SAGE ESG

Sage Advisory Asset Management

2021 Annual ETF Stewardship Survey

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by Emma L. Harper & Sara B. Rodriguez

Investors in U.S. mutual funds and ETFs are increasingly entrusting their assets to a handful of large fund companies. In fact, 25 of the largest fund companies account for over 82% of investors' assets in U.S. funds, and it is estimated that around 22% of shares of a typical S&P 500 company sit in their portfolios.[1,2] One segment of the market – exchange traded funds (ETFs) – has experienced outsized growth over the last three years and now represents $6.5 trillion, with three-year asset flows of $1.4 trillion. It is incumbent upon us as fiduciaries in a fairly concentrated market to understand the financial stewardship of ETF Providers.

We wish to extend our appreciation and gratitude to our respondents. Without their support and information, this report would not have been possible.

BlackRock
State Street
JPMorgan
PIMCO
Goldman Sachs
Invesco
Nuveen
DWS Group
Dimensional Fund Advisors
Charles Schwab
Janus Henderson
ClearBridge Investments
VanEck
Global X ETFs
Krane Fund Advisors
Candriam & IndexIQ
Change Finance

An ETF Provider (or Sponsor) is the company that constructs and manages the ETFs, which are essentially a basket of securities that trades on an exchange. Like individual stock investors, ETF Providers control the ownership rights for the underlying portfolio companies housed in the ETFs. These ownership rights allow the ETF Providers to proxy vote on major company decisions, such as board composition, executive remuneration, climate policy, and business strategy.

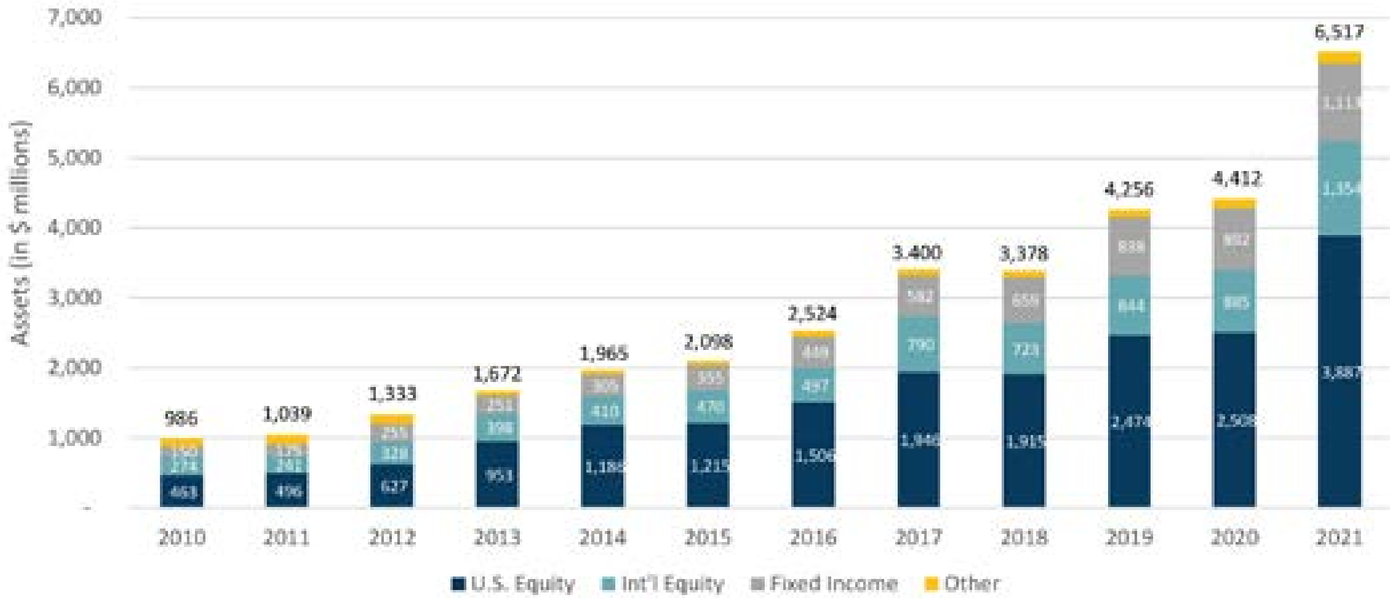
As an example of their influence, recently a small activist hedge fund, Engine No. 1, nominated independent director candidates for Exxon Mobil's board to implement better environmental policies, such as reducing carbon emissions. At first glance, it seemed like the little guy, Engine No. 1, won the fight against Exxon; however, it was not without the support of some of the largest fund companies – BlackRock, Vanguard, and State Street – and their votes against Exxon management's proposed board candidates that the battle was won. The Engine No. 1 story is but one example of the thousands of voting decisions ETF Providers make every year and the power they can wield.

Alongside the rise in ETFs has been the growth of Environmental, Social, and Governance (ESG), or sustainable, investing and a subsequent increase in the availability and variety of ESG ETFs. Flows into these sustainability-focused ETFs has been robust over the last several years, with nearly $21.5 billion in net inflows in just the first three months of 2021. And according to Bloomberg, global ESG assets are on track to exceed $53 trillion by 2025.[3] Strong inflows, combined with increasing regulatory scrutiny and a myriad of ways that ESG ETF portfolios can be constructed, have made it more important than ever to understand the sustainability policies and practices of ETF Providers.

