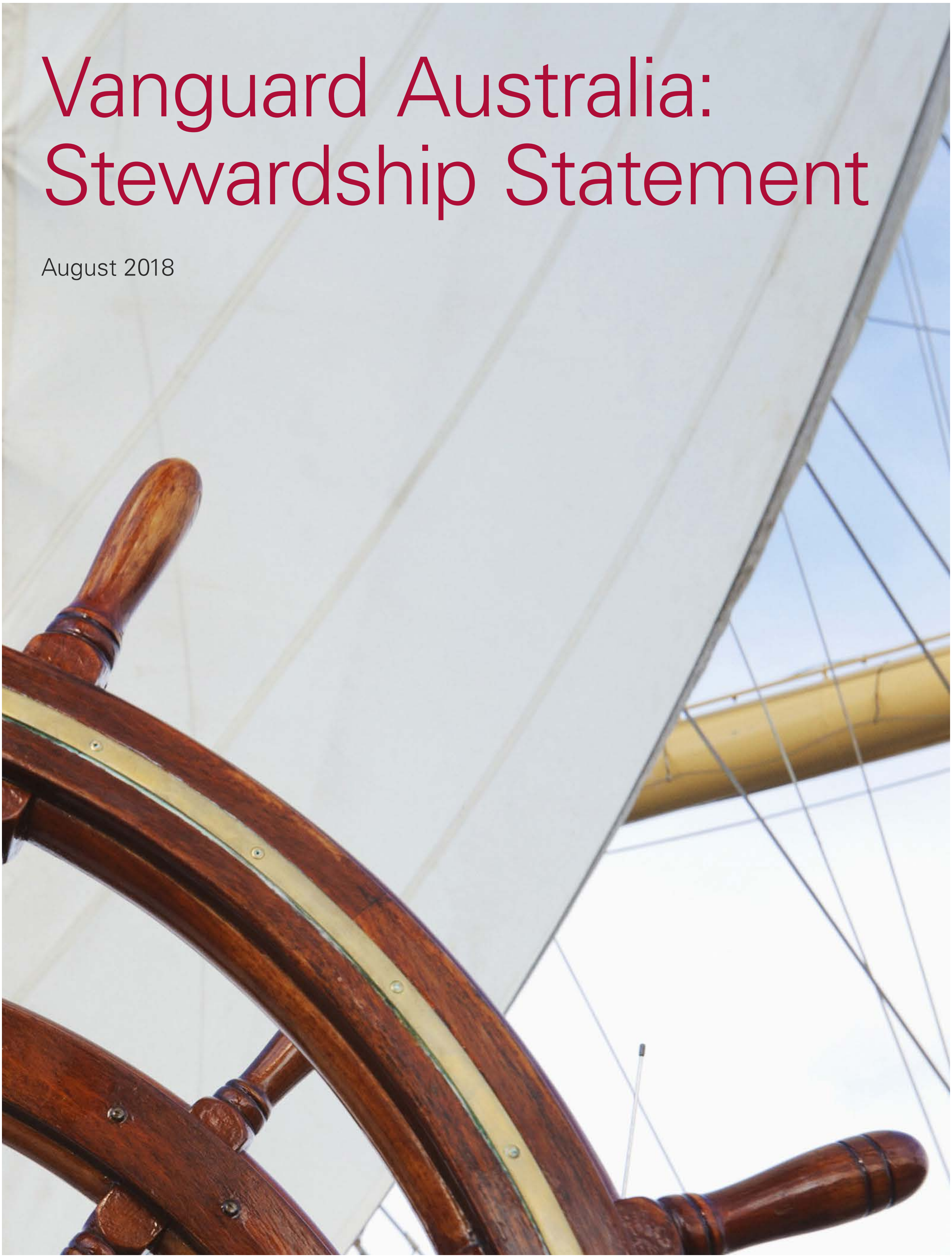
Vanguard

Vanguard Australia: Stewardship Statement

August 2018



Vanguard's approach to stewardship

The FSC Standard: Principles of Internal Governance and Asset Stewardship has been developed for FSC Asset Manager Members in order to:

- encourage higher standards of internal governance and stewardship practices;
- provide better information for clients and other stakeholders; and
- raise the quality and standing of Australia's financial services internationally.

Vanguard Investments Australia complies with the Financial Services Council Standard on *Principles of Internal Governance and Asset Stewardship* (Stewardship Code) in Australia.

Vanguard's core purpose is "To take a stand for all investors, treat them fairly and give them the best chance for investment success." Consistent with that mission, Vanguard strives to make sure the companies our funds invest in are subject to the highest standards of corporate governance.

Because our funds typically own the equities of companies for long periods of time (and in the case of index funds are practically permanent holders of companies), we believe it is important to ensure that these companies' governance and executive compensation practices support the creation of long-term value for investors. Our advocacy on this front is driven by our governance and compensation principles, which are described in the below Internal Governance section. The most visible sign of Vanguard's advocacy is our funds' proxy voting at shareholder meetings. We have an experienced team of analysts that independently evaluates each proposal and casts our funds' votes in accordance with the funds' voting guidelines.

However, voting by its nature reduces sometimes complex issues to a binary choice — "for" or "against" a particular proposal — making it a rather blunt instrument. In contrast, our engagement with the directors and managers of the companies in which we invest provides us with the opportunity to target feedback and messaging more precisely than does voting alone. So while voting is visible, we think voting tells only part of the story.

