AMP CAPITAL

CORPORATE GOVERNANCE REPORT

ESG insights & proxy voting

March 2017

INSIGHTS
IDEAS
RESULTS

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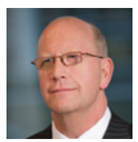
MEET THE TEAM



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Dr Ian Woods joined AMP Capital in December 2000, and since that time has focussed on how the issues of sustainability and ESG relate to financial investment and the investment risks. Ian's background is in environmental and risk consulting both in Asia/Pacific region and Europe. Ian assesses the management of intangible assets of companies on the Australian Securities Exchange through the assessment of ESG issues and in engaging with these companies in the areas of corporate social responsibility and sustainability. Ian also undertakes assessment of greenhouse gas risk issues for the wider AMP Capital Investment teams and has undertaken a number of studies in this area. He holds a PhD in Chemical Engineering from the University of Sydney, a Master of Environmental Law and a Master of Business Administration from the Australian Graduate School of Management.

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Kristen joined the ESG Investment Research Team in October 2015 with responsibility for the analysis of ESG issues and sustainability drivers across a number of sectors, as well as company engagement on ESG practises at the board level. Kristen has a diverse background with experience across ESG research and corporate governance, sell-side investment advisory and commercial litigation. Kristen joined AMP Capital from APP Securities, where she was Associate Director, Financials on the institutional desk, providing sell-side research to large institutions on banks, insurers and diversified financials. Prior to this, Kristen was a Senior Analyst with Ownership Matters, a corporate governance advisory firm where her clients included large fund managers. Before entering the investment industry, Kristen was a commercial litigator at Piper Alderman and ran large cases in the Supreme and Federal Courts for insurance and transport companies. Kristen started her career as a business journalist with Fairfax, writing on small and mid-cap companies for The Age, The Sydney Morning Herald and BRW. Kristen holds bachelor degrees in Commerce and Law from the University of Sydney and has just completed her Master of Laws at the same institution.

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Karin Halliday was appointed to her current position with AMP Capital in May 2000. She is responsible for determining how AMP Capital votes on behalf of the firm and its clients at all meetings held by the Australian companies in which AMP Capital invests. In doing so, Karin also monitors various aspects of corporate governance in many Australian companies. Prior to this Karin had a range of Portfolio Management roles within AMP Capital between June 1987 and June 1998, where she managed a wide range of Australian–based share trusts and was responsible for the Australian and international share component of a range of separately managed portfolios. Karin joined AMP in January 1984. Karin has more than 30 years of experience in the industry and recently completed the Australian Institute of Company Directors' Company Director Course.

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Richard was appointed to his current role of ESG Team Assistant Analyst in January 2015. Prior to joining AMP Capital in 2013 as a Business Operations Manager, Richard worked in a number of roles in both asset management and investment banking. Richard started work in the financial services industry in 1995 with Standard Chartered in its Treasury team. Since then, Richard has held a number of roles including running the operational side of a hedge fund as well as working in a wide variety of roles in leading financial firms such as Goldman Sachs, HSBC and UBS in both London and Sydney. He holds a Bachelor of Arts (Honours) in Economics from Royal Holloway, University of London. Richard brings solid project management and governance experience to the ESG team.

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Camille joined AMP Capital in January 2015 and is an Investment Associate for the Responsible Investment Leaders (RIL) range of funds, as a member of the firm's Technical Sales Specialist team. In this role, Camille is focused on client and prospect engagement for the firm's RIL and ESG capability, which involves close collaboration with the portfolio managers and ESG Investment Research team for these strategies. Camille also assists in our ESG investment research. Prior to her current role, Camille was on the AMP Capital graduate program and rotated through a number of teams across the business, including Investment Strategy and Economics, ESG Investment Research, and Strategy. Camille also previously interned at Orbis Investment Management and PlayfairTan. Camille holds a Bachelor of Commerce and Bachelor of Science from the University of Sydney, where she majored in International Business Studies, Economics and Environmental Studies.

Member of:

Signatory of:

AMP CAPITAL'S APPROACH TO ESG: The what, why and how

AMP Capital is one of the longest-standing managers of responsible investment funds in Australia.

Understanding how a range of environmental, social and governance (ESG) factors may affect an investment has long been an integral part of AMP Capital's investment process.

Long before becoming one of Australia's first signatories to the Principles for Responsible Investment in 2007, AMP Capital dedicated specific resources to understanding the impact of ESG factors. The key motivation for considering ESG issues within an investment process is to gain deeper insight into areas of risk and opportunity that could materially impact the value or performance of an investment.

As such, AMP Capital complements fundamental investment analysis with a thorough consideration of environmental, social and governance factors. ESG investment analysts pride themselves on digging deeper into the ESG risks and opportunities that each company faces. Over the long-term, factors such as a company's governance, leadership and their attitude towards risk are likely to have a greater influence on company value and share-price performance than the tangible factors that are traditionally considered by investment analysts.

For many years now, AMP Capital has compared the ESG attributes of individual companies and considered how these factors impact relative value and the long-term sustainability of company earnings. Our research focuses on a broad range of factors such as demographic trends, climate change, technological advances, risk management, supply-chain management, employee engagement, leadership, company culture, board diversity and occupational health and safety performance.

Unsurprisingly, when company earnings rely on them taking short-cuts and exploiting under-priced pollution, under-paid labour or weak regulation, the current level of their earnings may not be sustainable.

A deep dive into how a company is managing its ESG risks and opportunities can deliver investment insights that lead to better informed investment decisions and potentially higher returns.

It is a major task to identify the relevant industry-level drivers and then assess how each company manages those drivers. In order to gain new insights, and a competitive advantage, analysts must look beyond the information routinely reported by companies.

Which ESG factors are important?

The bulk of a company's value is typically, and increasingly, driven by a range of intangible factors. These drivers can generally be split into two categories: sustainability drivers that relate to the entire industry (such as the relevant demographic, regulatory and technological change) and intangible drivers that focus on each company's response.

While the specific sustainability drivers and their relative importance will tend to vary from industry to industry, there is a clear correlation between how effectively a company manages them and financial returns.

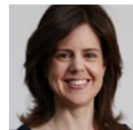
Before embarking on ESG analysis, it makes sense to take a step back and consider the factors driving earnings growth at the industry level. When determining which intangible drivers are most relevant to a particular industry, an ESG analyst would consider:

- **Environmental factors:** How likely is it that the value of a company in this sector will be influenced by how well they perform as a steward of the natural environment?
- **Social criteria:** How likely is it that the value of a company in this sector will be impacted by how a company manages relationships with its employees, suppliers, customers and the communities where it operates?
- **Governance:** How likely is it that the value of a company in this sector will be impacted by the quality of its leaders, the fairness of its pay structures, the audits and internal controls, and finally the rights of shareholders?

Pleasingly, AMP Capital's commitment to ESG research has been rewarded with clear evidence of a strong correlation between AMP Capital's proprietary ESG assessment of companies and their financial return. For this reason, AMP Capital believes thorough analysis of intangible drivers – or ESG research – is an important element of fundamental stock research.

The key motivation for considering ESG issues within an investment process is to gain deeper insight into areas of risk and opportunity

ESG TRENDS TO WATCH



Kristen Le Mesurier
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As long-term investors, understanding the way the world is changing is crucial. At any point in time, a complex web of trends is shaping industries, creating headwinds and fuelling tailwinds. It is these trends that we study in detail. It is an integral part of our environmental, social and governance (ESG) research.

In this article, we share the long-term investment trends that we expect to be prominent in 2017.

They include:

- **Sugar and obesity:** a risk to earnings
- **Disruption:** technology with the potential to upend mature industries
- **Climate change:** momentum on renewables will continue
- **Corporate governance:** CEO pay and persistence of bonuses
- **Social license to operate**
- **Supply chain:** scrutiny broadens beyond the garment sector
- **Food & agriculture:** human resistance to antibiotics

Sugar and obesity: a risk to earnings

Sugar is emerging as one of the most prominent investment risks for the global food and beverage industry. Science has linked high sugar consumption to obesity and Type 2 diabetes at a time when obesity rates are rising and healthcare costs for governments are growing.

Globally, 39 per cent of adults worldwide are overweight[1]. The number of obese adults doubled between 1980 and 2014[2]. China is expected to have the highest number of obese children in the world by 2025[3]. There is already three times the number of teenagers in China with diabetes than in the United States (US)[4]. In the US, obesity alone accounts for 21 per cent of healthcare spending[5] and in the UK, 10 per cent of the NHS budget is spent on Type 2 diabetes[6].

A long-term trend toward health and wellness is already limiting the growth profile of companies manufacturing and selling products with high sugar content. This would deepen materially if any of the following occurs:

1. Increased public concern from medical and public health organisations about the health impact of sugar consumption and greater awareness from consumers about the sugar content of food.
2. Clear numbers on the cost of delivering health services to combat obesity. This would create the political will to impose sugar taxes, nutrition labels and/or advertising restrictions in an attempt to reduce consumption.
3. Scientific evidence that sugar is the cause of particular diseases that cause death, which may enable large-scale litigation.

There are early signs that the first two are occurring. The World Health Organisation halved its recommended proportion of daily calories from sugar to six teaspoons a day in 2015 and publicly called for governments to impose sugar taxes on beverages for the first time in 2016[7]. There is evidence of increasing numbers of consumers making healthier food choices. Soft drink sales for some listed companies are flat lining or trending lower and processed food purchases per capita are down in some markets.

Some countries and states are already responding with sugar taxes. There are now soda (soft drink) taxes in Mexico, the UK, Philadelphia in the US (the first large US state to impose a tax on soda), the city of Berkeley in California, and there is a current proposal in Ireland. Thirty-three cities in the US have attempted to introduce some form of soda tax. There are restrictions around advertising to children in Mexico and France and nutrition labels that include sugar content are being imposed for the first time in the US.

In Australia, the Greens have a soda tax on its policy platform and the party has said it will introduce a private senator's bill by the end of 2017 if the Federal Government does not move to introduce one of its own. While the major parties in Australia do not yet have plans to introduce any form of soda tax, the public discussion generated by the possibility of a soda tax has the potential to reduce consumption given that it shines a spotlight on the issue and accelerates consumer education about the health impacts of sugar. We believe these discussions will step up a notch during 2017.

Disruption: technology with the potential to upend mature industries

Disruption was one of the buzz words in 2016 but the discussion largely focused on the potential of technology to disrupt established business models. In 2017, we expect technologies to deliver the first waves of impact. A few industries in particular will see technology change the way they do business, namely manufacturing, finance and retail.

AUTOMATED VEHICLES

Driverless cars have the potential to impact a number of industries in profound ways, all of which AMP Capital considers in detail in our long-term ESG research[8].

