CORPORATE GOVERNANCE
Proxy Voting and Engagement Report 2018

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For Qualified Investors (Art. 10 Para. 3 of the Swiss Federal Collective Investment Schemes Act (CISA)). For Institutional Investors.
Active Ownership is Part of Our Fiduciary Duty

At DWS, we act as a trusting partner for our clients when protecting their investments and perceive corporate boards as our partners who cautiously supervise the companies in which we are invested.

We have an ongoing active ownership approach, whereby we continuously focus throughout the year on the different aspects of our corporate governance activities in a centralized manner via our dedicated Corporate Governance Center, supported by our investment teams. This ongoing process involves the corporate governance due diligence of investees as well as governance engagement activities. These are then followed by voting at shareholder meetings, participating actively in the relevant governance working groups, updating the Corporate Governance Policy and Proxy Voting Focus List and ensuring that these activities are made transparent via our reporting practices and on our website.

1 The Proxy Voting Focus List represents a list of the most relevant equities held by our funds domiciled in Europe and Japan, screened regularly in terms of their weighting measured by market capitalization, the amount of assets they have under management and several Environmental, Social and Governance ("ESG") criteria.
We continued our efforts in active ownership and built on our existing expertise and thought leadership by participating in various industry initiatives but also dynamic discussions with investee companies. Since our last report, there has been significant transition in the views of policy makers around the world regarding the role of sustainable and responsible investment in the capital markets. Part of this included increased focus on the role of asset managers and the definition of their fiduciary duties, which is not only centered around attractive long-term financial outcomes for their clients but also their influence and impact on societal and environmental aspects.

Adjustments to the guidelines applicable for funds in Europe and Japan

As in past years, we have reviewed our Corporate Governance and Proxy Voting Policy to ensure that our corporate governance expectations reflect relevant regulatory changes and remain robust against market standards in 2018 (more details on our policy on dws.com).

The relevant adjustments include:

- A more detailed description of our core values for good governance, approach on governance engagements as well as proxy voting framework.
- More rigorous executive remuneration guidelines with specific requirements for bonus malus and clawback mechanisms.
- More detailed and explicit guidelines on Environmental, Social and Governance ("ESG") related shareholder proposals.

We also introduced our country-specific guidelines for Japan. We acknowledge what has been achieved in the last couple of years in the corporate governance developments in Japan and support the progress, which has been made in that regard, in particular with the introduction of the Corporate Governance and Stewardship codes.

Adjustments to the guidelines applicable for funds in the United States

In 2018 we have continued reviewing and enhancing the relevant areas in the Proxy Voting Guidelines applicable to the US funds (more details on the guidelines on dws.com).

The relevant adjustments include:

- Introduction of additional factors to be considered when electing directors:
  - Accountability to shareholders and transparency of governance practices.
  - Responsiveness to investor input and shareholder vote.
  - Composition of the board with directors adding value through skills, expertise and time commitment.
  - Independence from management.
- General support for proposals that require a company to appoint a chairperson who is an independent director.
- Enhanced guidelines on ESG-related shareholder proposals.

In particular when it comes to companies based in the US or Canada, shareholder proposals play an important role and represent a powerful tool for shareholders to express their suggestions for the company.

For us, active ownership has long been an integral part of our investment processes based on more than 25 years of experience in corporate governance activities.
In 2018, we have continued working towards enhancing all aspects of our processes and capability with the purpose of covering important general meetings with our proxy voting activities as well as general meeting attendance. Proxy voting activities go beyond our fiduciary duties to exercise our voting rights and play an important role in our engagement approach.

The legal entities of DWS\(^1\) in Europe and Japan exercise the voting rights arising from their portfolios according to a stringent and transparent process that aims to protect and further the interests of their client investors. The process focuses on a quality-based approach versus quantity of votes. The voting decisions follow the proprietary policy of the legal entity, a thorough analysis by the members of the Corporate Governance Center and discussions with the investment professionals.

In the US, due to local regulations, we strive to exercise all of our equity holdings’ voting rights to the extent that other local market restrictions do not restrict it. The policy and guidelines for our funds domiciled in the United States are overseen by the Global Proxy Voting Sub-Committee (GPVSC). The Guidelines set forth the GPVSC’s standard voting positions on a comprehensive list of common proxy voting matters.

