



2Q 2016

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. The Group headquarters is based in Tokyo, Japan (NAM Tokyo).

"NAM UK"
"Our"
"We" This refers to Nomura Asset Management U.K. 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 26 companies were reviewed and assigned ESG ratings. Of these 14 were awarded a rating of 'N' (No Issues) and 12 a rating of 'I' (Issues to Address), with no companies assigned a 'U' (Uninvestable) rating.

In addition the team also followed up on a broader 'Social' concern regarding leather goods companies, which was carried out outside of an individual company review.

Of the companies reviewed 11 were within Developed Markets, whilst 15 were within Emerging Markets. In total 7 companies were contacted to discuss ESG concerns. Of these, responses were received from 6 (86% response ratio).

Companies reviewed		Companies contacted	
N (No Issues)	14	Number of contacts	7
I (Issues to Address)	12*	Number of responses	6
U (Uninvestable)	0	Total	86%
Total	26		

Notes: * One company considered borderline I/U.

Notes from our Responsible Investing Research

- **Contact:** Broadly we found companies receptive to our queries and concerns. However, we did experience a clear preference for responding via telephone as opposed to email – this was most notable for EM companies – which did raise some concerns as to potentially not wishing to commit in writing to the responses.
- **Governance:** The primary concerns raised surrounded CEO relationships with the board or the CEO/Chairman positions not being separated. However we highlight that these concerns were predominantly raised for the EM businesses that were reviewed.
- **Remuneration:** The most common concern raised was that of failing to have clear performance targets or targets that were overly vague. Of the companies reviewed none were found to have a remuneration policy tied to Return on Invested Capital (ROIC) which we believe is a key driver of long term investment return.
- **Environmental / Social:** There were no major concerns raised across the companies reviewed. We contacted one company, outside of a formal individual company ESG review, with regards to a broader investigative journalism piece on the very poor quality working conditions within Bangladeshi tanneries; it was confirmed that this specific company did not use Bangladeshi tanneries.
- **Other:** Over the quarter members of the team attended various ESG events. It was notable that across peers, and even amongst our very largest Asset Manager competitors, there remains a level of frustration as to company willingness to respond to ESG queries from investors. However, it is further notable that across the investment community the interest in responsible investing is continuing to grow.

Responsible Investing Case Study

Over the quarter we reviewed a Korean automotive parts supplier with our responsible investing research flagging a number of relatively serious governance issues. The primary concerns centred around a relatively poor track record in acting in the best interests of shareholders, which was further aggravated by a 'circular ownership' structure (employed to ensure control across a range of different companies). The most recent example of not acting in shareholders' interests had been the very well documented overpayment for land designated for the new group headquarters, which in our view was clearly to the detriment of shareholders and driven more by the personal interests of senior management.

We were further concerned that the Chairman had previously been involved in an embezzlement scandal in 2007 and that this had been pardoned by the Korean President for the good of the Korean economy.

We followed up on our concerns with the investor relations teams of both the company itself and other companies within the 'circular ownership structure'. It was strongly suggested to the investor relations teams that corporate governance practices were not adequate and that the company does not give the impression of acting fully in shareholders' best interests.

The company was assigned a rating of 'I' though it was deemed borderline 'U' (Uninvestable). The primary redeeming factors against awarding a rating of 'U' were:

- A. The poor corporate governance environment in South Korea was noted and a degree of relative comparison vs. domestic peers was taken into consideration
- B. The investor relations team were open in stating that the company had received overwhelmingly negative feedback following the land acquisition and internally it has now been recognized (in light of exceptionally poor share price performance) that corporate governance must improve moving forward. In our view this significantly decreases the probability of any further value destructive capital allocation.

In our view primarily the latter point with regards to the company actively looking to improve corporate governance moving forward, and the discontent with the share price performance decreasing the probability of additional value destructive capital allocation, was the primary reason for not awarding the company a rating of 'Uninvestable'. However, the team will be closely monitoring the progress of the company's corporate governance and will consider reviewing the rating should this not improve.

Proxy voting record 2Q16

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 "Principles on Corporate Governance of Portfolio Companies." in order to enhance our mutual understanding and to seek changes in their company practices. NAM UK employs the services of Institutional Shareholder Services (ISS) 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 1,967 proposals across 122 shareholder meetings and 142 ballots. In total 54% of proposals were director related with a further 23% in relation to the general course of business. Other proposals related primarily to capital allocation, compensation and M&A.

In total NAM UK voted 'With' management on 1775 (90.2%) proposals and 'Against' management on 192 (9.8%) proposals. Of the 192 Votes 'Against' management these were heavily weighted towards EM companies (68% of total 'Against' votes) and predominantly categorized as related to Compensation, Directorships and Capitalization.

