



# STEWARDSHIP STATEMENT

May 2018

## The UK Stewardship Code

The aim of stewardship is to enhance the quality of engagement between institutional investors and companies in order to promote the long-term success of companies, such that the ultimate providers of capital (investors) also prosper. Responsibility for stewardship is shared between companies and investors, and effective stewardship benefits both parties as well as the economy as a whole. The UK Stewardship Code, which was last updated in 2012, sets out the role of investors in effective stewardship. It consists of seven key principles, which are discussed below. Other markets have in place codes that are similar to the UK Stewardship code. When Northern Trust determines that it is in a position to adhere to such other codes, this statement will be updated accordingly.

## Northern Trust

Northern Trust Corporation, together with its affiliates (**Northern Trust**), is a leading provider of wealth management, asset servicing, asset management and banking to corporations, institutions, and affluent families and individuals. Founded in Chicago in 1889, Northern Trust has office in the United States and in 24 international locations in Canada, UK, Europe, the Middle East and the Asia Pacific region.

As of December 31, 2017, Northern Trust had assets under custody of US\$10.7 trillion, and assets under management of US\$1.2 trillion. For more than 125 years, Northern Trust has earned distinction as an industry leader for exceptional service, financial expertise, integrity and innovation.

The investment management division of Northern Trust, Northern Trust Asset Management (**NTAM**)<sup>1</sup>, is a leading global investment manager, managing predominantly listed equities, fixed income and cash. NTAM's clients include

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<sup>1</sup> NTAM is composed of Northern Trust Investments, Inc., Northern Trust Global Investments Limited, Northern Trust Global Investments Japan, K.K., NT Global Advisors, Inc., 50 South Capital Advisors, LLC, and personnel of The Northern Trust Company of Hong Kong Limited, Northern Trust Global Services SE and The Northern Trust Company.

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## Overview

This document describes how Northern Trust approaches stewardship, including specifically how Northern Trust's approach meets the requirements of the UK Stewardship Code.

Visit [northerntrust.com/stewardship](http://northerntrust.com/stewardship) for information about Northern Trust's proxy voting, stewardship and engagement activities.

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institutional investors (such as sovereign wealth funds, pension funds and financial institutions), affluent families and individuals.

Northern Trust Global Investments Limited (NTGIL) is the entity within NTAM which is primarily responsible for managing assets for investors outside of the United States. NTGIL is a London-based investment manager which is authorised and regulated by the Financial Conduct Authority. Its clients are mainly institutional investors (such as sovereign wealth funds, pension funds and financial institutions). It manages separately managed portfolios, often customised to the particular needs of the specific client, as well as a range of pooled funds. NTGIL manages listed equities, fixed income and cash and is well recognised for its expertise in both sustainable investing and quantitative investing, as well as for passive management. Approximately 56%<sup>2</sup> of the equities managed by NTGIL are managed according to some type of sustainable investing principles.

Effective stewardship is very important to Northern Trust. The following sections of this document explain how Northern Trust addresses each of the seven principles of the UK Stewardship Code.

### **PRINCIPLE 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.**

Northern Trust discharges its stewardship responsibilities in three key ways:

- Monitoring of and engagement with investee companies;
- Proxy voting (discussed under Principle 6); and
- Where appropriate to the particular investment mandate, integrating stewardship-related considerations into investment decision making.

#### ***Monitoring of and engagement with investee companies***

Northern Trust's primary objective as an investment manager is to create long term value for its clients. This objective applies to all portfolio management decisions, including those related to monitoring and engagement with company management and boards of directors. Northern Trust has a comprehensive engagement process in place that utilises both Northern Trust resources and outreach, and third party specialists where appropriate.

The majority of Northern Trust's overall asset management business is based in the US, with assets held on behalf of clients being predominantly US securities. As a natural consequence, the majority of current direct engagement tends to be with US companies. This also reflects the fact that Northern Trust's client base tends to hold a larger share of holdings in individual US companies, as compared to overall client shareholdings in companies outside of the US.