Survey Highlights

Voting – Most of the respondents (71%) received a passing grade of C or above, up from a 64% passing rate in 2020.
Engagement – 42% of repeat ETF Sponsors improved their scores, and the number of those that have metrics to gauge the success of engagements has increased.
Disclosure – This section saw one of the highest grade increases. While only 36% passed the disclosure section with a score of C or higher in 2020, 71% passed this year.
Stewardship Professionals– We saw a significant improvement in the pool of repeat respondents, with 75% improving their grades and 25% maintaining their 2020 grades.
Diversity, Equity, and Inclusion – Most respondents excelled in this section, and 88% had a perfect score.
Climate Initiatives– Of repeat respondents, 25% improved their scores.

ETF Asset Growth



Source: Bank of America Global Research and JPMorgan, years 2020 and 2021 end in May.

Stewardship Survey Origin

Since 1998 Sage has been deeply involved with the ETF market as an institutional investor utilizing a variety of funds from a range of ETF Providers. Through our due diligence and assessment process, we have actively engaged and reviewed each of the leading ETF Sponsors on their investment processes, security research efforts, and overall performance. In recent years, with the rapid growth of the ETF market and the inherent expansion in voting power associated with these trends, we aggressively expanded our assessment efforts to fully explore a range of important financial stewardship and fiduciary issues with each ETF Sponsor.

A few years ago, we formalized this process through our Annual Stewardship Survey to gain a better understanding of how each ETF Sponsor developed and executed its core fiduciary policies and stewardship practices. We anonymize responses to increase survey participation, and we actively engage with ETF Sponsors on their survey results.

2021 Annual Stewardship Survey Trends

In general, we were pleased with the quality of the responses received from most ETF Providers, with 76% receiving an overall passing grade of C or higher, up from just 57% in 2020.[4] With the majority (75%) of repeat respondents receiving an improved score, we foresee continued improvement and trust that our stewardship process is working.

When we analyzed this year's survey results, we were left with three key takeaways. First, voting practices have significantly improved year over year. Second, there is a positive and intentional focus on diversity, equity, and inclusion (DEI) at the majority of the ETF Sponsor firms. Lastly, the structure of stewardship teams, whether they were centralized or decentralized, had no bearing on how well ETF Sponsors performed on the survey.

Voting Improved Dramatically

This trend is highly encouraging, given the increasing importance of voting as a key tenet in the practice of stewardship. The number of participants who passed increased from 64% in 2020 to 71% in 2021, and there was improvement in scores for multiple questions, including those relating to using proxy advisors for research, exercising voting rights for portfolio companies, voting against management, and having ESG-related factors impact voting behavior. Last year we studied the relationship between voting and engagement and found somewhat disappointing results, in that the Sponsors' voting records did not reflect the extent to which they claimed to care about ESG issues. This year, we are happy to report that many ETF Sponsors specifically focused on their voting records and showcased their commitment to supporting proposals that had a positive impact on ESG factors. This was especially notable with climate voting proposals, where some ETF Sponsors that fell well below the mark last year changed course and made vast improvements to their processes and support of these types of proposals.

A Focus on Diversity, Equity, and Inclusion Issues
With 2020 being the year of increased focus on important social issues, it comes as no surprise that diversity, equity, and inclusion (DEI) practices in the corporate world came under scrutiny. Having heard a litany of stories about unfair working environments and promotion practices, we wanted to ensure that we were doing our part to understand the diversity practices of each ETF Sponsor. This year we added our DEI section to ensure that our ETF Sponsors are set up to not only foster DEI, but also to verify that they have strategies to improve upon areas in which they may be behind their peer group.

We are happy to report that 88% of our ETF Sponsors received the highest possible score on this section. Furthermore, 94% of the ETF Sponsors have a stated DEI policy, monitor and report on the diversity statistics of their workforce, and have plans to promote DEI at every level of their organization. Given that some of these diversity practices are mandated, however, there is clearly more proactive work to be done in this area, and we are highly encouraged that the majority of ETF Sponsors recognize the importance this plays in creating a thriving and successful workforce.

Structure of Stewardship Teams
As we analyzed the responses to this year's survey, we came across an interesting divergence in the structure of the internal stewardship teams of various ETF Sponsors. It seemed that ETF Sponsors set up their teams in one of two ways, centralized or decentralized. In the centralized system, stewardship professionals are central to all stewardship processes. They not only advise portfolio management teams on ESG issues but are responsible for most or all proxy voting activities, engagement activities, and setting the strategy for all ESG issues. In the decentralized system, stewardship professionals operate in more of an advisory capacity with expertise in areas of stewardship and ESG issues. In this system, portfolio managers are responsible for proxy voting activities and engagement activities, ultimately deciding the direction of ESG decisions for the firm.

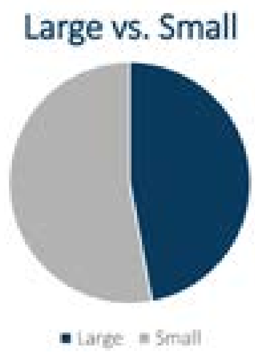
There are pros and cons to both systems, and ultimately Sponsors operating in both a centralized and decentralized manner scored well on our survey. It could be said that a centralized system allows for more cohesion in proxy voting, engagement decisions, and in the creation of a core vision on ESG factors for an entire firm; however, it also could be said that in the decentralized system those that are most involved with the daily activities of portfolio companies might be best informed on the proxy voting and engagement decisions. Although there was no positive or negative grade correlation to either system, it is something we will be monitoring and striving to understand in greater detail.