We believe our active engagement demonstrates that passive investors don't need to be passive owners. In fact, our involvement in hundreds of direct discussions every year has taught us that we can accomplish as much — if not more — through dialogue than through voting alone. Through engagement, we're able to put issues on the table for discussion that aren't on the proxy ballot. In essence, we continually strive to provide constructive input that will, in our view, better position companies to deliver sustainable value over the long term for all investors.

Vanguard supports responsible investment by:

- **Voting** in support of proxy proposals that, in our view, will improve our clients' long-term investing outcomes.
- **Advocating** for responsible corporate governance, particularly with the companies in which we invest, as a driver of long-term value creation.
- **Acting** on material environmental, social and governance (ESG) opportunities or risks in our investments.

Organisational and investment approach

Vanguard was founded in the United States in 1975 on a simple but revolutionary idea - that an investment company should manage the funds it offers in the sole interest of its clients. Over the decades, Vanguard has grown to become one of the world's largest investment management companies – with a presence in Australia, Europe, Asia, and the Americas.

In Australia, Vanguard has been helping investors meet their long-term financial goals with low cost investment solutions for over 18 years.

Vanguard's ownership structure in the United States means integrity is foundational to our character as an organisation. The Vanguard Group is owned by Vanguard's US-domiciled funds. Those funds, in turn, are owned by their investors. This unique mutual structure aligns our interests with those of our investors and drives the culture, philosophy and policies throughout the Vanguard organisation worldwide. Our long-term perspective and disciplined approach to investing puts our focus squarely on clients and the sustainable value of their investments. Our stewardship is reflected in a commitment to keep costs low and to protect our clients from undue risk. We believe responsible investment is inherently part of Vanguard's culture and is consistent with our fiduciary duty to manage investments in the best interest of clients.

Description of the distinguishing features of Vanguard and how these features are directed towards achieving client objectives

What sets Vanguard apart – and lets Vanguard put investors first around the world –is the ownership structure of The Vanguard Group, Inc., in the United States.

Rather than being publicly traded or owned by a small group of individuals, The Vanguard Group is owned by Vanguard's US-domiciled funds and Exchange Traded Funds (ETFs). Those funds, in turn, are owned by their investors.

This mutual structure aligns our interests with those of our investors and drives the culture, philosophy and policies throughout the Vanguard organisation worldwide.

As a result, Australian investors benefit from Vanguard's stability and experience, low costs and client focus.

An explanation of how Vanguard aligns its purpose and values with its duty to clients

Vanguard's core purpose is "to take a stand for all investors, to treat them fairly and to give them the best chance for investment success".

Successful investment management companies base their business on a core investment philosophy, and Vanguard is no different. Although we offer many specific strategies, an overarching theme runs through the investment guidance we provide to clients—focus on those things within your control.

Instead, too many focus on the markets, the economy, manager ratings, or the performance of an individual security or strategy, overlooking the fundamental principles that we believe can give them the best chance of success.

These principles have been intrinsic to our company since its inception, and they are embedded in its culture. For Vanguard, they represent both the past and the future—enduring principles that guide the investment decisions we help our clients make.

An overview of the ownership, management and governance structures of the organisation

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This mutual structure aligns our interests with those of our investors and drives the culture, philosophy and policies throughout the Vanguard organization worldwide.

In Australia, Vanguard leverages the scale, experience and resources of our established global business. Vanguard's ownership structure means that our clients don't have to worry that we'll be acquired. The company they invest with today will continue to serve them in the future.

The Vanguard Group, Inc.: Key facts and figures*

Founded	1975
Total assets under management	AUD $6.4 trillion
Funds offered	187 in the US, and 208 funds in markets outside the US
Ownership	Client-owned**
Headquarters	Valley Forge, Pennsylvania, USA
Chairman:	F. William McNabb III
CEO:	Mortimer J. Buckley
Number of employees	Around 16,600 worldwide

* Data as at 31 March 2018.
** The Vanguard Group, Inc. is owned by its US-domiciled funds, which are owned by their shareholders.

The Board

The Board has overall responsibility for the governance of Vanguard Investments Australia (VIA). The Board of Directors approve the overall strategic direction, monitor management performance and meet on a quarterly basis. The following committees report to the Board:

- Australian Executive Team (AET) – reports on a fortnightly basis.
- External Compliance Committee – quarterly
- Australian Risk Committee – quarterly

Led by the VIA Board and Executive Team, Vanguard is very much focused on, and is committed to, upholding a strong compliance culture with leadership from senior management and oversight via the following three core underlying governance functions:

- Risk focus
- Compliance focus
- Internal Audit focus

Governance structures – Risk focus

Enterprise Risk Management (ERM) serves as a check and balance for operational risk management and strategic risk management.

The Head of Risk Management, Australia reports to the CFO, Australia and Global Head of Enterprise Risk Management. They also chair the Australian Risk Committee which is a management committee comprising the members of the Australian Executive Team, Head of Internal Audit, APAC, Senior Compliance Manager, Australia and Head of Risk Management Group, APAC.

