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AMP Capital’s approach to ESG: the what, why and how

AMP Capital has long argued that investors benefit from looking beyond financial statements when valuing companies.

For more than a decade AMP Capital has been a pioneer in environmental, social and governance (ESG) investment research. As one of the first managers to genuinely integrate ESG research into investment decisions, our team has accumulated proprietary knowledge and experience in analysing and integrating ESG investment issues across a range of asset classes. Our commitment to responsible investing led to the establishment of the AMP Capital Sustainable Share Fund in 2001, the Responsible Investment Leaders Australian Share Fund in 2006 and to AMP Capital becoming one of the first signatories to the Principles for Responsible Investing.

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.²

Having said that, 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?

The article discussing cyber and data security (Page 3 of this report) and AMP Capital’s recent review of the banking sector (Page 6 of this report) demonstrates how AMP Capital puts ESG analysis into practice.

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 greatest driver of company value is not what you can see, but what lies beneath the surface.
Why is data and cyber security an ESG investment issue?

As governance and risk-management go hand in hand, it is no surprise that well-governed companies are more likely to have a better understanding of the cyber risks and opportunities they face.

For precisely this reason, understanding the quality of a company’s governance and risk-management processes has always formed an integral part of AMP Capital’s ESG investment research. On the flip-side, by delving into issues such as a company’s understanding and preparedness for cyber-attacks, we also gain further insight into the quality of a company’s governance, risk management and leadership.

AMP Capital’s ESG analysts first raised risks associated with breaches of data security as an investment issue in the team’s 2009 report on the ESG factors impacting the telecommunications industry. While every sector study since 2009 has highlighted data security as an important risk, there is no doubt the investment implications of this risk are increasing.

Using the iceberg analogy, AMP Capital believes the less-visible factors may ultimately have the greatest impact on a company’s ability to generate superior long-term returns for shareholders. Investors expect companies to have tangible technological/digital capabilities such as point of sales systems, customer databases and a social media presence. As recently as 2012, having big data was considered a competitive advantage but today the advantage increasingly comes from how that data is leveraged.

This article focusses primarily on the investment implications associated with a board’s understanding and management of their cyber risks and responsibilities.

The real impact on company value is no longer driven by its access to data sets, but rather by how efficiently the company captures, manages, understands, leverages and protects that data.

GROWING INVESTMENT IMPLICATIONS OF DATA SECURITY

Everyone gathers, shares, uses and benefits from technology and data to varying degrees. The pace of technological change has been exponential. Ideas that were simply ‘hype’ a few years ago have already moved from ‘experimentation’ into ‘production’.

As companies have the potential to understand, reach and service their customers better, many senior leaders see big data, digital transformation and disruption as a significant source of value to their companies. However, with these great opportunities come significant risks.

... if companies know where risks could potentially come from, they will be in a better position to prevent and detect them.

KARIN HALLIDAY
Manager, Corporate Governance

As technology widens its reach, we have become more connected, but also more vulnerable. Data being collected and stored could be used to both our benefit and our detriment. It is for this reason that companies need to be increasingly vigilant in protecting the integrity and privacy of data and systems. While it may be costly for companies to implement processes and systems to adequately protect their data, not doing so could potentially be even more costly. News of data breaches can travel quickly and put a company’s reputation and financial stability at immediate risk.

WHAT COULD POSSIBLY GO WRONG?

Our research into the issue of cyber-security highlighted the large number of ways systems and data could be compromised. While it is not possible to discuss all potential internal and external threats here, it appears 90 per cent of breaches can be put down to the actions of people.

Cyber and data threats could come from:

**Internal threats**

> Staff being careless: accidentally sending emails to the wrong people, losing a memory stick, sending data via public WiFi.

> Staff being malicious: information sent to a competitor, sensitive data improperly accessed by system administrators or IT personnel, fraud, and disgruntled employees.

**External threats**

> Social engineering which relies on staff being tricked (by people) to act contrary to their proper security processes

> Phishing where third parties attempt to gain access to sensitive data by using websites or emails that appear legitimate. Phishing can either be a targeted attack or can be deployed via a scattergun approach.

7 reasons why data security matters more now than ever before:

1. Technology is constantly changing and has an ever-widening reach.
2. There is greater emphasis on privacy of data.
3. Risks are relentlessly shifting and becoming more complex.
4. Ever-increasing numbers of records and inter-connectedness mean a greater number of people will be affected by breaches.
5. It is impossible for companies to be prepared for all attacks.
6. News of breaches travels fast and has an instantaneous impact on reputation and demand for a company’s products or services.
7. The costs of prevention and remediation of data security breaches are rising.
An ex-employee accessing data.
A thief stealing a laptop computer.
Hackers or competitors monitoring data flows, espionage.
Malware and viruses. (CryptoLocker is an example of malware – once activated it encrypts files and, akin to a kidnapping, payment of a ransom is required to regain access to files)

Other threats
Natural disasters and physical equipment failure.
AMP Capital argues that all companies have some IT systems, processes or data at risk. We were therefore disappointed to learn from our conversations with company directors that some boards have not yet turned their attention to identifying and managing the specific data and cyber risks their companies could face. While we accept the risks are greater in some industries than others, we do seek assurance that the board has sufficient IT skills and experience to at least allow them to ask the right questions.

