NOMURA ASSET MANAGEMENT

2Q 2017

NOMURA ASSET MANAGEMENT U.K. LTD.

Responsible Investing Report

Introduction

Nomura Asset Management U.K. Ltd. (“NAM UK”) is committed to Responsible Investing on behalf of our clients.

Responsible Investing requires that we balance the objectives of multiple stakeholders – our clients, the investment community, the broader community and the environment. Over time we expect that through investing responsibly we can achieve superior returns for our clients and the broader stakeholder group.

Our equity investment process involves gaining sufficient information about the companies in which we may invest through research and due diligence. As a result we may have concerns about a company’s performance or outlook which could be, for example, a financial or operational issue, or one of an environmental, social or governance (ESG) nature.

We actively engage with those companies in which it is felt that stakeholder objectives are not being fully met. Engagement may be in a variety of forms, though it is most likely to start with an initial telephone discussion with the investor relations team, with escalated action if necessary. Where appropriate, we may consider and partake in joint action with other institutional investors and companies. We hope that through our engagement and encouragement these companies will improve internal practices to the benefit of our clients and other stakeholders.

Proxy voting is an important way in which we discharge our stewardship responsibilities. We may direct our vote based on the recommendations of a third party proxy voting service vendor but will also take our own independent decisions where appropriate.

In this report we set out our Responsible Investment and corporate engagement activity over the last quarter.

"NAM Group" "NAM"	These references relate to the whole Nomura Asset Management organisation and will generally be used when referring to matters such as investment philosophy, style, company structure and other policies which are consistent across the Group.
"NAM UK" "Our" "We"	This refers to Nomura Asset Management UK Limited, the UK based subsidiary of NAM Tokyo. NAM UK will typically be appointed as investment manager and will retain responsibility for the management, control and servicing of the client portfolio and relationship. Responses within this document will refer specifically to practices and procedures undertaken within the NAM UK office.

Summary

Over the period 20 companies were reviewed and assigned ESG ratings. Of these, 6 were awarded a rating of ‘N’ (No Issues) and 14 a rating of ‘I’ (Issues to Address). In addition, 2 companies were contacted, supplementary to full company reviews, to discuss ESG related queries that arose over the period.

Of the companies reviewed, 18 were within Developed Markets, whilst 2 were within Emerging Markets. In total 7 companies were contacted to discuss ESG concerns. Of these, responses were received from 7 (100% response ratio).

Companies reviewed	
N (No Issues)	6
I (Issues to Address)	14
U (Uninvestable)	0
Total	**20**

Companies contacted	
Number of contacts	7
Number of responses	7
Response Ratio	**100%**

Notes from our Responsible Investing Research

- **Governance:** We frequently encounter, particularly across US listed companies, entrenched boards, over boarded directors and combined CEO/Chairman positions. We will continue to push for these practices to be improved, and indeed over the quarter we took steps to support the proposal of an activist investor to reform the composition of a board that had showed signs of not performing optimally for shareholders. Please see this quarter's case study for further details.
- **Environmental / Social:** We encountered a number of companies over the period that scored favourably on environmental & social considerations. The high scores were primarily driven by having manufacturing operations and/or or providing services that are highly geared towards reducing emissions and environmental impact.
- **Remuneration:** Just 1 of the 15 companies reviewed over the quarter had management remuneration targets that incorporated Return on Capital components. We continue to push for management to be remunerated based on Return on Capital metrics, which more closely reflect what we, as shareholders, experience.
- **Other:** The team attended conferences hosted by Responsible Investor and the UNPRI (to which Nomura Asset Management is a signatory) over the period with a view to supporting the development of our Responsible Investment practices. Most notably the UNPRI conference provided perspectives from both the corporate side (with whom we are engaging) and the academic world that we have been able to use to further improve our engagement activities.

Nomura Asset Management has appointed GES Investment Services to supplement our own efforts to engage with and push for change in the companies we invest in for clients. GES is a leading provider of engagement services with a 15-person engagement team focusing on stewardship and ESG integration. Whilst GES have been appointed primarily with a view to supporting engagement for passive global equity mandates, the Nomura Asset Management (UK) active equities investment team will work closely with GES to help supplement our internal research and engagement practices.