The Australian Risk Committee has oversight of the Risk Management framework at VIA, and specifically the effectiveness of local risk management, governance and compliance activity. It is responsible for considering whether the risks of the local enterprise are adequately managed by the risk management framework. Where appropriate it will sponsor change across the organisation to ensure that VIA standards are met. This committee meets quarterly.

The local Australian Risk Committee rolls up to the Enterprise Risk Governance Council, a group of senior executives representing Vanguard's different business units and divisions, and then through to the Executive Risk Committee, which includes the CEO and Chairman of The Vanguard Group, Inc. and members of senior staff.

Governance structure - Compliance focus

The Office of the General Counsel (OGC) has a robust legal and compliance framework, designed to meet its regulatory obligations, and includes several unique areas of expertise and focus including Legal and Compliance.

OGC oversees Vanguard's compliance with the scheme's compliance plans and manages regulatory issues, breaches and compliance reviews in order to assess whether VIA has discharged its compliance obligations.

The function keeps up to date with relevant regulatory obligations and legislative changes via a number of sources, including updates from external legal providers, regulatory alerts, attendance at industry conferences and membership of and engagement with various industry associations and working groups.

The Senior Compliance Manager (Australia) reports through the Head of Legal and Compliance, Australia and ultimately to the Managing Directors of International and Legal & Compliance. The Senior Compliance Manager (Australia) also reports to the VIA External Compliance Committee, which is comprised of the CEO, Australia and two independent members.

As a Responsible Entity of the Australian domiciled managed investment schemes, VIA has an External Compliance Committee (ECC) to monitor the compliance management of these schemes. The ECC has a documented Terms of Reference and is chaired by VIA's Managing Director and has two external members. The ECC has access to the Board of Vanguard, management of Vanguard, the Vanguard Head of Legal and Compliance and the Vanguard Head of Compliance on giving a reasonable period of notice. The ECC reports to the VIA Board on a quarterly basis and has an obligation to report to ASIC any breaches of a significant nature.

Governance structure – Audit focus

Internal Audit is an independent function with the Chief Audit Executive reporting to the Audit Committee of The Vanguard Group, Inc. The Head of Internal Audit, Asia Pacific reports functionally up through to the Chief Audit Executive and also through the Audit Committee of Vanguard Investments Australia, Ltd. Audit matters from Australia are reported up the management line to the Audit Committee of The Vanguard Group, Inc. and ultimately the board of directors.

The Audit Committee for Australia is responsible for ensuring the local entity discharges its responsibilities under Corporations Act 2001 and other applicable legislation in regards to reported financial information and audit requirements of VIA and the funds. This includes the integrity of financial reports, internal controls systems and framework and other audit activities.

An internal audit function has been established within Vanguard, with an independent reporting line to the Audit Committee.

An overview of the key management and investment personnel within the organisation

Frank Kolimago | Principal, Managing Director, Vanguard Investments Australia

Frank Kolimago is Managing Director of Vanguard Australia. In this role, Frank is responsible for all aspects of management, distribution, and operations of Vanguard's Australian business.

Since joining Vanguard in 1996, Frank has served in a variety of roles including working in the Institutional Investor Group as a principal in Malvern, Pennsylvania and Scottsdale, Arizona, and leading the teams that support institutional retirement plan clients across a variety of segments.

In 2000, Frank moved to Japan to assist in establishing and managing Vanguard's Tokyo office, and in 2013, he headed up the combined Shared Services and Defined Benefit Services Group within Vanguard Institutional Investor Group. Most recently, Frank was principal and head of Vanguard Personal Advisor Services in the United States, which provides Vanguard clients with ongoing asset management and investment advice consultations with Certified Financial Planner professionals.

Before joining Vanguard, Frank was a vice president in the corporate banking division of PNC Bank, N.A. Frank earned a B.S. in finance from Saint Joseph's University and an M.B.A. from Villanova University, and has completed the Advanced Management Program at the Wharton School of the University of Pennsylvania.

Daniel Reyes | Principal, Head of Investments, Asia-Pacific and Head of Investment Strategy Group (ISG), Asia-Pacific

Daniel Reyes is a Principal, Head of Investments, Asia-Pacific and Head of Investment Strategy Group (ISG), Asia-Pacific, and a member of the Vanguard Australia executive team.

In this role, Daniel leads Vanguard's experienced team of investment management and strategy professionals in Australia and Asia. Prior to taking on his role in October 2017, Daniel was based in Vanguard's Malvern office in the Investment Strategy Group with responsibility for the team's support of Vanguard's advised solutions. The Investment Strategy Group is Vanguard's research and client-facing team that develops asset allocation strategies and conducts research on the capital markets, global economy, portfolio construction and other related investment topics.

Daniel joined Vanguard in 2004 and has held several roles spanning Vanguard Institutional Advisory Services®, the Fixed Income Portfolio Management Group, Human Resources, the Retail division and Vanguard's Education Savings business.

Before joining Vanguard, he worked for Towers Perrin in their Executive Compensation consulting practice.

Daniel holds a Bachelor's degree in Economics with concentrations in finance and management from the University of Pennsylvania's Wharton School. He also earned an MBA from the Kellogg School of Management at Northwestern University. He is a CFA® charterholder.