The technology is gathering pace. Some observers are now forecasting that a level four automated car (one level beneath full automation) capable of mass production will be tested in 2017. Entrepreneur Elon Musk has promised to have a Tesla drive itself from Los Angeles to New York City with no human input this year and it is possible that Waymo (formerly Google's autonomous driving subsidiary) will launch a commercial level four service in some locations this year.

> Driverless cars have the potential to impact a number of industries in profound ways.

Waymo has also recently announced that it has developed technology that operates in rain, fog and snow while BMW said in January 2017 that it will test 40 self-driving cars in suburban environments in the second half of this year. These were previously considered to be key barriers to the technology.

Volvo is lending 100 of its level four automated SUVs to Swedish customers to test it on commuter routes at average speeds of 70 kilometres per hour. Some governments are proactively courting driverless car technologies by offering areas as test sites and passing regulatory guidelines for the operation of driverless cars on public roads[9].

Real estate, retail, infrastructure and insurance are the four industries that are shaping up to be the most profoundly affected by these vehicles in the medium term.

BLOCKCHAIN

Blockchain has the potential to be one of the most transformative technologies for large businesses in decades. Blockchain is basically a shared distributed ledger, or a database of real-time transactions, that can be accessed by any node in the network at any time. Blockchain allows for the exchange of data in real time for very little cost and is relatively safe and secure because the system operates across a network of computers. It is a peer-to-peer system so is considered safer and more transparent than its traditional brethren, which was managed by one central authority on the one internal platform. It is possible that 2017 will be the year that one of the large financial services organisations globally will announce that it is switching a significant IT platform to blockchain. The Australian Securities Exchange (ASX) has been the global leader to date in developing applications for its exchange; more specifically, its cash equities clearing and settlement operation. It ultimately hopes blockchain will replace CHESS, its system for recording shareholdings and managing the settlement of share transactions.

In January 2017, the largest settlements and clearing business in the US, the Depository Trust and Clearing Corp, announced that it will be switching one of its major data warehouses to blockchain technology from early 2018.

Most of the focus has been on financial services to date but, just like driverless cars, it has been on potential rather than implementation.

ONLINE RETAIL MOVING OFFLINE

At the end of 2016, Amazon announced that it is testing bricks-and-mortar grocery stores in the US and that these stores will not have check outs. A mobile phone app keeps a record of the goods consumers pick up from the shelves, then charges consumers through the app as they leave the store.

Amazon's announcement was further evidence of the trend we are seeing in global listed real estate and retail: online is moving offline. The last few years have proved that online is not destroying bricks-and-mortar real estate. Rather, the two will co-exist and need each other to survive. Consumers expect to be able to choose whether to shop online or on foot, and bricks-and-mortar stores will morph into real-life embodiments of the brand to provide experiences that cannot be replicated online. This trend has far-reaching implications for investments in global listed real estate, with changes to supply and demand dynamics likely to impact property valuations. We will be publishing a detailed white paper on disruption in global listed real estate in May 2017.

Climate change: momentum on renewables will continue

In January 2016, global regulation directed at CO2 emissions seemed imminent. The Paris Agreement had just been signed at COP21, signifying a global goal to keep global warming to below 2 degrees Celsius. A year later, US President Donald Trump has stated that climate change is a hoax and legislative action on climate change in the US will be dismantled. While disappointing, President Trump's position is not seen as a barrier to curb emissions. It's a matter of economics. The old coal generation model no longer makes financial sense and the private sector is proactively preparing for a renewables-centric and climate change-resilient world.

Renewable energy in particular will continue to grow irrespective of any likely legislative or policy change by Trump. The cost of producing the energy is declining, the technology is improving and the old coal fired power generators need significant investments or upgrades. Even in the absence of new climate commitments in the US, renewable energy capacity is expected to nearly double from 2015 levels by 2021. Bloomberg New Energy Finance[10] predicts that renewables will overtake natural gas as the dominant source of electricity generation in the US in 2031, even without policy support after 2020.

The continued focus on renewables and energy security will ensure that electricity prices and energy will remain heated discussions globally in 2017. This is likely to add to short term uncertainty for investors as well as utility and fossil fuel companies in the medium term.

Corporate governance: CEO pay and persistence of bonuses

The spotlight on executive pay is firmly on bonuses and long-term incentives as fixed pay appears to have receded to pre-Global Financial Crisis levels. The most recent annual study on executive pay in Australia, commissioned by the Australian Council of Superannuation Investors (ACSI), found that median fixed pay for chief executives of ASX200 companies was back to pre-2008 levels at $1.7 million in 2015. However, the size and frequency of bonuses for chief executives remains an issue, as well as the performance hurdles attached. AMP Capital's Karin Halliday discusses this in detail on page 10.

ACSI found that in 2015, 93 per cent of chief executives in the ASX100 received a bonus equivalent to 76 per cent of their maximum entitlement, implying that the vast majority of chief executives met and exceeded their bonus hurdles. This was the highest proportion of CEOs to receive a bonus since 2008.

This is consistent with our research on remuneration trends in global listed real estate, which we commissioned in December 2016. Of 19 Australian externally managed real estate investment trusts (REITs) proxy adviser, Ownership Matters found that only five of 79 executives received less than 50 per cent of their maximum bonus potential and four of these five executives were at one real estate investment trust. All but one REIT paid their executive teams more than 65 per cent, on average, in 2016. These are remarkably persistent bonus outcomes. With increased investor focus on the components of executive pay and whether or not the hurdles that determine vesting reward stretch performance, executive pay will be a key issue for investors in 2017.

Social licence to operate

In Australia, a key community concern in 2016 was the extent to which customers are treated fairly by the financial services sector. A few corporate scandals fuelled debate about whether some financial services companies are abusing their right to operate and led to calls from some in politics for a Royal Commission into the sector.

In the US, similar concerns arose in 2016 when one of the largest retail banks was accused of opening approximately two million customer bank and credit card accounts, in many instances without customers' knowledge. US regulators have alleged that these accounts were opened to meet sales targets.

Key in 2017 will be the remuneration structures financial services firms have in place for front-line sales staff. If there are sales incentives for those who sell to customers, the structure of these incentives will be scrutinised as well as the presence of safeguards to ensure that customers are sold products that are in their best interests, irrespective of internal sales targets. Investors now recognise that sales targets alone may deliver growth in the short term but the flipside is a risk to earnings and reputation in the medium to long term, if sales targets are not checked with measures to ensure that those sales are in customers' best interests.

Supply chain scrutiny broadens beyond the garment sector

This year will mark the four-year anniversary of the collapse of the Rana Plaza building, which killed more than 1,100 garment workers in Bangladesh. Encouraging progress has been made on worker rights and safety in the country since then, partly as a result of investor engagement, but there is more work to be done particularly on ensuring workers are paid adequately, given rising cost-of-living pressures, and enabling union representation and collective bargaining.

Globally, some of the largest retailers and manufacturers are only just starting to audit their lengthy supply chains in response to growing scrutiny that is unlikely to abate. For instance, the Modern Slavery Bill in the UK will increase attention on human rights across all sectors and all supply chains. Companies operating in the UK are now required to publish a 'slavery and human trafficking statement' from financial years ending 31 March 2016. This is a regulatory development that will drive increased transparency globally, particularly as the large European companies are forced to comply.

AMP Capital is now investigating other supply chains outside of the garment sector, particularly in the electronics and food and agriculture sectors. Ultimately, a lack of control over a supply chain raises the risk of business interruption and reputational damage and investor awareness of this issue is important.

Food and agriculture: human resistance to antibiotics

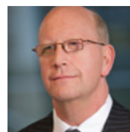
An emerging issue that is expected to gain traction in 2017 is the use of antibiotics in global food chains. Recent scientific studies have linked human resistance to some types of antibiotics to their use in meat production. In the European Union, two thirds of antibiotics produced (by weight) are used by the animal farming industry[11]. In the US, this figure is 80 per cent[12].

To some extent, antibiotics have enabled the rise of factory farming as a business model. Globally, the growth in industrial-scale meat production has meant that animals are being increasingly farmed in close proximity to each other, in unnatural spaces, requiring the use of antibiotics to fight viruses and prevent viruses. The most recent studies suggest that about 70 per cent of bacteria globally have already developed resistance to antibiotics[13], leaving large sections of the population exposed to potentially fatal diseases including pneumonia. In 2016, it is estimated that 700,000 people will have died from antibiotic resistant infections worldwide[14].

As consumers become more educated about the potential health risks, they are likely to demand antibiotic-free meat. This is already happening in some parts of Europe and the US. Regulators may also intervene. Both of these dynamics are likely to lead to reduced use of antibiotics by factory farmers, which will change cost structures and may lead to price rises for consumers. Consumption patterns may therefore also change, affecting the growth and profitability of listed food and agricultural companies globally. We will be publishing a white paper on this issue in April 2017.

... a lack of control over a supply chain raises the risk of business interruption and reputational damage

THE ETHICAL DILEMMA: Is it OK to exclude companies purely on ethical grounds?



Ian Woods
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AMP Capital

AMP Capital argues that 'yes', under certain circumstances it is OK. As of March 2017, AMP Capital has revised its ESG and Responsible Investment Philosophy to allow companies to be excluded on purely ethical grounds.

Fund managers used to be discouraged, or even prohibited, from taking ethical issues into account when making investment decisions on behalf of their clients. It was widely agreed that investment managers should not let consideration of ethical criteria distract from choosing investments that maximised financial returns for their clients; unless of course the client had specifically mandated ethical investment. Asset owners, so people said, were best place to take action on ethical grounds.

But times have changed and so has society. We at AMP Capital also had to change because we increasingly believed we didn't want to deliver investment returns to customers at any cost to society. Consequently, we have introduced a new ethical decision-making framework to our ESG and Responsible Investment Philosophy. This framework allows for the exclusion of companies across our investment portfolio on purely ethical grounds.

The result of implementing the framework is that we will no longer invest in manufacturers of tobacco and companies involved in manufacture of cluster munitions, land mines, and chemical and biological weapons.

It's important to note we are only excluding certain companies or sectors by exception. AMP Capital still firmly believes in company engagement in order to effect meaningful change. In the case of tobacco, cluster munitions, landmines, biological and chemical weapons manufacturers, however, no engagement can override the inherent dangers involved with their products.

We can meet our fiduciary obligations to investors and our obligations to be a responsible fund manager, delivering strong investment returns that continue to meet client objectives. Our analysis has found that our funds can continue to be managed effectively under this new framework without compromising investment objectives.

How do investors best discharge their duties?