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### DWS GROUP ASSETS UNDER MANAGEMENT ("AuM") SPLIT BY ASSET CLASS AND VOTED EQUITY ASSETS GLOBALLY

- Alternatives: 12%
- Passive: 27%
- Active Multi-Asset: 7%
- Cash: 5%
- Active Fixed Income: 54%
- Active Equity: 12%
- Active SQI: 9%

662 bn €

76% of equity AuM voted globally (per Dec. 2018)

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### 2018 Proxy Voting Activities at a Glance

- **Meetings voted in 2018:** 12,452
- **Increase to 2017:** +64%
- **Meetings voted in 2017:** 7,192
- **71%** of equity AuM voted for funds domiciled in Europe and Japan
- **93%** support for climate-related resolutions
- **23%** were voted with an “Against”/”Withhold”
- **28%** were voted with an “Against”
- **19%** were voted with an “Against”/”Withhold”
- **27%** were voted with an “Against”
- **10%** were voted with an “Against”/”Withhold”
- #1 highest support of climate-related resolutions amongst major asset managers in the US for past 6 years (according to Ceres)
- **97%** support for climate-related resolutions

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\(^1\) The representative voting rights are exercised by their respective capital management company, i.e., either by representatives of the DWS Investment GmbH, DWS Investment S.A., DWS International GmbH or by the representatives of the DWS S.G.I.I.C., S.A., Deutsche Asset Management (Japan) Limited.
In 2018, we voted at a total of 1245 meetings in 46 markets of listing, which represented an increase of 64% in the meetings voted compared to last year. We continued to gradually increase the number of meetings voted per year, making sure not to compromise on the quality of the analysis.

These meetings represented approximately 71% of the equity assets under management of our funds domiciled in Europe and Japan. The majority of the voted meetings was for companies listed in the United States and Germany, followed by Japan and other Asia-Pacific countries.

MEETINGS VOTED PER MARKET

MEETINGS VOTED

BREAKDOWN OF VOTES "AGAINST" MANAGEMENT RECOMMENDATION VOTES „FOR” OR „AGAINST” MANAGEMENT

We voted “Against” management recommendations in 24% of the total number of items voted in 2018, out of which 19% were “Against”/”Withhold” and 5% “Abstain”. The proposals we most commonly opposed were director-related and particularly related to the election/re-election or discharge of directors (54%).
When evaluating the discharge of non-executive directors of our investees, we paid particular attention to:

- the general governance practices of the company
- the functioning of the board
- the level of transparency on the individual directors
- the board’s oversight of relevant and material ESG risks.

The most common reasons for opposing the discharge of non-executive members of the boards were due to:

- insufficient transparency on individual directors, in particular the lack of adequate disclosure around the individual board members such as their attendance of board meetings or number of external board seats
- no regular (at least every four years) vote on the executive remuneration, in particular when there are changes to the plan
- failure to address existing ESG controversies appropriately and/or violating such in a repeated manner, which we believed could be material for the company.

Regarding the election/re-election of directors, most rejections were around:

- lack of majority of independent directors on the boards: mainly due to a prevailing number of long tenured directors, combined CEO/Chair with a lead independent director, who was not classified as independent due to tenure
- “overboarding” issues: the extensive number of outside board seats held by directors
- ESG controversies, which have not been properly handled, where we held board members accountable for the mismanagement of such issues.

Executive compensation plans were the second most critical item for us at general meetings in 2018 (11%) of votes against management recommendation. However, looking at only the executive remuneration related proposals that we voted, this number increases to 28% in which we voted with an "Against". These numbers increased slightly compared to 2017, which could be by the fact that some countries introduced a mandatory “say-on-pay” in 2018 or a decrease in the quality of disclosure, comprehensibility and appropriateness of the plans. Adequate, comprehensible and transparent executive compensation does represent one of our core governance values and thus, we do have stringent standards for assessing these items. For the executive remuneration plans that we opposed, we found that:

- the disclosure and comprehensibility levels insufficient, in particular regarding the key performance indicators/ metrics and the weights assigned to them
- the lack of transparency on the discretionality of the non-executive directors on determining these metrics
- the lack of transparency on the relevant maximum levels of compensation, which can be potentially realized
- missing bonus-malus and clawback mechanisms.

It should be recognized, however, that we have also seen a certain level of improvement in the adoption of such mechanisms, in particular clavbacks, based on investor feedback and engagement efforts.

We also had to oppose some of the items related to capitalization/ equity issuances in the 2018 season (5%) due to an extensive cumulative amount of authorized equity issuance levels (with and/or without preemptive rights). We do analyze such cases individually and may consider supporting an exceptional issuance due to the company being in distress or in a period of fast-paced growth. However, we do expect our investees to comply with the best practice standards for each individual market, which, in certain cases, may be stricter than the minimum limits set by law.

Insufficient transparency surrounding the external auditors and, in particular, the lead partners/auditors and their internal rotation periods, caused the auditor-related items proposed by our investees to be one of the opposed items in our voting against management (9%). However, it must be noted that we saw a strong improvement in particular on this topic, which declined from 21% previously of the votes against management in 2017. The transparency on the external auditor is improving considerably.

We are generally supportive of shareholder proposals that enhance shareholder rights, foster reporting and increase transparency. In 2018, out of all the shareholder proposals we have supported 78%. We analyze such on a case-by-case basis, taking into consideration the details of the proposal as well as the company existing practices addressing the issue.

When exercising our voting rights, we also take into consideration important ESG topics raised by shareholders, where we are generally supportive of ESG-related shareholder proposals while considering recognized standards:

- the CERES Roadmap for Sustainability
- the CERES Blueprint for Sustainable Investing
- the UN Global Compact.