It is generally accepted that if companies know where risks could potentially come from, they will be in a better position to prevent and detect them. To this end, we have found it instructive to review examples of recent data breaches such as:
Target (USA, 2013): Credit and debit card data for 70 million customers exposed.
Sony (2014): Cyber criminals (Guardians of Peace) leaked 47,000 social security numbers of current and former Sony staff.
Domino's Pizza (2014): Hacking group Rex Mundi held Domino’s Pizza to ransom over 600,000 Belgian and French customer records.
Sony (2011): Sony's PlayStation network hacked, impacting customer data.
Optus (2014): Three data breaches affected more than 300,000 customers by the unauthorised release of names, address and mobile phone numbers. Security flaw allowed unauthorised access to voicemail.
Lynas (2012): Hackers crashed website to protest proposed Malaysian metal processing plant.
EBAY (2014): 145 to 233 million customer records compromised. EBay users advised to change passwords immediately.
Anthem Inc (2015): 80 million customers of the US’s second-largest health insurance company, Anthem Inc., had account information including names, birthdays, medical IDs, Social Security numbers, street addresses, e-mail addresses and employment information, including income data stolen.
Ashley Madison (2015): Hackers aiming to publicly embarrass members of the infidelity website recently accessed and began exposing the private data of 37 million customers.

From these examples it is clear the data most often targeted relates to the personal information, bank and credit card details, and passwords of customers. Thieves can use stolen data for financial gain; either by embarrassing and then extorting those exposed, or by using the data to access tax refunds or to apply for new loans and credit cards. It is also evident that an increasing number of data records are being affected.

Companies running essential infrastructure are also vulnerable to cyber-attacks as hackers could wreak havoc with transport, energy and water services.

One thing is clear – cyber and data security can no longer be categorised as purely a ‘technology issue’, it is equally about people and processes. The physical, financial and reputational implications of an attack on a company’s technology data and systems will, to a large extent depend on how prepared the company is for an attack.

Precautionary steps companies should take:
Identify the data, intellectual property and process that are core to the success of the company and which must be protected
Understand how security breaches could occur
Educate staff on the importance of data and cyber security, including:
Implications of breaches
How to protect data and processes
How to identify risks
How to avoid being tricked
Reporting mechanisms.

FINANCIAL IMPLICATIONS
As with all ESG issues, cyber security is a governance issue with real financial implications. Understanding the potential magnitude of financial losses helps companies prioritise the management of these risks, with those potentially causing the biggest damage to the business requiring the closest attention.

There are various estimates with regard to the financial cost associated with data and cyber-crime. Average loss for a breach of 1,000 records is forecast to be between A$52,000 and A$87,000 with larger companies suffering higher losses per breach. Estimating the financial impact of breaches is becoming more sophisticated, rather than just multiplying the number of compromised records by a cost-per-record estimate, better estimates can be made by looking at cyber liability insurance claims.

Data released by NetDiligence in 2013 showed the median claim payout for incidents that occurred between 2010 and 2012 was US$242,500 and the average was US$954,253. Data released by NetDiligence the following year showed a median payout of US$144,000 and an average US$733,109, the average declining 23% compared to the previous year.
In their recent report: Putting Numbers around IT Security^24 Citi Group states that:

“Security spending growth was especially strong in 2014 for a number of reasons, including a larger focus on security by companies and their corresponding boards, a weak spending environment in 2012-2013, and a corresponding refresh cycle of many core markets due to the changing threat landscape with constant data breaches.”

The Citi report states that the IT Security market was US$29 billion in 2014, and is expected to increase to $39.6 billion 2019.

With a malignant threat landscape and continued media coverage of major breaches, it’s not hard to imagine how IT security market growth could continue to trend higher in perpetuity. Citi however points out that IT Security spending is cyclical with the rise and fall of ‘new’ products and regular ‘refresh cycles’ of existing products.

WHAT DO SHAREHOLDERS WANT TO KNOW?

Shareholders want to be confident that boards have the issue of cyber security firmly on their radar. To this end, at AMP Capital we now raise the issue more frequently in our dialogue with company management and company boards. The questions we seek to have answered include:

> Does the board understand cyber security risks?
> Has the board identified the aspect of their business at greatest risk? What information, what processes, what long-developed intellectual property is core to the business’s success?
> Has the company identified how that data or process could be compromised or stolen?
> Has appropriate data security been put in place and subjected to regular testing including external independent review?
> Does access to sensitive data require strong passwords and/or second-level authentication?
> Does the board/senior management possess the necessary skills to truly understand the risk-management practices that have been put in place to mitigate against risk of cyber-attack?
> Are they confident breaches will be detected promptly?
> If a breach were to occur, how quickly could the company respond?
> What is the process for notifying affected customers/stakeholders?

How a company answers questions about cyber security provides valuable insights into the general quality of the company’s governance and risk management.

To date, few companies have addressed the issue of cyber and data security in their communication with shareholders. A spot check of 55 recently-released annual reports shows only seven companies (12 per cent) made reference to cyber and data risks. Large resource/mining and large financial companies appear to be at the forefront in commenting on the issue. Of the seven companies reporting on cyber and data risks in, the 2014 annual reports, BHP Billiton and AMP made the following comments:

BHP Billiton acknowledged the risk as follows:

“Breaches in our information technology security processes may adversely impact our business activities. We (BHP) maintain global information technology (IT) systems, consisting of infrastructure, applications and communications networks to support our business activities. These systems could be subject to security breaches (e.g. cyber-crime) resulting in theft, disclosure or corruption of information, including information relating to acquisitions and divestments, strategic decision-making, non-public investment market communications or commercially sensitive information relating to major contracts. Security breaches could also result in misappropriation of funds or disruptions to our operations.”

Our parent company, AMP Limited, made the following comment in relation to cyber risk:

“...the ongoing evolution of technologies has led to a rapidly changing environment that criminal networks seek to exploit. Cybercriminals can impact AMP and our customers by finding new ways to exploit weaknesses in online processes, hacking into customers’ computers, and exploiting potential weaknesses in AMP’s control environment. AMP’s network and assets are protected through the use of detective, preventative and responsive tools. In assessing and mitigating cybercrime, AMP considers vulnerabilities and the potential for control failures. The directors expect these risks will continue to have the potential to impact AMP and management will continue to monitor and manage these, and other, risks closely.”

