Introducing our approach to investment stewardship
Foreward

Capital Group was founded 90 years ago on the belief that a deep understanding of companies we seek to invest in will result in better outcomes for investors. This belief is part of our organisational DNA and continues to shape the structure and operation of our investment effort. The hallmark of that effort is engagement. We visit companies, forge relationships with their management teams and develop investment perspectives focused on long-term outcomes. Our process rewards investment professionals for their long-term results.

Over time, our research effort has expanded and evolved, with an eye toward better understanding companies. We’ve always believed that knowing how a company interacts with and impacts its community, customers, suppliers and employees is important to understanding its potential as an investment. We’ve sought to invest in firms well positioned for the future, those able to sustainably grow their businesses. Our experience and research indicate that a company taking a thoughtful and robust approach to Environmental, Social and Governance (ESG) dimensions is a positive indicator of sustainability and strategic thinking and that those factors will eventually be positively reflected in their security prices. That is why ESG is an essential part of our investment process and contributes to long-term results.

In our most recent long-term strategy review, we confirmed ESG as a top priority for the firm and accelerated a number of initiatives already underway to invest in people, data and technology to support and scale our approach to ESG integration.

Our ESG philosophy and process is investment led and built around three inter-related elements: investment frameworks, monitoring and engagement & proxy voting (where we vote on behalf of our investors at shareholder meetings) which are outlined in this report.

Robust processes and thoughtful frameworks are crucial, but we know that current and would-be investors want more than pledges. This report demonstrates our commitment to providing more transparency on our engagement and voting activities and our processes around ESG integration.

Finally, I am delighted to share with you that we have joined the UN Global Compact initiative and are supporting the Sustainable Development Goals (SDGs) - see page 7. The SDGs are increasingly becoming the framework that companies use to quantify their impact. In this report we have linked our engagement activity to the SDGs that we have identified as being the most material to us as a business and as an investor. We hope that you find this additional perspective helpful.

Regards,

Robert W Lovelace
Vice Chairman and President of The Capital Group Companies
Capital Group’s approach to engagement

At Capital Group, we believe we have a responsibility to our investors and wider society to encourage sustainable corporate behaviour. This means engaging on any environmental, social or governance (ESG) issues that could affect a company’s long-term prospects.

As genuinely long-term investors ourselves, our forward-looking perspective fits naturally with these horizons. The average time each investment is held for and the average industry experience of our investment professionals is testament to this:

On average...

Engagement is one of three tightly woven components of our investment process, along with our own investment frameworks and monitoring system.

Why it’s important

We are committed to providing better outcomes for our investors, as well as society more broadly. We believe that by engaging with companies on important issues, Capital Group can minimise risks to our investments and encourage the responsible allocation and management of capital across the investment community.

How we do it

Our engagement efforts are underpinned by extensive fundamental, proprietary research - on average, over 400 investment professionals hold around 20,000 company meetings every year. These engagements are led by our investment professionals, who are directly accountable for integrating ESG considerations into the investment process. They have deep experience of the sectors and companies that they invest in and where possible they evaluate companies based on years, and sometimes decades, of fundamental company and sector analysis and interactions. Our investment professionals are supported in their ESG undertakings by a well-resourced and experienced ESG team.

The majority of our engagements are carried out in face-to-face meetings, or where this is not possible, by video call to ensure full debate and interaction. As the world’s largest active mutual fund manager1, we have unparalleled access to companies on a global basis so we meet with top-level executive management, board chairs and investor relations personnel.

The nature of these conversations is often oriented towards improving our understanding of how management is approaching ESG-related challenges or developments. These “relationship building” engagements account for over 300 of the 700+ ESG engagements that we tracked during 2020.

It’s our preference to engage with companies directly. Given our size, fundamental research-based approach to investing and global footprint, we find that constructive engagement is most effective when we tackle key issues with companies and their boards candidly and without intermediaries.

However, we do collaborate with other asset managers through our industry memberships on initiatives to improve the framework universally for investors. For example, the UK Investor Forum – which we are founding members of – helps collective engagement. Through such organisations, we can have a collective impact in certain situations where we believe it could achieve better outcomes for our investors.

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1 As at 31 December 2020. Source: Morningstar.
If engagement doesn’t work

We will consider escalating a specific engagement when we observe a lack of progress towards our stated objective. Engagement on governance issues such as board composition or executive pay can be escalated by voting against specific proposals at the shareholder meeting. Further escalation is possible by voting against the election of members of the board.

Other situations may require different forms of escalation such as writing letters to the board, additional meetings with non-executive directors, or seeking views of other stakeholders. We will weigh the potential benefits of such action for our investors and consider on a case-by-case basis whether escalation is likely to contribute towards our objective and better outcomes for our investors.