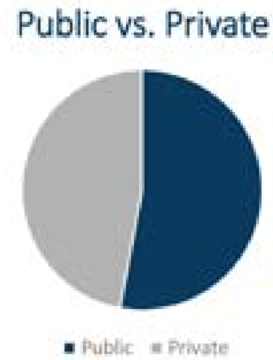
2021 Survey Participants

Sage received responses from 17 ETF Sponsors, including five new and 12 returning participants. Collectively, participating ETF Sponsors totaled $24 trillion in assets under management (AUM), of which ETF assets represented $3.7 trillion. This represents about 58% of the U.S. ETF market and 86% of the U.S. ESG ETF market. Because this survey is integral to our understanding of how ETF Sponsors carry out their fiduciary duties on behalf of investors, it was unfortunate that one large firm didn't participate in this year's survey due to a reallocation of resources.

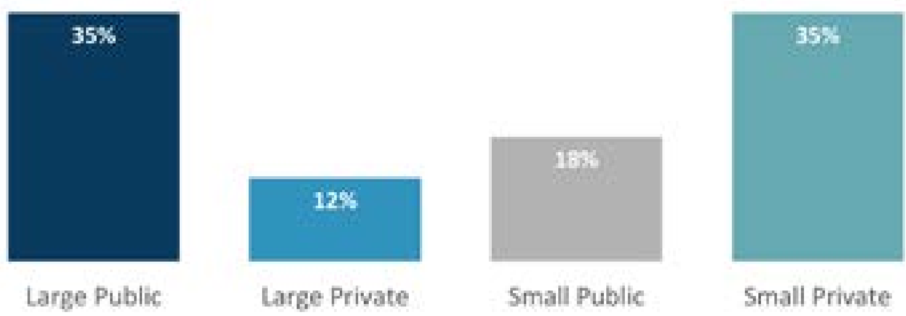
The Sponsor group was composed of both small and large firms. Sponsors managing more than $950 billion were considered large, and the makeup of our group was close to an even split, with 53% small firms and 47% large firms. Additionally, the group consisted of both publicly held and privately held firms, with an almost even split between the two; 53% of the ETF Sponsors were publicly held and 47% were privately held.

Every ETF Sponsor had ESG-mandated strategies; however, the percentage of AUM that these mandates represented varied greatly, with the smallest at just 0.05% of AUM and the largest at 100% of AUM. The average was roughly 28% of AUM and the median was 13% of AUM. In terms of Sponsor size and ownership struc-





We combined size and ownership structure, and our group of ETF Sponsors is summarized below.



ture, we found that the average ESG-mandated AUM for large firms was 24% versus 31% for small firms, and the median was roughly the same for both groups at around 13% of AUM. Public firms had an average of 27% of AUM in ESG-mandated strategies versus 28% for private firms. The median for each group was 12% of AUM and 21% of AUM, respectively.

We found these numbers surprisingly low, but encouraging. They indicate that ESG-mandated strategies, although popular in the investing world, still have room to grow. Overall, these ETF Providers manage about $4.2 trillion in ESG assets across all strategies, including ETF strategies.

Survey Overview & Overall Results

Our 2021 Sage Stewardship survey assessed six core areas of stewardship through the lens of 36 questions. This year, given the increased global attention on DEI, we introduced a series of questions focused on this topic and determined that DEI is core to stewardship practices. All responses were evaluated based upon the standards of practice Sage believes should be reflected on behalf of investors across the key focus areas. Most of the survey questions were designed to identify a simple “yes” or “no” answer, and each ETF Sponsor was given the opportunity to provide additional support information. Every question was assigned a one-, two-, or three-point maximum value, and poor responses received zero points. The maximum score value for responding to each of the survey questions was 42 points. Upon completion of our response evaluations, we then determined a letter grade (A, B, C, D, F) for each respondent that reflected the relative strength of their respective answers within the peer group for the key focus areas. Each of the focus area grades were then combined to create the cumulative Sage Stewardship Grade for each respondent.

2021 ETF Stewardship Survey Questions

Voting Practices

1) Does (the Sponsor) have independent proxy voting policies? If so, please provide the stated policies.
2) Does (the Sponsor) have a proxy voting advisor?
   a. If yes, in what capacity does (the Sponsor) utilize information from the advisor (e.g., research, voting recommendations)?
   b. If the information is used for voting recommendations, does (the Sponsor) align in-house voting policies with the recommendations? Please provide an example.
3) Are voting guidelines consistent across all strategies, asset categories, and geographic regions? Please provide a brief explanation.
4) Do varying rules and regulations regarding shareholder proposals affect (the Sponsor)'s voting behavior (e.g., in Europe versus the United States)? Please provide a brief explanation.
5) Does (the Sponsor) assess all non-routine voting activities? Please provide a brief explanation of this process.
6) For how many of the ETF portfolio companies does (the Sponsor) exercise direct voting rights? How are proxy voting decisions made? Are there thresholds (i.e., a proxy vote requires the company to have a minimum portfolio weight)?
7) In the past year, what percentage of votes has (the Sponsor) made in favor of portfolio company management positions?
8) What are (the Sponsor)'s views on engagement versus voting against company management?
9) Does (the Sponsor) view a negative vote as a way to effect change in a portfolio company? Please provide a brief explanation.
10) Does (the Sponsor) consider ESG factors when proxy voting? If so, please explain.
11) Does (the Sponsor) engage in securities lending?
   a. If so, what percentage of the portfolio holdings will (the Sponsor) lend?
   b. What is the security recall strategy of (the Sponsor)? Did this strategy undergo any changes during 2020 as a result of challenges due to COVID-19?