In order to broaden the scope of Northern Trust's engagement program to companies both in developed and emerging markets, NTGIL has appointed, on behalf of a number of Northern Trust pooled funds, Hermes EOS - one of the leading providers of corporate engagement, intelligent voting, portfolio screening, public policy engagement and advisory services. This arrangement covers 24<sup>3</sup> of NTAM's European-domiciled equity pooled funds and encompasses 3210 companies, with total market capitalisation of \$49.4tr<sup>4</sup>, including almost all of the companies included in the FTSE 100 (98% by value) and 81% (by value) of the FTSE All-share, as well as the entire universe of both the MSCI World and MSCI Emerging Markets Indices (comprising 1653 and 846 securities respectively<sup>5</sup>). Whilst NTGIL's relationship with Hermes EOS is specific to the relevant equity pooled funds, it covers most of the market capitalisation of companies included in NTGIL's separately managed

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<sup>2</sup> As at 31 December 2017

<sup>3</sup> As at 31 December 2017

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portfolios.

NTGIL has chosen this approach because there are significant benefits in engagement being conducted on a collective basis to complement Northern Trust's internal engagement activities. NTGIL selected Hermes EOS on the basis of its leadership position in this space, its substantial resources (which include an independent advisory council, four senior advisers and 22 full time staff) and the fact that Hermes EOS engages on behalf of \$454 billion<sup>6</sup> of assets for investors.

Hermes EOS conducts a structured monitoring and engagement process focused on corporate governance, environmental and social matters, and strategy, risk and other stewardship issues. It screens companies on at least an annual basis and selects companies for its core engagement program according to factors including the size of clients' holdings, the materiality of the risk and the likelihood of success. Within the core engagement program there are three tiers of engagement that vary in intensity depending on the seriousness of the issues and the size of holdings. Engagement typically involves face-to-face meetings with board members and executives and, where appropriate, collaboration with other investors. A constructive and discrete approach is taken to dialogue with companies, based on a belief that engagement is likely to be more effective when carried out in private. Hermes EOS provides significant transparency with respect to its engagement activities. Further details of this approach are described under Principle 3.

### ***Integrating stewardship-related considerations into investment decision making***

Engagement with management is a core part of the fundamental equity research process. Northern Trust's equity research analysts engage with hundreds of companies annually. The focus of these engagements is to accumulate and interpret facts to reach sound investment conclusions with the aim of delivering positive long-term investment outcomes for clients. Both quantitative and qualitative approaches are employed in this process. In addition to strategy, risk, and sustainability of financials, equity research analysts also monitor corporate governance, environmental and social factors that are of material concern to the long-term sustainability of the investment. Northern Trust's engagement team supplements the fundamental analysis performed by Northern Trust's equity research analysts with additional research on corporate governance and environmental and social matters that contribute to the long-term value of the investment and reflects Northern Trust's commitment to **sustainability issues**. Our supplemental analysis allows Northern Trust to build a deeper understanding of how companies manage **sustainability**, and helps us evaluate a company's overall corporate governance practices and structure. Corporate governance topics covered include board structure, executive compensation, risk oversight, and environmental and social risks and opportunities.

Complementing NTAM's fundamental equity management capabilities, we also offer a quantitative factor-based investment capability, which has a strong focus on high quality as an equity factor. Northern Trust has a unique, multi-dimensional definition of quality (the Northern Trust Quality Score – **NTQS**) which plays an important role across almost all NTAM **Quantitative** Equity solutions. Unlike most providers, the NTQS does not only take into account profitability and cash flow metrics, but also has a core focus on certain management signals that NTAM believes are critical in helping to identify companies that are managed in a sustainable, prudent and conservative manner. The philosophy is that high-quality companies will outperform lower quality companies over time and will provide investors with improved returns and lower risk within their investment portfolios in the long run. This approach is aligned with stewardship principles.

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<sup>4</sup> Free float, as at 31/12/2017

<sup>5</sup> As at 31/12/2017

<sup>6</sup> As at 31/12/2017

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As previously noted, 56% of the total equities managed by NTGIL incorporate some type of **sustainability** principles into the investment process. While the specifics vary, these principles typically have a strong linkage to stewardship considerations. In the US, NTAM also manages a number of portfolios to **sustainability** principles.