Deviations from the Policy

In 2018 there were 18 proposals that deviated from the recommendations of the Corporate Governance and Proxy Voting Policy, which were raised for discussion in the Proxy Voting Group. These are generally as a result of a successful engagement with a company where:

- more transparency is provided by the company (available publicly on website)
- the company committed to relevant aspects going forward
- certain issues are clarified with discussions with the company in terms of their management of such issues.

The majority of the cases were director-related followed by executive compensation related issues. In 16% of the cases, we voted with an “Abstain” instead of “Against”, mainly due to the company’s credible rationales for the deviations, which made them to fall in line with our understanding. In the remaining cases, we supported the management recommendation based on the company changing its behavior, providing us with more clarity on their structure as well as more transparency in general.

### PROXY VOTING GROUP CASES:

#### EXTRAORDINARY DEVIATIONS FROM THE CORPORATE GOVERNANCE AND PROXY VOTING POLICY

- Board: Overboarding related 25%
- Executive Remuneration 25%
- Board: Independence related 15%
- M&A and related actions 10%
- Board: Diversity related 5%
- Auditor related 5%
- Board: Committee related 5%
- Board: Transparency related 5%
- Board: ESG Risk Oversight 5%

#### BREAKDOWN OF VOTES: SHAREHOLDER PROPOSALS

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<thead>
<tr>
<th></th>
<th>For</th>
<th>Against</th>
<th>Abstain</th>
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<td></td>
<td>78%</td>
<td>14%</td>
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Source: ISS Proxy Exchange; data as of 12/31/2018

Source: ISS Proxy Exchange; data as of 12/31/2018
Proxy Voting Activities in 2018 for Funds domiciled in the United States

For the funds domiciled in the United States, we strive to exercise the voting rights for all equity holdings, given that the market does not have any restrictions or requirements, which deem the voting process not feasible. Thus in 2018, we voted at a total number of 9,292 meetings in 64 markets of listing, which represented 96% of all votable meetings. The majority of the voted meetings was for companies listed in the United States and China, followed by Japan and other Asia-Pacific countries.

In the past year we continued our strong support of shareholder proposals that positively address important financial issues faced by companies in our portfolios. We supported 97% of the climate-related shareholder proposals.

MEETINGS VOTED PER MARKET

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<thead>
<tr>
<th>Market</th>
<th>Meetings Voted</th>
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<tr>
<td>Africa</td>
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<td>Asia Pacific</td>
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<tr>
<td>Benelux</td>
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<td>CEE</td>
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<td>CDZ</td>
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<td>China</td>
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<tr>
<td>Others</td>
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<tr>
<td>Italy</td>
<td>372</td>
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<tr>
<td>Latin America</td>
<td>701</td>
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<tr>
<td>USA</td>
<td>192</td>
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<td>Others</td>
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<td>372</td>
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| Source: Institutional Shareholder Services Inc. Proxy Exchange (“ISS Proxy Exchange”); data as of 12/31/2018

### SHARE OF US PROXY VOTES IN FAVOUR OF CLIMATE-RELATED RESOLUTIONS

<table>
<thead>
<tr>
<th>Year</th>
<th>Share of Votes in Favour of Climate-Related Resolutions</th>
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<tbody>
<tr>
<td>2013</td>
<td>100</td>
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<td>2014</td>
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<td>2015</td>
<td>98</td>
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<td>100</td>
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<td>2017</td>
<td>100</td>
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<tr>
<td>2018</td>
<td>97*</td>
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* Ceres as of 2018

### BREAKDOWN OF VOTES “AGAINST” MANAGEMENT RECOMMENDATION: VOTES “FOR” OR “AGAINST” MANAGEMENT

- **45%** Directors-related
- **18%** Executive remuneration related
- **10%** Anti-takeover, reorg/merger related
- **9%** Capitalization-related
- **9%** Other shareholder-related
- **8%** Auditor/Dividend Policy/ Director remuneration related
- **1%** Shareholder Proposals: Environmental and Social Matters

![Bar Chart]

We voted “Against” management recommendations in 14% of the total number of items voted in 2018. The proposals we most commonly opposed were director-related, in particular elections/re-elections of directors (48%).

When evaluating the election of non-executive directors of our investees, we paid particular attention to:
- Accountability to shareholders and transparency of governance practices.
- Responsiveness to investor input and shareholder vote.
- Composition of the board with directors adding value through skills, expertise and time commitment.
- Independence from management.

Executive compensation ranked second on the most opposed proposals list (18%). This outcome demonstrates that companies still need to focus on aligning pay with long-term performance and simplifying compensation plans. We believe there is also a need for more rigorous stock ownership requirements to better align the interests of executives and shareholders.
The objective of our ESG Engagement Policy is to establish our framework for our investment professionals (defined as research analysts and portfolio managers) to fulfill their stewardship duties. This involves acting in their clients’ best interests by engaging in a two-way dialogue with investee companies on material ESG factors and monitoring the effects of the engagement on company practices.