Introducing the Concept of High Societal Value

In Q1 2017 Nomura Asset Management published "The Philosophical Thoughts of a Responsible Investment Team" (available on our website at: http://www.nomura.com/nam-europe/resources/upload/the-philosophical-thoughts-of-a-responsible-investment-team.pdf). A central tenet of this paper is that the Responsible Investor should consider the total impact of investee companies on all stakeholders and moreover sustainable attractive long term returns require not just the creation, but also the fair sharing of significant 'total value' amongst all stakeholders.

Based on the concepts introduced in the paper we have identified a group of companies that we believe can sustainably deliver significant value to society as a whole, while also responsibly allowing shareholders and other stakeholders to benefit from that value creation. We define this approach as 'High Societal Value at Discount Valuation'. We plan to use this philosophy to create a paper/model portfolio and in the interests of transparency will publish the 'shadow' performance and the holdings of this portfolio in the Responsible Investing area of our website.

High Societal Value: High total value creation, fair value sharing among all stakeholders, good corporate governance and ethical management decision making are all characteristics of companies that have a highly positive impact on society. Such companies can often also generate attractive financial returns so allocating capital to these companies can be beneficial to society at large as well as from an investment return perspective.

Discount Valuation: Means buying below intrinsic value and we believe the behavioural biases of other investors give us opportunities to do this.

Examples of 'High Societal Value' Companies

- **NextEra Energy** is the largest renewables generator in the United States, and a pioneer within the space. The corporation's huge investment in renewables supports the development of ever more efficient, competitive technology and has a vast benefit to society & the environment as a result of both directly lowering emissions and indirectly catalysing the global substitution of fossil fuel generation with clean energy sources.
- **Ross Stores** is a discount clothing store based in the United States. Within our framework for assessing 'societal value' Ross Stores is credited for its customer friendly pricing practices & indeed its low price business model that ultimately makes decent quality apparel more accessible for lower income families. Ross Stores furthermore has a positive impact on suppliers in providing an additional channel for sales and waste reduction (indirectly benefiting the environment).

Responsible Investing Case Study

Over the quarter we had significant interaction with an activist co-shareholder of a US Automotive manufacturer. The activist had proposed a change to the board composition and furthermore to ‘unlock’ value in the shares they proposed an unconventional split of the shares into two classes – one that paid a constant and attractive dividend and another in which the share buyback programme would be concentrated.

To comprehensively assess the proposal the investment team engaged with both the company and the activist investor on multiple occasions. The team also held two meetings to debate the arguments for and against the proposals with a vote ultimately being taken to determine our actions at the company Annual General Meeting:

- **Proposed Share Structure**
  There was some merit to the argument that the change in share structure could lower the overall cost of capital, but we were quite sceptical of this theory in that it is somewhat circular – if the share price goes up without any change to the basic operation of the business then the cost of capital must have gone down. However, that assumes the share structure change has the desired effect on the stock price, which it might not and we do not have any obvious precedent for the situation. That said the team felt that the downside risk was very low and there was some upside risk. **The team voted 5 For, 3 Against. All our funds therefore voted For the Activist’s proposal**.

- **Director Proposals**
  We felt that the company has been doing the right things and operationally has been strong therefore the board oversight is not obviously bad. Having said that the board is populated by industry veterans and we questioned what many of them brought to the discussion, as such the activist’s proposed board members might have been a positive addition. We were also somewhat concerned by the evidence presented to us by the activist investor that the board had not been operating optimally. **The team voted 8 For, 0 Against. All our funds therefore voted For the Activist’s proposal**.

Ultimately, and despite our votes, both proposals were voted down by the majority of shareholders. We feel this is the wrong decision but are not surprised given that ISS and Glass Lewis both recommended voting against the proposals and we are aware that many shareholders just follow the recommendations of the proxy advisory firms. We made effort to discuss the proposals with the proposing activist shareholder and the company and had extensive internal discussions to come to our conclusion on how to vote. In this instance we voted against the recommendation of ISS. We believe in our approach, and feel that it is probably quite different to that of our peers.

Proxy Voting Record 2Q17

Nomura Asset Management U.K. Ltd. (“NAM UK”) seeks to act in a manner that it believes is most likely to enhance the economic value of the underlying companies owned on our clients’ behalf. We engage with companies based on our "Ideal Form of Business Management of Investee Companies" in order to enhance our mutual understanding and to seek changes in their company practices. NAM UK employs the services of ISS (Institutional Shareholder Services) to efficiently apply our proxy voting policy to individual proposals. ISS are provided with comprehensive guidelines detailing NAM UK’s proxy voting policy.