Engagement

1) How often does (the Sponsor) engage with ETF portfolio companies? Are engagements initiated on a scheduled basis or are they event driven?
2) Does (the Sponsor) have a formal corporate engagement strategy? If so, please attach.
3) What is the relationship between engagement and voting?
   a. When is engagement preferred over voting, and how often is each practice used?
   b. Is engagement ever used in lieu of a negative vote?
4) What information does (the Sponsor) seek from engagement with portfolio companies (e.g., operating data, ESG data, general information gathering, policy voting intentions)?
5) Are there industries in which engagements are of greater importance than in others? If so, please explain.
6) Is (the Sponsor) more or less likely to engage with companies that represent a higher portfolio weight? Please explain.
7) What team at (the Sponsor) is responsible for corporate engagement activities?
8) After engaging directly with a portfolio company, what is the time frame within which (the Sponsor) will allow portfolio companies to effect change? If there is no specific time frame, please provide an explanation.
9) How does (the Sponsor) determine if an engagement was successful?
10) Please provide examples of measurable changes that have occurred as a result of direct engagement(s) with companies.
11) Is there an escalation strategy post engagement if it is determined that necessary changes have not been made by the portfolio company?
12) Does (the Sponsor) participate in collaborative engagements through industry organizations (e.g., Ceres, PRI, USSIF, Climate Action 100+)? If so, please provide examples of collaborative engagements.
13) Does (the Sponsor) engage with policymakers or standard-setters? If so, please provide examples of these engagements.

2021 ETF Stewardship Survey Questions

Stewardship Professionals

1) Does (the Sponsor) have a dedicated stewardship evaluation team? If so, when was the team established and how many professionals are on the team?
2) In the past five years, how many professionals have been added to the stewardship team?

Disclosure

1) Please include voting records for FY 2020.
2) Please include examples of engagements with portfolio companies.

Climate Initiatives

1) What are the guiding principles for (the Sponsor)'s climate strategy?
2) Does (the Sponsor) monitor portfolio companies' oversight of climate-related risks and/or climate-related opportunities?
3) Please provide (the Sponsor)'s climate-specific voting record for FY 2020.
4) In general, does (the Sponsor) vote for resolutions requesting that portfolio companies disclose information on climate change risks and how they are managed (i.e., financial, physical, or regulatory risks they face related to climate change effects on operations and investments)?
5) Describe (the Sponsor)'s climate-related engagement strategies and scope. Please provide examples of climate-related engagements.

Diversity, Equity, and Inclusion

1) Does (the Sponsor) have a stated diversity, equity, and inclusion policy? Please attach.
2) Does (the Sponsor) monitor and report on the demographic information of its employees?
3) Does (the Sponsor) have an intentional DEI plan to promote equity at all levels of the company, including management, executive, and board levels?

2021 ETF Stewardship Survey Results

Firm Type	Overall Grade	Voting	Engagement	Stewardship	Disclosure	Climate	Diversity
Large Private 1	A	B	A	A	A	A	A
Small Public 1	A	A	A	A	A	A	A
Large Public 1	A	B	A	A	A	A	A
Large Public 2	B	C	A	A	A	A	A
Large Public 3	A	B	A	A	A	A	A
Small Private 1	B	B	F	A	A	B	A
Large Private 2	B	F	A	A	A	A	A
Small Private 2	D	C	F	F	F	F	A
Large Public 4	B	F	B	A	A	A	A
Large Public 5	B	B	A	A	F	F	A
Small Private 6	F	F	F	F	A	F	F
Small Private 3	B	C	B	A	A	A	D
Large Public 6	B	A	C	A	F	F	A
Small Private 4	C	F	A	A	A	D	A
Small Public 2	C	C	D	A	F	D	A
Small Private 5	D	F	D	A	A	D	A
Small Public 3	D	C	C	A	F	F	A

In general, we were pleased with the quality of the responses received from most ETF Providers, with 76% receiving an overall passing grade of C or higher, up from just 57% the prior year. Through our grading and analysis, we found that approximately 75% of repeat respondents had improved their scores and 25% had no change. Additionally, while last year's survey saw no overall 'A' letter grades, we are pleased to have four respondents earn an 'A' this year. These results are very intriguing and show the positive correlation between engagement and outcome.

The results also show a correlation between size and ownership structure and overall grade distribution. Large firms tended to fare well on our survey, with an average overall score of B. For large firms, ownership structure had no effect on grades; both large public and large private firms had an average score of B. Smaller firms had an average score of C, but when segmented by private versus public, there was a noticeable difference. Small publicly held firms had an average score of B versus an average score of C for privately held small firms.