WHERE TO FROM HERE?

Shareholders should and are becoming increasingly interested in data and cyber security.

The discussion above highlights that cyber threats are real and significant, especially as the reliance upon technology increases.

AMP Capital is keen to understand the extent to which companies have identified the risks and are managing them appropriately. We have no doubt the way companies understand and manage these issues today will have a significant impact on a company’s value and ability to generate sustainable returns for shareholders over the long-term.

**COMPANY VALUE AFFECTED BY TECHNOLOGY AND DATA**

Point of sales systems  
Customer databases  
Social media presence

However ...

greatest impact comes from companies’ ability to collect, manage, understand, leverage and protect data
The Banking Sector ... through the eyes of an ESG analyst

Financial companies now make up the largest portion of the Australian share market. At a time when the mining industry has slumped, the share prices of banks have benefitted from their reputation for high profits and high dividends.

Despite some recent weakness, the financials comprises 47.7% of the ASX200 index, which is up from 38.8% just five years ago.13

Given the size and importance of financial companies in the Australian share market, AMP Capital’s ESG research team recently conducted another detailed review of the Australian-listed banking and diversified financials sector. While at a high level the ESG drivers were found to be the same in both reviews, the manifestation of those drivers and how companies were positioned had changed.

Traditional banking reviews undertaken by ‘responsible investors’ generally did not go far beyond an evaluation of the banks’ lending and investment policies, focussing only on ethical issues such as human rights, environmental harm, and financial crimes. Today, ESG analysts also consider how the company performs as an environmental steward, how it manages its social relationships and the quality of its governance.

Again, it is AMP Capital’s approach to consider the ESG risk and opportunities that affect the industry (industry drivers) and then to drill down into how each company manages them (company drivers).

DRIVERS OF VALUE: INDUSTRY

Before analysing individual companies, it makes sense to take a step back and consider what factors are likely to shape earnings growth at an industry level. While these can change from time to time, the drivers of value for the banking and diversified financials sector can broadly be broken down into a number of familiar themes:

Maturing domestic markets

The sustainability of earnings growth for banks has been questioned in light of Australian banks’ high gearing to the property market combined with the high indebtedness of Australian households. Of particular concern is the prospect of baby boomers downsizing at retirement and the impact this will have on the property market and the profitability of banks. It is argued Australian banks operate in a mature market and need new areas to propel growth. New growth areas could lead to new operational, legal and reputational risks.

Technological change

The introduction of new technology has lowered barriers to entry, driven greater customer empowerment and increased data privacy and cyber security concerns. The change in information technology has been relentless and characterised by significant complexity, breadth, cost and associated risk factors. With the success and execution of major IT projects likely to impact their profitability, companies are understandably cautious with regard to their overall IT and IT security spend.

Regulatory change

Regulatory change is another long-standing industry driver. At its core, banking regulation aims to improve the transparency, stability and efficiency of the financial system. After the 2008 financial crisis, AMP Capital researched this industry more closely, engaged with various companies and concluded that increased regulation was likely.

DRIVERS OF VALUE: COMPANY

While a broad range of ESG factors could drive the value of individual companies in the banks and financial services industry, AMP Capital argues the most material factors are those that relate to risk management.

Given the size and complexity of most financial institutions it is difficult for those outside the company to determine precisely how well risks are managed across the entire organisation. The public disclosure of risk management frameworks and policies provides a good starting point but ESG analysts seeking a better understanding of the effectiveness of those processes and policies will need to dig deeper. In order to gain a fuller picture of each company’s risk-management AMP Capital considered factors such as customer satisfaction, company culture, corporate governance and innovation.

Customer satisfaction

While banks often speak of the importance of customer satisfaction, the fact that it can be difficult for customers to switch banks means customers would need to be very unhappy with customer service before choosing to switch their business elsewhere. This situation is however changing, so an analysis of customer satisfaction metrics can provide investors with valuable insights.

Before analysing individual companies, it makes sense to take a step back and consider what factors are likely to shape earnings growth at an industry level.

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consumer banking satisfaction was significantly higher than today. This convergence may have been driven by greater IT enablement or higher staff engagement or, in some cases, reduced fees or prices. It might also be linked to remuneration of management as well as staff.

Relevance of measures: In an ideal world incentive plans should be designed to align the interests of executives and shareholders. While it makes sense for incentives to focus on customer satisfaction, our analysis has shown that without a link to profitability there is a risk bonuses could be paid for the achievement of good customer satisfaction amongst unprofitable business segments.

Culture

Regardless of what industry a company operates in, it is widely accepted that company culture is a major determinant of company value. Given the importance of this issue, early insights into any red flags in relation to company culture will help investors avoid many negative surprises. As is generally the case with such intangible drivers of company value, company culture is difficult to assess from outside an organisation. For this reason, our ESG analysis uses a range of proxies to shed light on company culture. These include:

Transparency: It says a lot about a company if they choose to be open and honest with their stakeholders. The banking industry is one of the more transparent industries, providing better ESG disclosure, including disclosure on key people performance metrics, than other sectors.

The disclosure provided by banks is good but it does tend to focus on historical performance and reporting at a total group, rather than divisional level. AMP Capital’s recent sector review drew upon a range of information sources including external and independent staff reviews. These staff reviews paid particular attention to employees’ belief in the company’s business outlook, their approval of the CEO, and qualitative assessment of the culture in various areas of the organisation. This information gave AMP Capital a firm view on cultural differences between banks, and therefore an indication of potential risks. While there is good data available in relation to banks, there does tend to be less information publicly available on diversified financials.