NAM UK will closely consider the voting agenda of a company that meets certain conditions (including, but not limited to, the violation of any applicable laws, inadequate board composition, and financial strategies that are not deemed to be in the best interests of shareholders). Where we believe that a specific agenda item is not in the best interests of shareholders, NAM UK will decide either to vote against or to abstain from voting on the item. Please see the Nomura Asset Management Proxy Voting Policy for full details.

Voting Data

Over the quarter NAM UK voted on 1172 proposals across 254 shareholder meetings and 302 ballots. In total 62% of proposals were Director related with a further 15% in relation to remuneration and 12% the general course of business.

In total NAM UK voted ‘With’ management on 1053 (90%) proposals and ‘Against’ management (or ‘Withheld’ our vote) on 119 (10%) proposals. Of the 119 Votes ‘Against’ management, these related predominantly to Directorships and Compensation. Examples of where we voted ‘Against’ management, or elected to ‘Withhold’ our vote included:

- Voted Against the directorship proposals of a US automotive OEM in favour of the slate proposed by activist investors. Please see our case study for a more detailed discussion of the work carried out in developing our view.
- Voted For the proposal to assess the environmental impact of non-recyclable packaging (in relation to a US Food Products business). Management had advised a vote Against the proposal.

Proposals Voted on in 2Q17

Proposal subject	Count	Proportion of Total Votes
Anti-takeover	12	1.0%
Capitalisation	76	6.5%
Directorships	722	61.6%
Compensation	172	14.7%
Reorg/M&A	3	0.3%
Routine Business	143	12.2%
Health/Environment	16	1.4%
Other	28	2.4%
Total	**1172**	**100.0%**

Proposals Voted 'Against' Management in 2Q17

Proposal subject	Count	Proportion of Total Votes
Anti-takeover	5	4.2%
Capitalisation	3	2.5%
Directorships	55	46.2%
Compensation	29	24.4%
Reorg/M&A	0	0.0%
Routine Business	8	6.7%
Health/Environment	8	6.7%
Other	11	9.2%
Total	**119**	**100.0%**

Voting Record vs. Management in 2Q17

	With	Against
Votes	1053	119
Proportion	*89.8%*	*10.2%*

Voting Record vs. ISS in 2Q17

	With	Against
Votes	1162	10
Proportion	*99.1%*	*0.9%*

ESG queries raised

Stock	ESG Rating	ESG queries raised: Governance	ESG queries raised: Specific Management/Pay	ESG queries raised: ROIC Driven Pay?	ESG queries raised: Environmental/Social	Company Contacted?	Company Responded?	Notes from Company Contact
US Health Insurance	N	Accounting flags related to intangibles on the balance sheet and M&A risk. We do not view these as material concerns. Ownership and shareholder rights are above average. There are no major controversies associated with the company	CEO remuneration not overly generous	N	No major concerns	N	N	N/A
UK Listed Telecom	Contacted Outside Formal Review	Concerns over disclosures to the market with regards to timing	–	Contacted Outside Formal Review	Operates in an industry that is not heavily exposed to environmental or social issues	Y	Y	We contacted investor relations with regards to concerns over their communication strategy. We do not believe the company has disclosed inside information, but are concerned that the strategy for communicating with the sell side could potentially result in an inequitable distribution of knowledge from a timing perspective and believe practices should be improved
UK Online Food Retailer	N	No major concerns	Management incentive well aligned with shareholders	N	Operates in an industry that is not heavily exposed to environmental or social issues	N	N	N/A
US REIT	I	Legacy company recently involved in a merger of equals. Governance has been an issue in the past but we believe the governance structure now in place is much better	Remuneration is performance based although we would like the targets to be explicitly stated. Cash bonus compensation will pair 60% weighting across core FFO and capital raising, along with 40% to subjective criteria. Long term incentive awards will be part vested on time-served vesting terms and a portion subject to a combination of that and performance	N	Non-traded REITs used to have very high upfront fees of 13%+ across all sponsors	N	N	N/A
Brazilian Telco	I	Parent controls company through dual class share structure. Does not have independent majority board	Nothing of note	N	Provides universal telephony service	N	N	N/A
Spanish Engineering Business	I	Very long serving, old directors raise some concern	CEO since 1997. Obviously a very long tenure, but he did preside over a big fall in ROIC from 2004 onwards and a fall in margin	N	–	N	N	N/A
German Engineering Business	I	Governance appears to be OK	CEO since 2012. The drivers are Adj Free Cash Flow, Consolidated Net Profit and Consolidated Net Profit Growth plus strategic targets	N	Involvement in 'green' construction and below average injury rates flagged as positives. Concerns over corruption and fatalities at one of its subsidiaries	Y	Y	We contacted the company to discuss three fatalities, and corruption concerns at a subsidiary. The company strongly denied any corrupt practices but was not able to provide any additional details on the deaths of the three workers (referring only to general statements made by the publicly listed subsidiary)
Australian Engineering Business	I	Has been involved in historic corruption scandals which bring into question governance and management control	–	N	Historic corruption scandals and fatalities in 2016	Y	Y	See parent (German Engineering Business)

