12. Vanguard

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| | ► During the 2017 proxy year, it had 954 in-person meetings (with 680 portfolio companies), up from 617 meetings in 2014.<br>► The majority of these engagements were with U.S. companies, but Vanguard expects its engagements outside the U.S. to increase in the future. |
| | **Reasons for direct engagement**<br>► The Investment Stewardship Team prioritizes candidates for engagement based on material events, such as a controversy or major issue up for vote, or corporate-governance practices that Vanguard believes don't adequately protect shareholders, looking for industry outliers.<br>► Vanguard seeks to build collaborative relationships with its portfolio companies and voices its concerns and recommendations privately to build trust and drive change. Social and environmental risks fall within the scope of these engagements because Vanguard believes that effectively managing these risks is integral to good corporate governance. |
| | **Collaborative engagement**<br>► Vanguard does not collaborate with other investors in its engagements with individual companies. |
| | **Other forms of engagement**<br>► Vanguard contributes to the development of regulatory policy with other asset managers and participates at industry events.<br>► It also publishes open letters to its portfolio companies outlining its corporate-governance philosophy. |
| **Disclosure on Website** | ► Vanguard outlines its investment stewardship principles and proxy voting guidelines on its website.<br>► The firm also publishes an Investment Stewardship Annual Report on its website, which includes data about its proxy voting and engagements. Vanguard doesn't disclose the name of the companies it engages with.<br>► Like all U.S. fund providers, Vanguard discloses the proxy voting records of its U.S.-listed funds on Form N-PX, which it files with the SEC. These records are also available on the firm's website. |

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