Our ESG integration and engagement activities are guided among others by the following international standards: UN-supported Principles for Responsible Investment (PRI), UN Global Compact, the OECD Guidelines for Multinational Corporations, Cluster Munitions Convention, the CERES Roadmap for Sustainability, The CERES Blueprint for Sustainable Investing, IIRC Integrated Reporting Framework. Moreover, our approach is in line with the most current regulations and stewardship codes and principles in the respective markets in which we undertake our business activities. Companies that seriously contravene internationally recognized E, S or G principles will be subject to heightened scrutiny.

Engagement activities are a key part of our ESG Engagement Policy*. They are based on our objective to induce enhancement in our investee’s behavior on environmental, social and/or corporate governance aspects with the aim of improving their long-term performance.

Engagement and company meetings are an integral part of our investment process. Our investment professionals engage regularly with the senior management of our investee companies, whereby, in addition to the fundamentals, strategy and outlook of the company, ESG topics are also discussed. For specific corporate governance topics, the members of our Corporate Governance Center lead dedicated engagements and address relevant E, S and G issues, whereby the investment professionals would also attend the meetings.

For our passive investments it is even more important to engage in terms of governance and encourage positive change through voting and engagement since active adjustments are of course not possible. As passive investors and thus effectively “permanently” invested, we also have the fiduciary duty to our clients to push for changes that will increase shareholder value in the longer-term. The insights from the respective meetings would then feed into our global research database.

7 These activities encompass dedicated governance engagements for the following legal entities: DWS Investment GmbH, DWS International GmbH, DWS Investment S.A., Luxembourg SICAVs, Deutsche Wealth Management S.G.I.C., S.A., Deutsche Asset Management Liquidated Limited.

8 Please find a detailed description of our governance engagement approach in our Corporate Governance and Proxy Voting Policy (for funds domiciled in Europe and Japan, link in the appendix).

*please find more details on dws.com

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2018 Governance engagement activities at a Glance

**Engagement activities are documented and monitored constantly.**

- **169 one-to-one governance engagements held with 134 companies**
- **109% increase to 2017**
- **Overall held engagement activities with 923 individual companies**
- **Annual governance engagement letter sent to 900 investees with key expectations and new policy**
- **Annual General Meetings (AGM) attended in person with speech**
- **Post season letter sent to 126 investees for which DWS voted against relevant agenda items**
- **Extraordinary meetings on specific governance issues with boards**
- **Filing shareholder proposals**
- **Participating in person at AGMs and raising our concerns publicly**
- **Sending letters to both boards of directors**
- **Extraordinary meetings on specific governance issues with boards**
- **Pro-active engagement via meetings/calls**
- **Raising governance issues in regular management meetings**
- **Annual governance letter to investees on Focus List**

We follow a stringent step-by-step approach in order to engage with our portfolio companies.
Corporate Governance Activities 2018

Letters And One-On-One Governance Engagements With Our Investees

Reflecting the developments made in the Corporate Governance and Proxy Voting Policy in 2018 as well as our most eminent governance expectations formed out of the latest proxy voting season, the Corporate Governance Center, representing DWS Investment GmbH, sent a pre-season letter of engagement to the investees, which were part of the Proxy Voting Focus List for 2018 (more than 900 companies globally in 2018).

With the aim of improving the ESG disclosure practices of selected European small and mid-cap companies, we also sent an engagement letter to companies that have poor ratings based on data from multiple ESG data providers (e.g. Sustainalytics, MSCI, ISS-Oekom) which are aggregated into our internal proprietary database, the “ESG Engine”, creating a more objective ESG rating for every single company.

After the proxy season, we also sent individual letters to 126 of our investees, where we had issues with particular items of the agenda and voted against management recommendation on elections of directors and executive remuneration items or supported shareholder proposals related to E, S or G matters.

Throughout the year, we identified additional governance engagement opportunities via our corporate governance due diligence and continued several of our ongoing engagement cases. Thus, in 2018 we held 169 governance engagements with 134 companies, which represented an increase of more than 100% to last year. In addition, we also participated in person at the general meetings of 16 investees with a speech addressing our questions or concerns. 14 of the AGMs were in Germany, one we attended in the Netherlands and one in Italy.

Last year we met with a growing number of chairpersons of boards, lead independent directors as well as other board members. In particular, we find the discussions with the chairpersons of Remuneration Committees very beneficial when it comes to discussions on the executive remuneration plans as it gives us the opportunity to understand the strategy behind the plans and to better transfer our expectations as investors.

In terms of industry class, the span was quite extensive in 2018 and included representatives from 14 industries with a majority being from the financial industry and consumer discretionary, followed by the industrials and health care industries. Compared to the previous years, we substantially increased our engagement efforts in the energy as well as real estate and communication services industries.