The primary objective of superannuation fund investors is to act in the best interest of beneficiaries[15] all the while exercising the same degree of care, skill and diligence that a prudent superannuation entity director would exercise[16]. In addition, the 'sole purpose test'[17] encourages investors to focus on providing long-term returns by requiring they ensure the fund is maintained solely for the purpose of providing benefits to members upon their retirement.

Taken together, these objectives raise interesting questions about how investors best discharge their duties. Do investors 'wash one's hands' and dismiss 'immoral' activities and rely on governments to intervene via regulation? Is it sufficient for investors to say they tried to engage with a company to improve the nature of a product offering, or on their corporate risk management strategy?

As recent campaigns on a range of issues from climate change to tobacco to cluster munitions have demonstrated, investors are increasingly being asked to justify their actions. This has raised questions about the role of ethics in investing and whether it is defensible for investors to support an activity that, while commercially convenient, viable and legal, is inherently wrong (i.e. something that is bound to have an adverse impact on stakeholders).

Complexities exist when ethical and legal obligations compete – investors are not alone in this position. Ethical dilemmas by their very nature are 'dilemmas' and hence not straight forward. The question of 'whose ethics?' is sometimes used as a reason not to articulate and implement an ethical position. Certainly, criticism by others of a particular ethical position may make it tempting to choose the path of least resistance and avoid any explicit consideration of ethics.

Complexities exist when ethical and legal obligations compete – investors are not alone in this position.

What has AMP Capital done?

AMP Capital has had a long history of integrating environmental, social and governance issues into our investment decisions and in the discussions we have with the entities in which we invest. It is clear to us that doing so is entirely consistent with the objective of delivering appropriate risk-adjusted returns to our clients over the long-term. This was approach was formalised when AMP Capital became a signatory to the UN Principles for Responsible Investment (UNPRI) in 2007 and further reinforced in 2012 with the public statement of our ESG and Responsible Investment Philosophy. While our 2012 statement did not seek to exclude specific companies, asset types or industry sectors from our investable universe on wholly ethical grounds, this position was recently revisited.

After reviewing our ESG philosophy, AMP Capital concluded that it has an irreducible degree of responsibility for what it chooses to do, or not do, how it invests and that under rare or extreme circumstances it may be appropriate to exclude investments in a particular company or sector for purely ethical reasons. In February 2017, the AMP Capital Board approved a new ESG and Responsible Investment Philosophy setting out the ethical framework and decision-making process used to exclude investments from a portfolio based on purely ethical grounds.

The decision was also reflective of the changing attitudes of our clients, who increasingly do not want to be invested in harmful products.

Working with ethicist Dr Simon Longstaff of The Ethics Centre, AMP Capital concluded that the best way to address ethical concerns in investment decisions is to apply a principles-based framework thereby providing a consistent basis for considering a range of potential issues, not only now but well into the future.

The three concepts that underpin the ethical framework are consideration of the degree of harm caused, the denial of humanity and the principle of double effect.

1. Degree of harm

In assessing the degree of harm caused, it was considered that if a product, or service, has a safe level of use it is not automatically excluded from portfolios. More specifically, if a product or service can be used, or experienced, without causing a known harm to others, including those who may choose to make use of the relevant good or service, then it was permissible to invest in companies that manufacture, provide or support the product or service. Conversely, if a product has no safe level of use, then there is a case for potential exclusion.

Tobacco, for example, meets the ethical test set for exclusion as there is no safe level of use (i.e. any level of use could potentially increase the risk of cancer). By way of contrast, while the consumption of alcohol and gambling may cause significant harm, it is possible for individuals to consume alcohol or gamble without negative consequences. As there is a safe level of consumption, investment in alcohol and gambling companies is still permissible under the new policy as neither sector meets the high ethical hurdle required to be excluded. While these sectors are not automatically excluded from AMP Capital-managed portfolios, we do recognise the significant investment risk and significant social harm associated with alcohol and gambling. We will therefore continue to engage with companies on the regulatory and reputational risks they face.

2. Denial of humanity

The concept of denial of humanity recognises that persons have intrinsic dignity i.e. have an ability to exercise will and choice and have a range of basic rights and responsibilities, as described in the Universal Declaration of Human Rights. AMP Capital will consider whether a company relies on and is complicit in the denial of humanity (an example would be whether it relies on slave labour).

The issue of human rights in the supply chain is a common concern; and cultural, economic and political conditions can make the consideration of human rights complex. In considering these issues we reference the UN Guiding Principles on Business and Human Rights, which outlines the principles for companies to implement the United Nations Protect, Respect and Remedy framework.

AMP Capital believes investors can make a positive contribution in the area of business and human rights.

AMP Capital believes investors can make a positive contribution in the area of business and human rights. We have engaged, either by ourselves or collectively, with companies on a range of human rights issues such as the working conditions of workers in the garment industry in China and South-East Asia.

3. Principle of Double Effect

The application of the Principle of Double Effect allows AMP Capital to invest in companies involved in a legitimate business even though the company may manufacture a product or provide a service that causes an outcome that we would exclude by the application of the two principles above.

However, a number of criteria must be met by the product or service provided by the company:

- The product or service has a good or positive impact or is at least morally neutral.
- The company intends the product or service to be used for the good impact and not the negative impact either as a means to the positive impact or as an end itself.
- The positive impact outweighs the negative impact in circumstances sufficiently grave to justify causing the negative impact and the company exercises due diligence to minimise the harm.

Investment in companies involved in the manufacturer of armaments provides an example of the use of this concept and also the role of international human rights laws including, but not limited to, UN conventions. For AMP Capital, the focus is on the intended use of the product or service and the intent of the company which we may be consider investing in.

While recognising that most weapons are designed to kill, and as such would meet the 'harm criteria' outlined above, most are not designed to indiscriminately kill civilians and the weapons are produced primarily to enable nations, persons or individuals to defend themselves. As a result, most companies would not be excluded through the application of the policy.

In coming to this view, AMP Capital recognises that negotiation between nations is a better way to resolve differences than the use or threat of use of armed confrontation. It also recognise that inappropriate use of a weapon – for example in terrorism –may mean that restrictions on the availability or use of certain weapons is appropriate and that society and governments are best placed to decide on the extent of any restrictions.

So while there are significant issues around the manufacture, use and availability of weapons, the manufacture of weapons does not in itself meet the high ethical hurdle required to be excluded from investment. Put another way, the principal effect of defence outweighs the unintended double effect that someone may actually be killed by the weapon.

Having said that, weapons such as landmines, cluster munitions, chemical and biological weapons are designed to kill indiscriminately and often kill or maim innocent civilians post conflict. The indiscriminate killing of civilians is a fundamental denial of humanity. In addition, there are a number of international conventions banning the production and, in some cases, financing of such weapons and so it is clear that manufacturers of these weapons fail the high ethical hurdle set and are therefore excluded from investment.

The investment industry plays an important role in the provision of financial capital to companies. AMP Capital believes it cannot invest in a company i.e. provide them with capital, without first considering the impact of its goods and services.

Our core objective is to look after our clients' funds to the best of our ability. In doing so we consider it prudent that we articulate the principles by which we discharge this responsibility, especially as we have decided to exclude some companies on ethical grounds in some certain and exceptional circumstances. We acknowledge there are challenges and ramifications associated with excluding certain companies. Our clear Responsible Investment Framework, however, provides clarity, transparency and predictability to our approach. An understanding of environmental, social and governance issues plays a pivotal role in AMP Capital's investment decisions and company engagement.

REMUNERATION:
Can everything of value be measured?

Karin Halliday
Senior Manager, Corporate Governance
AMP Capital

Executive remuneration has once again been thrust into the spotlight. After investors protested against AGL and Commonwealth Bank of Australia's executive pay, media reports speculated this was due to the use of so-called 'soft' performance hurdles.

Pay is a notoriously touchy subject, not only because salaries and bonuses can be high but because it often rewards behaviour that can be hard to measure. This is especially the case if a portion of pay is based on non-financial targets that are difficult to assess from the outside. When companies use illusory performance hurdles, shareholders will need to decide if they can trust the board to make a fair assessment of executive performance.

It is important to acknowledge that just because a hurdle may be hard to measure objectively, it doesn't make it any less appropriate. Sometimes, non-financial targets like people and culture are exactly the targets that executives should be focusing on.

In this article, AMP Capital considers the important role non-financial performance measures can play in driving shareholder value.

Why shareholders (should) care about pay

Shareholders have a general expectation that company funds will be used wisely to create value.

As pay can be both a significant expense and a tool for creating value, it makes sense for shareholders, who have contributed a portion of these funds, to take an interest in pay.

Not only does pay go a long way to contributing to a workplace that is fair and cooperative, it also provides shareholders with insights around corporate priorities and accountability. Even the way pay is disclosed can provide interesting insights into a company's openness, honesty and what it considers to be important.

As the ultimate owners of companies, shareholders can exert influence through the directors that represent them, by asking the right questions, and by holding directors and management to account for their performance.

Why intangibles matter

Company value is driven by a range of factors. While hard assets are important, it's even more important to consider how companies develop, manage and protect those assets. One only needs to compare the value of hard assets on a company's balance sheet with the price shareholders are prepared to pay for a company to realise there is more to a company than meets the eye.

> While hard assets are important, it's even more important to consider how companies develop, manage and protect those assets.

The quality of a company's leaders and employees, its culture, its ability to innovate and its ability to manage risks are among the broad range of factors that have a bearing on company value. While such drivers of value are often called 'intangible' or 'soft', their overwhelming influence on company results means it may make sense for management to be incentivised to focus on them.

Yes, CEOs are already paid to manage people and culture as part of their day job but linking bonuses to such factors can focus the mind and send valuable signals about what's important. This is particularly the case in business and political environments, which emphasise short-term results with little regard for long-term consequences.

Regulators or share markets may pass judgement on bad behaviour through fines and/or falling share prices but this may take time to transpire. In the meantime, the costs of illegal and unethical practices are pushed to others. For example, our planet pays for poor environmental practices and people pay for breaches of their human rights.

Rather than wait for judgement to be brought down, management accountability can be brought forward through the wise use of performance management and incentive schemes. The consequences for poor performance include loss of job or bonus. On the flip side, companies that have incorporated non-financial measures into their incentive plans can reward management teams for exceptional environmental, social and governance (ESG) performance.

It is easy to blame culture when things go wrong. However on the flip-side, when companies perform well, shareholders rarely give credit to the culture and capability that drove those results. Were shareholders to do that, there would perhaps be less scepticism around the value of the so-called 'soft', capability-building initiatives.

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How intangibles impact company success

Three areas receiving considerable attention at the moment are people, culture and employee engagement. All three factors influence company performance.

PEOPLE MATTER

Let's start with people. People are the heart and soul of a business. They come up with the ideas, set the direction, drive the culture and produce the goods and services.

