Vanguard

Vanguard Asset Management, Limited

The UK Stewardship Code 2020 Report

March 2021

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Introduction

We are pleased to submit Vanguard Asset Management's first report for the UK Stewardship Code 2020. As a signatory of the previous code, we appreciate the Financial Reporting Council's recognition of the evolving market landscape, its ongoing effort to elevate stewardship standards and its drive to improve disclosure of principles, approaches and outcomes. The UK Stewardship Code has inspired the adoption of better governance and stewardship practices well beyond the United Kingdom.

As a global organization, Vanguard serves more than 30 million people around the world who are saving and investing for long-term goals such as retirement, education or housing. Our primary focus is on helping individual investors, whether through direct retail channels, intermediaries or employer-sponsored retirement programmes.

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. We encourage investors to adopt our sensible and straightforward investment principles of setting clear and appropriate goals, developing suitable asset allocation with broadly diversified funds, minimizing costs and maintaining discipline and a long-term perspective.

Vanguard has a fiduciary duty to maximise long-term shareholder returns. We fulfil this duty by being judicious in the funds we offer, managing those funds with rigor and continuously monitoring and managing risk – from idiosyncratic risks that can be found in a portfolio company to systemic risks that can threaten the health of markets and economies.

As a provider of index investment products, Vanguard places great importance on the role of investment stewardship. An index fund must own the securities in its benchmark index and cannot buy or sell a company based on the manager's assessment of its performance – past, present or future. The investment stewardship tools of proxy voting, engagement and public advocacy for good governance practices are therefore critical to promoting and safeguarding shareholder value over the long term.

Vanguard's investment stewardship programme operates at the intersection of corporate governance, environmental risk and social risk, and we examine these matters through a fiduciary lens. In 2020, key thematic areas of focus included climate risk, diversity of boards and workforces and how companies responded to the challenges of the COVID-19 pandemic.

Our stewardship programme has evolved a great deal in recent years. We have worked to become more global in our approach, deeper in our analysis and clearer in communicating our principles and outcomes.

Of course, many teams throughout Vanguard play an important role in stewarding our clients' assets. Our work is never done, and we continuously focus on improving how we carry out our mission. We seek to provide clarity about the challenges we face and the opportunities we have along the way. It's in that spirit that we submit this report. We thank the Financial Reporting Council for this revised framework and for the opportunity to both provide and receive input.

Sean Hagerty

Sean Hagerty

Managing Director
Vanguard Asset Management

About the UK Stewardship Code 2020

The UK Stewardship Code 2020 (the Code) is a revised version of the 2012 UK Stewardship Code and establishes a new definition of stewardship: the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society. The code comprises a set of principles and guidance for asset owners, asset managers and service providers to promote transparency and integrity in business, placing a strong emphasis on the outcomes of stewardship activities.

Vanguard is committed to effective corporate governance to ensure that companies, investors and the economy as a whole benefit. We serve our investors by promoting and safeguarding long-term value creation at the companies in which our funds invest. The following report and associated documents linked within (including our *2020 Investment Stewardship Annual Report*, published in March 2021) illustrate the stewardship activities and outcomes in respect of Vanguard Asset Management Limited (VAM), part of the Vanguard group of companies ('Vanguard'), for the 12 months ended 31 December 2020, and explains how our policies and practices address each principle. This report signals our intention to become a signatory to the Code and fulfils certain reporting requirements of Article 3g(b) of the Shareholder Rights Directive II (Directive 2017/828) as implemented in the UK.

Principles for asset owners and asset managers

Purpose and governance

Principle 1: Purpose, strategy and culture

Principle 2: Governance, resources and incentives

Principle 3: Conflicts of interest

Principle 4: Promoting well-functioning markets

Principle 5: Review and assurance

Investment approach

Principle 6: Client and beneficiary needs

Principle 7: Stewardship, investment and ESG integration

Principle 8: Monitoring managers and service providers

Engagement

Principle 9: Engagement

Principle 10: Collaboration

Principle 11: Escalation

Principle 12: Exercising rights and responsibilities

About Vanguard

Purpose, strategy and culture

Vanguard was founded on a simple but revolutionary idea: An investment company should manage its funds solely in the interests of its clients. The success of our approach has enabled us to expand over the decades to become one of the world's largest asset managers, with 17 global offices, including our international head office in London. We offer our products and services directly to individuals as well as to financial professionals and corporate and institutional investors.

What sets Vanguard apart – and lets us put investors first – is our unique mutual ownership structure in the US. Vanguard is owned by the US-domiciled funds, which in turn are owned by their investors. This framework has inspired our client-first culture – our clients are at the heart of all our decisions and our drive to continually lower investment costs. While this ownership structure is not replicated outside of the US, we believe that it drives the culture, processes and philosophies throughout Vanguard's global organisation. As a result, our clients benefit from our stability and experience, low costs and client focus.

We are guided by our core purpose: **To take a stand for all investors, to treat them fairly and to give them the best chance for investment success.** We fulfil this mission and ensure that Vanguard's interests are aligned with those of our clients by adhering to three core values:

Integrity. Vanguard's unique ownership structure means we have no conflicting loyalties. We are built to 'do the right thing' for our clients.

Focus. Our long-term perspective and disciplined approach to investing keep our focus squarely on clients and the sustainable value of their investments.

Stewardship. Our stewardship is reflected in a commitment to keep costs low and to safeguard our clients from undue risk. We also strive to ensure that companies in which our funds invest are subject to the highest standards of corporate governance. We believe good governance can promote and safeguard long-term shareholder value.

Four investment principles have been intrinsic to our company since its inception and are based on a long-term time frame: **goals, balance**, **cost** and **discipline**. These principles are the foundation of the advice and guidance we provide to our clients. They inform our approach to managing the funds, and they are evident in how we run our business.

We view our Investment Stewardship programme as a natural extension of Vanguard's core purpose and values. The majority of our global investment offerings are index funds, which seek to track a stated index. The funds invest in public companies and can theoretically hold a stock forever – or for as long as the stock is included in the underlying index. ESG-related risks (environmental-, social- or governance-related matters that can materially affect a company) can erode shareholder value over the long term.

For companies held in Vanguard's internally managed global equity funds, our Investment Stewardship team applies ESG oversight by voting proxies, meeting directly with portfolio companies and their boards to assess their oversight of risk and advocating for market-wide adoption of governance best practices. We believe that well-governed companies will generally perform better over the long term as sound governance of risks, including social and environmental risks, accrues value to investors. Vanguard's Fixed Income Group is responsible for the stewardship of our fixed income assets. Credit research analysts assess ESG risk factors as part of their process.

An unwavering focus

Vanguard serves more than 30 million individual investors around the world who have a wide range of personal beliefs. The one thing they have in common is that they have entrusted us with their money in the expectation that we will safeguard it and help it to grow. It's a role and responsibility we take seriously. Our investors, most of whom are saving for important long-term financial goals such as retirement, expect their mutual funds to meet the specific objectives set forth for those investments. Accordingly, they expect our index funds to follow their benchmarks with minimal tracking error. As a fiduciary, we are required to manage our funds in the best interests of shareholders and obligated to maximise returns to help shareholders meet their financial goals.

When people invest in a mutual fund, in addition to professional investment management, they expect professional investment stewardship. Our shareholders depend on Vanguard to establish and maintain governance principles and consistent voting guidelines that will safeguard their investments and promote long-term value. They count on us to know the issues, do the research, maintain vigilance and be an effective steward.

In the UK, the primary strategy of Vanguard Asset Management (VAM) is to distribute funds and deliver services to individual investors and those that serve them in the following ways:

Direct retail. We serve direct investors through the UK Personal Investor platform, our direct-to-consumer business launched in May 2017.

Intermediated retail. Our financial intermediary clients serve investors directly using Vanguard mutual funds and ETFs in their clients' portfolios through a range of digital platforms and services.

Intermediated wholesale. We work with financial institutions such as banks and asset managers that use Vanguard mutual funds and ETFs in their products and in clients' portfolios.