Source: Capital Group. Please note ‘Other’ is a combination of E, S and/or G. E covers carbon emissions, climate change solutions, pollution & waste and resource use and efficiency. S covers consumer protection, diversity & inclusion, employee welfare, human rights and privacy & data security. G covers board composition, business ethics, capital allocation, executive pay, proxy items and shareholder rights. Due diligence describes a thorough evaluation of a company prior to investment.
Proxy voting

Capital Group considers proxy voting an integral part of its investment and stewardship processes. We have robust policies for major corporate governance and proxy voting matters. Our voting process ensures that each proxy vote is analysed on a case-by-case basis and benefits from multiple decision-makers, whose collective experience brings a wealth and breadth of knowledge to the specific issues.

We determine our own proxy positions and vote regularly in all annual shareholder meetings. Our approach is made more powerful by the fact that our engagement and proxy voting is led by our investment professionals, giving consistent messages to companies on areas where we want to see progress. We do not outsource our proxy voting responsibilities to service providers or proxy voting companies.

Proxy voting statistics for calendar year 2020

<table>
<thead>
<tr>
<th>Region</th>
<th>Meetings voted</th>
<th>Proposals voted</th>
<th>Votes against management</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>1,851</td>
<td>22,170</td>
<td>1,561</td>
</tr>
<tr>
<td>Americas</td>
<td>793</td>
<td>8,520</td>
<td>518</td>
</tr>
<tr>
<td>Asia</td>
<td>530</td>
<td>4,655</td>
<td>524</td>
</tr>
<tr>
<td>Europe, Middle East and Africa (EMEA)</td>
<td>528</td>
<td>8,995</td>
<td>519</td>
</tr>
</tbody>
</table>

Votes Against Management are defined as proposals where at least one division expressed a vote against the management recommendation. A de minimis number of Abstain votes were excluded in the counts of voting outcomes. Regional breakdowns include both developed and emerging markets in alignment with MSCI indices.
Engagement in practice

Capital Group is a participant of the UN Global Compact and we are supporting the UN Sustainable Development Goals (SDGs). These goals have become the most widely-adopted framework that companies (including asset managers) use to address the world’s most pressing needs. We have mapped our own investment frameworks and business operations to the SDGs. By doing so we were able to identify the SDGs with the highest overlap with the material ESG issues identified in our investment frameworks and business operations. There are five SDGs that we have prioritised as a result of this analysis:

- Achieve gender equality and empower all women and girls
- Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
- Reduce inequality (within and among countries)
- Ensure sustainable consumption and production patterns
- Take urgent action to combat climate change and its impacts

We have linked our engagement activity to these five SDGs.
Case studies

The following selection of case studies illustrate how we undertake engagement in practice. This information should not be interpreted as an offer or recommendation to buy any securities.

Remuneration engagement with Netflix

Our long-standing investment and engagement with Netflix throughout the company’s evolution has enabled us to promote good corporate governance practices in a context in which we are able to have a meaningful impact. We have consistently promoted stakeholders’ preference for greater reporting and disclosure at Netflix, on elements such as political contributions and lobbying. External rating-agency assessments have previously raised concerns around Netflix’s corporate governance, specifically poor board structure and pay practices, which was illustrated by significant votes against company executive compensation in 2018. As such, we were able to identify the company as an excellent opportunity for constructive engagement that could enhance the company’s value. This was due to our significant investment in the company, our longstanding relationship with management and the nature of the requests that were being made of the company.

Our investment analysts and governance team engaged multiple times on compensation structure and Netflix’s level of disclosure. Capital Group analysts directly commented on a draft of the revised compensation structure; Netflix took on our suggestions and also improved transparency at our request.

In 2020, we met with company management and shared an overview of how Capital Group looks at ESG issues. We specifically discussed a shareholder proposal on political contributions and lobbying. We noted that we are generally in favour of greater disclosure, particularly if the company falls short on reporting certain information. This two-pronged approach of engagement and voting has been recognised by Netflix as a positive, as we have been consistent in articulating our view while supporting developments that make sense in the company’s context. We continue to engage with management on the issues that matter to our investors, and will look to gain greater clarity on the company’s direction of travel during the next cycle of company engagements and annual general meetings (AGMs).
Collective ESG engagement with Barclays

Our deep relationships with companies allow us to gain greater insight into management thinking and promote outcomes that are well aligned with long-term shareholder interests. This was the case with the recent Barclays AGM, at which two proposals were put forward on climate change and ESG concerns.

One proposal was put forward by the company, while the other was proposed by a shareholder group. The primary tensions between the two proposals were related to the expected timeline for the reduction of involvement in carbon-intensive industries, and the manner through which these reductions could be achieved. External coverage of the proposals was extensive, and multiple industry initiatives focused on engaging with the company.

Given our long relationship with Barclays, Capital Group was able to engage directly in constructive dialogue with the chairman and the board about the proposals, in which we were able to gain added context of the situation. We also took part in collective engagement activity through The Investor Forum by lending our name to the efforts it was undertaking in working closely with the Barclays’ chairman, company secretary and ShareAction (a shareholder action group) to structure a compromise.