Together, senior leaders and employees can contribute to financial success. Senior leaders impact corporate culture though the behaviour they model. 'Good' employees can generate goodwill and customer loyalty. On the other hand, 'bad' employees can cost companies dearly. They can diminish goodwill and compromise customer loyalty. There are also the financial costs associated with hiring, training and firing along with poorer productivity, negative morale and damage to reputation.

As companies become more reliant on human capital, they must attract, motivate and retain employees with the right mix of skills and the right attitude.

CULTURE MATTERS

Company culture can be described as "the way we do things around here" and its impact on company success or failure indicates its importance.

Companies need to focus on creating a culture that attracts the best employees and creates an environment that enables employees to contribute their best.

While it can be difficult to articulate aspects of a good culture, it is very clear when things go wrong. For example, merging a company with a culture that is focussed on 'exceptional customer service' with a company focussed on 'lowest-cost' will send conflicting messages to employees about the way things should be done. Problems are likely to occur until the merged entity can clearly articulate its values and practices, and redefine its processes accordingly.

Company leaders can drive culture by hiring the right people and implementing considered processes and pay structures but their biggest influence on culture comes through the behaviours they model.

Corporate culture can be driven by:

- Leaders being clear and consistent about their beliefs.
- The way leaders act when times are tough, for instance, seeing what leaders prioritise in a crisis.
- How leaders allocate capital.
- Who leaders choose to hire and fire.
- The willingness of leaders to invest in the development of their people.
- The behaviours that leaders role model and what they choose to incentivise and reward.

EMPLOYEE ENGAGEMENT MATTERS

Engagement can be described as "how people feel about the way things work around here". An engaged workforce is committed to its work and therefore stands a better chance of delivering good outcomes. When employee engagement is poor, the lack of commitment will often result in lower productivity, poor service and ultimately an increase in staff turnover.

It has been demonstrated that employees feel most engaged when:

- They find their work meaningful.
- They appreciate the values of their employer.
- They respect and trust leadership.
- Their working conditions are safe.
- They have opportunities for development.
- They receive fair compensation for their work/contribution.

What does good pay and performance look like? What should be rewarded?

AMP Capital's rule of thumb is that an executive's remuneration should comprise three components:

- A level of fixed pay commensurate with the size of the company and the complexity of the task at hand.
- An annual bonus that rewards exceptional performance on specified tasks aligned with the agreed strategy.
- A long-term incentive that provides encouragement and recognition focussing on long-term value creation.

These three components belie the fact that pay is complex. Not only do companies face different challenges but stakeholders can have differing, and often diametrically opposed, views. Shareholders agree remuneration structures should be fair and align the interests of management and shareholders but have difficulty agreeing what that should look like in practice.

The concepts of 'fair' and 'aligned' are subjective and difficult to pin down. Even arguing that 'fair pay' is about a level that is right and acceptable or that 'alignment' is about linking goals doesn't provide a lot of clarity. For whom is this right? For whom is this acceptable? Whose goals are being linked to?

Some shareholders argue that bonuses should be linked to the achievement of an accounting-based hurdle such as growth in earnings per share or return on equity. We, on the other hand, prefer to see a portion of CEO bonuses linked to long-term relative that shareholder returns (RTSR). Not only do share-prices reflect information from a broad range of sources, but share-price performance can be observed objectively and is also most aligned with our investment management goals.

Despite being a supporter of measuring CEO performance on a RTSR basis, AMP Capital has long recognised that having a single 'hard' measure risks taking attention away from other priorities. For this reason, AMP Capital advocates using a range of financial and non-financial measures as both are important in impacting short-term, and ultimately long-term, shareholder returns.

> Our brains like to categorise things … unfortunately, categorising non-financial measures as 'soft' has had the effect of devaluing their importance.

> Over the long term, non-financials will impact financial outcomes. The timing is just less clear.

The tendency to categorise financial-based criteria as 'hard' measures and non-financial criteria as 'soft' makes it easier to talk about the two. Our brains like to categorise things: good or bad, male or female, hard or soft, tall or short, white or black. Unfortunately, categorising non-financial measures as 'soft' has had the effect of devaluing their importance.

Profit growth attained at the expense of customer satisfaction is not sustainable nor is profit growth achieved by underpaying workers or neglecting legal responsibilities. By adding a safety or customer satisfaction measure to financial targets, boards are signalling to executives that they can't pursue earnings growth at the expense of employee health or customer satisfaction.

> … Despite being a supporter of measuring CEO performance on a Relative Total Shareholder Return basis, AMP Capital has long recognised that having a single 'hard' measure risks taking attention away from other priorities.

Total reliance on hard performance measures can be harmful if they discourage executives from focussing on the strategic goals linked to building and enhancing the capability required for long-term value creation. Over the long term, non-financials will impact financial outcomes. The timing is just less clear.

Given the impact factors such as employee engagement or workplace diversity or culture can have on company value, there will be times when it makes sense to link executive bonuses to such soft measures. At the end of the day, executives focus on what gets rewarded. If one's pay, wealth and reputation depends on how successfully certain things are done, it is natural that this is where attention will be directed.

Setting the ideal mix of performance measures can be extremely complex. Not only do companies need to balance the conflicting views and interests of a range of stakeholders, they also need to be mindful of the signals sent by their choice of metrics. Consider for example what hurdles say about:

- The actions and behaviours tolerated and/or encouraged in the pursuit of financial targets.
- The importance placed on safety, customer satisfaction and employee engagement.
- The achievements judged to be 'over and above' the day job and deserving of a bonus.
- Whether the company has non-negotiable targets or gateways, that must be met (such as safety or absolute share price growth).

Companies are increasingly focussing on setting non-financial targets alongside financial targets to build an environment where they drive optimal value to deliver financial results. In turn, getting these things right will help generate sustainable, long-term returns for shareholders.

In the same way, bonuses should not be paid for a CEO "doing their job". Surely, an executives' base salary already pays for an expected level of performance whether this relates to production, margin and/or revenue targets, or non-financial requirements of the job like culture, employee engagement and customer satisfaction.

Measuring the hard-to-measure

By their very nature, investors want to put a value on everything but doing so is not always helpful. Human behaviour is impacted by countless things including many that cannot be measured. As such, hard performance measures may prove to be more powerful at deluding and distracting than they are at guiding.

Financial measures such as profit, return on equity and earnings per share tend to be clear, fairly unambiguous and easy to measure. But they are outcomes or lagging indicators and therefore provide little insight into the quality and sustainability of future earnings.

Ideally, management should be incentivised and rewarded for what they have done (lagging indicators) but also for how well they have set the company up for future performance (leading indicators).

To build a clearer picture of the drivers and leading indicators of long-term performance it helps to consider the following questions:

> How happy are customers?
(Customer growth and recommendations.)

> How engaged are employees?
(Productive, co-operative, creative.)

> How well have things been done?
(Quality, timeliness and cost effectiveness.)

> How well have risks been managed?
(Safety, reputation, legal, environmental.)

> Have we invested for the future?
(Education, sustainability, innovation, development.)

In relation to these questions, a lot can be learned from things like employee engagement surveys, absenteeism statistics, safety records and the speed at which management responds in times of crises.

In fact, empirical tools that can be used to assess employee and customer attitudes and actions are developing all the time. For instance, one interesting measurement followed calls by the former Victorian premier Jeff Kennett for companies to partly tie performance bonuses of CEOs to the mental wellbeing of employees. Deloitte and Medibank created an index of employees' mental and physical health by surveying both employees and managers on employee wellbeing across the four pillars of mind, body, purpose and place.

Why the scepticism?

It is difficult for companies to set pay structures that effectively attract, motivate and reward their employees. Given society's increased concerns around inequity, it is difficult for members of the broader community to be comfortable with the sheer size of many CEO pay packages especially when it appears that generous bonuses have been paid to executives for simply doing their job. It is also difficult for shareholders, who sit outside companies and boardrooms, to form a clear opinion on what is required, and what is reasonable and supportable.

As companies vary in complexity and will face different challenges over time, it follows that the quantum of pay and the structure of bonuses that works for one company may not always work or may never work for another. This is particularly relevant for some companies that struggle to find and retain leaders with the required skills.

One challenge for shareholders is the limited disclosure around performance hurdles, particularly non-financial metrics and how they're measured. Shareholders become sceptical when pay appears overly generous or lacks transparency.

Also, and unsurprisingly, most shareholders want evidence that 'at-risk pay' is indeed 'at-risk'. Bonus plans shouldn't reward executives of companies with average performance for 'business as usual'. This is particularly the case where executives persistently receive their full bonus potential on top of their already considerable amounts of fixed pay or when executives get bonuses to correct problems they created in the first place.

Another criticism of bonus plans is that hurdles have simply been set too low. It is particularly frustrating when companies provide shareholders with earnings guidance, and then deem it appropriate for reward executives for achieving only a fraction of that forecast.

When performance measures are subjective, a level of trust is required.

How shareholders decide if companies can be trusted

When performance measures are subjective, a level of trust is required. Shareholders need to believe that boards will do their best to apply hurdles in a fair and acceptable manner.

Companies need to get better at describing why particular focus areas are important relative to others and how they will generate future shareholder value.

To assist shareholders to come to this conclusion, companies should articulate the nature and purpose of the hurdles as clearly as possible, indicate how the quality of performance will be judged, and identify what is considered to be over and above the day-to-day requirements of the role. It's also important that the performance measures are objective and not easily 'game-able'.

The clearer the explanation of the purpose of the incentive and the measures used, the more likely this explanation will mitigate any expectation gap.

Unfortunately, some companies have demonstrated they can't be trusted. Boards that grant overly generous bonus payments are likely to come under increased scrutiny in subsequent years at least until they have managed to earn or re-gain shareholder trust.

A way forward

In an efficient share market, financial and non-financial factors combine to determine the value of a company and the price investors are willing to pay for it.

Companies need to build an environment where they can drive optimal value to deliver financial results. Ideally, remuneration that is fit for purpose will provide a well-considered and clearly-articulated balance of measures that link strategy and performance.

Companies are more likely to design effective pay structures when they:

- Are crystal clear about their strategy.
- Understand the capabilities required to deliver that strategy.
- Understand where gaps exist and therefore what capabilities they need to reward and influence.

It is the board's duty to identify the remuneration approach that best supports this objective and then communicate that approach to all stakeholders.

Incentives linked solely to financial metrics risk fuelling negative culture and conduct. Companies would therefore do well to carefully consider which non-financial performance measures to introduce, how they can be adequately measured and monitored, and how these measures can be transparently explained to shareholders. The clearer the link to long-term value creation and the more clearly targets can be measured and articulated, the more likely it is that shareholders will support the pay structure.