For the full Board of Directors and Management Team please see: *https://www.vanguardinvestments.com.au/adviser/adv/about-us/our-australia-team.jsp*

Explain how Vanguard ensures client assets are managed in accordance with their investment strategies and how conflicts of interest are managed

As a steward of assets for over 20 million investors worldwide Vanguard has rigorous processes and procedures to ensure that these assets in line with their investment strategies. Vanguard's global Investment Management Group (IMG) has one of its three hubs located in Melbourne and this team work closely with other stakeholders across the business to manage the assets of Australian investors accordingly.

Investment Risk Management

The investment risk management team within the Investment Management Group is an independent function that works closely with the portfolio management and operational risk management teams to help ensure that portfolios are being managed in accordance with their investment strategies and within the constraints established for each portfolio.

Investment risk management follows an established framework that involves a series of activities related to assessing, managing, and monitoring risks. Each fund has documented investment objectives and strategies, a benchmark against which its portfolio construction and performance is assessed, documentation of permitted instruments, and risk limits. Vanguard's appetite for deviating from the established portfolio management guidelines is low and therefore our appetite for risk taking beyond the inherent risk of each portfolio is low.

Compliance

The Compliance team is responsible for the post trade monitoring program.

Trades are sent through an automated pre-trade compliance system prior to execution. Compliance rules are established for each fund specific to the requirements of the investment strategy, which operate in conjunction with generic rules that are designed to support the internal investment policies of Vanguard. Design, implementation and monitoring of pre-trade compliance rules are segregated from the trading desks.

Code of ethics and Conflict of interest

All companies of The Vanguard Group, Inc. have a code of ethics (the "code") that protects shareholders' investments, as well as Vanguard's reputation as a trusted source for investment management.

The code applies to all employees, including internal investment managers. All employees are prohibited or restricted from engaging in certain activities, based on job function and access to fund investment information. All employees must certify in writing that they have read and understood the code, have adhered to its provisions, and have not engaged in any prohibited activities.

Our code covers various topics, such as:

- Standards of conduct.
- Duty of confidentiality.
- Gifts and entertainment policy.
- Rules governing ancillary activities.
- General restriction on trading.
- Special restriction on trading for employees having access to sensitive information (preapproval clearance required).

Our Compliance Department monitors the code's implementation and ensures that it meets applicable regulatory rules. The compliance team reports to VIA's board of directors, providing the highest level of accountability for administering the code.

Vanguard personnel act as fiduciaries for shareholders' investments in Vanguard funds and must comply with the following standards:

- Shareholder interests come first.
- Conflicts of interest must be avoided.
- Compromising situations must be avoided.
- Act with integrity.

Trade Allocation Policy

At Vanguard, individual portfolio managers may manage multiple accounts for multiple clients. In addition to mutual funds, these accounts may include separately managed accounts. Managing multiple funds or accounts may give rise to potential conflicts of interest, including, for example, conflicts among investment strategies and conflicts in the allocation of investment opportunities. Vanguard manages potential conflicts between funds or accounts through allocation policies and procedures, internal review processes, and oversight by trustees and independent third parties.

Vanguard has developed trade allocation procedures and controls to ensure that no one client, regardless of type, is intentionally favoured at the expense of another. Allocation policies are designed to address potential conflicts in situations where two or more funds or accounts participate in investment decisions involving the same securities.

Internal Governance

Ethical conduct and professional practice

Vanguard has a global Code of Ethics policy (“Code”) that applies to all employees. This includes related policies that deal with gifts and entertainment, outside business activities and insider trading.

The Code sets out guidelines, including the requirement for approval by the Legal & Compliance department, for employees wishing to undertake certain outside business activities, such as appointments to external organisations. There are certain activities that are specifically prohibited.

All employees are subject to the Insider Trading Policy which prohibits employees from communicating to internal or external parties any material non-public information about any security or issuer of securities.

All employees must provide an annual certification that they have complied with the Code of Ethics policy.

Personal trading

Vanguard's Code sets out the requirements in respect of personal trading. This includes employees designated as “access persons” (those who have access to client portfolio or trading information) to pre-clear personal trades (including those of family members) with the Compliance team prior to execution and for broker statements to be provided after every personal trade.

Management of conflicts of interest to ensure client interests take priority

Vanguard has an obligation to do all things necessary to ensure we provides financial services efficiently, honestly and fairly. Should a conflict of interest arise, it will be dealt with appropriately based on the individual facts and circumstances surrounding the particular conflict situation, as per the requirements of Vanguard Conflicts of Interest Policy.

Vanguard's Gifts and Entertainment Policy sets out guidelines in respect of giving and receiving gifts and entertainment. There are reporting requirements for all employees and pre-approvals required subject to certain value thresholds.

Risk management and compliance

Vanguard is committed to a risk framework which, through a series of concepts, values and practices supports the proactive identification and assessment of risk, and uses this information to inform decision making and develop sustainable mitigation strategies.

Vanguard takes a holistic view of risk across its operations, encompassing market risk, credit risk, liquidity risk, operational risk, strategic risk and reputational risk. The advantage of this approach is that it allows management to take an enterprise-wide view when evaluating risks to the business and to effectively prioritise risk mitigation activities.

Vanguard uses three lines of defence to protect the organisation from financial loss and reputational damage associated with not proactively managing its risks. It also has a robust governance structure that provides effective oversight.

Error correction policy

Vanguard's Breaches & Incidents Policy cover the roles and responsibilities to the identification, management, rectification and reporting of issues that have an actual or potential adverse impacts to our funds and/or clients.