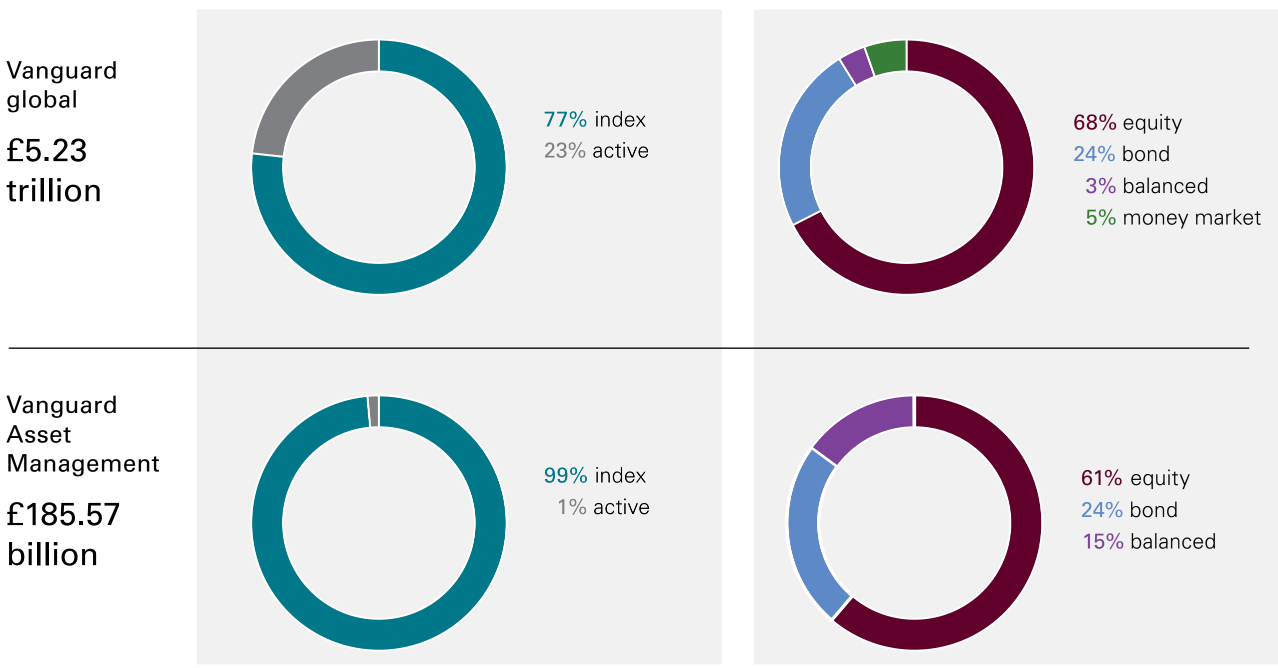
The ultimate long-term investor

Index funds represent the majority of Vanguard's global total assets under management (AUM) (see **Figure 1**) and are practically permanent owners of the companies in which they invest. Theoretically, they will hold a stock forever, or as long as the company is included in the underlying benchmark.

Our long-term approach to investing looks beyond the next quarter or next year. Generally, we consider 30 years a reasonable investment time horizon.

We take a measured approach to introducing new funds and ensure that all proposed Vanguard funds meet client needs before offering them. We do not launch funds to chase fads or cash flows in the marketplace. Although our product offering in the UK consists of a core range of index and active equity, fixed income and money market mutual funds, the investor assets that VAM manages are predominantly held in our index products. We also offer low-cost, broadly diversified core portfolio products such as Vanguard LifeStrategy® Funds and Vanguard Target Retirement Funds, with varying asset allocation mixes to meet a range of investor needs, including those of our retail-oriented clients.

Figure 1. Vanguard assets under management, by strategy and asset class



Source: Vanguard, as at 31 December 2020. Figures may not sum to total because of rounding.

Delivering value to our clients

Vanguard is a steadfast advocate for the interests of all investors, and providing value is core to fulfilling our mission. We act in the best interests of our clients, giving them the best chance for investment success in areas such as:

Ongoing charge figures. We have demonstrated a history of regularly cutting fees to investors since we entered the UK market in 2009. Our most recent assessment (as of 30 September 2020) shows that the ongoing charge figures for our funds are amongst the lowest in the market.[1]

Share-class structure. In June 2020, we simplified the share-class structure of our UK-domiciled funds. We now offer only two share classes: General (aimed at retail investors) and Institutional Plus (aimed at select professionals and institutional investors). This change provides our investors with simple, fair and transparent pricing.

Distribution of funds. In 2020, Vanguard's UK Personal Investor platform was recognised by the consumer champion Which? as a Which? Recommended Provider for Investment Platforms, achieving the highest overall customer score for customer satisfaction and value for money for the second consecutive year.

Our second annual *Assessment of Value Report*, covering the year to 30 September 2020, provides greater detail about how we assess the value Vanguard provides to the investors in its UK-domiciled funds.

1 The ongoing charges figures (OCFs) for our funds were, on average, 75% below the average OCF of their Morningstar categories. The comparison is of ongoing charges relative to comparable share class of direct peers in their respective Morningstar category. Morningstar categories include both index and active funds.

Source: Morningstar as at 30 August 2020.

Responding to systemic risk

We believe that the appropriate identification and management of risk is key to our clients' long-term financial success, and in the case of systemic risk, it can promote a well-functioning financial system. Vanguard has established a European Enterprise Risk Management Framework based on the common risk management frameworks used by all Vanguard businesses. It has been designed to address the inherent risks arising from or related to activities throughout Europe and facilitates a consistent approach to risk management. Supported by robust governance, it helps inform our business strategy, risk appetite and operating model.

We have identified five broad categories to assess risk – strategic, operational, investment management, legal & regulatory and corporate financial. Our clear and consistent approach enables us to:

- Aggregate and compare risks throughout Vanguard and Europe to identify themes and opportunities for efficient remediation
- Share and discuss all risks in a common language throughout the organisation
- Identify and analyse risk trends
- Compare with external benchmarks

Using this framework, we have identified key market and systemic risks that we sought to manage and respond to in the past year.

Key market risks

Liquidity risk and foreign exchange volatility

Liquidity risk can be defined as the chance or inability to fund liabilities through the sale of assets under a range of market conditions. As a trusted steward of our clients' assets, Vanguard must have effective oversight and tools in place to manage this risk. Our liquidity management tools are multifaceted and comprise both standard and nonstandard mechanisms. Examples of standard tools include offsetting investor flows and employing swing pricing, whereby swing factors can be adjusted to cover the higher costs of transacting typical during times of market stress. Nonstandard tools include mechanisms that safeguard existing investors from more extreme liquidity challenges, such as fund gating (the temporary restriction of fund redemptions) and the availability of secured credit lines (short-term bank loans to fund liability shortfalls).

The COVID-19 crisis presented financial markets with a significant test of resilience, particularly during March and April 2020. The ability of the market to manage high levels of asset-side stress (mostly in the form of wider bid-ask spreads) whilst managing redemptions presented a challenge to asset managers, and Vanguard was no exception. However, our liquidity management tools proved effective, and we needed to deploy only standard mechanisms such as swing pricing.

As we navigate the ongoing crisis, we continue to strengthen our liquidity management toolkit. One challenge relates to collateral management tied to currency-hedged positions, mostly in Vanguard's corporate bond funds. We employ a conservative approach: We fully collateralise positions in over-the-counter derivatives, including foreign exchange forwards, to hedge currency risk. The use of credit derivatives as an additional liquidity management tool has strengthened our ability to fund liabilities (such as collateral calls) whilst maintaining the risk profile of our funds to meet investment objectives and client expectations.

Cybersecurity

The financial services industry faces complex and increasingly targeted cyber threats. As one of the largest global asset managers, Vanguard and our clients are attractive targets. Mitigation of these threats requires a knowledge of what motivates our adversaries, the tactics they use and our capability to design and implement a Defence in Depth (DiD) strategy – a multilayered set of controls providing several lines of defence – to safeguard Vanguard crew, data and client assets.

Though the threat of cyberattacks is constant, the tactics, techniques and procedures used by attackers are continually evolving.

Vanguard has a three-pronged approach to manage this challenge:

1. The development of a community of practice- and information-sharing programmes in collaboration with law enforcement agencies, like-minded financial institutions, universities and security consultants to stay abreast of security trends and maintain awareness of pertinent threats
2. Sophisticated technology to detect anomalies in logs and network traffic that may indicate an attack against Vanguard or our clients
3. Layered safeguards to mitigate the risk of advanced insider threats

Vanguard is an active member of the Financial Services Information Sharing and Analysis Center, an intelligence exchange platform specific to the financial services industry. As a member, we can receive and share information to help reduce cyber risk and stay abreast of security threats. We receive daily information and alerts and also source information from other external parties to support our security assessment process.

By combining an experienced cybersecurity team with best-in-class security controls, a comprehensive DiD strategy and state-of-the-art technology, Vanguard will continue to vigilantly monitor and diligently defend itself from cyber threats.

Brexit

Vanguard has devoted significant resources since 2016 to managing the impact of Brexit, and we continue to monitor and evaluate developments. We have performed detailed scenario planning to ensure that our corporate structure and response to stress events are robust.

Our activities in 2020 focussed on refreshing our no-deal Brexit planning and on assessing the impact of and responding to political and regulatory developments in the UK and EU, specifically:

- Any restrictions on our ability to trade equities in UK and European venues and any potential impact on market liquidity arising from UK and EU share-trading obligations
- Any restrictions on our ability to trade derivatives arising from the UK and EU derivatives-trading obligations
- Preparations for any short-term market volatility arising from a delay in negotiation of a Brexit trade deal and associated market uncertainty

Business resilience

Because Vanguard is responsible for carrying out critical regulated activities, clients and markets could suffer if a disaster scenario occurred leaving the company unable to continue operations for a period. Our business contingency planning provides for the recovery and restoration of all critical operations and consists of three components:

- Detailed documented business contingency plans
- Data security and recovery processes
- Business continuity tests

Vanguard has implemented several business continuity policies to address this risk, including alternative recovery sites and backup of IT infrastructure. Business interruption risk also considers the failure of key outsourced partners. Our outsourced partners are required to provide detailed business continuity and disaster recovery plans, which we test and review.