That said, there were a few outliers in each group that skewed the average; most notably, one of our highest-scoring firms was a small publicly held firm that pulled up the average for that group. Given the attention that proxy voting, stewardship, and sustainability have been given in recent years, it is not surprising that both large and publicly held firms' activities are being increasingly scrutinized by investors, who are demanding better performance on voting, engagement, sustainability, and transparency.

The Relationship Between Voting and Engagement

The first two sections of our survey addressed voting and engagement policies. We view voting and engagement as complementary and necessary to completing the active ownership piece of the stewardship puzzle. Voting allows ETF Providers to make their stance on an issue known and also effect change. Engagement is an equally important active ownership tool. It allows ETF Providers to partner with portfolio companies and work toward longer-term goals.

As an example, an ETF Provider may choose to engage with an oil and gas company on plans for greater disclosure of greenhouse gas emissions or on strategies to adjust their product mix to include a greater proportion of renewables. Many ETF Providers cite this partnership as an important aspect of the trust-building between portfolio companies and the ETF Providers, and they utilize this partnership to further the progress of meaningful change. In this year's survey, we saw increased transparency from ETF Providers around both voting decisions and engagements, which we believe has been largely fueled by investor demand.

Voting Practices

Voting is an essential part of the stewardship process for each ETF Sponsor, as it can determine some of the largest strategic decisions facing portfolio companies. Like individual stock investors, ETF Sponsors can vote on board members, executive compensation, and sustainability reporting, to name a few. Put simply, voting allows investors to have a say in how companies are run. This is especially important for ETFs that follow an index.

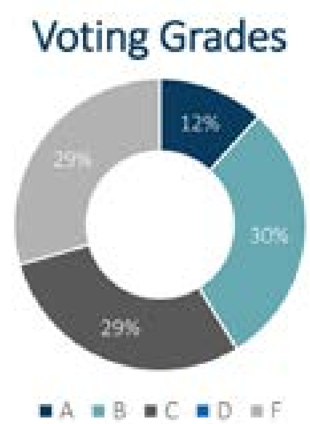
> "According to Morningstar, index investing's growing market share compounds the importance of the proxy voting process…Index funds don't have a choice in which stocks to own…ultimately the only lever they have is through their votes.[1]"

Therefore, we examine the voting practices of the Sponsors in detail. In a recent speech, former acting director of the SEC Allison Herren Lee made it clear that the SEC wants more transparent and broad disclosure of fund company voting practices and decisions to ensure they are aligned with stakeholder views.[5]

Voting Process Improvements

Each year before we send the survey to ETF Sponsors, we evaluate each survey section from the previous year and look for ways to improve not only the selection of questions, but the way in which we ask each question. This year in our voting practices section, we made a few minor changes to the set of questions to improve the clarity of responses. We expanded upon our questions regarding proxy voting advisors and the use of recommendations from those advisors. Additionally, we added new questions regarding voting guidelines across strategies, asset categories, and geographic regions, as those can be defining factors for Sponsor voting activities. Lastly, we sought to gain a better understanding of voting versus engagement and the Sponsors' views on how the two shape the stewardship process.

Most of the respondents (71%) received a passing grade of C or above, up from 64% in 2020. Compared to last year, 84% of repeat respondents received the same score or better.



Our first question asked respondents about their independent proxy voting policy. We found that the vast majority (94%) of participants have a formal policy in place, with one respondent utilizing the policy of their proxy voting advisor. Three-fourths (76%) of respondents gained an extra point by providing details about their policies for voting on specific issues, and only 18% (three Sponsors) did not get the extra point due to insufficient detail.

We believe ETF Sponsors should take an active role in voting, and last year's survey revealed that most voting decisions were being outsourced to third-party firms; 100% of respondents indicated that they utilized a proxy voting advisor, such as Institutional Shareholder Services (ISS) or Glass Lewis. This year, 94% of respondents indicated that they utilize at least one external proxy advisor, with only one respondent conducting all proxy voting research and decision making in-house.

One emerging trend this year was that proxy advisors have become more of a research tool rather than a recommendation source, with 44% of ETF Providers using the advisor exclusively for research, up from just 21% last year. The majority (75%) of respondents indicated that they exercise direct voting rights for all ETF portfolio companies, a significant increase from 2020, when only half of the respondents indicated they did so. (Credit was given to ETF Sponsors who had at least a 90% voting rate and could provide an explanation as to why they are sometimes unable to vote.) We find this to be a positive change and it signifies that the ETF Sponsors are more active in making their proxy voting decisions. This also supports evidence that we've seen that ETF Sponsors have been increasingly pressured by shareholders, regulators, activists, and others to become more engaged in their proxy voting process.

In terms of ESG, last year we were surprised to find that although 93% of our respondents indicated that ESG-related factors had a direct impact on their voting behavior, only 64% explained how and what factors impacted their proxy decisions. This year was similar in that 94% of respondents indicated that ESG factors impact their voting behavior; however, the explanation improved substantially. We found that 63% of respondents had ESG-specific sections of their voting guidelines. Many were highly transparent about these voting activities and had multiple policies, including details regarding shareholder proposals related to ESG issues such as climate risk and DEI. Only a few respondents chose to subscribe to the ESG proxy voting guidelines of their proxy voting advisor. While we would prefer an independent policy, this is a step in the right direction, especially for smaller participants with fewer ESG-specific resources.