GOVERNANCE ENGAGEMENT COUNTERPARTS

Head of IR 59%
Chairperson of the Board 14%
CFO/COO and other members of the management board 9%
CEO 8%
Lead Independent Director 4%
Chairperson of the Board 14%
Board of Legal/Head of HR/Compensation & Benefits / Secretary of the Board 4%
Appointments & Compensation Committee Chairperson 2%

GOVERNANCE ENGAGEMENT PER INDUSTRY

Financials 15%
Consumer Discretionary 15%
Industrials 13%
Consumer Staples 8%
Health Care 15%
Energy 5%
Real Estate 6%
Information Technology 9%
Utilities 4%

Source: DWS Investment GmbH, 12/31/2018
In 2018 we attended 16 AGMs in person and raised our questions publicly. Attending general meetings in person is one of the cornerstones of our engagement activities and represents an important measure to express our concerns and in some cases, express our appreciation for improvements and enhanced performance.

When we look at the spectrum of engagement topics in 2018, board composition and transparency as well as executive remuneration related issues remained among our most discussed topics. What was among the three most discussed aspects in 2018 was the ESG risk management and oversight discussing section we will elaborate on these engagement topics in more detail in terms of their importance for us as well as the range of discussions we held on them.

**Governance Engagement Per Topics**

- Board Composition and Transparency 32%
- Executive Remuneration 30%
- Shareholders rights 11%
- ESG Risks and Management 10%
- Overboarding 5%
- Board Independence 3%
- Capital Issues 3%
- CEO/Chairperson Combined Role 3%
- Auditor-Related 2%
- Strategy and Operations 2%

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**Board of Directors**

As the advocates of our interests, boards have the task to critically monitor and guide the executives of the companies we are invested in to ensure the company’s sustainable development. Qualified, experienced and independent directors are essential for competent and diverse boards to ensure efficient decision making processes and long-term sustainable performance.

**Composition: Independence/Diversity in Expertise, International Experience, Gender/ Overboarding**

We have a holistic understanding of diversity that encompasses age, gender, qualification, internationalization, independence, sector experience and tenure. These factors should reflect the structure and nature of the company and should enable the boards to work more efficiently and make better decisions. Boards should ensure a balance in representation and inclusiveness in order to allow broad perspectives to drive value in different scenarios. Gender diversity should provide for a more dynamic, well rounded board of directors, bringing unique perspectives, experience, talents and expertise. Furthermore, as to ensure reasonable board refreshment and succession planning, an adequate age range should provide balance between experience and new perspectives. We also welcome any developments that aim to achieve a better gender balance; however, for us, qualification remains the decisive factor that needs to be assured for a sound board. In 2018, we continued further engaging with our investees on board composition topics and monitored their progress in achieving the appropriate balance of independence, expertise and diversity in their boards.

**Independence:** Independence was one of the central topics of our discussions with portfolio companies. In our evaluation of director independence, among the personal and commercial ties to the company, we also analyze tenure. We do value the experience of board members serving for multiple years in a board, in particular for companies involved in long-cycle and relationship-based businesses. However, the chairperson of the board must ensure that fresh perspectives are also factored in for a dynamic culture. Thus, we do believe that a majority of the board must comprise of independent directors, including such, who are serving for less than 10 years to ensure a balanced structure exists for effective decision-making and board performance.

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**Case Study Board: Independence | Sector: Energy | Country: Russia**


- Although the company has classified three directors as independent, our analysis indicated that due to their direct or indirect affiliations with the State or other interested parties, none of the nominees, which were proposed for election could be considered truly independent.

For this reason, no support was warranted to any of the 11 nominees.

Governance engagements with the company were initiated.

- The board lacks independence according to the standards of the Russian Corporate Governance Code as well as DWS standards. We raised the attention to local best practice standards that should be applied.

- In addition, it was agreed to discuss several environmental and social matters in 2019.

We will continue engaging with the company and closely monitor the succession planning.

Source: DWS Investment GmbH, 12/31/2018
Diversity: A majority of the boards of companies we have talked to have been very active in achieving a good mixture of diversity in its true sense. What we really appreciated were those who are disclosing a competence matrix, which makes it very transparent to see how each director contributes with his/her experience in the relevant international markets and sector expertise. The development in the technology area, digitalization and cybersecurity has without a doubt a strong effect for the strategy planning of all sectors worldwide. A lot of boards have already hired digitalization experts or found new cybersecurity committees.

We see this development as unquestionably necessary and important in terms of their outside board seats. However, in a majority of the cases, we were able to get a better understanding of how the board manages these risks and what individual directors’ plan prospectively in terms of their outside board seats. In some cases, we were still working together with the boards through our constructive dialogue with the goal of potentially having a reduced number of board commitments in the companies in our portfolios.