Examples of votes 'Against' management include:

- Voted against director proposals for a Brazilian consumer lending business because the proposals would lead to an inappropriately low level of board independence
- Voted against director proposals for a Vietnamese energy company as a result of incomplete disclosure with regards to nominee backgrounds
- Voted against executive officer compensation proposals for a US industrial conglomerate given inappropriately complex and unsuitable pay-out formulae, and a broader creep in total compensation.

Proposals Voted on in 2Q16

Proposal subject	Count	Percentage
Director related	1071	54.4%
Business related	454	23.1%
M&A	22	1.1%
Compensation	152	7.7%
Capitalization	140	7.1%
Other	128	6.5%
Total	1967	100.0%

Proposals Voted 'Against' in 2Q16

Proposal subject	Count	Percentage
Director related	43	2.2%
Business related	28	1.4%
M&A	1	0.1%
Compensation	36	1.8%
Capitalization	38	1.9%
Other	46	2.3%
Total	192	9.8%

Voting Record vs. Management in 2Q16

	With	Against
Votes	1775	192
Proportion	90.2%	9.8%

Voting Record vs. ISS in 2Q16

	With	Against
Votes	1962	5
Proportion	99.7%	0.3%

ESG queries raised

ESG queries raised

Stock	ESG Rating	Governance	Specific Management/Pay
Indian Textiles Business	I	The company is 59% owned by the 'Promoter'.	Lack of disclosure on compensation.
French Luxury Goods Holdco	N/A	–	–
Indian Consumer Goods Business	N	Relatively strong with well aligned practices.	Lack of compensation committee (but ranked 92nd percentile in home market).
Argentinean Telecom	N	Complicated holding structure to maintain voting control. Fintech also owns a stake in the leading pay TV company in Argentina, which could lead to a conflict of interest in the future.	Has long term incentive plan to incentivize management but no details.
US Industrial Products Company	N	Governance generally good, flags include long standing board.	CEO comp ca. 1.3% EBIT. Bonus is 75% EPS driven (rest FCF).
UK Insurance Company	N	–	Not disclosed quantifiable performance targets.
HK Listed Life Insurance Company	N	Lack of independent lead Director.	–
US Sportswear Operator	I	Screens poorly; highlight two share classes with different rights.	Comp high but inline with industry practice.
Egyptian Hospital Operator	N	Limited ESG information given is an IPO.	Entirely new management team has been brought in.
US Biopharmaceutical	N	Accounting for collaborations not transparent. Poison pill provisions.	Stock based comp 15% Opex. Pay very high vs. peers.
Korean Automotive Parts Manufacturer	I (Borderline U)	Poor governance track record, circular ownership and clearly see cash not as SH's (cf. huge overpayment for HQ's).	Chairman previously convicted of embezzlement, pay structure unclear.

ESG queries raised

ROIC Driven Pay?	Environmental/Social	Company Contacted Regarding ESG?	Company Responded?	Notes from Company Contact
N	–	N	N/A	N/A
N/A	Followed up on concerns over companies using Bangladesh tanneries with very poor conditions.	Y	Y	The company responded to our concerns to assure us that they did not use Bangladesh tanneries.
N	Screens very well on Social and Environmental impact.	N	N/A	N/A
N	Operates in an industry that is not heavily exposed to environmental and social issues.	N	N/A	We felt it was not necessary to contact the company given the track record of protecting minority shareholder interests by their controlling shareholder.
N	Exposure to nuclear power and asbestos claims dating to 1930s.	N	N/A	N/A
N	–	N	N/A	N/A
N	–	N	N/A	N/A
N	Supply chain labour standards flagged.	Y	Y	Two different share classes (founder controls A shares – recently transferred the majority of these shares to a trust with independent board majority). No plans to separate CEO/Chairman.
N	–	N	N/A	N/A
N	–	Y	Awaiting Email Response	Awaiting Email Response
N	–	Y	Call May 2016	We questioned the company about a past incident when the company overpaid for property and expressed our view that corporate governance practices could be improved. The company responded that they are working on improving governance based on investor feedback.

ESG queries raised (cont'd)