Last year, we highlighted a Morningstar report that found that from 2014 to 2019, five of the 10 largest fund families voted against more than 88% of ESG-related shareholder proposals. This was an issue, as many of the large fund families were active participants in the conversation about furthering ESG but were not proxy voting in line with their policies; instead, they were likely avoiding disrupting the status quo and, in effect, portfolio company management. This year, we saw an improvement, with 63% of respondents indicating they voted in opposition to management ballot proposals more than 10% of the time, up from the 50% of respondents that did so in 2020, a significant improvement.

Lastly, we examined each ETF Sponsor's securities lending policy. This section is important because when ETF Sponsors engage in securities lending, they may be forfeiting their right to proxy vote. The tradeoff is that the ETF may benefit from income generated from securities lending. Most respondents indicated that they participate in securities lending, and almost half took the time to explain that they do so to generate income for the fund. Only two Providers choose not to lend securities and refer to the ownership of clients' assets as paramount to the possible reward of income for the fund.

Engagement

Engagement Process Improvements

Just as voting is an essential part of stewardship, so too, is engagement. Engagement is a vital piece of the puzzle; therefore, we need to ask not only the right questions, but also the most direct questions to determine the strength of each Sponsor's practices. This year's engagement process improvements included several new questions regarding not only engagement style, but also escalation and follow-up strategies. Additional questions included inquiries on engagement initiation and how the decision to engage is made. This provided insight into the factors driving the engagement process and whether it is a proactive or reactive process for the Sponsors.

We added questions regarding the relationship between voting and engagement, the frequency of both practices, how companies are selected for engagement, and whether those decisions were impacted by industry and portfolio weight. Lastly, we added questions on measuring outcomes of engagements and escalation strategies.

The percentage of participants who passed this section with a C or higher was the same in 2020 and 2021 (71% passed). Of the repeat respondents, 42% improved, 50% saw no change, and 8% received a lower grade.

We believe there is no one right way to approach engagement; however, it should be used as a complement to proxy voting rather than a substitute, and the majority (94%) of respondents were in agreement with this view.

Many companies schedule regular engagements to discuss a variety of topics, and some use them as a response to an event. Therefore, we believe it's important for ETF Providers to have a formal set of guiding principles for their engagements. This year, the majority of respondents (76%) indicated that they have a formal engagement strategy, and 59% provided a detailed, company-specific response. Although the overall number of respondents with a formal engagement strategy decreased year over year (from 79% to 76%), most respondents did not or could not provide an explanation of their strategy last year. We saw great improvement in this question, with 71% of participants having formal and public engagement policies that they were able to attach to their survey.

Engagement policies were sometimes stand-alone, and sometimes paired in conjunction with the Sponsor's proxy voting policy under an "investment stewardship" policy umbrella. We do not have a preference, but we do commend those ETF Sponsors who carefully detail the ESG topics on which they often engage with portfolio companies. Engagement topics can vary from ESG-specific topics, such as broad environmental disclosures, Task Force on Climate-Related Financial Disclosures (TCFD), sustainability standards disclosure, pandemic-related response efforts, social supply-chain management issues, and governance issues, such as board independence and director recommendations.

We also asked participants about how they choose to initiate engagements, and 29% of respondents indicated that their engagements are industry dependent, meaning they will choose to deep dive with companies of an industry in which they find it important to drive change. Similarly, some respondents choose to prioritize engagements based on the percentage of portfolio weight a company comprises, especially smaller firms that may need to be more selective with their engagements due to having fewer stewardship professionals. Additionally, this year 76% of the respondents explained information gathered from engagements, up from only 71% in 2020. Almost all respondents indicated they have a plan in place for who at their company is responsible for engagements.

As all engagements have unique goals, we prefer companies to have concrete metrics for gauging the success of their engagements. This year, 76% of respondents indicated they have metrics to determine the success of engagements, and of those who do not have concrete metrics, 18% explained their methods of determining success. This is an improvement from 2020 when only 43% of respondents indicated they had metrics to determine the success of an engagement.

One way ETF Providers can gauge the success of an engagement or choose to escalate the issue is by setting a time frame in which they expect the portfolio company to enact change. Only one respondent indicated they set time frames, and most respondents explained why they don't. Many respondents chose to communicate that they expect change within a "reasonable amount of time," which we find acceptable when combined with a strategy for an expected outcome.

Lastly, this year we took the questions a step further and asked the Sponsors to provide us with examples of measurable changes that have occurred because of direct engagement with a portfolio company. We were pleased to find that 76% of respondents provided examples. These examples help investors understand the discussions between ETF Sponsors and portfolio companies, and if there are measurable and demonstratable outcomes from those engagements.