All compliance breaches or suspected breaches must be reported to the Compliance team. The Compliance team ensures that rectification is timely and appropriate, issues are reported to clients when necessary, and that processes are improved or revised if necessary to prevent issues from reoccurring. Where required, breaches are reported to the auditors and the relevant regulators, and to an external compliance committee.

Soft commissions and soft dollar brokerage

It is Vanguard's strict practice to not enter into any soft-dollar arrangements with counterparties.

Equitable asset valuation and pricing

Vanguard's Unit Pricing Policy provide guidance on the practices that relate to the different functions that contribute to the unit pricing process. The Policy is designed to comply with Industry guidelines such as the ASIC and APRA Unit Pricing Guide to Good Practice and the relevant FSC (Financial Services Council) standards.

Assets and liabilities valuation and pricing methodology focuses on recent actual market prices of listed securities. When market price is unavailable, a fair value of the asset is determined using similar or economically-related assets using the most recent reliable market price adjusted by the relevant index movement since the date of the most recent reliable market price.

Best execution and trade allocation

Vanguard's policy is to take all reasonable steps to obtain the best possible results for its clients when executing transactions. Our traders consider price, cost, speed, likelihood of execution and settlement, size, market impact, nature or any other consideration relevant to the execution of an order and selecting counterparties; as determined by trading policies.

It is Vanguard's policy to treat all clients fairly and not favour one account over another. To that end, Vanguard will allocate investment opportunities and transactions it identifies as being appropriate and prudent for its clients, including initial public offerings and other investment opportunities that might have a limited supply, among its clients on a fair and equitable basis. We prohibit any allocation of trades in a manner such that any particular client account or group of client accounts systematically receives more favourable treatment than other client accounts or that would result in any client being defrauded or the front running of investments. This applies to both purchase and sale transactions.

Remuneration policy

Vanguard's compensation practices are aligned to a ‘pay-for-performance' philosophy and have been designed to reward performance that is consistently of a high standard and serves the best interests of our clients. All employees are subject to a common grade structure that allows the firm to align performance management across similar, but not identical roles. Individual merit and bonus allocations are then tied to common leadership standards, some of which include risk and/or control expectations, which are assessed as part of the annual performance management process. Vanguard ensures that the incentive schemes themselves are not structured in a manner so as to promote inappropriate risk taking by employees.

Whistle-blower protection policy

Vanguard makes available a variety of communication channels for employees to bring matters of concern to the attention of the Vanguard management and/or Board. Through the Vanguard Global Code of Ethics and Fraud Control policies, Vanguard has taken steps to ensure that appropriate mechanisms are in place to facilitate fair and thorough investigations of all reported instances of improper conduct, through either fraud investigation processes, complaints processes and/or discussions with line management or human resources contacts.

In addition to these mechanisms, Vanguard also provides a whistleblowing facility, allowing employees to report instances of suspected improper conduct or matters or concern through a mechanism that ensures that the employees making the disclosure is protected from potential reprisals or recriminatory action by persons internal or external to Vanguard.

Training and development

The ability of Vanguard to meet its corporate and regulatory objectives is dependent on the skills and capabilities of its employees.

Vanguard aspires to be an employer of choice. Vanguard is committed to employee's development and to the provision of training to enhance the skills and ability of employees to perform their role in an efficient and effective manner.

A key leadership standard expectation of all Vanguard leaders is that they will build diverse talented teams and hold employees and themselves accountable for that development. Vanguard requires employees to participate in training so they are able to competently carry out their work and to also ensure training levels are maintained to the standard required by regulation.

Complaints and dispute resolution

Vanguard is committed to delivering exceptional client service including the resolution of complaints in a fair, equitable and timely manner. Vanguard is of the view that complaints including feedback are an opportunity to continuously improve the quality of services and achieve a higher level of customer satisfaction.

The Complaints Policy details Vanguards position in handling a complaint or feedback relating to the financial services provided by Vanguard to manage clients, service providers and agents, media groups and clients who invest via a third party platform.

Vanguard will try to resolve the complaint and get back to clients as soon as possible, but in any event we will acknowledge receipt of a complaint within 2 business days and provide a final response, within 45 days of receipt.

In the event that clients are not satisfied with the outcome of the complaint, they have the right to refer the matter to an external dispute resolution process the Australian Financial Complaints Authority (“AFCA”).

Asset stewardship

Vanguard's core purpose is "to take a stand for all investors, to treat them fairly and to give them the best chance for investment success". This means more than offering smart investments, trustworthy guidance and low fees. It also means working with the companies held by Vanguard funds to make sure that our investors' interests remain paramount.

We take this responsibility seriously. As one of the world's largest investment managers, we recognise that our voice carries considerable weight. Because the funds' holdings tend to be long-term in nature (in the case of index funds, we're essentially permanent shareholders), it's crucial that we demand the highest standards of stewardship from the companies in which our funds invest.

Consequently, we are making our voice heard loudly and clearly in corporate boardrooms. Our advocacy encompasses a range of issues, including corporate governance, executive compensation and succession planning, board composition and effectiveness, oversight of strategy and relevant risks, and communication with shareholders. We also exert our influence as fiduciaries in a very important way when each Vanguard fund casts its proxy votes at companies' shareholder meetings.