Employee engagement: In this sector, staff are key assets. As such employee engagement is closely linked with productivity, profit growth and operating efficiency. Staff churn can be costly in the financial services sector due to rehiring costs, training costs and sunk costs spent on risk management. In addition poor employee engagement might impact customer satisfaction.

To assess the strength of each company’s employee engagement, AMP Capital considered staff engagement surveys, voluntary staff turnover, absenteeism and productivity. This analysis provided helpful investment insights by identifying companies with positive momentum in staff engagement and others with negative momentum.

Corporate governance

The financial sector is highly regulated and overall compliance with the basic ASX Corporate Governance Guidelines is good, particularly among the large banks. As smaller banking and diversified financials companies often draw on the expertise of affiliated directors, their strict adherence to the ASX Corporate Governance Principles can lag somewhat.

While non-adherence with the ASX Corporate Governance Guidelines might result in risk flags for investors, we believe the usefulness of such a ‘tick-in-the-box’ approach is limited and, arguably, the findings should be priced in by the market already. Our analysis looked further into factors such as board skills, potential accounting issues and how remuneration structures could drive particular management behaviour. A number of company-specific risk flags were identified. These included: changes to and the unchallenging incentive hurdles for executive remuneration, boards lacking relevant industry experience or vital skills to protect minority shareholder interests, long auditor tenure/ high non-audit fees versus fees for auditing services, tilts to short-term performance and seemingly ‘discretionary’ bonus schemes.

The review also identified certain risk flags related to accounting practices, such as the use of ‘cash earnings’ instead of statutory earnings that impact executive remuneration outcomes as well as questionable accounting practices related to the treatment of merger and acquisition integration.

Innovation

The rate of technological change in particular will contribute significant risks and opportunities when it comes to innovation.

Technology: We argue while it is imperative that each company’s technology remains competitive, over the long-term the greatest impact on company value will come not from merely ‘having technology’ but from how data is collected, managed, stored, leveraged, understood and protected. Digitisation can deliver cost efficiencies, cross-border activities and growth opportunities. Due to technological change, combined with behavioural change, banks need to adapt the way they interface with customers. The customer transition away from bank branches, through automatic teller machines and to virtual online and mobile services has taken only a few years to occur. Risks associated with disruptions in technology include disrupted service and reputational damage caused by anything from human error, malicious attacks or natural disasters.

IT spend: There is a suggestion that Australian banks more broadly have under-invested in IT, possibly as a result of our oligopolistic market. To keep up with the high pace of technological change, there is now a risk that banks will need to spend more and faster. There is a risk that increased operational and geographical diversification, and product complexity, could add to execution risk and costly delays along the way. The appropriateness of a company’s IT strategy and the effectiveness of implementation are difficult to determine from outside the company. In order to avoid a negative shock in the form of significant failures, delays and write-downs, however, the more information that can be gathered the better. An investment in cyber and data security will also be required.

Data security: The rate of technological change, particularly when combined with the afore-mentioned under-investment, presents significant risks and opportunities. As technology develops, there is a risk of increased security breaches through hacking into systems to steal sensitive information. (See the related article on Data Security.)

Regardless of what industry a company operates in, it is widely accepted that company culture is a major determinant of company value.
Other material issues

AMP Capital’s study covered a wide range of other company-specific factors and also industry-wide factors. Many value drivers raised in the report have been discussed by the media both during the time the review was conducted and after the review was completed. These issues include:

- **Loan book**: The composition of a banks’ loan book will impact both the reputation and earnings of the bank. Significant investor and media attention has been given to banks’ lending exposure to fossil fuels as well as indirect exposure to human rights issues in south-east Asia. This pressure has led to more robust discussion by the Australian banks and improved disclosure on fossil fuels exposure through formal statements on climate change. However there is a strong chance the success of recent shareholder resolutions on climate disclosure brought against global giants Shell and BP will see further pressure applied here. To varying degrees, banks have also responded to non-governmental organisation campaigns about indirect exposure to human rights issues. Many banks have comprehensive human rights policy frameworks; in some cases, however, it remains unclear how and to what extent these are implemented in practice.

- **Payday lending**: Payday lending refers to the short-term loan market with small and short-term loans. These loans differ from personal loans, as payday loans are generally smaller and have shorter repayment terms. Technology has been a key innovator in consumer lending where online platforms allow borrowers to quickly get payday loans from their smartphone in a couple of minutes. The market is estimated to be worth approximately $800m and is rising quickly. According to research by stockbroker Credit Suisse, industry participants say payday lending needs interest rates higher than 30 per cent to be viable. While Cash Converters Ltd has dominated this space in Australia new entrants with technology aimed at ease and speed of application have now entered the market. The banks have moved away from traditional small personal loans with the gap being filled by companies like Cash Converters and Money3. When banks lend to such companies, rather than directly to the consumers, banks can demonstrate a commitment to ‘financial inclusion’ without taking on too much specific risk.

- **Competition**: The barriers to entry in the banking and diversified financials sector have broken down as a result of globalisation and technological advances. This has resulted in a new range of players including peer-to-peer / online lenders (e.g. Ratesetter) and new payment systems (e.g. Bitcoin). A recent US banking survey indicated that the new generation of banking customers will become less loyal, switching banks when dissatisfied with fees, loyalty programs and their online experience. Financial institutions will therefore have to work harder to discourage their customers from switching to other banks or non-bank providers.