When it comes to gender diversity, a lot of boards have managed to fill in some gaps. However, the overall response of the companies to this topic globally has unfortunately been not as convincing as we expected. We do value in the first place that the board consists of the best qualified people possible for a particular company. But we will also no longer tolerate the argument that ensuring an appropriate gender-balanced representation on boards is very difficult and for some sectors, as companies note, almost impossible. We expect boards to try harder and longer if necessary as from what we experience, those that did do that in the past couple of years, succeeded and are already seeing the benefits.

Overboarding: Our expectations for board members are to allocate enough time to fulfill their mandates and allow for an ‘independence in mind’ for strategic guidance and oversight of management. The issue of overboarding is an important aspect to avoid in order to have a good governance in place. A lot of companies have set internal limits for a maximum number of seats one of their directors is advised to have in total. Others, have resorted to a more qualitative evaluation of the individual directors’ time commitments. Unfortunately, we still see overboarding as an issue in most markets. We engaged with a number of investees where we identified overboarding situations. In some cases, we were able to get a better understanding of how the board manages these risks and what individual directors’ plan prospectively in terms of their outside board seats. In a majority of the cases, we still working together with the boards through our constructive dialogue with the goal of potentially having a reduced number of board commitments in the companies in our portfolios.

We held an engagement with the company to discuss these matters.

ESG Management and Sustainability

Climate: 2018 was another year for record-breaking extreme weather and the risks and impacts of climate change are becoming blunter. At the same time, more financial institutions, companies, governments, central banks, and regulators are accelerating their action in response. Yet, the efforts are still not enough as the Intergovernmental Panel on Climate Change (IPCC) warned recently that carbon emissions still pose an existential risk to society. In the past year we have continued our efforts on environmental and climate change issues. In our role as fiduciaries we strive to safeguard and enhance the sustainable long term economic value for our clients. We believe the long term value of companies is also linked to having a sound governance which would allow them to be in a better position to effectively manage material environmental and social factors relevant to their businesses and potentially improve their risk-return profiles. Therefore, our focus on climate change related proposals has yet again been robust this year and we will continue advocating the consideration of societal impact with the companies we are invested in.

In 2018 we also continued supporting the Climate Action 100+ initiative and started our engagement efforts with the climate-related goals. The company we have in scope is moving in the right direction and has already enhanced their reporting practices and demonstrated the prioritization of those from 2017 to 2018.

Case Study Board: Overboarding, Independence | Shareholder Rights
Sector: Biotechnology | Country: United States
Proposals concerned at AGM in 2018: Vote on Re-election Items (DWS Policy Recommendation: “Against”)

- One director is overboarded with a total directorship count of 6
- The company has a combined CEO/Chairman, but the Lead Director is not considered to be independent, as he serves for more than 15 years in the board.
- The company currently does not have an age limit and the average age of the board is 66, which is considered relatively high.
- For ESG matters, the Nominating and Governance Committee is considered responsible and brings each topic up for discussion at board level.

We joined the Climate Action 100+ initiative in 2017. It is a five-year investor-led initiative to engage more than 100 of the world’s largest corporate greenhouse gas emitters to curb emissions, strengthen climate-related financial disclosures and improve governance on climate change risks.

We initiated an engagement with the company, which was in our scope to discuss their governance, strategy, risk management as well as specific targets regarding climate risk.

Last year, we also attended the AGM of the company in person to address these important questions to the board of directors in person and publicly.

In the last two years, the company made significant improvements to the governance of ESG aspects. They also enhanced their transparency in terms of reporting on non-financial aspects, following also the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD"). The oversight is made at a board level via the dedicated Corporate Governance and Sustainability Committee.

In terms of governance, the company also made improvements in the board composition in terms of diversity as well as transparency on executive remuneration.

We will continue supporting the initiative and our constructive dialogue with the company in the following year as well.

Source: DWS Investment GmbH, 12/31/2018
Oversight of relevant ESG risks: We believe that companies should identify relevant and material Environmental, Social and Governance risks and opportunities for their business and have the relevant expertise as well as awareness within the company.

In 2018 we have engaged on these topics intensively, in particular with companies that were facing some controversies and mismanagement of these aspects. We do believe that ESG matters should be discussed extensively within the company and the awareness, experience and responsibility should be ensured.

The non-financial reporting requirement in Europe has been an important development for increasing the awareness on the importance of disclosing extra-financial information.

Executive Remuneration

The discussion around executive remuneration is one of the most important aspects of a company’s governance for us as investors. How management is incentivized is an essential signal to get a better understanding on the strategy and direction of a company. Having comprehensive, appropriate and transparent executive remuneration plans is one of the cornerstones for us of good corporate governance.

Transparency

Sufficient transparency on the individual components and metrics is absolutely imperative for our analysis and we have further discussed these aspects with our portfolio companies. When it comes to transparency on the individual metrics, what caught our attention was the improved level of disclosure within 2018 and an increased level of consideration of investor feedback. Where we wish for more transparency are individual targets, which would generally be part of the short-term incentives.