The majority of the other equity portfolios and pooled funds that NTAM manages (that is, other than those managed based on fundamental input or according to **sustainability** and/or factor principles) are passively managed to benchmarks specified by the client/pooled fund constituent documents and, as such, it is not appropriate to incorporate stewardship principles into investment decision making. Clients make an intentional choice between the differing products on offer.

### **PRINCIPLE 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.**

Northern Trust has policies in place to identify and manage conflicts of interest across its businesses. However, where arrangements are insufficient to ensure, with reasonable certainty, that risk of damage to client interests will be prevented, Northern Trust will endeavour to disclose the nature of such conflicts to clients.

In relation to stewardship, the specific elements of conflicts of interest management are incorporated within the Northern Trust Proxy Voting Principles and Guidelines ([Proxy Guidelines](#)).

Northern Trust has delegated to an independent third party proxy voting service (**Proxy Voting Service**) the responsibility to review proxy proposals and to make voting recommendations to an internal committee of Northern Trust (**Proxy Committee**) in a manner consistent with the Proxy Guidelines.

Where the Proxy Guidelines instruct that proposals be voted on a case-by-case basis, Northern Trust has provided supplementary instructions to the Proxy Voting Service to guide it in making vote recommendations. The Proxy Voting Service is not to exercise any discretion in making vote recommendations. In situations that are either not covered by the Proxy Guidelines, including any supplementary instructions, or where application of the Proxy Guidelines is unclear, the Proxy Voting Service is to seek guidance from the Proxy Committee. To ensure that the Proxy Voting Service is applying the Proxy Guidelines without discretion, Northern Trust performs regular service oversight and review.

The Proxy Committee may occasionally be subject to conflicts of interest in the voting of proxies. Clear examples include proxy votes on securities issued by Northern Trust, and proxy votes on matters in which Northern Trust has a direct financial interest (such as a shareholder approval of a change in mutual fund advisory fees where Northern Trust is the fund advisor). Conflicts of interest may also be present due to relationships that Northern Trust, its board members, executive officers, and others, maintain with the issuers of securities, proponents of shareholder proposals, participants in proxy contests, corporate directors, candidates for directorships, client or counterparty relationships.

The potential for conflicts of interest in the voting of proxies generally arises only where the Proxy Committee is considering the possibility of voting in a manner contrary to a vote recommendation received from the Proxy Voting Service, or where the Proxy Voting Service has not provided a vote recommendation. In these situations, the Proxy Committee will determine if a conflict of interest exists and, in situations where a conflict is

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determined to exist, whether the conflict is so severe that the Proxy Committee is unable to exercise independent judgement. In the rare situation of a severe conflict it may resolve the conflict in any of the following ways, which may vary, consistent with its duty of loyalty and care, depending upon the facts and circumstances of each situation and the requirements of applicable law:

- Following the vote recommendation of an independent fiduciary appointed for that purpose;
- Voting pursuant to client direction;
- Abstaining; or
- Voting pursuant to a “mirror voting” arrangement (under which shares are voted in the same manner and proportion as some or all of the other shares not voted by the Proxy Committee).

Various accounts over which Northern Trust has proxy voting discretion participate in securities lending programs administered by Northern Trust or a third party. Because title to loaned securities passes to the borrower, Northern Trust will be unable to vote any security that is out on loan to a borrower on a proxy record date. If Northern Trust has investment discretion, it reserves the right of the portfolio manager to instruct the lending agent to terminate a loan in situations where the matter to be voted upon is deemed to be material to the investment and the benefits of voting the security are deemed to outweigh the costs of terminating the loan.

Northern Trust has retained an independent third party share recall service, ISS Global Share Recall, to monitor proxy proposals for securities to identify scenarios where the matter to be voted upon may outweigh the costs of terminating the loan. The ISS Global Share Recall service monitors proxies for securities held by the Northern Funds, Flex Shares and NTAM’s US based Common/Collective funds. Arrangements are being put in place to extend this service to NTAM’s European domiciled pooled equities funds. Proxies meeting the initial parameters (confidence of the record date and the percent of shares outstanding owned) are referred to a proxy analyst responsible for the issuer or its business sector. Taking into account the recommendation of the proxy analyst, a decision is made on whether to recall all shares on loan and transfer the ownership back to Northern Trust for the purpose of voting the proxy. All restrictions on participating in securities lending are lifted once the proxy voting deadline has passed.