**UNDERSTANDING ESG CAN LEAD TO BETTER INVESTMENT OUTCOMES**

The ability for a bank to generate sustainable long-term growth for shareholders will to the greatest extent rely on how it manages risks. By looking beyond risk flags already be captured by the market, analysts can uncover valuable insights and early warning signs.

Analysing the performance within the banking and diversified financials sector shows, the major banks with our best ESG ratings outperforming the poorest ESG banks over one year (3.9 per cent), two years (3.8 per cent) and four years (2.0 per cent), and performing in line over three years. For regional banks, the most preferred have outperformed the least preferred over most years. An unweighted portfolio of diversified financial companies showed similar out-performance by preferred companies.

When analysed during a longer time frame (five to ten years), the outperformance by the most preferred major banks is even stronger: 15.5 per cent cumulative over five years and 71 per cent cumulative over ten years.

These results demonstrate the strong positive correlation between the investment performance of banking and diversified financials companies and the way they manage their ESG risks and opportunities.
In the News

Human rights: an investor issue?

More people are becoming concerned about where their superannuation money is invested. Fund trustees and investment managers are increasingly being asked to scrutinise the actions of companies when making investment decisions, taking into account how companies set about generating shareholder value.

This interest is evident in the questions raised to large investors about issues ranging from a company’s corporate governance and executive remuneration, through to climate change. Recently, there has been a focus on issues around human rights whether it is those of factory workers in Bangladesh, asylum seekers in offshore detention centres or indigenous people’s cultural and land rights. But are investors justified in asking about human rights issues?

Before answering that question, it is worth clarifying what is meant by human rights. Human rights recognise the freedom to make choices about one’s life and develop potential as human beings. Basic freedoms that should apply to all humanity include:

- Freedom from discrimination – by gender, race, ethnicity, national origin or religion
- Freedom from want – to enjoy a decent standard of living
- Freedom to develop and realise one’s human potential
- Freedom from fear – of threats to personal security, from torture, arbitrary arrest and other violent acts
- Freedom from injustice and violations of the rule of law
- Freedom of thought and speech and to participate in decision-making and form associations
- Freedom for decent work – without exploitation

Such rights are outlined in a number of international laws and treaties including the Universal Declaration of Human Rights, the Universal Human Rights Instruments, the ten Core International Human Rights Instruments (e.g. Convention on the Rights of the Child), the International Bill of Rights and a number of core conventions of the International Labour Organisation.

While these international conventions generally apply to the responsibility of countries, there is increased acknowledgment of the role companies also have to play. For example, the UN Global Compact is a call to companies to align strategies and operations with universal principles on human rights.

According to the UN Protect, Respect and Remedy Framework, companies need to recognise that not all human rights are adequately translated into domestic laws of the countries in which they might operate; the administrative and regulatory regimes that exist in countries may not effectively implement laws aimed at protecting human rights. In other words, the lack of adequate domestic law and or enforcement does not obviate a company’s responsibility to respect human rights in all of its operations and business relations.

So why are human rights an issue for investors? At a basic level, the respect for human rights is fundamental to the long-term functioning of society and economies in which companies operate and investors invest. As such, it is in an investor’s interest that companies they invest in uphold and facilitate basic human rights within their sphere of influence.

How human rights as an investment issue may manifest will vary depending on the industries, sectors and countries they or their supply chain might operate in. Reputational and legal risks are at the forefront of investors’ concerns when a company is involved or complicit in human rights abuses. However, as demonstrated in our recent research on supply chain issues in Bangladesh, the investment risks can be much more tangible. These tangible risks are also seen in extractive industries in developing countries or those companies relying on the action of private or public security forces.

So what should investors expect of companies? Investors should check if companies are guided by the UN’s Principles on Business and Human Rights. Three key principles for companies are:

1. Business enterprises should respect human rights – and that this responsibility exists independently of States’ abilities and/or willingness to fulfil their own human rights obligations, and does not diminish those obligations. And it exists over and above compliance with national laws and regulations protecting human rights.

2. A human rights due diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights.

3. Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute.

The responsibility for companies to respect human rights highlights the increased complexity companies must manage as a result of globalisation and shifting societal expectations. Just as companies move to capture the business opportunities of becoming more global, some in society are also demanding companies be far more accountable for their actions. Increasingly, investors expect companies to understand and manage the human rights risks they are exposed to, whether these risks reside in their business relationships and supply chain or in their own operations.

Given that respect for human rights is fundamental to the long-term functioning of society and economies, it should not come as a surprise that some investors will be even more sensitive to human rights issues than others and will choose not to invest in companies that cannot demonstrate an adequate understanding and management of these risks.
The role of ethics in business and finance

BY STEPHEN DUNNE
CEO AMP Capital

AMP Capital’s CEO, Stephen Dunne, recently presented at an Australia-Israel Chamber of Commerce panel discussion on the Global Perspective on Business, Finance & Ethics.

In this article, he expands on his view of the greater role ethics should play in building trust in business.

In many respects the global financial crisis (GFC) was caused by a lack of ethics or, more to the point, ethics that didn’t extend beyond self-interest. It is not surprising that many believe that those involved or who benefitted from the causes of the GFC have not been made accountable for their actions, which were so clearly wrong. This has had far reaching impacts on the finance industry as it tries to regain the trust of its clients and the general public. The GFC highlights that compliance with the law is the beginning of individuals and companies taking responsibility for their actions and the importance of ethics, which extends beyond personal interest.