Our business resilience has been fully tested during the COVID-19 pandemic, requiring a swift transition to a virtual work environment for more than 95% of our global workforce to support mandated government lockdowns. Additional information about Vanguard's response to COVID-19 is discussed below.

Service provider failure

This risk arises from the failure to adequately identify, select and monitor third-party service providers to ensure that they maintain and demonstrate strong operational effectiveness and strategic and cultural alignment.

Each Vanguard third-party service provider is carefully selected from high-quality institutions that are key players in the industry. We have documented outsourcing agreements, due diligence activity, business continuity and exit plans in place alongside business-as-usual oversight. We undertake a proportionate and stringent due diligence process when critical activities are outsourced.

In 2020, the Vanguard European businesses approved and implemented a Third Party Service Provider Oversight Policy to complement our global policy. It is supported by a register of relevant arrangements and a set of implementation guidelines designed to enable a consistent approach to the governance and assessment of the quality of service provided by external third parties and compliance with evolving regulations.

The policy is also supported by vendor oversight functions and relevant formal governance forums that provide oversight of our significant external outsourced service providers. Defined processes for reporting on critical service provider performance enable a flow of information on governance of services throughout the organisation.

Failure of a critical outsourced partner is one of a number of risks Vanguard assesses through a Key Risk Scenario workshop as part of our Internal Adequacy Assessment Process. This workshop helps us measure and understand risk exposures, their potential impacts, what appropriate contingencies are required and where to allocate capital.

Key systemic risks

Climate change

The earth's climate is changing in unprecedented ways, with far-reaching implications for individuals, society, companies and the global economy. Vanguard recognises that climate change represents a profound, fundamental risk to investors' long-term success. Few companies – and few if any long-term investors – will be exempt from its far-reaching implications. We invest time and resources in monitoring climate-related risks in our funds' portfolio companies.

In 2020, we sought to increase awareness of how we view climate change risk and our related stewardship activity. We published four papers on our perspectives:

- *How Vanguard Addresses Climate Risk*
- *Why Climate Change Matters to Long-Term Investors*
- *Climate Risk Governance*
- *Votes on Selected Climate-Related Shareholder Proposals*

We also participated in the U.S. Commodities Futures Trading Commission Climate-Related Market Risk Subcommittee, which included representatives from the business and investor community, the public-policy sector and academia. In September 2020, the subcommittee released a report, *Managing Climate Risk in the U.S. Financial System*, which presented findings and recommendations to mitigate the risk to US financial markets posed by climate change.

Vanguard supports the Task Force on Climate-Related Financial Disclosures, and we are a member of the Investor Advisory Group of the Sustainability Accounting Standards Board (SASB), which seeks to foster company disclosure of environment, social and governance data that is comparable, consistent and financially material.

In 2020, we continued to engage with issuers when we viewed climate change as a material risk, both in carbon-intensive sectors and beyond (such as financials), and focussed on better articulating our perspective. We analysed each climate-related shareholder proposal on a case-by-case basis, evaluating whether it identified a material risk to the company, whether it dictated a company's business practices or strategy and whether the company had already met the request. In the year ahead, we will further expand our engagement with portfolio companies on this issue and hold them accountable to our expectations on climate risk governance. This is an area of priority for voting and engagement in 2021.

For detailed case studies related to our engagement activity on climate risk, please see our March 2021 *2020 Investment Stewardship Annual Report*, beginning on p. 14, and our September 2020 *2020 Investment Stewardship Annual Report*, beginning on p. 22.

COVID-19

COVID-19 has taken a devastating toll on human life, health, well-being and economic activity. What began as crisis management for companies has evolved into a focus on the health and safety of employees, customers and communities. Companies have shifted capitalisation strategies to meet immediate business needs, and boards have considered the short- and long-term impacts of the pandemic on business strategy.

COVID-19 presented unique challenges for Vanguard as an investor, a financial market participant and an employer.

Investor. Since the pandemic struck in early 2020, many of our conversations with our portfolio companies have been linked to COVID-19. We have sought to understand how boards are considering strategy and risk management and the implications for stakeholders. We are encouraged to see companies making clear disclosures of their approach to these issues. We have also taken a pragmatic approach to capital allocation proposals given the unprecedented nature of the crisis.

In May 2020, we published *Executive Compensation: In Uncertain Times, Good Judgment Is Critical for Boards*. We emphasised the need for a long-term outlook on executive compensation during times of crisis and outlined our expectations of how boards will seek to manage executive pay plans over the coming year.

For case studies detailing our engagement with our portfolio companies on COVID-19, please see our March 2021 *2020 Investment Stewardship Annual Report*, pp. 11–13, and our September 2020 *2020 Investment Stewardship Annual Report*, pp. 15–16 and 21.

Financial market participant. Vanguard plans for and stress tests a number of contingency events, including pandemics. As a result, we were well-prepared for the COVID-19 crisis and client services continued seamlessly.

The crisis presents stresses for Vanguard financially, operationally and in terms of market volatility. Though the wide-ranging impact of COVID-19 on global economies, health and business operations remains uncertain, we are confident we have sufficient capital to limit any impact on future operations.

Employer. Vanguard constantly focusses on employee well-being. Mental health initiatives, crew engagement programmes and safe return-to-work strategies ensure that safety, culture, conduct, diversity, equity and inclusion remain at the forefront. We have strong governance and risk controls to support us in adapting to altered ways of working.

Industry initiatives

Vanguard participates in a number of industry initiatives related to systemic risks. We have senior-level representation on several committees and working groups in the UK Investment Association ('IA') and membership in the European Fund and Asset Management Association. These industry bodies cover a broad range of capital markets issues that promote liquidity, transparency, investor protection and the development of common standards. Through these organisations, we work with other firms to help ensure that the market functions effectively.

During the year, Vanguard participated in the Asset Management Taskforce and provided input to the underlying Investment Stewardship Working Group. Vanguard's head of Investment Stewardship Europe, the Middle East, Africa and Asia Pacific was appointed to the IA's Stewardship Standing Committee in December 2020.

Our governance principles

Vanguard's investment stewardship approach is framed by four principles of good governance:

Board composition

The foundation of good governance starts with a company's board of directors. Our primary focus is to ensure that the individuals who represent the interests of all shareholders are independent, committed, capable and appropriately experienced. An effective board should be independent and reflect diversity of personal characteristics (such as gender, race and ethnicity) and of skill, experience and opinion. We believe – and research shows – that diverse boards can make better decisions. Diversity can set in motion a virtuous circle that enables a company to innovate, seek out new customers and enter new markets. If a company's board is capable, diverse and experienced, good results are more likely to follow.

Oversight of strategy and risk

Boards are responsible for oversight of a company's long-term strategy and any material risks, including ESG risks. Because it is the job of the board to be highly engaged in this oversight, we look for a constant exchange of information between the board and company management. Vanguard expects directors to be fully knowledgeable about the risks and opportunities that stem from a company's strategy; they can provide valuable counsel to the leaders who are executing it. We look for progress by the board in aligning strong risk oversight and disclosure with long-term shareholder value, as such reporting can lead to a more accurate company valuation.

Executive remuneration

Performance-linked remuneration policies and practices are fundamental drivers of sustainable, long-term value. The board plays a central role in determining appropriate executive pay that incentivises outperformance versus industry peers over the long term and emphasises the importance of incorporating relative performance metrics (particularly relative total shareholder return). Providing effective disclosure of these practices, their alignment with company performance and their outcomes is crucial to giving shareholders confidence in the link between incentives and rewards and the creation of long-term value.

Shareholder rights

Shareholders should have the power to use their voice and vote to ensure the accountability of a company's board and management. We expect companies to adopt governance structures such as annual director elections that require securing a majority of votes to ensure that boards and management serve in the best interest of the shareholders they represent. We view such structures as a safety net to safeguard and support foundational shareholder rights.

Vanguard Investment Stewardship programme

Caretakers of our clients' investments

Vanguard's Investment Stewardship programme is carried out by a dedicated global team of experienced governance professionals. They are responsible for portfolio company engagements and the day-to-day operations of the funds' proxy voting process in relation to Vanguard's internally managed global equity holdings. Investment Stewardship Officer John Galloway, appointed in 2020, leads the team, which as of 31 December 2020 had 35 members.