Companies may benefit from asking themselves:

- Do our performance management and pay structures contribute to a more positive corporate culture?
- Do we need to invest more in staff development? If so, what costs are we willing bear?
- What cultural issues have we faced including fraud, poor conduct, loss, or compliance issues? Can we most effectively address them through rewarding good behaviour, through education, or by punishing poor behaviour?
- In mergers, how can we identify and address any cultural barriers to integration?
- Where are we? Where do we want to be?
- Is our culture affecting the ability to attract, hire and retain top talent?
- How is company culture portrayed on social media platforms such as Glassdoor and LinkedIn?
- Does the CEO's behaviour reinforce our culture objectives?
- Does our business provide a safe and nurturing environment in which our employees can both operate effectively and thrive?

Ideally, remuneration that is fit for purpose will provide a well-considered and clearly-articulated balance of measures that link strategy and performance.

GENDER DIVERSITY: The real reason we are still talking about it.

Karin Halliday
Senior Manager, Corporate Governance
AMP Capital

In December 2016, AMP Capital released a comprehensive report giving an investor perspective on the issue of gender diversity.

The report is publicly available via the AMP Capital website: http://www.ampcapital.com.au/about-us/esg-and-responsible-investment

For many years AMP Capital has been concerned about the poor state of gender diversity on Australia's corporate boards.

In 2010 we were alarmed to find 60 percent of the Australian companies held in our portfolios had no female directors. Since then, we have often raised this issue in our engagement with companies.

Pleasingly, the representation of women on corporate boards has since improved but despite all male boards now being a rarity, in 2017, women still only comprise 25 percent of ASX 200 boards.

As an investor, AMP Capital seeks to invest clients' money in the companies that are most likely to generate strong returns. We have noted the many studies that demonstrate the business case for improving gender diversity. While improved board diversity will not guarantee better governance or performance, AMP Capital's analysis has found there are benefits to companies that promote gender diversity at board level, owing to the different perspectives that women bring to the table.

AMP Capital argues investors benefit from digging deeper and looking beyond financial statements when valuing companies. We maintain that, over the long term, the way in which companies approach the environmental, social and governance (ESG) risks and opportunities they face is likely to have a far greater influence on company value than the tangible factors traditionally considered by investment analysts. Diversity is one such issue.

If one accepts that a company's value is largely driven by the actions of its people, it follows that teams best able to generate strong returns for shareholders will be those that are happy, engaged, collectively intelligent but also cognitively diverse.

Report synopsis

The world is more complex. Change happens fast, news travels faster. We're increasingly aware: aware of injustices, aware of disruption and aware of what we want to be a part of.

For our organisations to succeed, we'll need to harness our collective intelligence and approach problems with cognitive diversity. It's no longer OK for workplaces to lack gender equity; not only is it not fair, it's not smart.

But we've known this for a while.

Why then is there so little diversity in the composition of leadership teams and boards of directors?

We know women are different to men and can bring a different perspective to team dynamics and problem solving but rather than excluding women on the basis of these differences, they should be included for them.

We generally understand the need for greater diversity, yet it appears we all have roadblocks and biases so deeply entrenched they make us part of the problem and hence contribute to the inertia.

The paper aims to clarify the issue but more importantly it aims to help each of us identify and overcome the roadblocks that hold us back on the road to greater gender diversity. Our own particular roadblocks are likely to differ; for some it will be a lack of understanding around our own biases or about how diversity can impact productivity and performance. For others the roadblocks may well be a lack of understanding around fairness, about the impact of cognitive diversity or privilege, or how diversity also benefits men. One thing is certain: gender diversity is a hugely complex but rewarding issue.

The implementation of a number of successful initiatives in Australia during the last five years has resulted in better gender diversity on company boards. Despite this progress, answers given by some company chairman in relation to gender diversity show how harmful unconscious bias can be.

It's no longer OK to simply agree that someone needs to do something. As employers, employees, educators, men, women and, yes, even investors, we all need to take ownership and become part of the solution.

It's time to hurry up history.

SHAREHOLDER ENGAGEMENT

Governance

AMP Capital continues to be actively committed to encouraging good corporate governance at the companies held in portfolios we manage.

While our lodgement of proxy votes has an impact on governance, we believe communication, either via letters or our meetings with company directors, to be a far more constructive and effective form of shareholder activism. Since the introduction of the two-strikes rule on executive pay, there has been a significant increase in the number of companies seeking to engage with shareholders.

In a year, it is not unusual for AMP Capital to have 50 specific meetings/conversations with companies on governance issues, and to have written to a further 50 companies outlining the rationale for the decision not to support a company-proposed resolution. We continue to be pleased with companies' positive response to these letters, with many companies addressing our specific concerns and improving governance practices in subsequent years.

Some visible improvements have included: greater disclosure and transparency, the appointment of independent directors, improved terms for incentive plans, and the abolition of termination benefits for non-executive directors.

Many company chairmen have accepted our invitation to discuss governance matters further by meeting with us personally to address issues of concern. AMP Capital values these interactions with companies, not only for the ability to ensure remuneration is fair and aligned with our interests but also because the interaction provides the opportunity to raise broader ESG issues.

A good example of this is where remuneration discussions at some companies turned into constructive dialogue on topics such as succession planning, supply chain risks, diversity, safety and various aspects of risk management including cyber security.

ESG: broader stakeholder engagement

AMP Capital undertakes a broad range of thematic and company-specific engagement activities. Thematic engagement generally focuses on key issues facing the broader share market and industry sectors while company-specific engagement focused on issues affecting individual companies.

In addition to governance-focussed meetings, the AMP Capital ESG research team had more than 80 meetings with companies, focussing on environmental, social and governance issues. Most of these meetings were undertaken with our mainstream investment analysts, reinforcing the link between investment analysis decisions and ESG issues. The response from companies was mixed but we have noticed a general acknowledgement that companies need to be prepared to discuss these issues with investors. The continuity of the ESG focus by a large investor and our linkage with 'mainstream' investment meetings has also helped us reinforce the increasing importance that investors are placing on ESG issues.

More specifically, current key thematic engagements have focussed on corporate governance (including remuneration and the composition and gender diversity of boards), supply chain management / labour rights, climate change, unconventional and coal-seam gas and improved ESG disclosure.

AMP Capital has again been involved in various ESG forums and media opportunities to share insights with regard to our views on ESG issues. The AMP Capital ESG Research team participated in around 100 non-company meetings where we either actively engaged other investors or other stakeholders or took the opportunity to develop a better understanding of an industry or key ESG issue.

These activities reflect our broader objective of improving the ESG performance of all companies and the investment industry generally, not just the ones we may have chosen to invest in on behalf of our clients.

AMP Capital is interested in company culture and engages with companies on the relevant drivers of value, for example:

- **Board structure:** right mix of independence, skills and experience.
- **Diversity:** tapping into collective intelligence and cognitive diversity.
- **Pay:** a fair use of shareholder funds, being aligned with performance, while adequately attracting, motivating and rewarding the best people.
- **Productivity:** impact of optimal talent management and an engaged workforce.
- **Disruption:** how companies respond to risks and opportunities presented by the forces of innovation, globalisation, demographic change and new technologies.
- **Risk management:** are critical assets adequately protected? Reputation, people, data, systems, intellectual property, hard assets etc.
- **Climate Change:** companies' response to the risks and opportunities it presents.
- **Ethical behaviour:** treatment of workers in entire supply chains, human rights, supportive and honest culture, transparency and integrity.
- **Disclosure:** provision of consistent, clear and honest information
- **Regulation:** potential change and the impact on company operations and profits.
- **Customers:** challenge of remaining relevant to old and new market segments, millennials, pink economy, grey economy, Asian economy, etc.

OVERVIEW OF PROXY VOTING

Internally voted Australian equities

Recent voting highlights

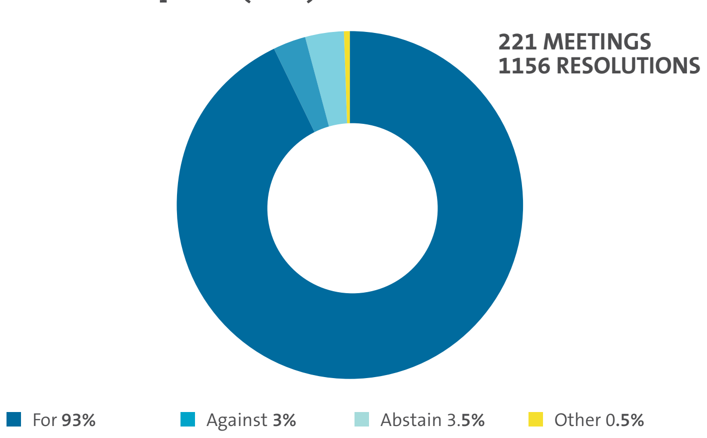
The majority of Australian companies close their annual accounts on June 30 each year. For this reason, the second half of each calendar year is traditionally the busiest time for annual general meetings (AGMs) and proxy voting in Australia.

As part-owners of the companies we invest in, shareholders have a say in matters such as: the election of the directors who will represent them, company-changing transactions and takeovers, and executive pay.

While most resolutions were supported, AMP Capital did lodge votes against resolutions when concerned with issues such as overly generous or poorly aligned pay structures and poor board composition.

AMP Capital also specifically took no action on resolutions where we are excluded from voting. This situation arises when, for example, we have participated in share issues on behalf of our clients and are therefore deemed to have a conflict of interest and are excluded from voting to ratify that transaction.

Australian Equities (2016)



Board composition

Board composition continues to be one of the most important corporate governance issues for shareholders. Despite its significance, we acknowledge it is often difficult for shareholders to determine whether they have the right boards governing their companies. In line with best practice corporate governance, we have a preference for boards with an effective composition of skills, knowledge and independence. The short biographies available in annual reports provide little detail and without being present in the boardroom, shareholders cannot observe the dynamics of the board, nor its overall effectiveness.

In any proxy season, most company meetings are AGMs at which shareholders vote on the election or re-election of directors. Votes against directors generally reflect concerns such as poor board attendance, an insufficient number of independent directors to represent public shareholders and broader issues related to poor governance.

Once again in 2016, AMP Capital supported the majority of directors seeking re-election. Those not supported were predominantly self nominated, non-board-endorsed candidates, who we considered not ideal candidates. However, companies where AMP Capital voted against at least one company-endorsed director during this financial year include:

AUSNET Services	News Corporation
CIMIC Group Ltd	Super Retail Group Ltd
Harvey Norman Holdings Ltd	

AMP Capital will usually choose to abstain from voting, rather than vote against, where there may have been a better representation of independent directors, albeit still a minority, and/or this was the first time the issue of board composition had been raised with the particular company. In almost all cases, we endeavoured to communicate our specific concerns to the company involved.