Unfortunately, the industry has some way to go in instilling this broader ethical mindset. The more than $260 billion of fines imposed on the industry for market manipulation and money laundering reinforces this point. A survey of the US financial services sector in 2013 found that 24 per cent of financial services professionals would engage in insider trading to make $10 million if they wouldn’t get caught. The figure increases to 38 per cent for individuals with ten years or less in the industry. In addition, 29 per cent of those surveyed believe that rules may have to be broken in order to be successful. Those with less than 10 years of experience were twice (36 per cent of those surveyed) as likely to have this view than those professionals with more than 20 years’ experience. These figures provide a sobering insight into the attitudes of future potential leaders in the US industry.

While these figures apply to the US financial services sector, there are lessons for those in other industries and countries about the importance of ethics in business.

It is not surprising that management and business leaders are key to setting the values or the ethical floor beyond compliance that the organisation expects. But actions speak louder than words and consistency of management action to espoused values is critical. For example, “integrity” and “respect” were key values for Enron but the actions of senior management suggest there was a significant and very clear disconnect between espoused values and actions.

One of the challenges for management and companies is “conditional blindness” or the acceptance of the “that’s the way it gets done around here”. Breaking with negative aspects of conditional blindness can be particularly challenging given that many unstated values or attitudes can be deep seated or may have been perfectly acceptable or reasonable when they were originally developed but which are no longer valid in the environment in which the company now works. I have found that asking people who have just started in the organisation, say after six months, for their observations of how the company actually operates and the values it works by is a good litmus test of whether there is a disconnect between actions and espoused values and how well we have been at addressing potentially negative conditional blindness in the organisation.

In summary, trust in relationships is critical for a successful business – whether it be the trust between employees or in relationships with business partners, regulators, customers or the community more generally. Trust relies on acting beyond complying legal obligations. It is going beyond pure self-interest and means taking responsibility for the broader consequences of actions and behaviours. Company actions and management leadership in modelling clear ethics that endears trust is critical. The finance sector, like all sectors, has some way to go and the future of the industry will depend on regaining the trust of the public and clients.

Trust relies on acting beyond complying legal obligations.

It is going beyond pure self-interest and means taking responsibility for the broader consequences of actions and behaviours.
New rules on disclosure requirements

In March 2014, the ASX Corporate Governance Councils released the 3rd edition of their Corporate Governance Principles and Recommendations. Some of the major changes relate to disclosure around risk management and board composition. AMP Capital’s thoughts on two of the changes are as follows.

ESG RISKS

“A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.”

(ASX Corporate Governance Council’s Recommendation 7.4)

AMP Capital has long argued and demonstrated that environmental, social and governance (ESG) issues impact investment performance. Our preference therefore is to invest in companies that understand and manage their ESG risks and opportunities appropriately.

Requiring companies to disclose any material exposure to economic, environmental and social sustainability risks and how they manage those risks has two main effects:

1. It encourages companies to consider the issues.
2. It enables investors to make a better investment decision.

As has happened with the introduction of remuneration reports and the two-strikes rule, we expect the increased focus on ESG matters will positively impact how companies and shareholders understand these issues.

As companies establish what and how they will disclose this information, we would encourage companies to provide information that: we can find; is relevant in the context of the company’s business; makes sense; is comparable; is complete.

AMP Capital has no preference as to whether the disclosure appears in the company’s annual report, the sustainability report or on the company’s website as long as it is easy to find.

Companies often ask AMP Capital what ESG / Sustainability information we would like to see in their reporting. Unfortunately this is a difficult question to answer as the relevant ESG risks vary from industry to industry and from company to company.

When reviewing ESG risk data shareholders are simply seeking assurance that companies have identified the material risks, collected the relevant data and are managing the risk appropriately. It may also be appropriate to include some or all of the following information; the nature of the risk, how it was identified, when the risk is likely to play out; what the implications are and at what level of the organisation is it being discussed.

One challenge AMP Capital has faced over the years arises from the disclosure of different data across years and across companies. It is not helpful if companies provide different statistics each year as it makes it impossible for us to see trends. Safety statistics is a typical case in point; some companies include data relating to contractors while others don’t, some report on injury frequency while others report on severity, and some change their reporting from year to year. The different interpretation of what constitutes a major injury and the different metrics being reported makes it difficult for shareholders to establish if there is an improving trend or how the company measures up relative to others in its industry.

Finally, we would encourage disclosure that is complete and includes all subsidiaries, companies and assets owned by the company.

BOARD SKILLS MATRIX

“A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.”

(ASX Corporate Governance Council’s Recommendation 2.2)

AMP Capital places great importance on the issue of board composition. It is important that companies have boards of directors in place with the skills, intellect, time and enthusiasm to effectively govern the company on shareholders’ behalf.

To date, the way in which companies publicly disclose their assessment of directors’ skills has varied considerably. Some companies have led the field, voluntarily providing detailed disclosure, others have made less fulsome disclosure or have indicated how they plan to address this reporting in future, and the remainder have not yet commented.

While AMP Capital is reluctant to dictate on what skills a board should have, we do look for evidence that the issue has been given full attention and an appropriate plan is in place to fill the required skill set.

We appreciate companies are complex and ever changing. As the risks and opportunities companies face are too complicated to be tackled by one person, or by a board comprised of homogenous directors, it is vital to bring different skills and views to the table.

In our analysis and discussions with companies, we try to understand the landscape around the company and whether board, as a whole, possesses the skills to navigate that terrain.

In determining the required board skills it is useful to step back and consider factors such as:

> What is the strategy/vision?
> What are the short-term influences? What’s happening now: acquisition, down-sizing, expanding off-shore? What are the immediate risks?
> What are the longer-term influences? What does the future look like? What are the macro trends? What are the disrupters?
> What kind of company does this want to be?
> What skills are needed to get the company there? Does the current board (and management) possess skills?
> If not, can those skills be learned, or does the company need to find new directors with those skills?
> Does the company have a plan?
> Can shareholders be confident the board possesses the required skills?