### **PRINCIPLE 3: Institutional investors should monitor their investee companies.**

As discussed under Principle 1, above, Northern Trust runs both an internal and external engagement program.

#### ***Internal engagement program:***

As discussed under Principle 1, above, due to the nature of its clients’ holdings Northern Trust’s internal engagement program is primarily focused on US companies.

When monitoring and engaging with investee companies, Northern Trust’s fundamental equity analysts, supported by the sustainable investing team and proxy analysts, routinely analyse the following:

- **Board structure, including the processes used for board succession planning and board refreshment.** While Northern Trust may not automatically vote against individual directors for matters such as age, tenure, or attendance, Northern Trust will engage with companies and express concerns where issues arise as to the attentiveness or competency of individual directors or the board as a whole.

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- **Executive compensation, specifically how companies structure executive incentive compensation.**  
Northern Trust focuses less on the level of pay managers take home and more on the connection between pay and performance. In examining pay, Northern Trust looks at whether there is an explicit regard to value creation embedded in the pay model, as well as whether the overall level of pay would be appropriate for the executive given basic criteria (i.e. relevant skills and experience). Further, Northern Trust looks for signs that pay differentials are having a detrimental impact on firm performance. These signs may include higher turnover of senior executives, lower or poor talent development, and evidence of agency problems such as a lack of performance rigor, poor disclosure or poor shareholder communication.  
  
Northern Trust will vote against executive compensation plans which Northern Trust believes are not designed to enhance shareholder value, or where there is a lack of disclosure or metrics around performance goals. Northern Trust will vote against compensation committee members where the board and company management have failed to take reasonable action over concerns raised by a majority of the company's shareholders.
- **Risk oversight.** Northern Trust believes that the most sustainable companies have a holistic approach to sustainability and risk. Companies should have an enterprise-wide approach to risk management. In Northern Trust's view, companies which address sustainability as a legal, risk or compliance exercise or which treat each business unit individually in terms of risk management may not be in a position to identify the most salient risks to business coming down the pipe. We consider it good practice to involve the board in both establishing and overseeing risk management structure.
- **Environmental and Social Risks and Opportunities.** Northern Trust routinely examines and analyses the policies and processes that companies have in place to protect, elevate and strategically position their organisation. Northern Trust believes that sustainable companies embrace uncertainty and proactively prepare for and minimise the impact of threats through effective planning, including reputational risks associated with environmental and social concerns that could become material risks.

### ***External engagement program:***

As discussed under Principle 1, above, NTGIL has appointed Hermes EOS to carry out engagement activities on behalf of 24 of NTAM's European-domiciled equity pooled funds. .

Hermes EOS undertakes investee company-specific engagements where it is believed that:

1. Engagement has the potential to lead to an increase in the value of a company's shares over the long term;  
or
2. Engagement has the potential to prevent or limit a decrease in the value of a company's shares over the long term.

In determining whether and how the engagement is taken forward, due regard is given to the level of the company's exposure to the identified concerns, the likelihood of engagement success and the potential to bring about positive change. Such considerations are based around an assessment of the likely impact of the engagement and the ultimate benefit to the value of its client's holdings.

Engagements may involve:

- Meetings with executive and non- executive directors
- Meetings with other company representatives
- Discussions with other shareholders of the company

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- Participation in collaborative investor initiatives
- Submission of shareholder resolutions at general meetings as appropriate
- Advocacy of or support for public policy or regulatory intervention
- Highly selectively use of public media to advance the objectives of a company engagement.

Topics on which engagement may occur, the engagement process and how effectiveness is assessed are described under Principle 4.

Northern Trust limits its activities to avoid a situation in which it would become an insider because to do so would be inconsistent with its role as a manager of listed equities, in respect of which it needs to be able to manage and trade securities in order to carry out the investment requirements of its clients.