Remuneration reports

Since the introduction of non-binding votes on remuneration reports in 2005, Australian investors now have a mechanism by which to review and comment on the approach to remuneration used by the companies in which they invest. The impact of a shareholders 'against' vote on remuneration is now greater since the introduction of the two-strikes rule.

When reviewing the appropriateness of remuneration reports, AMP Capital generally considers a wide range of factors.

Remuneration reports should be concise and facilitate a clear understanding of the company's remuneration policy, providing evidence that the policy is both fair and reasonable and is aligned with shareholder interests.

In particular we look for criteria such as the clarity of disclosure, satisfactory short and long-term incentive and termination arrangements and also appropriate non-executive director remuneration.

Over this financial year, AMP Capital submitted votes on 192 remuneration reports. In total, 87 percent of reports were supported, 5 percent against and on 8 percent we abstained. The remuneration reports AMP Capital voted against over this period were:

Abacus Property Group	Evolution Mining Ltd
Automotive Holdings Group Ltd	Fortescue Metals Group Ltd
Carsales.com Ltd	Goodman Group
Commonwealth Bank Of Australia Ltd	IDP Education Ltd
CIMIC Group Ltd	News Corporation

What is the two-strikes rule?

The two-strikes rule is legislation giving shareholders the ability to vote on whether to 'spill' an entire board of directors (that is, remove the board of directors) over remuneration concerns. Two strikes occurs when 25 percent or more of shareholders vote against the adoption of the remuneration report in two consecutive years.

Companies where AMP Capital specifically abstained from voting on the adoption of Remuneration Reports include:

BWX Ltd	Orica Ltd
CSL Ltd	Ramsay Health Care Ltd
G8 Education Ltd	RESMED Inc
GBST Holdings Ltd	Seek Ltd
Infomedia Ltd	Sims Metal Management Ltd
Metcash Ltd	Sonic Healthcare Ltd
Mineral Resources Ltd	TPG Telecom Ltd
Nearmap Ltd	Woodside Petroleum Ltd

In general, AMP Capital will vote against remuneration reports where they exhibit one or more of the following criteria: poor disclosure, poor alignment with shareholder interests, inclusion of non-executive directors in executive incentive plans, excessive quantum and poorly structured performance hurdles (for example, absolute rather than relative, not sufficiently challenging, too short-term, purely accounting-based, allowing too many opportunities for re-testing etc.).

During this period, the specific reasons for voting against Remuneration Reports included:

> Overly generous retention benefits, coupled with generous new grants.
> Low performance hurdles, e.g. vesting well below earnings guidance.
> Retrospectively changing performance hurdles and/or start-dates, or using board discretion to vest incentives when hurdles were not met.
> Overly-generous quantum.
> Poor alignment.
> Structural concerns, especially where they potentially incentivise behaviour that is contrary to the best interests of shareholders (for example, making acquisitions, beating budget etc. – with no reference to the longer term benefit to shareholders of meeting these targets).
> Boards unlimited discretion to allow incentives to vest upon a CEO's termination.
> Overly complex incentive structures that would potentially fail to motivate or retain key management personnel.
> Poor disclosure.

In the past, AMP Capital has expressed concern with regard to excessive termination payments (both actual and potential) that were made to some departing senior executives – particularly as actual payments often bore little resemblance to previously agreed limits. Pleasingly, this has become less of an issue.

Share and Option Incentive Plans

In 2016, AMP Capital voted against at least one incentive-related resolution at:

Abacus Property Group	Premier Investments Ltd
BAPCOR Ltd	Seek Ltd
Carsales.com Ltd	Sims Metal Management Ltd
Commonwealth Bank Of Australia Ltd	Sonic Healthcare Ltd
Evolution Mining Ltd	Syrah Resources Ltd
Fortescue Metals Group Ltd	

Companies where AMP Capital specifically abstained from voting on incentive related resolutions included:

Bellamy's Australia Ltd	Northern Star Resources Ltd
CSL Ltd	Ramsay Health Care Ltd
Healthscope Ltd	Sims Metal Management Ltd
JB HI-FI Ltd	Spark Infrastructure Group
Magellan Financial Group Ltd	Super Retail Group Ltd
Nearmap Ltd	Worleyparsons Ltd

As investors, we seek to invest in companies that will provide the best relative share market performance over the long-term and as such we prefer a significant portion of the CEO's remuneration to be aligned with that goal. The underlying reasons for not supporting long-term incentive related resolutions include:

> Poor disclosure of the terms of the incentive plans.
> Plans are shorter than the desired three-year minimum.
> Plans had no performance hurdles or hurdles that lacked sufficient alignment with the interests of shareholders.
> Proposed plan amendments would increase the value to employees without any corresponding benefit to shareholders.
> Participation of NEDs in executive schemes.
> Plans showed no improvement, despite the company having received comments/input and the matter being not supported previously.

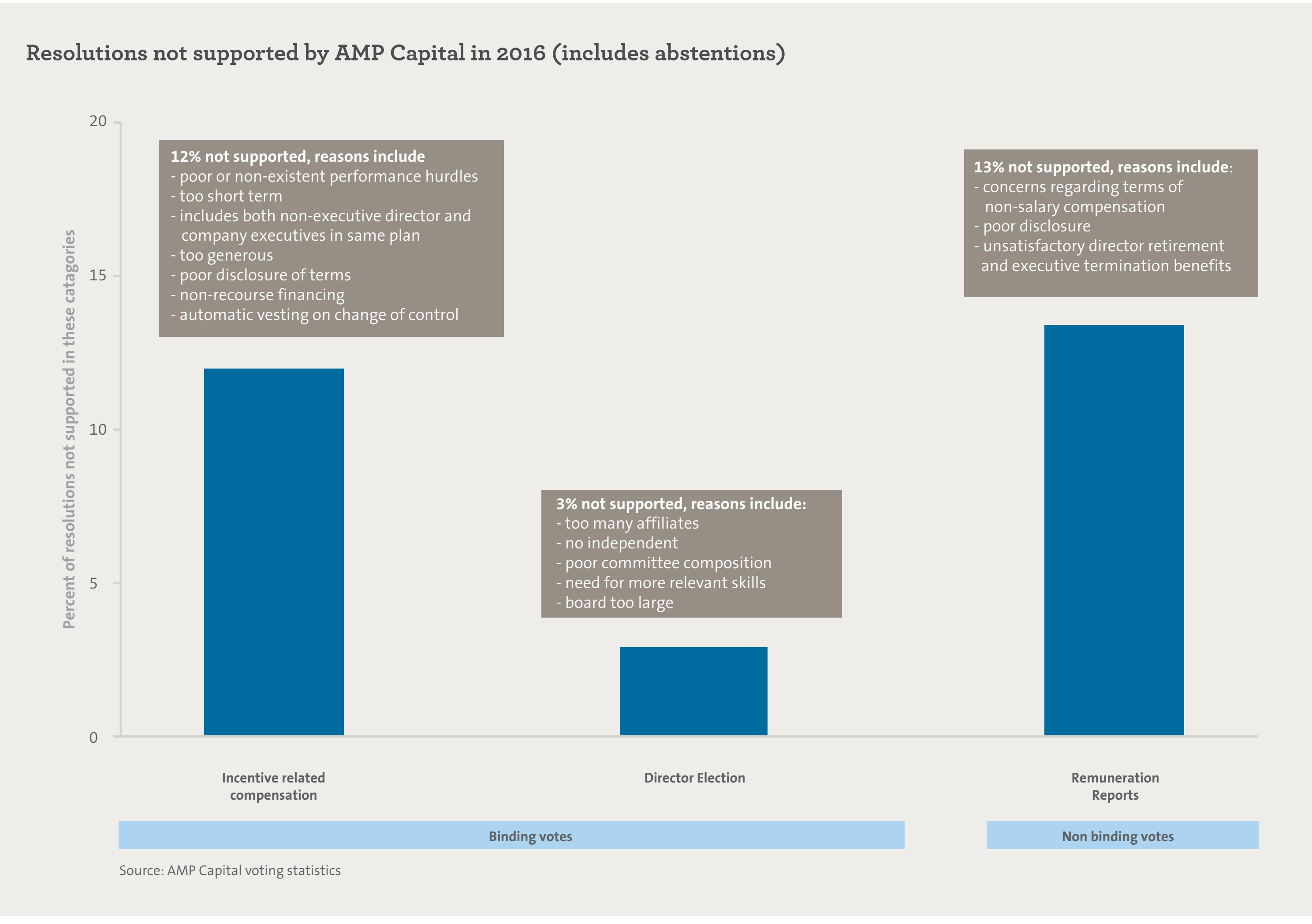
AMP Capital continues to consider how incentive grants should respond upon a change of control at the company. We became interested in this feature several years ago after seeing instances where company executives and directors engaged in behaviour that could potentially destroy shareholder value while themselves reaping significant personal gains.

Board spill resolutions

In this calendar year, only four companies held in portfolios managed by AMP Capital could have received a second 'strike' and thus potentially faced a board spill. This trend continues to improve; three years ago there were 22 board spill proposals and last year there were ten.

This year, AMP Capital voted in line with company management and rejected each board spill resolution. In our experience, most first-strike companies had engaged with shareholders and/or had also demonstrated progress toward addressing concerns and ensuring pay was indeed fair and aligned with shareholder interests.

(Note: Those companies where votes were cast against the adoption of the remuneration report are listed earlier in this report)



Non-Executive Director Remuneration

Over the period, 36 companies held in the Australian portfolios managed by AMP Capital sought approval for an increase in the maximum aggregate level of fees that could be paid to the company's non-executive directors.

Most increases sought were considered reasonable after taking into account various factors including the size of the company, the company's complexity, performance, board composition (including the number of directors and the balance of independent directors), whether options or retirement benefits are paid to directors and the factors put forward by the company to explain the need for the increase being sought.

All increases were approved, except at Programmed Maintenance Services Limited where we specifically abstained from voting on the resolution.

In line with generally accepted principles of good governance, AMP Capital is not in favour of option grants being made to non-executive directors. It is preferred that non-executive directors' interests be aligned with the shareholders they represent rather than potentially being influenced by incentive structures that may not reflect the experience of the shareholders who hold listed securities. Preferably, non-executive directors should be encouraged to invest their own capital in the company or to acquire shares from the allocation of a portion of their fees.

Termination Payments

As a result of amendments made to the Corporations Act 2001, any employment contracts entered into (or varied) on or after 24 November 2009 require shareholder approval for termination benefits (paid to directors or certain executives) in excess of one year's base salary. Before 2009, termination benefits could reach up to seven times a recipient's total annual remuneration before shareholder approval was required.