The Vanguard Investment Stewardship team employs a regionally focussed model. All engagement, company research, analysis and voting activities are overseen in the Americas by the regional head based in the United States and in Europe, the Middle East, Africa and Asia Pacific by the regional head based in the United Kingdom. They maintain responsibility for their respective coverage areas in partnership with a team of analysts who are further aligned by sector. This structure enables the programme to balance the need for global consistency with regional relevance by developing in-depth knowledge on pertinent issues in all of our funds' portfolios, developing contacts in local markets and identifying industry, regional and country-specific trends.

The Investment Stewardship programme also includes three cross-regional groups that support the voting and engagement teams. Our policy and research team drives our global perspectives on key topics and partners with regional teams to shape voting, engagement and advocacy strategies. Our research and communications group publishes the views, policies and thought leadership that demonstrate our focus on long-term value creation and safeguards for shareholders. And our data, operations and control team enables every aspect of our programme's research, analysis and execution as well as risk oversight and the delivery of regulatory filings.

Oversight of investment stewardship

Vanguard plays a role in the proxy voting process with respect to the shares of equity securities held in the portfolios for each UK and Irish-domiciled fund advised by Vanguard. For this purpose, Vanguard has tasked the Investment Stewardship Oversight Committee (the 'Committee') with oversight of the proxy voting and stewardship functions for Vanguard's internally managed equity funds and delegated the day-to-day operations of the funds' proxy voting process to the Investment Stewardship team. The Investment Stewardship team provides periodic updates to the funds' boards.

The Committee is accountable to the relevant boards. It is chaired by Vanguard Chairman and CEO Tim Buckley and comprises Vanguard's most senior leaders of investment management, investment stewardship, global risk, legal, compliance, investment products, finance and communications, including John Galloway as the Investment Stewardship officer and Sean Hagerty as the head of Vanguard's UK and European businesses. The Committee is structured as a multidisciplinary team reflecting diversity of gender, ethnicity, skill and experience to enable better policy, strategy and risk oversight decisions.

The Committee meets at least quarterly and provides ongoing oversight, guidance and strategic vision by approving governance policy to be presented to the relevant boards and advising the Investment Stewardship team on proxy voting decisions for complex, high-impact or controversial issues. More information about Vanguard's Investment Stewardship Oversight Committee can be found in the Oversight of Investment Stewardship section of our *Engagement Policy*.

Building an effective stewardship programme

The foundation of an effective stewardship programme is its people and processes. Vanguard makes investments in these areas each year to appropriately resource the team to properly steward the assets in our care. The team is part of the Office of the General Counsel, independent from our investment management and client businesses.

The wide range of experience and skill sets of our global team brings a breadth of knowledge to our programme. Our Investment Stewardship leadership team and analysts come from diverse backgrounds and provide deep expertise in areas such as credit research, corporate governance policy and structures, research and academia and risk management. We employ a regular rotation of talent and knowledge. Our leadership team has rotated among various positions within Vanguard. For example, our head of Investment Stewardship policy and research was previously the head of credit research in Vanguard's Fixed Income Group, drawing on his investment and research expertise to add new dimensions to the programme.

A number of team members currently hold or are pursuing advanced professional degrees and designations including PhD, JD, MBA, CFA® and CPA. All members are encouraged to be engaged and up-to-date on ESG and corporate governance-related topics. They deepen their expertise through internal and external training, courses, webinars and conferences and by pursuing specific technical certifications, for example, the SASB's Fundamentals of Sustainability Accounting. These unique perspectives collectively enable us to maximise the impact of our advocacy, engagement and voting activities on behalf of the Vanguard funds and their investors.

We use data, technology and prioritisation frameworks to focus our time on the engagement, voting and advocacy activity that will have the greatest impact on long-term shareholder value on a fund-by-fund basis. Investments made to our internal systems over the past year have increased the efficiency in which we engage with companies, monitor progress (if we have expressed concerns) and perform research. These efforts help to ensure that we are having the right conversations with the right companies at the right time. We continually evaluate future investments in additional data capabilities.

In addition to our own internal proprietary databases, we consult a wide variety of third-party research providers, as outlined in **Figure 2:**

Figure 2. Third-party ESG data providers

	Services
Bloomberg	ESG data provision
CDP	ESG data provision
CGLytics	ESG data provision
Equilar	ESG data provision
FactSet	ESG data provision
Glass Lewis	Proxy voting research
Institutional Shareholder Services (ISS)	Proxy voting research, ESG data provision
Sustainability Accounting Standards Board (SASB)	ESG data provision
Sustainalytics	ESG data provision

Vanguard's Investment Stewardship data, operations and control team conducts a robust supplier evaluation process that continues through the life-cycle of the relationship. On an annual basis, each supplier is evaluated for its quality of services, industry reputation, financial stability and data security. We use a framework to monitor key performance indicators and determine the ongoing suitability of relationships. Prospective suppliers are evaluated against existing relationships for fitness and ability to drive value for our programme.

Following our review of suppliers in 2020, we believe that all services have been delivered satisfactorily.

Vanguard's Investment Stewardship team is engaging with an increasingly broader set of companies in markets around the world. We have invested in globalising our approach and moved engagement and proxy voting responsibilities for Europe, the Middle East, Africa and Asia Pacific to our team based in the United Kingdom. To support this increased global coverage, we reevaluated and modified existing processes to better reflect regional nuances in stewardship and expanded by hiring talented individuals with ESG data, risk and governance and regulatory change expertise.

Further details about how we assess the effectiveness of our investment stewardship activities and the improvements we have made to our policies and processes can be found in the Assurance of our Investment Stewardship programme section of this report, on p. 30.

Performance management

Vanguard's global total rewards philosophy is based on the principle that 'crew [Vanguard employees] win when clients win.' It aligns remuneration with our business strategy and the investment experience of fund shareholders. Vanguard Europe's remuneration policy aims to promote sound and effective risk management. It takes into account the risk profile of Vanguard Europe, the long-term interests and strategy of the business and the risks it faces, including sustainability risks. Our remuneration policy does not encourage risk-taking that exceeds Vanguard Europe's tolerated risk and it does not seek to integrate investment stewardship and investment decision-making. For our index funds, companies are included in or excluded from their underlying index as determined by the sponsor of the index, which is independent of Vanguard. For more on this, please see Vanguard's approach to ESG investing, p. 18.

Conflicts of interest

Vanguard has an established Investment Stewardship Conflicts of Interest Policy to manage any actual and potential conflicts of interest relating to our advocacy, engagement or proxy voting activities on behalf of the funds. A summary of this policy can be found in Vanguard's Engagement Policy.

A conflict of interest, either actual or potential, may be present when:

- Vanguard clients are issuers of securities held in Vanguard portfolios or proponents of shareholder resolutions
- Vanguard business partners or third-party vendors are issuers of securities held in Vanguard portfolios or proponents of shareholder resolutions
- Vanguard trustees, employees or former Vanguard executives sit on the boards of public companies held in Vanguard portfolios
- Voting personnel have personal or familial conflicts with issuers of securities
- Any other significant conflicts are brought to Vanguard's attention

The funds' proxy voting guidelines serve as our primary approach to mitigate conflicts of interest. When specific guidelines are not defined for a proposal or additional evaluation of the facts and circumstances is required, the Investment Stewardship team will take a case-by-case approach. We expect the high standards of these guidelines and approach will result in a process that is in the best interest of each fund, consistent with the objective of long-term shareholder value and free from conflicts of interest.

Our Investment Stewardship Conflicts of Interest Policy provides additional measures to mitigate and manage any potential or actual conflicts of interest with respect to the funds' proxy voting. These measures include but are not limited to:

Separation between external client, prospect and vendor relationship roles. We maintain an important separation between the Investment Stewardship team and other groups within Vanguard that are responsible for sales, marketing, client service and vendor/partner relationships.

Conflict reporting and recusal process. All persons involved in the proxy voting and oversight process are subject to Vanguard's Code of Ethics. They are required to disclose potential conflicts of interest involving Vanguard business interests or immediate family employment arrangements that may present the potential for a conflict of interest with Vanguard's business or interests of Vanguard clients. Individual proxy voting analysts must recuse themselves from all voting decisions and engagement activities when a conflict of interest exists. Nonetheless, the Investment Stewardship team will continue to maintain appropriate coverage to engage with portfolio companies and vote shares on behalf of the funds. The Investment Stewardship leadership team regularly receives a report of self-disclosed potential conflicts for each team member. Any violation of the conflicts policy, such as nonrecusal of a vote in which a conflict of interest exists, is reported to the Investment Stewardship Oversight Committee.

Refraining from voting. In certain circumstances, Vanguard may refrain from voting shares of a company when voting would present a potential conflict of interest. Situations may also arise in which we engage an independent third-party fiduciary to vote proxies as a further safeguard to avoid potential conflicts of interest or as otherwise required by applicable law. As a result of our current mitigation measures, we have never determined a need to refrain from voting or engage a third-party fiduciary to vote our proxies.