Monitoring and engagement

Our funds typically hold companies' stock for long periods of time, and in the case of index funds, we are near-permanent investors. We believe good corporate governance is key to helping these companies maximise returns over time, and we view effective management of environmental and social risks as an integrated component of good corporate governance practices. Significant analysis and effort are put into discussions with the directors and managers of the companies in which we invest; the level and frequency of these discussions may be influenced by the material impact to our funds and the contentiousness of the issue. We believe these engagements, more so than voting, provide an opportunity to fully understand issues and target feedback and messaging to companies.

We characterise our approach as "quiet diplomacy focused on results" – providing constructive input that will, in our view, better position companies to deliver sustainable value over the long term for all investors.

We have a well-established process for identifying governance risks in our portfolio companies. Our key areas of focus for engagement include:

- A well-composed, independent, capable and experienced board.
- Governance structures that empower shareholders.
- Sensible compensation that incentivises long-term performance.

Monitoring and engagement in practice

Here are some recent examples of how our engagement and informed voting have influenced positive change:

Encouraging change in board membership. At a real estate company, every director failed to receive the majority of shareholder support at the previous shareholder meeting. However, all still retained their board seats. We have particular concerns about so-called zombie directors remaining on boards after receiving less than majority support in director elections, and we had conveyed these views numerous times with board members and management. At the same time, the company drew the attention of an activist investor who was also seeking significant board turnover. After blocking the attempted proxy contest, the company left shareholders with only their existing nominees for election at their 2016 annual meeting. Our Corporate Governance team pursued repeated dialogue with the company and the dissidents, encouraging proactive change to board membership and the resignation of directors who had not, in fact, been re-elected by a majority of shareholders. Although the proxy contest did not move forward, we expect to firmly pursue an engagement and, if necessary, voting approach to further emphasise the need for change to the company's future slates of directors.

Changing board composition and executive compensation. The first time we engaged with a large consumer products firm, we stressed the need to incorporate performance-based vesting, not just time-based vesting, to long-term executive incentive awards. We also discussed board composition and the company's plans for rotating in new board members to serve long-term strategic needs. Finally, we encouraged the board to develop a shareholder engagement programme that actively seeks input and demonstrates meaningful changes over time. Six months later, the company disclosed meaningful changes to incentive compensation that directors attributed directly to our discussions with them. The company also added several new board members and senior executives aligned with its long-term strategic needs.

Deepening discussions on climate change risks. We engaged a large oil and gas company to discuss shareholder proposals on environmental issues to understand how the company assesses and manages some of its greatest risks, particularly those related to climate change. We also met with other company shareholders who shared concerns that the company lagged its peers in risk assessment, disclosure and response to emissions and other environmental matters. Ultimately, the company received a high-profile climate change proposal that had already been approved at several peer companies with management support. After analysing the issues underlying the proposal, we have encouraged company management to make specific improvements in how it assesses the severity of these risks, communicates to shareholders about the risks and works with key stakeholder groups to improve its practices.

Pressing for better understanding of risks in supply chains. Upon seeing a number of ESG-related shareholder resolutions on the ballot for a large food producer, we sought to better understand the company's approach to environmental risks and labour practices and its plans for improvement. We learnt of the company's already robust engagement with key stakeholders and interest groups, its recent improvements to risk management and independent audits of farmers and its development of a third-party advisory panel of experts. The company also described its process for elevating environmental concerns to the board of directors. Our team requested further enhancements to the charter of an existing committee, which we believed would better ensure consistent reviews of these issues and improve accountability. Our team also encouraged the company to improve its public disclosures and communication about the board's role in overseeing such risks and the progress already under way. We believe these developments will deservedly improve the company's reputation in the investment community and with the general public.

Increasing attention to environmental risk. We had been meeting with a large energy company to discuss its response to pipeline spills, recent litigation and violations of environmental regulations. We had been concerned with whether environmental risks were receiving appropriate attention from the board, and we questioned how shareholders and stakeholders could effectively assess such risks when the quality of the company's disclosure lagged that of its peers. After we encouraged the establishment of a board committee to oversee environmental risk, the board amended its bylaws and disclosed the role of the new committee on its website and in this year’s proxy statement.

Acting on ESG opportunities and risks in our investments

Fixed Income Group

Our actively managed fixed income mandates are supported by a global team of credit analysts that develops independent risk assessments and investment opinions for each fixed income issuer. The team seeks to understand the material implications of ESG risk as part of an overall independent risk assessment and to determine whether or not market pricing adequately reflects those risks. Focus is placed on consistently applying an ESG integration framework to our investment decision-making process and working with issuers to better understand risks and how improvements can be made to address them.

Equity Investment Group

The majority of our global investments, including most of our equity mandates, seek to track an index. Index providers determine the benchmark constituents, which may not take into account ESG risk when selecting or retaining investments. Our global product line-up includes a number of funds designed to track indices that exclude companies that do not meet social responsibility criteria specified by the index provider.

Portfolio Review

The Portfolio Review team is responsible for the ongoing oversight of our external managers, as many of our active funds use external advisers to manage investments. The team's manager search and oversight process focuses on understanding the drivers of investment performance and a firm's ability to sustain investment success over the long term. Multiple inputs are considered when assessing an investment manager, including the firm's culture, ethics and stability; the skill and depth of the investment team; the investment philosophy and process; and the firm's ability to implement its investment process while managing risk effectively. The team engages with our external investment managers periodically to review their practices to better understand how ESG factors inform the investment process. Additionally, we retain documentation of each manager's responsible investment or ESG policy to help monitor improvements, developments and changes over time.