This financial year, ten companies sought approval for termination benefits. Those voted against included:

Magellan Financial Group Ltd
Premier Investments Ltd

Companies where AMP Capital specifically abstained from voting on termination benefits included:

Automotive Holdings Group Ltd
GBST Holdings Ltd

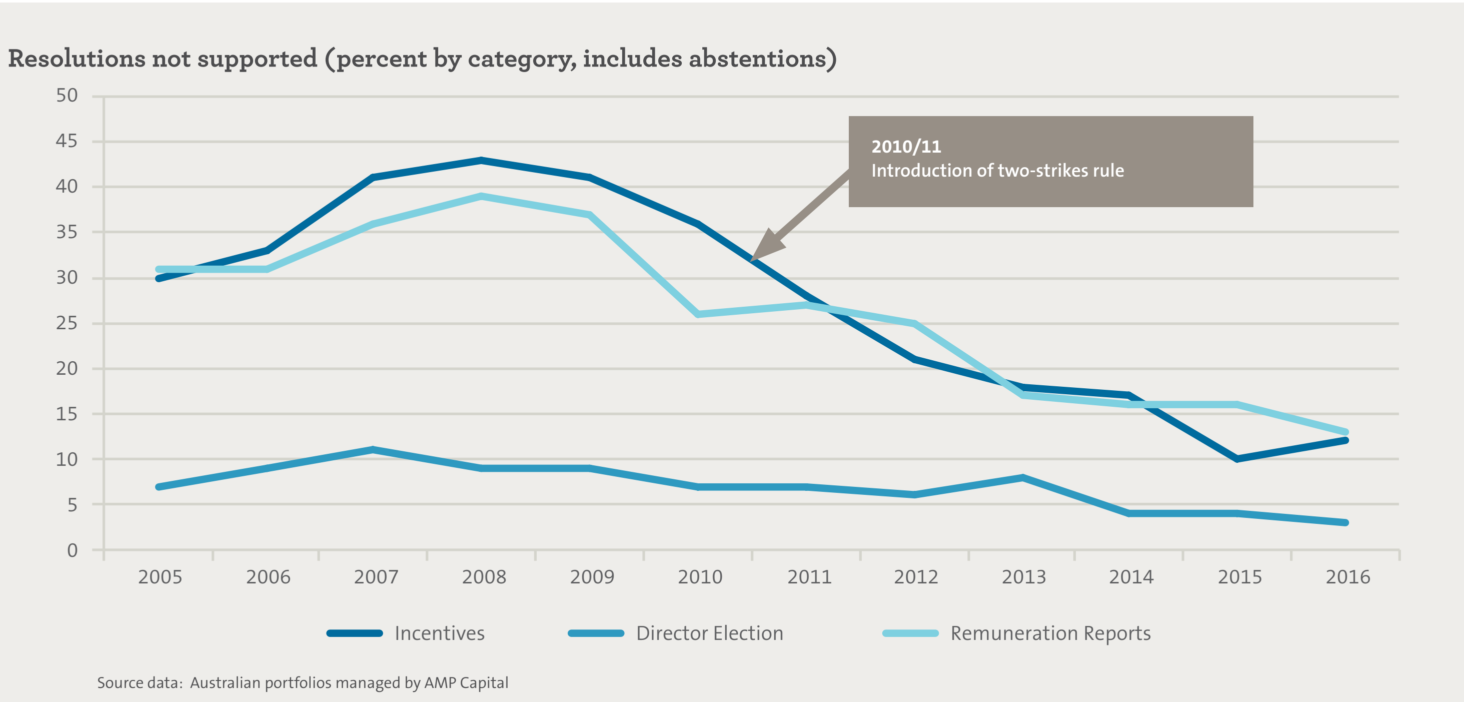
Where AMP Capital had concerns, these generally related to potential windfall payments upon change of control, the length of time the approval would remain in force (in perpetuity) and the level of discretion some boards had sought in relation to the vesting of payments.

AMP Capital proxy voting statistics (2003 to 2016) (Votes cast by AMP Capital)*

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Number of company meetings	336	396	381	413	496	418	406	349	365	332	319	308	279	221
Number of resolutions voted upon	1335	1662	1824	2049	2482	2154	2007	1748	1827	1734	1645	1685	1453	1156
% of meetings where all supported	74%	74%	63%	64%	58%	59%	55%	69%	64%	63%	71%	72%	74%	80%
Resolutions: % not supported														
Incentives	n/a	n/a	30%	33%	41%	43%	41%	36%	28%	21%	18%	17%	10%	12%
Director Election	n/a	n/a	7%	9%	11%	9%	9%	7%	7%	6%	8%	4%	4%	3%
Remuneration Reports	n/a	n/a	31%	31%	36%	39%	37%	26%	27%	25%	17%	16%	16%	13%
	n/a	n/a	(68/219)	(97/312)	(120/337)	(122/314)	(108/288)	(66/252)	(73/271)	(64/258)	(43/251)	(40/245)	(36/232)	(24/192)
TOTAL														
Abstained & No Action*	n/a	n/a	7%	6%	9%	9%	8%	6%	7%	7%	5%	7%	6%	4%
Against	n/a	n/a	8%	8%	9%	8%	11%	8%	8%	7%	7%	5%	4%	3%
Not supported	n/a	n/a	15%	14%	18%	17%	19%	14%	15%	14%	12%	12%	10%	7%

* Includes meetings where AMP Capital was excluded from voting due to conflicts of interest eg. Participation in share issues.
Internally managed Australian equity portfolios

Resolutions not supported (percent by category, includes abstentions)



Source data: Australian portfolios managed by AMP Capital

Internally voted – International portfolios*

For the last 20 years, AMP Capital has focussed the attention of its corporate governance and proxy voting work on the Australian companies held in the portfolios we manage. The process for voting shares held in our Asian funds was formalised in 2006 and the Global Listed Real Estate (REIT) and Global Infrastructure Funds in 2012 after the Brookfield joint venture was dissolved.

This Corporate Governance Report now presents a snapshot of the voting of shares held in these internally-managed global portfolios.

AMP Capital's experience and tradition of taking seriously the responsibility of investing our clients' money has held us in good stead as we have broadened our international proxy voting remit to align with the expansion of our global investment capabilities.

Key governance issues such as non-executive director remuneration, share and option incentive plans, and board independence impact listed companies throughout the world. Our experience in dealing with these issues locally has helped us to be able to vote on resolutions of internationally listed companies.

There are notable differences in the governance culture throughout different regions in the world. For example:

> **Board structure:** Whilst most Australian listed companies would avoid a combined Chairman/CEO structure, this structure is far more common in US listed companies. While AMP Capital is committed to the basic principles of good governance and as far as possible would not vote on structures that sacrifice the independence or accountability of the board, the context of a company's situation is also taken into account before we vote on a resolution.

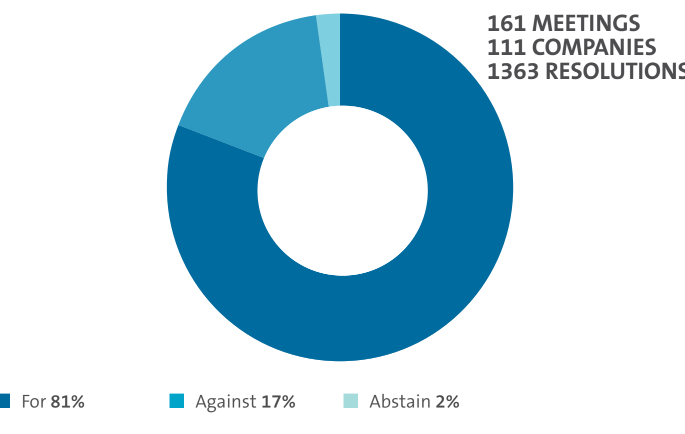
> **Disclosure:** Disclosure of governance-related issues by listed companies overseas is not always as comprehensive as it is in Australia. In this situation it helps to seek feedback from our network of portfolio managers and analysts who deal with the companies from day to day and to draw on research and advice from proxy advisers. However, in instances where it was not possible to access sufficient information portfolios, we may have abstained from lodging a vote on particular resolutions.

Why resolutions were not supported

Resolutions not supported by AMP Capital during the 2015/16 financial year related mainly to the election and re-election of directors, the ratification of share issues, ratification of specific incentive structures and support sought for undisclosed resolutions.

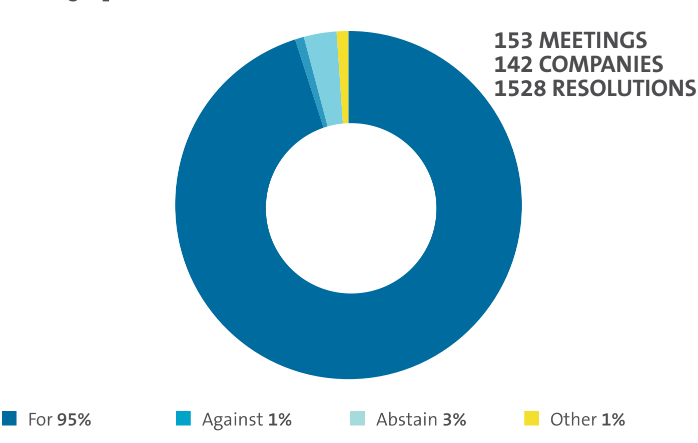
As the analysis below shows, a significant number of AMP Capital's concerns could have been averted through improved disclosure. Pleasingly many countries are making progress in this regard and have introduced a range of guidelines addressing the issue of disclosure.