ESG queries raised (cont'd)

Stock	ESG Rating	ESG queries raised: Governance	ESG queries raised: Specific Management/Pay	ESG queries raised: ROIC Driven Pay?	ESG queries raised: Environmental/Social	Company Contacted?	Company Responded?	Notes from Company Contact
Eastern European Airline	I	Governance is average. Related party transactions are flagged, and notably within the most recent directorship elections negative voting (greater than 10%) was seen	There are no serious concerns flagged with regards to management remuneration. Short term bonuses are driven predominantly by group profit, whilst the long term incentive plan is driven by EPS growth and TSR relative to EU airline peers	N	The airline industry clearly has a negative environmental impact given the level of airplane emissions, but the company's fleet is amongst the most efficient globally	Y	Y	We followed up with the company to express our concerns over the voting against directorship proposals, and confirm the strategy with regards to emissions
UK Retailer	N	Strong on governance	Incentives are too linked to sales growth and market share gains and it would be sensible to look at ROIC targets	N	No issues	N	N	N/A
US Automotive OEM	Contacted Outside Formal Review	Several governance concerns were flagged over the quarter by an activist investor with regards to board oversight	We are in favour of voting for changes in the board composition given issues raised by an activist	N	Manufactures automobiles which are highly emitting, however the company has recently developed substantially in the EV space	Y	Y- Call in June	Contacted with regards to activist proposals (board changes and share structure). We also enquired as to why senior management had sold substantial holdings despite publicly stating the stock is exceptionally cheap (and a very large buyback strategy). We were somewhat disappointed by the IR team's willingness to discuss an alternative point of view
US Beauty Company	I	Board does not have majority and there is some over boarding	Compensation seems to be better than peers, note early vesting provisions	N	–	N	N	N/A
European Auto Supplier	I	Flagged for relatively poor governance with concerns over the ownership structure	No issues	N	Geared to the auto industry which drags down the environmental score, but developing new products for solar and tidal energy	Y	Y	We followed up with the company to enquire about an explosion at one of its facilities. The company was unable to comment further at the time as a result of this still being an ongoing investigation
Spanish Telecom	N	No issues. 83% of the board are outside directors	No issues	N	Recurring restructurings, but treats employees fairly by offering early retirement as opposed to layoffs	N	N/A	N/A
UK Aerospace Supplier	I	Deemed as having average accounting risk, with the main flag being goodwill arising from prior acquisitions. No governance issues with the board having an independent majority. Currently searching for a new Chairman who didn't want to serve 2 terms	Annual bonuses are based on adjusted EPS and FCF targets. LTIPS are based on a 10% EPS growth target over 3 years and relative TSR. It would be preferable to see ROIC incorporated into the LTIPS given the fairly capital intense nature of the business	N	Operates in the aerospace industry and is a supplier to diesel engine manufacturers as well as the oil & gas industry	N	N/A	N/A
Canadian Bank	I	Chairman and CEO role are separated. Flagged areas are over boarded exec directors and votes against directors. We also feel that segmental disclosure could be vastly improved for stakeholders. On accounting rated average in the 40th percentile. Flags include revenue recognition, and restructuring and leverage ratios	We would prefer if remuneration targets were tighter as the range for each metric is wide with the lower bounds easily achievable	N	Rate Social and Governance very highly whereas Environmental is weaker. Key concerns over lending to indebted consumers, commercial lending to companies that harm the environment and investment banking activity	N	N/A	N/A