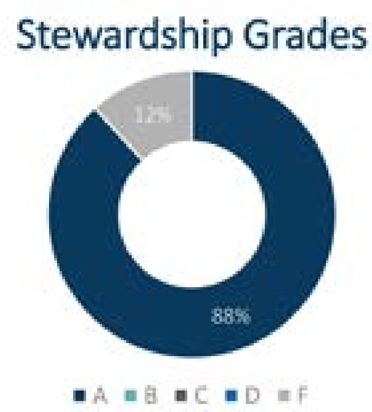
Stewardship Professionals

Stewardship Process Improvements
Our Stewardship Professionals section improves our understanding of how ETF Providers allocate resources to the practice of stewardship. This gives us insight into both the level of commitment to the stewardship process and how well ETF Sponsors tackle the very complicated and large-scale task of voting and engaging. Recently there has been a hiring spree of individuals that specialize in ESG and stewardship at major asset management and accounting firms. As an example, PwC is investing $12 billion over five years to build out its ESG capabilities and create around 100,000 new jobs in the space.[6]

> According to the *Financial Times*, the number of people in the stewardship teams of the leading fund houses almost doubled between 2017 and 2020.[7]

This year, we streamlined the stewardship section and asked only the most important questions about dedicated stewardship evaluation teams and additions to those teams. The stewardship grades showed immense improvement, with respondents who earned a passing grade of C or higher totaling 88% compared to 64% in 2020. The grades were quite polar, however, with all passing respondents earning the highest possible score for the section and the other 12% failing. We note that there was significant improvement in the pool of repeat respondents, with 75% improving their grades and 25% maintaining their 2020 grades. No repeat respondents received a lower grade.

Nearly all respondents (88%) indicated they have a dedicated stewardship evaluation team, and in the past five years, the same percentage have added to the team. This is not surprising, as stewardship has grown increasingly important in the past decade and companies are committing more resources to it. Compared to last year, this number saw a slight decrease (down from 93%), which is most likely due to our addition in 2021 of more small firms that tend to have fewer resources.



While we do attribute these grade increases to our process improvements, overall we believe there is a trend in companies allocating more resources to ESG, and that includes ESG-specific personnel.

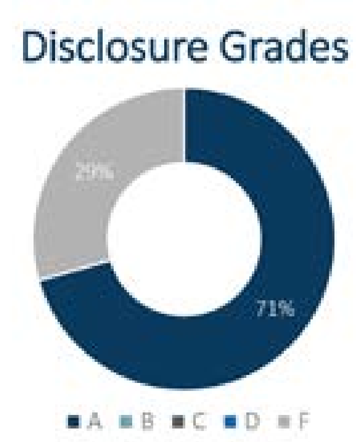
Disclosure

Disclosure Process Improvements
Disclosure is extremely important in the evaluation of ETF Sponsors' stewardship processes. Transparency is the key to understanding how operations are managed internally, followed by their external communication on those operations. This year, as in the past, we focused on disclosure of voting records and engagements to better understand the outcomes that are driven by both. The outcome analysis helps to gauge the effectiveness of each ETF Sponsor's engagement strategy.

Recent changes in European regulation requirements under the Sustainable Finance Disclosure Regulation (SFDR) have challenged U.S. fund companies operating in Europe, according to *The Wall Street Journal*.

> Surging investor appetite for green investments means that rules on disclosure, both for traditional funds and those that call themselves sustainable, will become increasingly important.[9]

This section saw one of the highest grade increases in the survey. While only 36% passed the disclosure section with a score of C or higher in 2020, 71% passed this year. Of the repeat respondents, 17% improved their grades and 83% saw no change. None worsened. This indicates that the improvement in grades was driven by many of our new participants, and in fact, 100% of our new participants scored the highest possible grade for the disclosure section.



All respondents attached their proxy voting records; however, some respondents still took us on a wild goose chase when it came to questions related to voting records (votes against management) and in the climate section (climate-related voting records). While those respondents often lost points, they received a boost in the disclosure section due to the regulation surrounding proxy voting records—they are required to be posted on the SEC website. Unfortunately, the SEC disclosure form is difficult to understand and compare across fund complexes. In fact, Morningstar's director of investment stewardship research has called the documents "impenetrable" and unusable for retail investors. While we gave credit this year for the SEC link alone, in the future we will be demanding more transparency of voting records and disclosure of more meaningful information.

Overall, we observed an increased openness to discuss engagement in detail and not in anonymity, and 71% of companies provided examples of engagements with portfolio companies, up from only 36% in 2020. About a third (29%) of those who did not provide examples provided anonymous examples. Additionally, in 2020 we included a question asking for an example of engagements in the survey Engagement section. Only 57% provided an example in 2020, so overall, we believe that ETF Sponsors are beginning to place more emphasis on sharing company engagements with shareholders and the public.

Climate

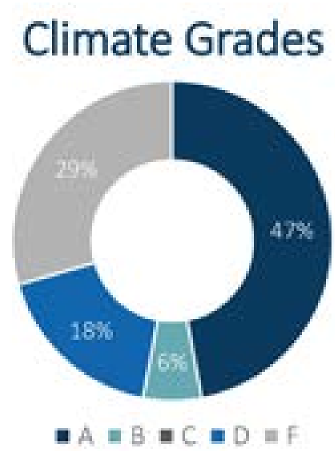
> The influence and power that investment managers hold through the investment capital they can provide to companies worldwide is pivotal to achieving meaningful climate change outcomes.