AMP Capital is supportive of the requirement for companies to have board skills matrices. We acknowledge the requirement for companies to disclose their skills matrices may be seen by some stakeholders as an unnecessary burden. However just as remuneration reports brought pay practices out in to the open, the clarity around board skills will simply give shareholders a greater understanding of something companies would have, or should have, been doing anyway.

From a review of recent annual reports, it is evident some companies are further down the path of having and disclosing board skills’ matrices than others.

In AMP Capital’s opinion, a best-in-class board matrix would ideally cover the following three aspects: the strategic priorities; the key skills required to achieve those priorities and, finally, which directors possess that skill set. Where skills shortages are identified, we would then expect to see an explanation as to how the board plans to fill that gap.

Over time it will be interesting to see how boards address specific skills shortages, recognising it will not always be possible or affordable to simply add an extra director. We have already seen more boards make use of ‘advisory boards’ and this is one solution we will monitor going forward.
AMP Capital shareholder engagement and proxy voting

Financial year 2014/15

SHAREHOLDER ENGAGEMENT

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 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.

This influence has been constructive, with some visible improvements including 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, 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 environmental, social and governance (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.

ESG: BROADER STAKEHOLDER ENGAGEMENT

In addition to governance focussed meetings discussed above, the AMP Capital ESG research team had over 80 meetings with companies. 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 generally, our current key thematic engagements focus specifically on corporate governance, supply chain management / labour rights, climate change, unconventional 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 had over a 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. In the first half of 2015 alone, the ESG team has had over 70 separate media opportunities to share insights with regard to our views on ESG disclosure.

These activities reflect our broader objective of improving the environmental, social and governance 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.

Percent of resolutions not supported by AMP Capital
Proxy voting – Australian equities

RECENT VOTING HIGHLIGHTS

As the financial year-end for the majority of Australian companies is June 30, most annual general meetings being reported on in this report were held in October and November. The first half of the calendar year is traditionally a quieter time for proxy voting in Australia.

While most resolutions were supported, AMP Capital often lodged votes against resolutions when concerned with 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:
Votes submitted to 298 Company Meetings

![Votes cast by AMP Capital: Australian equities - financial year data](image)

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<td>1%</td>
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% of resolutions not supported

Incentives
- 28% (83/315)

Director Election
- 5% (62/258)

Remuneration Reports
- 26% (37/246)

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

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, 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 Annual General Meetings 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 2015 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:

- Greencross Ltd
- Harvey Norman Holdings Ltd
- Leighton Holdings Ltd
- Mount Gibson Iron Ltd
- News Corporation
- News Corp

In addition, AMP Capital specifically abstained from re-electing directors at several other companies. In these cases 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 shareholder’s ‘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 245 remuneration reports. In total 81% of reports were supported, 8% against and 11% abstain. The remuneration reports AMP Capital voted against over this period were:

- Alchemia Ltd
- Ansell Ltd
- Automotive Holdings Group Ltd
- Cromwell Property Group
- Dexus Property Group
- Evolution Mining Ltd
- Flexigroup Ltd
- Harvey Norman Holdings Ltd

In general AMP Capital will vote against remuneration reports which 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 (e.g. 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 not met
- Overly-generous quantum
- Poor alignment
- Structural concerns, especially where they potentially incentivise behaviour that is contrary to the best interests of shareholders (e.g. 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.

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% or more of shareholders vote against the adoption of the remuneration report in two consecutive years.

Share and option incentive plans

In the 2014/15 financial year AMP Capital submitted votes on 258 incentive-related resolutions (not including votes on NED fees and remuneration reports). Of these 82% were supported, 11% were voted against and on 7% AMP Capital specifically abstained from voting.

Over the period, AMP Capital voted against at least one incentive-related resolution at:

- Abacus Property Group
- Alchemia Ltd
- Ansell Ltd
- Evolution Mining Ltd
- Mesoblast Ltd
- Mobile Embrace Ltd
- Newcrest Mining Ltd
- Ozforex Group Ltd
- Sundance Energy Australia Ltd
- Swan Gold Mining Ltd
- UGL 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, and
- 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 financial year only 10 companies held in portfolios managed by AMP Capital could have received a second ‘strike’ and thus potentially faced a board-spill. This is a marked improvement from two years ago when 22 companies were in the same position.

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.

While almost all of these companies are held exclusively in index/passive portfolios, AMP Capital endeavoured to engage with regard to the issues of concern.

On some occasions AMP Capital continued to have concerns with regard to remuneration issues but considered a board spill unnecessary. In these instances both the board spill resolution and the remuneration report were rejected.

(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 47 Australian companies held in 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 (NEDs).

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 one company where we specifically abstained from voting on the increase and communicated our concerns which related to options granted to non-executive directors.

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 16 companies sought approval for termination benefits, as compared to 7 companies in the previous financial year. The terms of most payments were considered acceptable and therefore most were supported.

Where AMP Capital had concerns these 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.