Oversight and disclosure

The integration of ESG in Vanguard's investment and engaged ownership practices is currently overseen by the Proxy Oversight Committee, which consists of our chief executive officer and select senior officers of Vanguard. Day-to-day management of ESG integration is supported by a cross-functional team representing those groups that regularly evaluate and address environmental, social and governance risks across our product line-up.

Ongoing review of policies and practices

We will continue to adapt and evolve our approach to responsible investment as we uncover new risks and issues affecting our investments. Our policy, and other departmental guidelines and practices, will be revisited on a regular basis. Any updates will be disclosed on Vanguard's external website and through other relevant channels.

Proxy voting

The most visible sign of Vanguard's engaged ownership is our funds' proxy voting at shareholder meetings. We have an experienced group of analysts on our Corporate Governance team that evaluates proposals and casts our funds' votes in accordance with our voting guidelines. Our guidelines are designed to promote long-term shareholder value by supporting good corporate governance practices. They frame the analysis of each proxy proposal, providing a basis for decision-making.

In evaluating votes, the Corporate Governance team may consider information from many sources, including company management, shareholder groups and various research and data resources including proxy advisers. We periodically review our voting guidelines to consider further developments in governance standards or risks to long-term shareholder value.

Please see our website for more information on proxy voting and our disclosure of our votes.

Voting at companies' shareholder meetings is an important aspect of our role as a fiduciary acting in the long-term interests of our investors. To that end, our governance analysts evaluate proxy proposals in the context of guidelines adopted by each of our funds' boards of trustees. These guidelines reflect our long-standing views on what we believe are the optimal governance structures that strike the appropriate balance among the rights and responsibilities of owners, managers and directors.

In the 12 months ended 30 June 2016, Vanguard funds voted by proxy at approximately 16,700 company meetings covering nearly 160,000 items. These included director elections, auditor ratifications, compensation plans, mergers and acquisitions and other management and shareholder proposals.

On average, Vanguard funds voted with management 92% of the time. Here is a summary of our activity:

Global voting and engagement record	July 2015– June 2016	July 2014– June 2015
Number of shareholder meetings at which we voted	16,740	12,785
Number of countries in which we voted	73	72
% of proposals voting with management recommendations	92	92
Number of company engagements	817	685

The following provides a more detailed discussion of the categories we voted on most frequently.

Director elections

Board elections constitute one of the most critical areas of governance, because shareholders rely on directors to monitor management. Over the 12 months ended 30 June 2016, the funds supported 94% of director nominees. The funds voted against the remainder primarily because of concerns about candidates' independence, their attendance or actions taken by a committee on which they served. Less frequently, we withheld votes from directors who in our view failed to observe good governance practices or showed a disregard for shareholder interests.

Compensation

We dedicate considerable effort to ensuring that compensation programmes align the interests of executives with those of shareholders. The funds' votes reflected our views on compensation as follows:

- The funds supported 96% of nonbinding compensation proposals (including "Say on Pay" in some markets). In the United States, the funds voted against proposals at 91 companies where there were significant concerns regarding the execution or design of executive compensation programmes.
- The funds supported 88% of binding votes worldwide (and 84% in the United States) on equity compensation plans. The funds voted against plans that could generate potential voting dilution created by the number of shares authorised and/or the rate at which the company has been granting shares.
- The funds voted against 396 directors in the United States who served on compensation committees.

The funds were most likely to vote against compensation plans because of concerns about whether they properly incentivised long-term performance or could result in excessive dilution of current shareholders. We also engaged with companies to encourage positive change. We held direct discussions with more than two-thirds of the midsize and large US companies where the funds voted against their "Say on Pay" compensation proposals. Many of those firms have since made improvements reflecting our feedback.

Corporate proposals

The funds voted in favour of 92% of proposed mergers and acquisitions, supporting them if our analysis showed they would contribute to long-term value. A number of other company proposals asked for authorisation of new shares or technical amendments to governing documents. We supported approximately 96% of these proposals; the funds voted against 4% when the authorisation of new shares would unreasonably dilute current shareholders' ownership stakes.

Shareholder proposals

Shareholders put forth proposals on issues ranging from governance provisions (such as proxy access) to calls for enhanced disclosure of certain risks. The funds were most likely to support changes that were consistent with our governance principles, such as annual elections for a board of directors. Vanguard funds sided with incumbent boards in 13 of the 19 US proxy contests (68%) that went to a vote – a similar rate as in prior years.

The most significant category of shareholder proposals over the past year in the United States involved those seeking proxy access. Proxy access gives long-term shareholders the right to nominate directors on a company's proxy card. We consider it a meaningful tool that can promote accountability and protect shareholders' long-term interests. That said, it must also include safeguards to avoid potential abuse by investors who do not have a significant long-term interest in the company. Vanguard favours proxy access proposals that permit a group of shareholders who have held 3% of outstanding shares for at least three years to nominate directors, but we considered each proposal on a case-by-case basis. Based on our evaluation, the funds supported 53% of proxy access proposals (47 of 88), a 16% increase from the previous 12 months. We also engaged with more than 60 recipients of such proposals and urged them to adopt proxy access.