Other aspects where transparency is of significance and were part of dialogues are the share ownership guidelines and severance payments. When it comes to stock ownership by non-executive members of the board, there are currently different views in the different markets globally. The UK Corporate Governance Code for 2019 is one of the most critical views on the subject, namely it mentions that non-executive members’ remuneration should not include share option plans or that any such plans would impair their independence. Some of our discussions revealed that some investees, who are operating globally and have shares listed partially or mostly in the United States, have the challenge to comply with this requirement in the UK as in the US such share option plans are rather best practice.

Link to Long-term Sustainable Performance

It is particularly challenging to analyze whether executive remuneration is aligned with company performance. Generally, we would take into consideration the multi-year development of the total shareholder return. In 2018, a number of our investees had remuneration policies, which were excessive in relation to market standards or the pay was not aligned with performance. We held in particular discussions with investees, which had a remuneration system that was not geared to the sustainable long-term success of the company or was substantially out of line with a relevant peer group, resulting in an insufficient and/or inadequate alignment with our interests as shareholders.

The question what companies define as material, qualitative and quantitative key performance indicators concerning their business has been one of the most discussed topics in the last couple of years. This brought increased attention to how companies link their executive compensation to these factors in an effective way, using the relevant factors and weights in the variable short and long-term plans.

Board Evaluation Mechanisms

The mechanisms behind efficient board processes have been another topic for discussion in 2018. Most of our investees would have formal internal and external evaluations, the results of which are generally preferred not to be published. However, we expect companies to disclose the steps they have taken in the direction of improving some of the findings in the evaluations. Another important aspect of the board evaluation is the individual meeting attendance for the board and committee members. Unfortunately, the transparency on such attendance still lacks sufficient disclosure.
Risk Mechanisms in Executive Remuneration Plan: Season 2018 and Regional Review

The discussions around which risk mechanisms are essential for a good executive compensation plan has yet again been one of the central topics of our engagements. In particular when it comes to relevant bonus-malus and clawback mechanisms. Most companies have already established a bonus-malus mechanism. When it comes to clawbacks, for some markets such as the United States, Germany and France, managed to include a clawback mechanism in their executive management contracts. In fact, the Pacts law in France, if adopted in May or June in 2019, can help solve this issue around the clawback implementation, which we will be closely monitoring. We have been in close dialogue with the companies, which implemented clawback for the first time in 2018 and thus, we highly appreciated these efforts and will continue supporting these and monitoring their wider implementation.

Many countries currently do not have any regulations with clawback provisions. The various corporate governance codes provide only broad guidelines without mandatory clawback requirements. To address those issues, different regulatory frameworks for managing executive compensation enable companies to recover or withhold payment of any sums made or to be made to executives. The United States, the Corporate Governance Code requires that executive remuneration plans include provisions that would enable companies to recover or withhold payment of any sums made or to be made to executives. The United States is still best positioned with more than 90% of the S&P 500 companies (Source: Institutional Shareholder Services, 2017) having the mechanism. A majority of the companies we talked to in Spain have also ensured that they have a similar mechanism.

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Many countries currently do not have any regulations with clawback provisions. The various corporate governance codes provide only broad guidelines without mandatory clawback requirements. To address those issues, different jurisdictions have put in place measures to strengthen the regulatory framework for managing executive compensation and excessive risk taking. In the United States, the Sarbanes-Oxley Act of 2002 requires CEOs and CFOs to reimburse a company for an incentive or equity-based pay and profits obtained from disposing company shares in the year issuance of misstated accounts. Also, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, among other requirements, provides a mechanism for recovering erroneously paid executive incentives. In the United Kingdom, the Corporate Governance Code requires that executive remuneration plans include provisions that would enable companies to recover or withhold payment of any sums made or to be made to executives. The United States is still best positioned with more than 90% of the S&P 500 companies (Source: Institutional Shareholder Services, 2017) having the mechanism. A majority of the companies we talked to in Spain have also ensured that they have a similar mechanism.

The transparency around the external auditors is one of our core values for good governance. In 2018, we did see a number of companies improving the disclosure around the lead audit partner, but we are still seeing a number of companies who are not disclosing details such as the name or/and duration of appointment of the lead audit partner. In terms of the audit firm rotation itself, most companies are orienting themselves towards the European Union standard of 20 years. We do encourage our investees to ensure a regular rotation not only for the lead audit partner every 5 years, but also for the audit firm as deemed necessary by them to ensure their objectivity and independence.
There were also important discussions around the proper treatment of shareholders’ rights in 2018. Involving shareholders in important M&A transactions via the right to exercise their voting rights was a major topic, which was widely argued. We do urges companies to involve their shareholders, especially in the case of critical transactions related to strategy or corporate governance. We also advocate the consideration of material E, S and G factors in the evaluation of such transactions. In that respect, we have expressed our opinion publicly during a critical annual general meeting in Germany once again, which involved such transactions to potentially result in a significant change in the strategy or governance structure of these companies.