Companies where resolutions relating to termination payments were voted against include:

| Flexigroup Ltd | Liquefied Natural Gas Ltd |
| Invocare Ltd | Myer Holdings Ltd |

Resolutions not supported by AMP Capital (includes abstentions): Financial Year 2014/15

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<thead>
<tr>
<th>Percent of resolutions not supported in these categories</th>
<th>18% not supported, reasons include</th>
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<tr>
<td>- poor or non-existent performance hurdles</td>
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<td>- too short-term</td>
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<td>- includes both non-executive director and</td>
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<td>company executives in same plan</td>
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<tr>
<td>- too generous</td>
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<td>- poor disclosure of terms</td>
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<td>- non-recourse financing</td>
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<tr>
<td>- automatic vesting on change of control</td>
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</table>

| 2% not supported, reasons include:                    |
| - new fee levels were too high                        |
| - board too large or ‘poorly’ composed                |
| - NEDs continue to accrue retirement benefits         |

| 4% not supported, reasons include:                    |
| - too many affiliates                                 |
| - no independent                                     |
| - poor committee composition                          |
| - need for more relevant skills                       |
| - board too large                                     |

| 19% not supported, reasons include:                   |
| - concerns regarding terms of non-salary compensation|
| - poor disclosure                                     |
| - unsatisfactory director retirement                  |
| and executive termination benefits                    |

Source: AMP Capital voting statistics
Proxy voting – International portfolios

For the last twenty 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 2014/15 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.

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**Key governance issues such as non-executive director remuneration, share and option incentive plans, and board independence impact of listed companies throughout the world.**

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**ASIAN EQUITIES**

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A country-by-country analysis of resolutions not supported by AMP Capital during this period can be summarised as follows:

**China:** Concerns included: Stock issuance where those issues were considered to be excessively dilutive, overly discounted or where made at undisclosed prices; directors where there was a lack of independence and/or over-boarding; overly generous grants of share options; and where insufficient information was given about resolutions.

**Hong Kong:** Concerns included: Directors where there was concern with regard to over-boarding, lack of board independence or lack of attendance by board members, issuance of stock made at undisclosed prices or where excessively dilutive, share option schemes made on overly generous terms, amendments to company constitutions where not in the interests of shareholders (e.g. shortened notice periods), and related-party payments that had potential to remove cash from the companies’ control.

**India:** Concerns included: Poor disclosure (including audit fees), directors’ independence and/or poor attendance.

**Indonesia:** Concerns included: The lack of information given by the companies on which to base a decision, excessive bonuses, directors where there was a lack of disclosure of the names of boards’ nominees, over-boarding and/or a lack of independence, and overly generous loan guarantees.

**Republic of Korea:** Concerns included: Unaudited financial statements, directors when concerned about a lack of director independence, conflicted directors or no robust director nomination process, and the bundling of unconnected proposals, particularly when some are not in shareholders’ interests.

**Philippines:** Concerns included: Directors’ lack of independence and over-boarding, and open-ended proposals that lacked the information necessary to form an opinion on voting.

**Singapore:** Concerns included: Open ended ‘any other business’ proposals, directors’ lack of independence, over-boarding and NED participation in the director share option scheme.

**Taiwan:** Concerns included: Directors where over-boarded, non-independent, non-attending, undisclosed and/or conflicted. We voted against ‘any other business’ general proposals and shares issues with excessive discounts, insufficient disclosure and significant dilution.

**Thailand:** Concerns included: Open ended ‘any other business’ proposals.
A country-by-country analysis of resolutions not supported by AMP Capital during this period can be summarised as follows:

**Australia:** Concerns included: Remuneration reports where pay structures were considered not fair and reasonable.

**Canada:** Concerns included: Board composition and 'Poison Pill' provisions.

**Hong Kong:** Concerns included: Directors where board independence or attendance is poor, and potentially dilutive share-option schemes.

**France:** Concerns included: Board appointments where overall board independence is poor, and companies seeking to limit voting rights if certain requirements were not met.

**Italy:** Concerns included: Remuneration for auditors.

**Japan:** Concerns include: Board independence

**UK:** Concerns included: Proposals to reduce the notice period required to call EGMs.

**US:** Concerns included: Executive compensation where the alignment between pay and performance was poor, directors on boards with poor independence, related-party transactions and potential conflicts of interest. Shareholder resolutions to separate the role of CEO and Chairman were supported as were proposals requiring greater disclosure of ESG themes and issues.

**VOTING UPDATE:**
**GLOBAL REAL ESTATE INVESTMENTS:**

**GREITS**

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**VOTING UPDATE:**
**GLOBAL LISTED INFRASTRUCTURE:**

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A country-by-country analysis of resolutions not supported by AMP Capital during this period can be summarised as follows:

**Australia:** Concerns included: Large focus on short-term performance and substantial rise in fixed pay.

**Canada:** Concerns included: Directors with poor records of attendance, and non-specific 'any other business' resolution.

**China:** Concerns included: Unspecified inter-company loans, a dilutive share issue and the re-election of directors seeking that issue.

**France:** Concerns included: Company seeking to appoint an unnamed shareholder nominee to the board.
Team Profiles

**IAN WOODS**
Head of ESG Research  
PhD Chem Eng MBA MEL  
AMP Capital 13 years, Industry 25 years  
ian.Woods@ampcapital.com

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.

**KARIN HALLIDAY**
Manager, Corporate Governance  
BBus, FFin, GAICD  
AMP Capital 30 years, Industry 29 years  
Karin.Halliday@ampcapital.com

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 Investors between June 1987 and June 1998, where she managed a wide range of Australian–based share trusts and was responsible 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.

**RICHARD STANTON**
ESG Team Assistant Analyst  
BA (Hons), Economics  
AMP Capital 3 years, Industry 20 years  
Richard.Stanton@ampcapital.com

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.
REFERENCES


11. http://www.reuters.com/article/2015/08/19/us-ashleymadison-cybersecurity-idUSKCN0HR23T20150819


13. Counting the real cost of cyber-attacks Dec 17, 2014 Stuart Corner The Age


15. S&P/ASX 200 Financials Index contains companies involved in activities such as banking, mortgage finance, consumer finance, specialised finance, investment banking and real estate, including REITs. Measured 1/7/2015 compared to 1/7/2010


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For your local contact, please visit ampcapital.com/contact or email inquiry@ampcapital.com

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