Voting shares of other Vanguard funds. Certain Vanguard funds (owner funds) may, from time to time, own shares of other Vanguard funds (underlying funds). If an underlying fund submits a matter to a vote of its shareholders, votes for and against such matters on behalf of the owner funds will be dealt with in accordance with local applicable regulations.

Vanguard manages potential conflicts between funds or with other types of accounts through its allocation policies and procedures, internal trading review processes, compliance department trading oversight and oversight by directors, auditors and regulators. We operate under a Code of Ethics that sets forth fiduciary standards that apply to all personnel, incorporates an insider trading policy and governs outside employment and receipt of gifts. Employees receive training to ensure that they will recognise the issues they need to be aware of and identity any conflict at an early stage.

Vanguard's approach to ESG investing

Vanguard's long-term perspective and disciplined approach to investing puts our focus squarely on clients' interests and the sustainable, long-term value of their investments. ESG-related factors can influence the success of a company over decades.

Core to Vanguard's mission – to give our investors their best chance for investment success – is our fiduciary duty to maximise our shareholders' long-term returns, and addressing ESG matters are integral to that duty. We approach ESG risks in three ways: investment stewardship, the design of the funds we bring to market and the integration of ESG assessments in our investment processes.

Investment stewardship and our global equity index funds

Vanguard's Investment Stewardship team operates at the intersection of corporate governance, environmental risk and social risk, working to promote and safeguard long-term shareholder value in boardrooms around the world. Our equity index funds are structurally long-term, practically permanent owners of the companies in which they invest. They have a primary objective of tracking the performance of a stated index that is constructed without consideration of ESG criteria.

Vanguard's investment stewardship activities help to drive better long-term outcomes in our equity index funds. They are the principal ways in which we apply ESG oversight to the funds' portfolio companies to safeguard our clients' investments and to help build long-term value. We steward the equity index holdings in three ways:

Proxy voting. Our team votes proxies at public company shareholder meetings on behalf of our internally managed equity funds.

Engagement. We conduct ongoing dialogue with company directors and executives to share our long-term orientation and principled approach and to understand a company's governance practices and strategy.

Public advocacy. We are tireless advocates for the highest standards and market-wide adoption of governance best practices that support the sustainable, long-term value of our shareholders' investments.

Our investment stewardship activities encourage boards to properly oversee material risks including environmental and social risks and enable investors to accurately price them. Vanguard expects companies to disclose significant risks to shareholders, explain why those risks are material to their business and disclose their approach to risk oversight and mitigation.

Investment stewardship, however, is not used as an active input to inform trade-related decisions for our equity index funds. Companies are included in or excluded from their underlying index as determined by the sponsor of the index, which is independent of Vanguard.

Products designed to avoid specific ESG risks

Vanguard takes a thoughtful and deliberate approach to developing new products, including ESG products. Investors should be able to express their investment preferences without jeopardising their ability to meet their long-term financial objectives.

Our ESG funds primarily employ an index investing approach using an exclusionary (or negatively screened) investing strategy. They exclude securities with poor ESG characteristics from their investment universe based on pre-determined ESG screening criteria. The resulting products are broadly diversified, market-capitalisation-weighted and low-cost, enabling individuals to use them as portfolio building blocks. While we expect these products' performance to differ (positively or negatively) from that of the broad market over the short term, we do not expect it to differ meaningfully over the long term.

As a demonstration of this approach, in June 2020, Vanguard expanded its range of funds for UK investors who wish to avoid exposure to companies and industries associated with certain ESG risks and launched the **Vanguard ESG Developed World All Cap Equity Index (UK)**. This fund excludes companies that fail to meet ESG standards established by an independent index sponsor, including but not limited to fossil fuel companies, producers of weapons and the tobacco industry.

Vanguard is committed to ensuring our products meet the long-term needs of our investors. We will continue to assess developments in ESG investing and throughout the industry and expect our product line-up will continue to evolve.

ESG integration in our fixed income investment process

Vanguard's Fixed Income Group integrates ESG into its investment process by quantifying the financial materiality of ESG risk and assessing whether a security's current valuation properly reflects that risk. ESG risk is one of the core elements comprising the bottom-up fundamental view of a credit instrument. Each investment under consideration is assigned an ESG risk rating based on the credit research team's assessment of the probability of an ESG event and the potential magnitude of its impact on the issue's credit profile. Our credit analysts then combine that assessment with a risk-adjusted relative value opinion to arrive at a recommendation of whether to buy or sell a particular security. As an example:

> *Vanguard fixed income credit analysts assessed an American bank that was under investigation for potential corruption charges and determined the ESG risks to be high. Fines could have been material and concerns were raised about management's financial controls and adherence to regulatory requirements. The credit analysts increased the security's ESG risk rating and event risk probability and determined that credit spread levels did not fairly compensate investors for the identified risks. The position in the security was reduced.*

While this process applies directly to the active fixed income funds that Vanguard manages, it also affects our fixed income index portfolios. Rather than purchasing every bond in an index, our index portfolio managers use a sampling approach that leverages the expertise of credit research, including valuations affected by ESG factors, to optimise security selection.

How we engage

Engaging on behalf of equity holdings

Engagement with portfolio company management and boards is the foundation of Vanguard's Investment Stewardship programme.

Through our engagements, we want to understand how companies govern their long-term strategy and set themselves up to stay relevant today, tomorrow and well into the future, but we do not seek to dictate strategy or operations. To help guide company leaders with the type of information we look for during our engagements and provide an outline of our approach, we published *Engaging With Vanguard: A Guide for Company Boards and Management Teams*.

We orient engagements around our principles of good corporate governance: a well-composed, diverse board that is capable of overseeing strategy, governing risk, setting appropriate performance-linked remuneration and embracing policies that give a voice and a vote to shareholders. We prioritise matters that pose a risk to long-term shareholder value.

Our Investment Stewardship team conducts significant research and analysis to prepare for our discussions with company leaders and board members. We have published *Common Questions for Portfolio Companies*, a list of the types of questions we use to learn more about governance perspectives and practices. Although such discussions can vary widely by company, sector and region, our engagements tend to fall into three broad categories:

Strategic engagements. These are meetings in which we learn about a company's long-term strategy. They enable us to understand the board's approach to overseeing and aligning governance practices with the company's long-term goals.

Event-driven engagements. These focus on specific ballot items – often contentious – or a leadership change or company crisis. In instances such as a proxy contest we want to hear all relevant perspectives before our funds vote.

Topic-driven engagements. These are held to discuss matters that we believe can materially affect a company's long-term value. They are usually conducted with companies that have a record of underperformance or gaps in corporate governance practices or that we have identified as being subject to a material risk.

For each engagement, we develop specific objectives based on the individual circumstances of the company. These may focus on areas such as:

- Gaining a better understanding of a company's governance processes and structures
- Gaining more information to execute a vote at a general meeting
- Providing feedback on governance processes and structure
- Encouraging the company to adopt best practices in governance processes, structures or disclosures

Our teams of analysts review a company's progress against these objectives and may revisit them as necessary. Often, an engagement on a single objective can span more than one year, depending on the complexity of the issue. We track our activity and progress in a proprietary database and may set milestones and timelines. If a particular action is requested and the company commits to changing a practice or policy, we will monitor its progress.

We look for progress if we have expressed concerns about a specific governance matter. Our escalation framework enables adequate flexibility to take actions relevant for each specific situation, including direct company engagement, letters to company directors and voting against the reelection of relevant directors or other items. Continued failure to respond to material risks or poor governance practices may result in escalation of the matter to our Investment Stewardship Oversight Committee and the fund's board of trustees.

More information about how the Investment Stewardship team engages with portfolio companies can be found in Vanguard's Engagement Policy.