Voting update: Asian equities



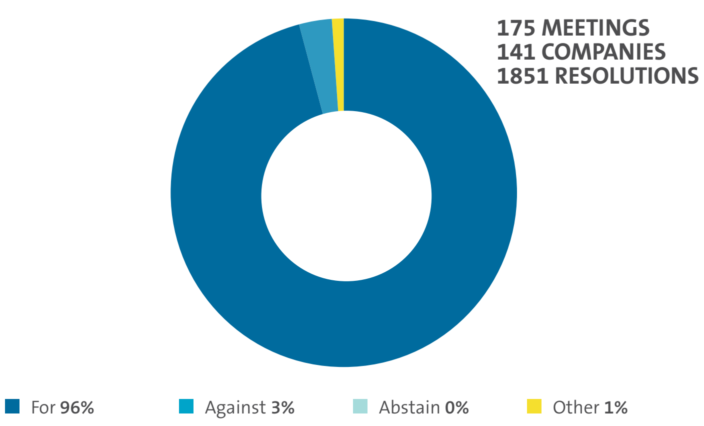
For 81% Against 17% Abstain 2%

Voting update: Global listed real estate



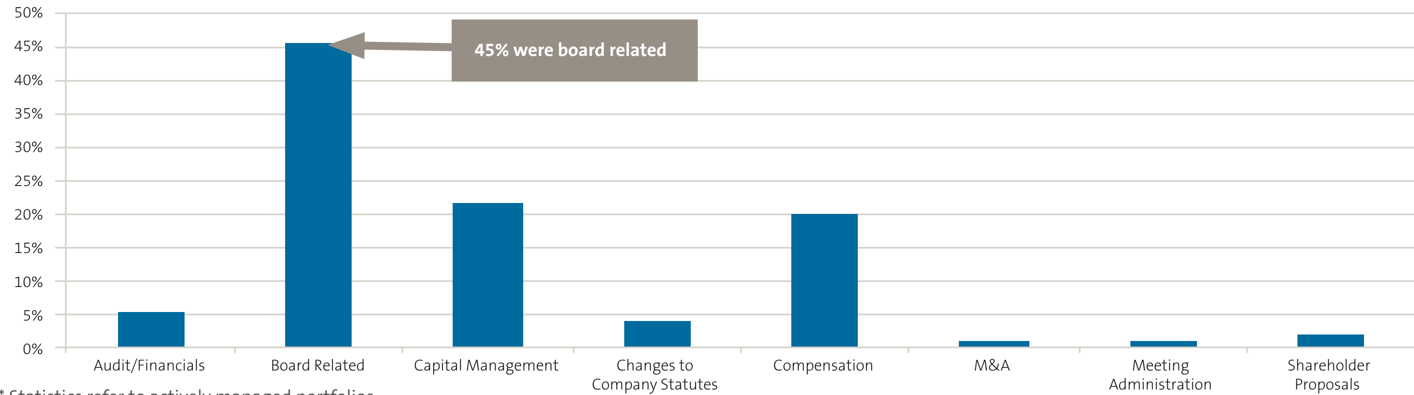
For 95% Against 1% Abstain 3% Other 1%

Voting update: Global listed infrastructure



For 96% Against 3% Abstain 0% Other 1%

Categories of resolutions external managers voted against



* Statistics refer to actively managed portfolios

2016: Votes Cast Against Management Resolutions (by country)

CATEGORIES	AUSTRALIAN EQUITIES	GLOBAL LISTED REAL ESTATE	GLOBAL LISTED INFRASTRUCUTRE	ASIA	GRAND TOTAL
Australia	60	2			62
Board Related	5				5
Changes to Company Statutes	2				2
Compensation	53	2			55
Bermuda				21	21
Audit/Financials				1	1
Board Related				10	10
Capital Management				8	8
Changes to Company Statutes				1	1
Compensation				1	1
Brazil			1		1
Board Related			1		1
Canada		5			5
Board Related		2			2
Changes to Company Statutes		2			2
Compensation		1			1
Cayman Islands				38	38
Board Related				14	14
Capital Management				21	21
Compensation				2	2
M&A				1	1
China				68	68
Board Related				26	26
Capital Management				36	36
Changes to Company Statutes				1	1
Compensation				2	2
M&A				1	1
Meeting Administration				2	2
France			1		1
Board Related			1		1
Germany		4			4
Board Related		2			2
Capital Management		2			2
Hong Kong		1	1	24	26
Audit/Financials				1	1
Board Related		1		7	8
Capital Management			1	14	15
Compensation				1	1
M&A				1	1
India				13	13
Audit/Financials				6	6
Board Related				7	7
Capital Management				2	2
Indonesia				9	9
Audit/Financials				3	3
Board Related				4	4
Compensation				2	2
Italy			2		2
Board Related			1		1
Compensation			1		1
Japan		15	2		17
Board Related		11	2		13
Changes to Company Statutes		4			4
Korea, Republic of				31	31
Audit/Financials				10	10
Board Related				16	16
Changes to Company Statutes				2	2
Compensation				3	3
Philippines				13	13
Board Related				11	11
Meeting Administration				2	2
Singapore		1		2	3
Board Related				1	1
Compensation				1	1
M&A		1			1
Taiwan				31	31
Board Related				30	30
Compensation				1	1
United Kingdom		1	3		4
Changes to Company Statutes			3		3
Other		1			1
United States	9	17	14		40
Board Related	6	11	8		25
Compensation	2	6			8
SHP*: Compensation			1		1
SHP: Environment			2		2
SHP: Governance	1		2		3
SHP: Social			1		1
Grand Total	69	46	24	251	390

*SHP - Shareholder proposal

Externally voted

Snapshot of votes cast by AMP Capital's external managers:

For many years, AMP Capital has offered clients the ability to invest in a range of multi-manager funds. These funds are designed to provide a single investment solution, blending a range of specialist investment managers in a single fund.

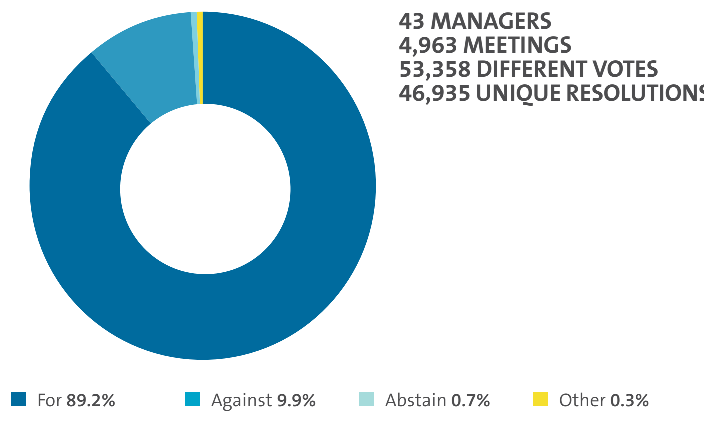
These funds aim to provide diversification across asset classes, manager types and manager styles, with the aim of achieving growth with smoother returns by negotiating the ups and downs of the market.

As AMP Capital actively manages the selection of investment managers (for multi-manager funds), we are constantly assessing and implementing new opportunities with the potential to improve the risk and return outcomes of clients' portfolios.

External managers exercise votes on the shares they hold on our behalf. However, AMP Capital monitors the voting and where we have concerns with regard to a specific issue, we can choose to override votes cast by the external manager. Further, AMP Capital also undertakes periodic reviews of our external managers with regard to their approach to considering ESG issues. Where possible, we seek opportunities to meet and discuss their approaches to voting and ESG integration more broadly.

Note: Approximately 89 percent of votes were cast in line with recommendations made by company boards.

Voting update: Multi Asset Group*



*AMP Capital has direct visibility over the voting activity of the majority of our external managers. This chart provides a high level summary of those votes.

New Zealand

The AMP Capital team in New Zealand manages a broad range of equity-based products for clients.

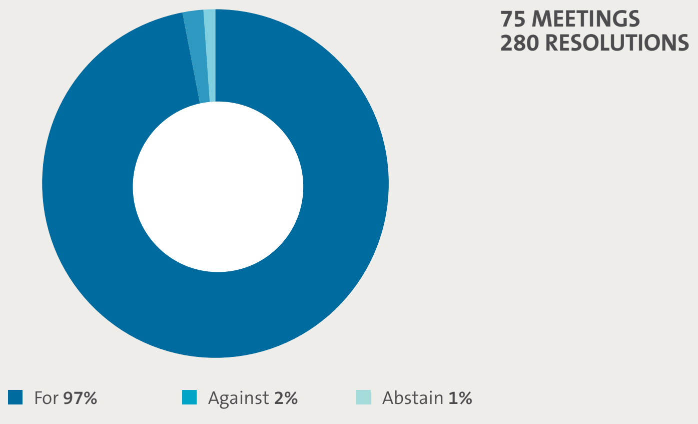
In January 2015, it was announced that the active portion of AMP Capital's New Zealand funds would be managed by Salt Funds Management. AMP Capital monitors the votes cast on its behalf by Salt Funds Management.

In 2016 the Salt team voted in support of 97 percent of resolutions, voted against 2 percent and abstained from voting on 1 percent. The concerns related to the following proposal categories:

- Director election
- Payments to non-executive directors

Please note: Voting statistics for other New Zealand products have been included under their respective assets classes above, such as Global Listed Real Estate, Global Listed Infrastructure, etc. In addition, more detailed voting reports can be accessed by the clients of separately managed portfolios or the Responsible Investment Leaders' Funds.

Voting update: New Zealand equities (Salt)



CONTACT US

If you would like to know more about how AMP Capital can help you, please visit **www.ampcapital.com**

References:

1 *World Health Organisation* Obesity and Overweight fact sheet, June 2016

2 As above.

3 *Planning for the worst: estimates of obesity and comorbidities in school-age children in 2025* by Lobstein & Jackson-Leach, Pediatric Obesity, September 2016

4 S. Yan, J. Li, S. Li, B. Zhang, S. Du, P. Gordon-Larsen, L. Adair, B. Popkin *The expanding burden of cardiometabolic risk in China: the China Health and Nutrition Survey*, Obesity Reviews Volume 13, Issue 9, September 2012

5 https://www.hsph.harvard.edu/obesity-prevention-source/obesity-consequences/economic/

6 https://www.gov.uk/government/news/five-million-people-at-high-risk-of-type-2-diabetes

7 World Health Organisation *Fiscal policies for diet and the prevention of noncommunicable diseases - Technical meeting report*, published October 2016

8 The legal, regulatory and consumer barriers to driverless cars were covered in AMP Capital's Corporate Governance Report in September 2016.

9 For example, the United States Department of Transportation released its Federal Automated Vehicles Policy in September 2016 titled *Accelerating the Next Revolution in Roadway Safety*.

10 Bloomberg New Energy Finance is a data-source that provides independent analysis and insight, enabling decision-makers to navigate change in an evolving energy economy.

11 See Table 4, p29 of ECDC/EFSA/EMA report published in 2015 efsa.europa.eu/en/efsajournal/pub/4006.htm

12 United States Food and Drug Administration. (2009). Summary report on antimicrobials sold or distributed for use in food-producing animals. Department of Health and Human Services

13 http://www.fda.gov/drugs/resourcesforyou/ consumers/ucm143568.htm

14 WHO Antibiotic Resistance factsheet, October 2015. Accessible: who.int/mediacentre/factsheets/ antibiotic-resistance/en/

15 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012: Section 52A Covenants relating to directors to be included in governing rules—registrable superannuation entities: Section (2)(c) to perform the director's duties and exercise the director's powers as director of the corporate trustee in the best interests of the beneficiaries;

16 Section (2)(b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation entity director would exercise in relation to an entity where he or she is a director of the trustee of the entity and that trustee makes investments on behalf of the entity's beneficiaries;

17 Superannuation Industry (Supervision) Act 1993 - Sect 62: Sole purpose test

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