### **PRINCIPLE 4: Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value**

**Internal engagement program:** Occasionally, Northern Trust will identify events or decisions on the part of the company's management or board which raise concerns related to the probability that our investment in the company's securities will generate the returns we expected. This may lead our equity research analysts to recommend selling or reducing the position in portfolios where such discretion exists. In some instances, Northern Trust may decide that an effort to engage the company in dialogue is a better alternative. Generally, Northern Trust will engage where we own a substantial amount of the company's shares and we intend to remain long-term owners.

Northern Trust engages on a case-by-case basis with select investee companies where serious governance concerns arise, there are potential material impacts of a matter that is being put forward for a shareholder vote, or the board has failed to show restraint/good judgement in its exercise of risk management (e.g., poor pay practices, audit concerns, board structure weaknesses). Triggering events include but are not limited to **specific governance features (e.g., lack of board diversity, significant board tenure, poor compensation practices)**, majority supported/opposed ballot issues, financial restatements, and contested director elections.

#### **External engagement program:**

Hermes EOS uses a structured process for engagement as described below.

- a) Materiality Assessment:** This process includes quantitative analysis. Using a broad range of research and data, Hermes EOS undertake a screen on NTAM's investee companies to assess where i) they materially contravene NTAM's Responsible Investment policies; and ii) they may be exposed to material risks associated with environmental, social, corporate governance and strategic issues. Hermes EOS integrate into this assessment both the size of NTAM's holdings in the European-domiciled equity pooled funds and the number of Hermes EOS clients that hold the relevant company.
- b) Feasibility Assessment:** This is predominantly a qualitative process. Building on their engagement experience, Hermes EOS assesses the likelihood of being able to positively influence the companies. This assessment includes consideration of the nature of the issue; whether they have an existing relationship with the company or individual board members; the size of clients' holdings; the presence of like-minded investors on the share registry; etc. Hermes EOS generally does not engage with companies where they do not foresee the possibility of success.
- c) Structured Engagement:** Once Hermes EOS has decided to engage with a company they begin a structured course of action to influence the company. This will generally involve contact with senior

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executives and/or board directors, and will frequently involve identification of other investors with whom they can collaborate (Hermes EOS is one of the leaders of PRI collective engagement projects).

Upon commencing an engagement with a company, Hermes EOS sets up a company-record on a database, which includes a clear articulation of the engagement objective; the background to engagement and a range of company-specific information (including client holdings; voting rights; etc.).

The database also enables them to maintain a clear record of activities and progress consistent with the following four-step milestone approach:

- Milestone 1:** Raise the issue at the appropriate level
- Milestone 2:** Confirmation that the company accepts the issue must be addressed
- Milestone 3:** The company has developed a plan to address the issue
- Milestone 4:** The plan has been implemented satisfactorily

The database also forms the basis of a client portal, a web-based tool that provides NTGIL with password-protected access to information on engagements.

- d) **Internal accountability:** Hermes EOS ensures that each engagement benefits from the collective experience of the Hermes EOS team, through weekly team discussions, specific engagement clinics held with engagement directors and reviews by directors of sector, country and theme plans and progress against objectives. These processes enable the team to challenge each other on the materiality of the engagement and the effectiveness of the engagement approach. This process feeds into NTGIL's engagement review process.
- e) **External accountability:**
  - i. *Transparency:* Hermes EOS provides NTGIL with a broad range of reporting on voting and engagement activity. This includes daily, weekly, quarterly and annual reporting. They also provide a web-based Client Portal, which gives NTGIL direct, real-time access to the most current information on engagements. They report on their progress in two ways: progress within the structured Milestones, and success in achieving objectives.
  - ii. *Regular dialogue:* Hermes EOS holds quarterly conference calls with NTGIL to review their work and to highlight as early as possible any areas that need additional attention, or that may no longer be a priority
  - iii. *Client Advisory Council:* Twice a year NTGIL is invited to a full-day meeting to review the work of Hermes EOS and to provide collective input to future priorities. These sessions are an invaluable opportunity for NTGIL to discuss with other investors and to agree common priorities and interests.