Climate change has taken center stage in investors' minds, and last year we added the climate section to better understand ETF Sponsors' climate change policies and oversight. How companies handle their emissions, pollution, and resource use is vital to how our society will slow climate change, which is becoming clearer to companies as wildfires, rising sea levels, and droughts continue to make headlines and affect business operations.[19]

The U.S. has signaled strong support for climate change initiatives, with the Biden Administration rejoining global efforts such as the Paris Climate Agreement. Additionally, the SEC is focusing on climate-related disclosures by companies,[8] signaling a strong shift toward greater regulation and disclosure surrounding climate risks.

Climate Process Improvements

Last year, responses to our climate section varied, with 50% of participants earning a passing grade of C or higher. This year, we further refined our questions on this subject and focused on a few key ideas surrounding guiding principles for climate strategy at the firm level, as well as climate-related voting decisions and general support for climate-friendly resolutions. Additionally, we concentrated on climate-related engagements and examples from those engagements. We saw a slight improvement in grades, with 53% of participants passing with a grade of C or higher. Of the repeat respondents, 25% improved, 75% saw no change, and none worsened.



The majority (76%) of respondents indicated that they have guiding principles for climate, and one respondent explained that they are working to craft this for the future. The majority (71%) of respondents indicated that they monitor portfolio oversight of climate-related risk, which we find to be critical, as physical climate risk and regulatory risk related to climate can have a tangible effect on the bottom line.

The majority (69%) of respondents provided their voting records on climate-related proposals; however, some chose to attach an exhaustive list of their participation in every single climate-related vote for 2021, making it far more difficult to gauge their overall pro-climate issue voting rate. We had 71% of participants indicate that they have a specific climate-related engagement strategy, and they were able to give examples of that climate engagement strategy.

Although the overall climate grades have not seen outright significant improvement, this year only 12% of participants scored very poorly with no points awarded, which is a positive indicator that most companies are considering climate to be an important part of their stewardship activities. Integrating climate considerations takes time and resources, and we find that most companies are doing their part to move in the right direction.

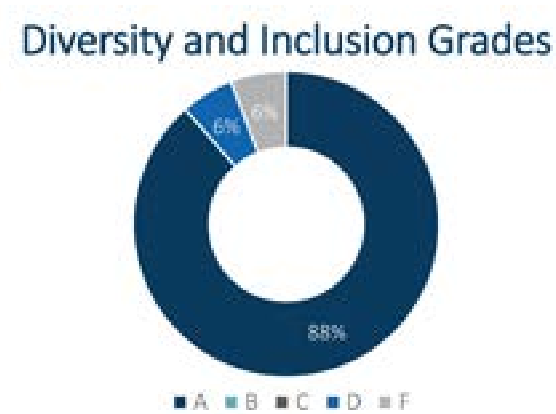
Diversity, Equity, and Inclusion

DEI Background & Process Introduction

One of the biggest impacts from the tumultuous year of 2020 was the increased focus on diversity, equity, and inclusion (DEI). The last section of the survey is new this year and focuses on understanding how the ETF Sponsors approach these issues within their own company operations.

Research has shown there is a positive correlation between DEI factors and corporate performance, including a popular McKinsey study that found companies in the top quartile for gender diversity in corporate leadership had a 21% likelihood of outperforming bottom-quartile industry peers. Leaders in racial and ethnic diversity are 33% more likely to outperform peers on profitability.[10]

Our goal was to better understand how the ETF Sponsors are handling this important issue and what their strategy is for further progress. We asked them about their in-house diversity policies, diversity monitoring practices, and plans to increase diversity in the coming years. We were pleasantly surprised to find most respondents excelled in this section, and 88% passed with a perfect score.



An inclusive environment is paramount to talent acquisition and retention, and companies should exercise due diligence to prevent and eliminate discrimination in the workplace. According to *Harvard Business Review*, "creating an environment where people can be who they are, that values their unique talents and perspectives, and makes them want to stay."[11] When approaching DEI, the first step companies can take is to write principles into their formal policies. Of our respondents, 94% indicated that they have a stated DEI policy.

Tracking and reporting on the demographic information of employees is key to creating change. This data is the backbone of many internal diversity programs, and transparency indicates a willingness to address issues of diversity and inclusion. Almost all (94%) of the respondents indicated that they monitor and report the demographic information of employees. One respondent chose to keep that information private. A few participants cited being an Equal Employment Opportunity employer, meaning they monitor and report based on the Equal Employment Opportunity Commission metrics. We gave credit for this answer; however, equal opportunity employment became federally protected under the Civil Rights Act of 1964, so following solely those guidelines is neither groundbreaking nor forward-moving but rather a baseline starting point for diversity and inclusion.

A report from the U.S. House Committee on Financial Services found that the proportion of employees of color at top U.S. banks matches the percentage in the overall population, but most of those employees are entry-level and not senior management. This example reflects the importance of companies having resources in place to promote equity at all levels, and 94% of this year's respondents indicated that they have exactly that. Many cited programs and initiatives including recruiting initiatives, reviewing promotions, diversity focus groups, and mentorship programs. We expect to see continued emphasis on diversity and inclusion, and we are pleased with the progress we have already seen in this area.

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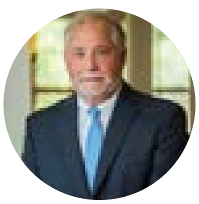

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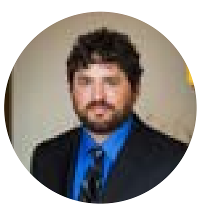

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