This included a significant commitment from Barclays, which reduced the tension between Barclays and ShareAction, and removed the need for a proxy battle.

In April 2020, the Barclays ESG Report was published setting out a transparent assessment of the issues; it reports against new frameworks (notably Sustainability Accounting Standards Board - SASB and Task Force for Climate-related Financial Disclosures - TCFD) and commits to some significant new policies.

For example, with regard to climate, Barclays announced it will:

• aim to be net zero on direct and indirect carbon emissions by 2050;
• increase prohibitions on thermal coal financing, applied at a legal entity level, rather than at a group level;
• provide no financing for energy projects in the Arctic Circle;
• help reduce the environmental footprint of oil sands through working with the Canadian government and its clients active in the country; and
• refuse financing for fracking in the EU and UK, and strengthen due diligence for fracking in the rest of the world.

Following additional engagement between the ESG report and the AGM, Barclays set out a more demanding long-term strategy than called for in the shareholder resolution. Shareholders and the company came to an agreement to host an event to give much more detail to shareholders on the strategy and targets, in particular relating to sensitive energy sectors. Barclays has committed to seeking input from multiple external stakeholders, including scientific experts, as it completes this work, and will report on progress from 2021.

We believe that engagement by investors, individually and collectively, was crucial in convincing Barclays to commit to an ambitious plan rather than choose to enter into a proxy fight. As shareholder resolutions potentially become more widely used in the UK, we believe it is crucial that investors play an active stewardship role throughout the process.
Engagement can lead to divestment

Engagement with company management can reveal new insights which can impact our investment conviction. Discussing issues of concern and gaining insights through the board and management responses to questions, can affect our expectations of risk-adjusted return. In 2020 we joined a group investor meeting with a European building products company which was under scrutiny for historical sales practices. The engagement raised serious doubts over management oversight. The interaction caused sufficient concern for us that our building products analyst decided to change her investment in the company.

While we believe engagement is a sharper tool than exclusion, divestment is always an option. We always consider our investors’ interests first. In this case we concluded that our investors’ interests were better served by reducing our exposure to the company rather than continued engagement.
Engagement leads to positive progress at Glencore

In mid-2020 one of our metals and mining analysts met with the chairman of global commodities producer and trader, Glencore. The discussion covered a range of topics, including the company’s coal business. Coal is increasingly considered a stranded asset on account of demand shifting towards renewable energy, reduced policy support from governments and the decreasing cost of investing in renewables. The analyst suggested Glencore could put the coal business into “run-off” mode, i.e. gradually run-down capacity without reinvesting other than to maintain safety and operating standards. His view was that “the carbon issue is having an impact on the multiples the market is putting on Glencore. What to do with the coal might be the key strategic issue facing the company today.” He reiterated this point with the CEO and other board members in subsequent engagements.

In October 2020, in line with our message, Glencore announced that it is “running down its coal mines” to reduce Scope 3 carbon emissions (which are emissions arising from the value chain) and will use the funds to invest in minerals, including copper, cobalt and nickel, which are needed in energy transition markets such as electric vehicle production (source: Financial Times, 16 October 2020). In December the company published its Climate Report 2020: Pathway to Net Zero, which describes its plans to achieve net zero emissions by 2050 and align with the Paris 1.5°C scenario*.

*Adopted in December 2015, the Paris Agreement aims to limit global warming to well below 2°C (preferably 1.5°C) compared to pre-industrial levels.
Escalation at Daikin

Our work with Daikin Industries in Japan is an example of a situation where we have escalated our approach to deliver beneficial outcomes for our shareholders, while also accommodating for differing investor needs. Japanese investors are often keen to understand how companies are able to return excess cash to shareholders, either through dividends or share buybacks, and we use our engagement opportunities with companies to gain greater understanding of these issues. In line with Japanese client reporting expectations, these conversations are systematically captured, and we can escalate concerns around persistent issues via our proxy voting.

As part of our proxy voting process in Japan, our internal policy is formulated to review dividends on a case-by-case basis. Ahead of each proxy season, the Governance and Proxy team will reach out to Investment Group analysts to get a sense for what they consider to be appropriate payout ratios, considering the market trend as well as the average payout among our portfolio companies. Where company payout levels fall below our internal expectation, we engage with the company on this issue, and can potentially escalate towards a vote against the dividend policy where we consider it appropriate. In the case of Daikin, our analyst has been in continuous dialogue with the company regarding the desire to increase the dividend payout ratio. The ratio was considered to be on the low side given the strength of the company’s balance sheet at the time of the AGM and contemporary analyst views.

In line with our escalation strategy, we voted against the proposed dividend payout at the 2020 AGM, signalling our continued dissatisfaction with the level of payout that could be distributed to shareholders. We have continued to engage with the company regarding our viewpoint, and will seek to ensure that our perspective is considered in future capital allocation decisions.
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