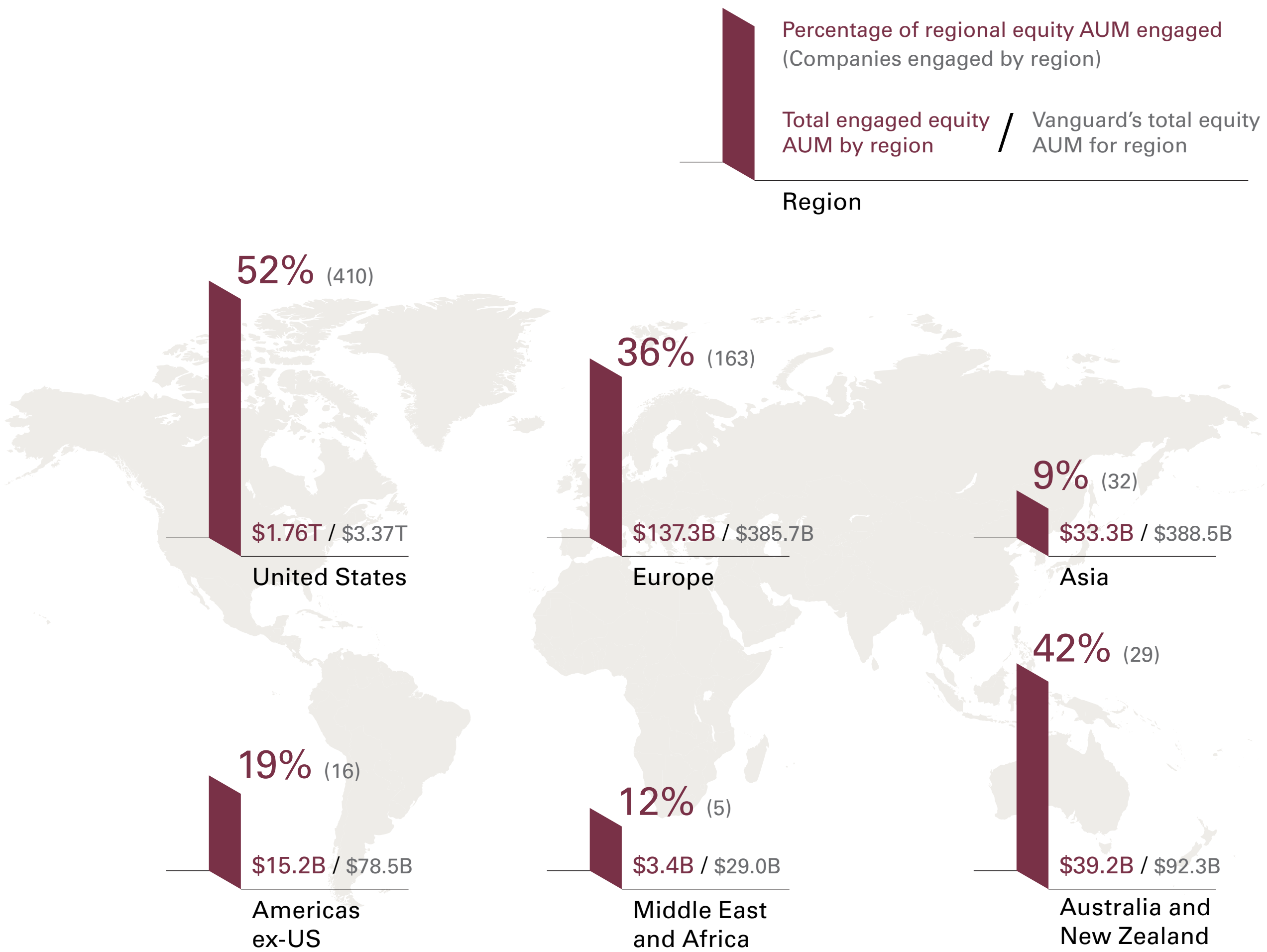
Engagements at a glance

As a global asset manager, we recognise the benefits of more regular disclosure of our investment stewardship activities. Our *Investment Stewardship Annual Report* outlines our global engagement, advocacy and proxy voting activities for investors in the Vanguard funds, portfolio companies and other stakeholders.

For the proxy year ending 30 June 2020, we published a *2020 Investment Stewardship Annual Report* in September 2020. Beginning in 2021, we transitioned to a year-end reporting period. In March 2021, we published a second *2020 Investment Stewardship Annual Report*, which covers the period 1 January 2020 to 31 December 2020.

The detailed engagement case studies included in the annual report represent a wide range of governance topics, regions and sectors and demonstrate the outcomes of our engagements – both successes and cases with room for improvement. In 2020, we engaged with 655 companies. A breakdown of our regional engagements is shown in **Figure 3**.

Figure 3. 2020 regional engagement breakdowns



Source: Vanguard, as at 31 December 2020.

Engagement case studies

The case studies below highlight some examples of our engagements with portfolio companies on behalf of the Vanguard equity funds held in 2020. Additional case studies for this reporting period can be found in the March 2021 *2020 Annual Investment Stewardship Report* and the September 2020 *2020 Investment Stewardship Annual Report*.

Concerns raised about CEO payout at Ocado

In 2019, the CEO of Ocado, a British online supermarket, received a total pay packet of £58.7 million. Of the payout, £54 million was attributed to the company's Growth Incentive Plan (GIP), which was put in place in 2014 as a one-off award atop its existing pay structures. Shareholders approved the GIP in 2014 despite opposition by 26% of the votes, including Vanguard's. Vanguard funds had voted against the plan because of the lack of a compelling rationale and our concerns that the total potential payout did not align with the best interests of long-term investors.

In 2019, we engaged with Ocado twice regarding its remuneration policy to encourage the company to make improvements to address shareholder concerns about pay outcomes.

In 2020, our concerns about the GIP came to fruition. Although Ocado performed well over the period, we did not support the award given our concerns about its structure and the total payout. Vanguard funds voted against the remuneration report at the company's annual meeting, and we contacted Ocado to explain the funds' votes.[2]

Teleperformance under scrutiny regarding workforce conditions

Following media and trade union allegations that Teleperformance, a French technology and customer service outsourcing company, was not providing appropriate COVID-19 safeguards to employees, we engaged with its chief financial officer and lead independent director to explore this topic.

We raised concerns about the work practices and health and safety arrangements put in place for the workforce in response to the pandemic and employees' ability to safely escalate issues. The leaders expressed that the board had been quick to react to the COVID-19 crisis and that safety guidelines had been issued for all employees. In addition, they told us that all incidents of COVID-19 at Teleperformance had been disclosed and that clear guidelines were in place about working from home and international travel. Despite this, they noted there had been some COVID-related casualties.

We highlighted the importance of companies addressing health and safety concerns through effective management and board oversight and that failing to do so could significantly hurt the business's long-term success. We told the company that shareholders look for companies to provide timely disclosure about risk oversight and management, especially in times of crisis.

Overall, we concluded that Teleperformance did not clearly articulate the systems and processes in place to help ensure that risks, especially pandemic-related ones, were elevated to board level.[3]

To advance our Investment Stewardship programme in 2020, we increased our focus on thematic engagements, specifically on climate risk and on diversity, equity and inclusion. We have begun targeting companies to engage with on these topics based on third-party data and our own research. For example, in the second half of 2020, analysts in our London-based office held engagements with board chairs and senior leaders at four major Australian banks, discussing a range of topics with a focus on climate-related disclosures and initiatives.[4]

We also published several Insights papers on climate risk (*How Vanguard Addresses Climate Risk*, *Why Climate Change Matters to Long-Term Investors*, *Climate Risk Governance* and *Votes on Selected Climate-Related Shareholder Proposals*) and board and workforce diversity, which set out our expectations for portfolio companies. We will be focusing on engaging with targeted companies on these topics throughout 2021 and will communicate our progress.

2 This case study was originally published in our September 2020 *2020 Investment Stewardship Annual Report*, p. 32.
3 This case study was originally published in our September 2020 *2020 Investment Stewardship Annual Report*, p. 21.
4 This case study was originally published in our March 2021 *2020 Investment Stewardship Annual Report*, p. 16.

While we are encouraged by the positive dialogue that we have had with company executives and their boards this past year, we recognise that opportunities still exist. We may adjust our engagement priorities as governance standards and market practices evolve. In the coming years, we will focus on enhancing our policies and engagement priorities in each region and increasing our disclosure on how we monitor progress and address responsiveness to change in order to reach the best possible outcome for shareholders. We will also continue to enhance our proprietary database to most efficiently capture a company's progress, help set objectives and drive long-term value for our shareholders.

Engaging on behalf of fixed income funds

Direct company engagements are one of the ways Vanguard integrates ESG risk into the investment process for its fixed income funds. Our credit research analysts regularly speak with company management teams to discuss a range of issues that might pose a financial or reputational risk, including ESG risk. Through these engagements, we seek to drive improved disclosure and reporting from the companies we invest in. The case studies below provide examples:

Anti-money-laundering scandals at Nordic banks

Over the past few years, our credit research analysts have been closely monitoring the developments of an anti-money-laundering (AML) scandal that unfolded in the Nordic banks sector. Because of poor information and a lack of visibility into this matter, it was impossible to distinguish banks with substandard AML practices from those that have been systemically involved in heavy money laundering of their clients' assets.

In every direct and group engagement with the issuers, we called for better disclosures in areas such as AML frameworks, the proportion of suspicious client flows involved and share of resident versus nonresident depositors.

As a result of the feedback received from Vanguard and other institutional investors, the banks involved in the scandal started offering useful disclosures that helped us asses the degree of this governance risk. For example, the Swedish bank Skandinaviska Enskilda Banken AB released detailed data of historical nonresident flows in its Estonian operations, enabling us to assess the severity of its conduct issues versus that of peer companies Swedbank and Danske.

Throughout the past year, banks have been more proactive in response to investor concerns about AML issues, and we have seen greater transparency and disclosure on the topic.

Decarbonisation and coal decommissioning at Energias de Portugal S.A.