### Engagement Topics

Topics upon which engagement is undertaken include the following:

#### *Governance*

- Board behaviours and composition
- Remuneration
- Risk management and audit

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- Promotion of equitable shareholder rights
- Shareholder Proposals

### *Company Culture*

### *Business Strategy*

### *Environment*

- Climate change, including energy use / CO2 emissions; renewable energy and carbon capture & storage (CCS); extractives and stranded assets
- Disaster avoidance and business continuity preparedness
- Water stress
- Pollution and waste management
- Biodiversity
- Forest Sustainability
- Animal Testing

### *Social & Ethical*

- People related including labour relations, community relations, health & safety, employee remuneration
- Ethics, including Supply chain / ethical sourcing, presence in troubled regions, bribery & corruption, human rights

### *Various Sector specific issues*

### **PRINCIPLE 5: Institutional investors should be willing to act collectively with other investors where appropriate.**

Northern Trust believes that collaboration with like-minded investors can enhance the effectiveness of stewardship. This has led NTGIL to enter into the relationship with **Hermes EOS, Climate Action 100+, Sustainability Accounting Standards Board (SASB), and UNPR** for engagement activities.

For the avoidance of doubt, the relationships with Hermes EOS, Climate Action 100+, Sustainability Accounting Standards Board (SASB), and UNPRI relate to engagement only and does not involve collaboration on voting. The relationships do, however, provide an input to Northern Trust's independent aggregate voting decisions.

### **PRINCIPLE 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.**

The fundamental precept followed by Northern Trust in voting proxies is to ensure that the manner in which shares are voted is in the best interests of clients/beneficiaries and the value of the investment. To support this, Northern Trust has established a Proxy Committee and a set of Proxy Guidelines.

The Proxy Committee includes senior representatives from its equities portfolio management and research teams, its sustainable investing team and its compliance and risk teams and is supported by proxy analysts. The Proxy Committee is responsible for the content, interpretation and application of the [Proxy Guidelines](#).

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The Proxy Guidelines include the following topics: the board of directors (including independence, lead independent director, overboarding, tenure); proxy contents and related defenses; tender offer defenses; capital structure; mergers and restructurings; executive and director compensation; social and environmental issues; and a variety of other governance matters. The Proxy Guidelines also address conflicts of interest (see Principle 2) and client disclosures (see below).

As noted under Principle 2, Northern Trust has delegated to an independent third party proxy voting service, the responsibility to review proxy proposals and to make voting recommendations to the Proxy Committee in a manner consistent with the Proxy Guidelines. Northern Trust has procedures in place to address situations where the Proxy Voting Service does not provide a recommendation. The Proxy Voting Service also executes the vote instruction by informing each client's custodian of such instruction.

The Proxy Committee undertakes regular monitoring of the Proxy Voting Service and reviews the service on an annual basis.

Northern Trust provides custom reports on proxy voting to clients that wish to receive this information. Northern Trust's quarterly disclosures on proxy voting can be found at [northerntrust.com/stewardship](http://northerntrust.com/stewardship).

### **PRINCIPLE 7: Institutional investors should report periodically on their stewardship and voting activities.**

Northern Trust provides reports on proxy voting activities in accordance with clients' needs and, where agreed, can report specifically on other aspects of stewardship activities such as engagements with company management.

Northern Trust seeks to be open and transparent with clients about its activities, and is continuously working to evolve and enhance its reporting on stewardship matters, both to its clients and in the public arena. **Starting in 2018, in addition to providing full disclosure of voting records, Northern Trust will provide (bi-annual) reports on all internal stewardship activity on its website, two quarters in arrears.** Quarterly reports on the engagement activities of Hermes EOS also provided to clients in relevant pooled funds.

Northern Trust utilises a variety of independent assurance tools including standard three lines of defense model. In particular the third line (internal audit function) is independent of business lines across the organisation. This is complemented by a structured approach to external independent assurance. In 2017, Northern Trust extended the scope of the testing in the Investment Management Service Organisation Control Report (conducted in accordance with SSAE 16 and ISAE 3402) to include proxy voting. The expectation is that this external independent assurance shall be extended to engagement activities over time, in line with the maturity and auditable nature of the activities, noting that a large proportion of engagement is inherently qualitative in nature.