ESG queries raised (cont'd)

Stock	ESG Rating	ESG queries raised: Governance	ESG queries raised: Specific Management/Pay	ESG queries raised: ROIC Driven Pay?	ESG queries raised: Environmental/Social	Company Contacted?	Company Responded?	Notes from Company Contact
US Diversified Financial	I	Aggressive accounting; the primary flags are the level of M&A and restructuring activity. Other flags include payables and receivables ratios in addition to the level of unusual expenses though we highlight this is driven predominantly by the one off DoJ fine (cash yet to be paid out). Governance is generally ok, board practices are strong, Pay practices are flagged as below the level of peers	The short term bonus portion of remuneration based on 50/50 operating income/EPS. LTIP is through a mix of stock options and performance shares (predominantly group EBITDA)	N	Rated highly on environmental impact, but scores poorly on social impact driven by both its involvement in the financial crisis and the level of M&A/ restructuring (driving employee discontent, though Glassdoor did not reflect this)	N	N/A	N/A
Australian Building Materials	N	Accounting is relatively conservative, and scores very highly on governance	CEO's total summary pay was more than four times the median pay for the company's other named executive officers which raises red flags over the company's succession planning process and the distribution of responsibilities among the executive management team. Paid on a combination of EBIT and TSR	N	Scores relatively highly mainly due to the emphasis on safety - has been employee fatality-free since Dec 2013, and in 2015 there were no contractor fatalities in the company	N	N/A	N/A
Australian Paper & Packaging	I	Governance is strong with the sole flag being that accounting practices screen as slightly aggressive, driven predominantly by the level of M&A	Remuneration practices are relatively strong (as considered vs. the industry and home market)	N	Scores well on Environmental concerns; have historically delivered beyond targets for sustainability. Chemical Safety measures found lacking and more reactive than proactive	N	N/A	N/A
US Utility	I	On the pure governance side is OK (37th percentile); the board is independent and no major flags are raised, but remuneration practices are average, 2 directors are flagged as over boarded and company has failed to adopt majority voting standards	Remuneration is driven somewhat by meeting operational targets but predominantly by relative TSR, and adj EPS growth	N	Scores exceptionally highly; most notably very highly on Environmental matters driven by its huge renewables investment	Y	Y	Followed up with the company to express our view that greater clarity should be given on the renewables business to assist modelling, comments were taken on board and guided that greater clarity will be given at the CMD . With regards to our concerns over management being paid on adjusted EPS, the team highlighted than contrary to peers cumulative 10y adjusted EPS is lower than reported EPS
US Medical Equipment	N	Flag accounting as "Aggressive" but this is based on receivable days which have been steady. Low asset turnover reflects high profitability. No major governance flags – these relate to long-serving/"entrenched" Board and "over boarded" directors	CEO pay is skewed to long-term incentives but no clear metrics for their administration. Long-term incentive rewards based on peer-group levels 70th percentile. Annual performance target under the annual Management Incentive Plan of 15% non-GAAP EPS growth	N	No concerns	N	N/A	N/A
US Industrial Conglomerate	I	Combined CEO/Chairman but otherwise board composition is fine	CEO's golden parachute post-merger appears rather unnecessary. LTIPs are based on earnings, ROIC and TSR, so are aligned with shareholders' interests	Y	Company scores highly in this area due to its focus on controlling and reducing building emissions. It also recycles 99% of the lead used in its battery business	N	N/A	N/A

Glossary

COGS	Cost of Goods Sold
COI	Conflict of Interests
DTA	Deferred Tax Asset
EBIT	Earnings Before Interest and Tax
EM	Emerging Markets
EPS	Earnings Per Share
ESG	Environmental, Social, Governance
FCF	Free Cash Flow
KPI	Key Performance Indicator
LTIP	Long Term Investment Plan
ND	Net Debt
Opex	Operating Expense
PSP	Performance Share Plan
RoA	Return on Assets
ROCE	Return on Capital Employed
ROIC	Return on Invested Capital
SH	Shareholder
SOE	State owned Enterprise
STIP	Short Term Investment Plan
TSR	Total Shareholder Return
WC	Working capital

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