We have conducted regular engagements over the years with the Portuguese utility company Energias de Portugal S.A. Our focus has been on the potential economic impact of continuing to run its coal capacity in the face of increased regulation and low power prices. We were pleased to learn of the company's decarbonisation and coal decommissioning plans in both Spain and Portugal announced last year.

Joint engagements with Vanguard's credit research team when common or complimentary areas of enquiry have been identified are a growing focus of our programme. We believe such discussions can increase our understanding of and impact on ESG investment issues.

Collaborative engagement

In addition to our company engagements, we also support governance-focused organisations, speak at conferences, publicly champion governance codes and standards and share our perspectives through the media and our published materials. As an investor in more than 13,000 companies worldwide, we aim to communicate our views on governance matters as widely as possible to portfolio companies, clients, policymakers, industry groups and academics.

We engage with regulators and policymakers and are also involved with several organisations and initiatives to create and advocate for enhanced industry standards for corporate governance, company disclosure practices and stewardship. For example, Vanguard is a member of the Sustainability Accounting Standards Board's Investor Advisory Group and the Advisory Group for the Infrastructure sector.

While we may engage in collaborative engagements with other investors on thematic issues, we have not undertaken specific activity with individual portfolio companies on this in 2020. **Figure 4** shows the collaborative initiatives in which we take part.

Figure 4 . Collaborative initiatives

Initiative/ organisation	Year joined	Description	Involvement
CECP's Strategic Investor Initiative	2013	An initiative that encourages companies to share their long-term strategic stories and focus more of their disclosure and reporting on sustainable long-term value creation.	**Member.** Former Vanguard CEO Bill McNabb and Glenn Booraem, principal, currently sit on the advisory board.
UN Principles for Responsible Investment (PRI)	2014	An organisation that encourages investors to use responsible investment to enhance returns and better manage risks. The PRI promotes six voluntary principles designed to support long-term investment value and a more sustainable global financial system. It also offers guidance to firms about how to incorporate ESG objectives.	**Signatory.** Vanguard is committed to adopting and implementing the six principles and reporting our progress in an annual transparency report.
Commonsense Corporate Governance Principles	2016	A set of principles endorsed as a basic governance framework for public companies, their boards and their shareholders.	**Founding signatory.** Former Vanguard CEO Bill McNabb participated in preparing this position paper.
Sustainability Accounting Standards Board (SASB)	2016	A nonprofit organisation established to develop and disseminate cost-effective sustainability reporting standards to facilitate communication by companies to investors of decision-useful information on sustainability matters.	**Member.** Vanguard serves on the Investor Advisory Group and is a member of the Standards Advisory Group for the Infrastructure sector.

Figure 4 . Collaborative initiatives (continued)

Initiative/ organisation	Year joined	Description	Involvement
Investor Stewardship Group	2017	The group established a framework of basic investment stewardship and corporate governance principles in the US.	**Founding signatory.** Vanguard representatives serve on the board of directors, nominating committee, Governance Advisory Council and Marketing and Communications Advisory Council.
30% Club	2017	A global organisation that advocates for greater representation of women in boardrooms and leadership roles.	**Member.** A Vanguard representative sits on the US Steering Committee.
Council of Institutional Investors	2017	A nonprofit, nonpartisan association of corporate, public and union employee benefit funds and endowments with a mission to be the leading voice for effective corporate governance practices for US companies and strong shareowner rights and protections.	**Member.**
Task Force on Climate-related Financial Disclosures (TCFD)	2017	An organisation that developed guidelines for voluntary climate-centred financial disclosures for all industries.	Vanguard publicly supports the TCFD and encourages portfolio companies to disclose climate-related risks in line with the framework.
CDP	2018	A not-for-profit charity that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts.	**Signatory.** CDP Climate Change, CDP Forests and CDP Water
International Corporate Governance Network	2019	An investor-led organisation with a mission to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies worldwide.	**Member.**
Business Roundtable's *Statement on the Purpose of a Corporation*	2019	A statement signed by more than 100 CEOs who committed to lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders.	**Signatory.**
The *Energy Transition and Care for Our Common Home* statement on climate risk	2019	The Vatican's participant statement on climate risk disclosures, which calls on companies to be transparent about climate-related matters and disclose them to investors.	**Signatory.** Vanguard participated in an executive-level, cross-industry dialogue about the potential long-term financial impacts of climate change and energy transition.

Proxy voting

Our approach to proxy voting

One of the most visible signs of Vanguard's engaged ownership is our funds' proxy voting at company shareholder meetings. We vote on a fund-by-fund basis in the best interest of each individual, internally managed Vanguard fund, based on our research and analysis and consistent with our published voting guidelines. The guidelines frame the analysis of each proxy proposal, providing a basis for decision-making, and stress Vanguard's role as a fiduciary acting in the long-term interests of our investors, responsible for evaluating each proposal based on its merits and the facts and circumstances presented.

Vanguard's proxy voting procedures and guidelines are designed and executed to achieve the sole overriding objective of maximising the value of shareholder interests in each fund over the long term. The trustees of the fund boards periodically review and approve each fund's proxy voting guidelines so that they incorporate current governance standards and address relevant risks to long-term shareholder value. More information about our approach to proxy voting (on behalf of our internally managed equity holdings) and governance around the globe can be found in the Proxy Voting section of our Engagement Policy.

We make every attempt to vote at all meetings at which the Vanguard funds are eligible to vote. For the year ended 31 December 2020, the funds voted at more than 99% of eligible meetings. They may not vote certain holdings for several reasons, including blocked shares, late ballots or materials, cost constraints or other administrative impediments.

In a review of our policies and procedures, we determined that implementation of formalised policies in priority markets would be valuable as the programme globalises. In addition to policies for the US, we published our proxy voting policy for UK and European portfolio companies and are working to formalise voting policies for additional markets in the Americas and Asia Pacific.

Proxy voting responsibilities for Vanguard's externally managed active funds are performed by those funds' external advisors, which each have their own policies and guidelines designed to ensure they vote consistently with their fiduciary obligations. The external managers are carefully selected to ensure their investment principles and processes align with the best interests of the Vanguard funds they manage. The funds hold them to high standards of management and compliance and are confident in their ability.

Security lending

The funds are permitted to engage in securities lending activity. Lent securities may be recalled for voting purposes. The Vanguard Investment Stewardship team monitors securities on loan and evaluates any circumstances that may require us to restrict and/or recall the stock. Please refer to the Securities Lending section of our Engagement Policy for more information.

Proxy adviser and research usage

Vanguard consults a wide variety of third-party research providers – including proxy advisers – to analyse issues that bear on long term shareholder value. We consider the analysis in conjunction with the funds' proxy voting guidelines and other relevant data, including insights from company engagements, to reach independent decisions on behalf of each Vanguard fund. Data from proxy advisers serve as one of many inputs into our research process.

Proxy voting disclosure

We disclose the proxy voting records for Vanguard's global fund lineup through an online tool on Vanguard's Investment Stewardship website. The tool provides details of the proxy votes cast by a fund from the most recent proxy year and can be found here.

Vanguard regularly discloses a global summary of proxy votes cast by the funds each year in its annual report. **Figure 5** summarises our voting trends for the last three years.

We publish *Investment Stewardship Insights* to share our perspectives on important votes ahead of the publication of our annual and biannual reports. For example, in 2020, we published *Support For an Independent Chair at Boeing* to convey our funds' vote rationale and *Insights: Votes on Key Climate-Related Shareholder Proposals* to discuss how and why Vanguard funds voted on important climate proposals during the 2020 proxy season. Our *2020 Investment Stewardship Annual Reports* published September 2020 and March 2021 provide examples of the outcomes of resolutions that we have voted on in select case studies.

We also disclose votes that we consider to be significant, along with an explanation of our vote, to fulfill the requirements of the Shareholder Rights Directive II. Our significant vote disclosure and rationale can be found here.