We analysed proposals that sought additional reporting or corporate policy changes, including those regarding environmental risks, on a case-by-case basis – focusing on a sufficient linkage between the particulars of the resolution and the impact on long-term shareholder value. In many instances, we did not support proposals that, although directed at a specific risk, were unduly broad or prescriptive. That said, our lack of support for individual proposals must not be confused with lack of awareness of and engagement on the underlying issues. We believe that the powerful combination of thoughtful company engagement and ultimate voting opportunity enables us to share nuanced concerns with boards and management teams and, where necessary, hold boards accountable for meaningful change.

Vanguard funds have ownership stakes in a growing number of companies outside the United States. Consequently, we are more frequently called on to evaluate and vote on shareholder proposals worldwide. Although our approach remains largely the same, we consider the various market differences with regard to board structure and accountability, as well as management's support of various proposals. Shareholder meetings outside the United States requiring our attention amounted to more than 12,000 in 72 countries in the 12-month period ended 30 June. Of that number, more than half involved shareholder meetings in China, where we have observed that shareholders are often controlling or sovereign.

Please see more information here: https://www.vanguardinvestments.com.au/adviser/adv/about-us/corporate-governance.jsp#/proxy_guidelines

Vanguard Investments Australia also complies with the Financial Services Council Standard on *Voting Policy, Voting Record and Disclosure* (Standard 13).

Collaborative engagement with other investors including involvement with industry groups and associations

Vanguard promotes good corporate governance and responsible investment through thoughtful participation in industry events and discussions where we can expand our advocacy and enhance our understanding of investment issues. We also engage with index providers to understand the methodology, construction and maintenance of various equity indices. Finally, we actively contribute to the development of regulatory policy with other market stakeholders to raise standards and promote best practices around the globe.

Vanguard Investments Australia is a member of the following industry associations, where we participate in working groups, policy discussion and advocacy issues:

- Association of Superannuation Funds of Australia (ASFA)
- Financial Services Council (FSC)
- Investment Company Institute (ICI) Global
- Responsible Investment Association of Australia (RIAA)
- Self-Managed Super Fund Association
- United Nations Principles for Responsible Investment (UNPRI)

Principles used for policy advocacy including participation with industry groups and associations

Core principles that guide the positions we adopt when advocating or informing Government.

Vanguard will determine its policy positions and its advocacy to Government in accordance with the following core guiding principles:

- **Purpose of the system:** Investor outcomes and investor value should be the primary measures of success of the wealth management system.
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- **Treating investors fairly:** Vanguard will advocate for a system that treats investors fairly, and will not advocate on behalf of a class of investors at the expense of another, or at the expense or detriment of all investors.
- **Transparency and choice:** Vanguard will support the imposition or maintenance of transparency and choice for the investor, except where this imposes such a degree of cost or complexity for investors whereby it undermines their chances of investment success.
- **Investor rights:** Vanguard will support the enhancement and maintenance of consumer rights for the investor, except where this imposes such a degree of cost for investors whereby it undermines their chances of investment success.
- **Long-term sustainability:** Vanguard will advocate and support system which is both favourable and sustainable for investors over the long-term, to the exclusion of a system which is conducive to short-termism or unsustainable.
- **Competition in favour of investors:** Vanguard supports a competitive system where investor value and outcomes are ultimately the key sources of competitive tension between firms.
- **Advocacy of Vanguard's business:** Vanguard will advocate for a system and regulatory environment which enables it to be commercially successful, consistent with the principles set out above, without engaging in rent-seeking.

Approach to client engagement, education and communication regarding asset stewardship

Through a range of external communications including regular reports, direct client meetings and communications, industry and media commentary Vanguard provides clients, existing and prospective, with insights into our Investment Stewardship principles, processes and recent activity.

Vanguard Chairman Bill McNabb has spoken before multiple industry groups promoting engagement with shareholders. In addition, he joined a coalition of prominent corporate and asset management leaders in signing on to the Commonsense Corporate Governance Principles. These principles, issued in July 2016, outline a comprehensive list of governance recommendations for corporate boards and management teams, as well as asset managers, to follow. The principles address issues including board composition and governance, board responsibilities, shareholder rights, transparency, succession planning, executive compensation and responsibilities of asset managers such as Vanguard. Executives from prominent manufacturing, finance and asset management firms joined Mr McNabb in signing on to the principles.

Also, senior Corporate Governance leaders have supported research and forums at academic institutions and associations promoting shareholder rights and discussing various environmental, social and governance (ESG) issues. And our Corporate Governance staff has engaged in thought leadership roundtables, participated in conferences and contributed to publications encouraging effective shareholder engagement and promoting ESG best practices among companies, investment managers and service providers.

We believe it's important to provide investors and directors with the resources to make these conversations productive. Accordingly, we have actively communicated our views on company engagement best practices to boards of directors through a variety of channels. And we continue to support initiatives such as the Shareholder-Director Exchange (SDX) and the Conference Board's Guidelines for Investor Engagement. Vanguard has also become a signatory to the Principles for Responsible Investment, and our first public report to the PRI is scheduled for spring 2017.

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liability for any errors or omissions.