Another important aspect we discussed in our engagements were the increasing number of shareholder proposals in the US, asking companies to decrease their minimum threshold to call a special meeting and to provide shareholders with the right to act on written consent. We are generally supportive of proposals asking for the right to act on written consent in cases where companies do not provide sufficient measures for shareholders to act in such a manner, i.e. the right to call for a special meeting by a shareholder requires a threshold exceeding 10%. However, we also take into account the shareholder structure of the company and also held discussions with several companies on their view for the proposed items.

In 2018, we continued seeing a number of important environmental and social proposals, aiming to address eminent issues such as gender diversity and climate change as well as social accountability of companies. In that regard, we continue to pay high attention to the amount of transparency our companies provide on their efforts to address these topics. In Europe, with the mandatory non-financial reporting and in particular some countries going even a step further and making it mandatory for companies to get the report approved on the shareholders’ meeting, it became even more clear that enhanced transparency on identifying relevant sustainability aspects as well as material ESG risks is absolutely a prerogative.

Case Study M&A, Shareholder rights and ESG Matters
Sector: Health Care | Country: Germany
- A strategically and volume-wise very important transaction was not put to vote for shareholders
- Relevant potential ESG and transparency issues around the deal discussed with company during governance engagements with CSO and Chairman
- Certain and regulatory issues as well as ESG risks regarded controllable by the company but the uncertainty due to ongoing investigations presses.
- The board committees were not considered majority independent by us
- One of the non-executive directors was considered overboarded DWS attended the AGM of the company in person (in 2017 and in 2018) to raise the relevant critical questions.

Outcome: ongoing
- Major concerns remain due to pending decisions of several regulators
- Potential synergies lower than expected due to antitrust investments
- DWS is closely monitoring the developments and will engage further with the company

Source: DWS Investment GmbH, 12/31/2018

Public Policy Engagement in 2018

Through various activities in relevant working groups, policy bodies, networks, and commissions, we aim to be a thought leader in corporate governance and seek to actively shape domestic and global corporate governance developments, striving to represent our clients’ best interests. Since 2009, DWS has been a signatory to the annual investor letter to governments calling for stronger public policies on climate change. In 2018, more than 400 investors with more than USD34 trillion in assets under management, signed this letter. Among the largest twenty asset managers, DWS is the only investor to have continuously signed the letter since 2009. In Germany, we participated in the consultation centered on the changes of the German Corporate Governance Code and as a member of the German Association for Financial Analysis and Asset Management (Deutsche Vereinigung für Finanzanalyse und Asset Management e.V. [DVFA]) continue promoting the DVFA Scorecard on Corporate Governance as a measure of governance quality for German companies.

In 2018, we have also participated in the discussions within the German Fund Association (BVI) on the implementation of the Shareholders’ Rights Directive II (SRDII) in Germany. On a European level, as a member of the European Fund and Asset Management Association (EFAMA), we have actively participated in the discussions around the development of a new European Union Regulation on Sustainable Finance.

In 2018, DWS was listed as a Tier One Asset Manager signatory to the Stewardship Code for the UK Financial Reporting Council (IFRC).* Also in the UK, DWS was invited to join the UK government’s Green Finance Taskforce: commercial real estate working group, where we provided feedback.

We have been recognized for our best-in-class voting guidelines on executive compensation plans, in an industry study of the top 40 investors in DAX companies. The study was compiled by http://group, Georg-August-University of Göttingen and the German Investors Relations association DIRK.

* Our statement of compliance with the UK Stewardship Code can be found here on our website. Please find link in the appendix.
CLOSING REMARKS

In 2019, we will continue to seek constructive dialogue with our investees, not only to elaborate on our key expectations in terms of governance but also to be able to gain a better understanding of their existing governance structures and strategies to help make better informed company evaluations and ring-fence our investment decisions.

Going forward in our engagement efforts in 2019, we will focus on the management and oversight of ESG risks and opportunities. Especially in light of the national implementation of the Shareholders’ Rights Directive II in 2019, we are actively following and monitoring the developments around and will place a stronger focus on our executive remuneration engagements. We have participated in the relevant working groups at an EU as well as national level (via our membership in the relevant industry associations-BVI and DVFA, in Germany), whereby we have provided our remarks. We also continue to encourage them for an enhanced disclosure on climate related financial disclosures based on the the Task Force on Climate-related Financial Disclosures (“TCFD”) recommendations.

We will also observe how our investees are ensuring gender diversity in their succession planning and board refreshment. We would like to see significant progress in this aspect and encourage companies to accelerate their efforts to ensure well balanced boards for a more effective decision-making process. The questions on board independence and refreshment, in particular in emerging markets, will also be at the center of our engagements. We will strive to participate in the relevant industry working groups.

Appendix
**FURTHER LINKS**


**IMPORTANT ESG SHAREHOLDER PROPOSALS WE SUPPORTED IN 2018 FOR FUNDS DOMICILED IN THE US**

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