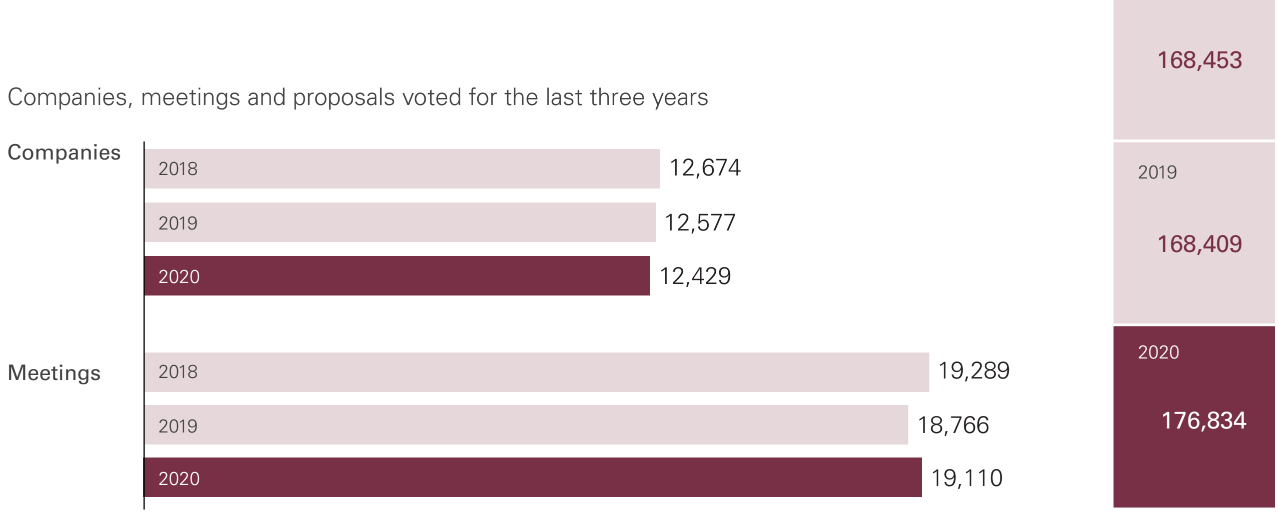
We monitor our shares and voting rights through our data, operations and control team and use proprietary systems to manage this process.

Fixed income

For our fixed income assets, we exercise our rights and responsibilities as an investor in several ways. Earlier in the report we described our approach to fixed income ESG research (Vanguard's approach to ESG investing, p. 18) and engagement activity (How we engage, p. 20).

We regularly review prospectuses and transaction documents. If features in the documents raise concerns, we may address them with the issuer or choose to not purchase a security. Currently, we do not seek amendments to terms and conditions in indentures or contracts, as the terms are generally standardised. However, we may examine consent solicitation when there are material changes that would form part of our regular investment process. We also do not seek access to information provided in trust deeds. Although trust deeds are a common form of documentation for the investment-grade bonds Vanguard purchases, if additional information is required, we engage directly with management.

Figure 5 . Our voting trends



Source: Vanguard.

Communicating our stewardship activities

Communicating to our clients

Our Investment Stewardship website is the primary source for information about our programme. We publish comprehensive communication pieces about our advocacy, engagement and voting activities on behalf of our funds in the form of reports, commentaries and research briefs. We are committed to providing materials that are clear and informative. A few examples include:

Investment Stewardship Annual Report. This report outlines our global investment stewardship efforts and outcomes for the calendar year. It includes summaries of key governance developments by region, engagement case studies, a comprehensive list of each company engaged, our voting rationale and aggregate regional voting outcomes.

Investment Stewardship Semi-Annual Report. This report provides a midyear update on investment stewardship voting and engagement activities.

What we do. How we do it. Why it matters. This paper is designed to give investors insights into our programme, its evolution and what lies ahead.

Vanguard Investment Stewardship Insights. We began publishing Insights papers in 2020 to better define Vanguard's perspectives on important governance matters and key votes.

Principles and policies. We provide details about our principles-based approach to effective corporate governance, our responsible investment policy and our market-specific proxy voting guidelines.

Our communication pieces are developed for Vanguard investors and clients, public companies and the market more broadly. The reports listed above and other publications can be found here.

Steps toward greater disclosure and education

We continue to identify opportunities to improve disclosure and increase transparency into our stewardship programme.

In the September 2020 *2020 Investment Stewardship Annual Report*, for the first time, Vanguard included the names of companies that had previously been anonymised in the engagement case studies. The report is intended to be fair, factual and respectful. It also included a new section on key votes that provides rationales for selected proxy votes at companies in which Vanguard holds a meaningful ownership position or to which we conveyed our perspective on an important governance topic elevated during the proxy season or communicated our view of progress – or lack of it – by a company and its board. Our online fund proxy voting records are now available in a new, more interactive format—a change in response to client feedback asking for improved usability. Additionally, the proxy voting records previously published each August for the prior proxy year are now reported on a quarterly basis.

Our Investment Stewardship team has been playing a greater role in helping to educate our internal business partners on ESG topics. We have held several knowledge-sharing sessions with the teams that support Vanguard's individual investors and financial intermediaries. The sessions are designed to be informative, interactive, two-way dialogues. We use our expertise to develop client-facing teams' acumen about our programme, our approach to ESG and relevant ESG topics. In turn, we learn about the governance topics and questions that are top-of-mind for our clients. As an example, we received feedback about a perceived lack of ESG content and infrequent publications. We responded by creating the Insights publications described above. In the year ahead, we will produce more frequent Insights in addition to our regular biannual investment stewardship reports.

We also have a strong commitment to support investment adviser education through our regular webinar series and will be building on this activity throughout 2021. We will encourage open dialogue with our advisers to gain insights on what is important to them and their clients.

Evaluation of our programme

Because our client base is primarily direct and intermediated retail, we face challenges in collecting feedback. Investments are made through our direct retail platform, third-party platforms or our transfer agency service – not through a client mandate. Unlike professional asset owners such as pension schemes, our retail client base does not generally have investment or stewardship policies that we are asked to implement and align to, nor does it have established views on stewardship or directed voting requirements. For those reasons, we have chosen to focus on three areas:

- A clear strategy that supports our fiduciary responsibility to all investors
- A communications programme that delivers timely and insightful information to allow investors to assess our programme
- Increased educational support to our internal business partners on ESG-related matters

We recognise the need to continuously evolve as regulator, client and stakeholder needs change. What remains constant is our commitment to safeguard our clients' investments and help build long-term value. Anecdotal feedback on our communication strategy in 2020 suggests that the addition of named case studies, vote-related Insights and greater disclosure about policy priorities were valued additions. We will continue to assess our approach to communicating our activities and impact to our investors and evaluate appropriate mechanisms for incorporating 'voice of client' into our programme.

Assurance of our Investment Stewardship programme

The Investment Stewardship Oversight Committee has oversight of the proxy voting and stewardship functions for Vanguard's internally managed equity funds and reviews the team's practices and proxy voting policies. The review includes areas such as changes to proxy voting policies, proxy season engagement and voting activities, content published on the Investment Stewardship website and risk control processes.

In 2020, the committee approved changes to the US proxy voting summary policy that included modifications to the assessments of key committee independence at controlled companies and director accountability in compensation-related situations. It also approved changes to the EU voting policy that reflected the evolution of our approach in the UK and Europe. The committee additionally commented on our global policies for director accountability votes for directors who have failed to effectively identify, monitor and manage risks and business practices related to board diversity and environmental risk, including climate. These risk-related topics are important for our UK and European proxy voting policy.

The committee receives regular updates from the Investment Stewardship team throughout the year. Members of the leadership team attend several meetings and provide a progress report on key initiatives, updates on current and future policy work, engagement strategy and global thematic trends. This partnership facilitates constructive dialogues to guide the direction of our stewardship programme.

As part of our current governance framework, we employ several control reports that ensure our voting and company engagements are aligned with internal policies. These reports along with all documented policies and procedures are reviewed on a regular basis by a dedicated team resource.

Our Investment Stewardship programme is subject to internal independent assurances conducted by Vanguard's Internal Audit department. Internal Audit's scope encompasses but is not limited to the monitoring and evaluation of the adequacy and effectiveness of the organisation's governance, risk management and internal controls. The audit plan is developed using a risk-based methodology. Summaries of audit results are shared with Vanguard's group and subsidiary audit committees, leadership team and senior stakeholders on a periodic basis. The Global Investment Stewardship programme (located in both the US and the UK) was last audited in December 2019. The scope included an evaluation of the programme's design and operating effectiveness, specifically covering proxy voting reporting, proxy voting, company engagement and advocacy work. The audit identified some areas for improvement, which have been fully addressed and implemented. Examples include:

- Enhanced dashboard reporting to provide greater insights into global voting and engagement activities
- Enhanced control reports to help identify when vote rationale has not been captured or votes are intentionally not voted and to verify that vote instructions are in accordance with a fund's voting guidelines
- A more rigorous vendor review process and oversight controls in accordance with corporate policies

Currently, external assurances are not used to evaluate our Investment Stewardship programme. We will continue to assess the most appropriate method for ensuring the effectiveness of activities on behalf of the funds' shareholders. Vanguard's internal audit discipline is well-established and provides an ongoing partnership for continuous improvement and programme assurance.

We also take a deliberate approach to ensure that our stewardship reporting is fair, balanced and understandable. Each publication we put into the market, including company engagement case studies and Voting Insights, goes through a thorough review process completed by the Investment Stewardship leadership team and lead analysts, Vanguard's Legal and Compliance teams and, if warranted, executive leaders. Our comprehensive review ensures that the reporting is fair, factual and respectful. When we publish company engagement case studies, we select examples balanced among different sectors and regions and based on a wide range of topics, challenges and successes.

We strive to continuously improve ourselves, our processes and our tools so we can maximise long-term value creation by each company in our funds' portfolios.

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