ESG queries raised			
Stock	ESG Rating	Governance	Specific Management/Pay
US Gaming & Entertainment Company	I	Poor rating with red flags due entrenched Board and large majority shareholder group. CEO/Chairman control entity owns around 23% of the company. CEO has 'Golden Parachute'.	60% of management incentive compensation is based on absolute adjusted operating income and absolute adjusted free cash flow. Potentially incentivises acquisitions.
Thai Tile Manufacturer	I	Founding family own 68% of the shares and hold 4/12 board seats. Organic growth focused strategy and 100% dividend payout policy mitigates risk for minority shareholders.	Do not disclose compensation metrics.
Japanese Internet Services Company	I	Controlled by other company with a record of trying to force this company to buy its assets influencing M&A. No independent board members.	Poor disclosure with regards to management pay and absence of compensation committee.
Dutch Dredging Business	N	Standout concern is the presence of a poison pill and Equity issuance to fund M&A.	Management targets are slightly vague.
Qatari Telecom	N	Like many telcos in emerging / frontier markets, majority owned by the government which could lead to a conflict of interest between profits and politics.	No disclosure about management pay.
UK Listed E&P	N	Accounting – excessively large intangible and prepaid expenses.	–
Chinese Power Cable Manufacturer	I	Chairman son in law is CEO / controlling shareholder. Equity issuance for M&A.	–
Dutch Chemicals Business	N	Capital allocation track record relatively strong (ST). CEO & Chairman positions combined.	Relatively complex – ST driven by HS&E, cost performance, EBITDA. LT on RoA & share price.
Mexican Financial Services Company	I	Concerns over CEO departure and related disclosures. Potential COI from interest in competing financial institution.	Lack of compensation disclosure or comp committee.

ESG queries raised				
ROIC Driven Pay?	Environmental/Social	Company Contacted Regarding ESG?	Company Responded?	Notes from Company Contact
N	–	N	N/A	N/A
N	–	N	N/A	N/A
N	Operates in an industry that is not heavily exposed to environmental and social issues.	N	N/A	Liaised with analyst team in Tokyo.
N	–	Y	Call May 2016	Company highlight poison pill very common in Netherlands, and more for buying time. Given cyclicity do not want ND/EBITDA >2x.
N	Operates in an industry that is not heavily exposed to environmental and social issues.	N		We felt we did not need to contact the company given there are independent telecom and antitrust regulators in Qatar.
N	E&P business and has high environmental impact.	N	N/A	N/A
N	Power intensive industry.	N	N/A	N/A
N	High carbon emission levels & waste.	N	N/A	N/A
Lack of disclosure	–	Y	Call May 2016	Highlight safety concerns if public aware of director remuneration/wealth. CEO & Chairman conflict should now be resolved. Bylaws potentially changing with respect to M&A.

ESG queries raised (cont'd)

ESG queries raised			
Stock	ESG Rating	Governance	Specific Management/Pay
Mexican Financial Services Company	I	Three M&A transactions in just 3 months.	Lack of disclosure on compensation.
US Electronics Retailer	I	–	Concerns that management pay related to absolute EBIT, related transactions & ex founder's comp.
European Staffing Firm	N	Scores very highly on Governance.	Shareholder disquiet over former CFO not being appointed as CEO.
Indonesian Telecom	N	Majority owned by Indonesian government may lead to conflict of interest. Building fiber nationwide in Indonesia could benefit consumers over shareholders.	No quantitative metrics given.
Hong Kong Listed Electronic Parts Company	N	Accounting practices average, with trailing M&A and liquidity (cash) ratio highlighted.	Relatively little disclosure within annual report though we note that stock options are a high proportion of total compensation.
Argentinean Integrated Utility	I	21% owned by management. Governance is OK though we highlight solely 4 of the 15 directors are independent and the company does not have a nomination / remuneration committee.	–
South African Retailer	I	Concerns raised with regards to the board – over boarded directors, entrenched board and related party transactions. Multiple share class structure.	Bonus linked to EPS growth and ROCE. Long-term incentives include share scheme and share option schemes.

ESG queries raised				
ROIC Driven Pay?	Environmental/Social	Company Contacted Regarding ESG?	Company Responded?	Notes from Company Contact
Lack of disclosure	Collections model could promote excessive force / immoral practices.	N	N/A	There were issues with contacting the IR met, emails bounced back.
N	–	Y	Call April 2016	Argued stores coming down (so not opening new margin dilutive stores) and ties to online growth. A result of agreement when founder tried to take private – paid for business plan.
N	Scores very highly on 'Environmental' screens.	N	N/A	N/A
N	Operates in an industry that is not heavily exposed to environmental and social issues.	N	N/A	We did not contact the company given their fiber buildout thus far has been limited and they have specific targets for subscriber additions.
Lack of disclosure	Potential 'environmental' impact from plating activities.	N	N/A	N/A
N	Owns a number of fossil fuel power stations and upstream O&G assets.	N	N/A	N/A
ROCE	–	N	N/A	N/A

Glossary

ROIC	Return on Invested Capital
ESG	Environmental, Social, Governance
EM	Emerging Markets
RoA	Return on Assets
COI	Conflict of Interests
EBIT	Earnings Before Interest and Tax
ROCE	Return on Capital Employed
EPS	Earnings Per Share
ND	Net Debt
Opex	Operating Expense

Disclosures

This information was prepared by Nomura Asset Management U.K. Ltd. (NAM UK) from sources it reasonably believes to be accurate. This document is for information purposes only on the general environment of investment conditions.

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