

FIRST TRUST ENHANCED EQUITY INCOME FUND
Form N-CSR
March 05, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-21586

First Trust Enhanced Equity Income Fund
(Exact name of registrant as specified in charter)

120 East Liberty Drive, Suite 400
Wheaton, IL 60187
(Address of principal executive offices) (Zip code)

W. Scott Jardine, Esq.
First Trust Portfolios L.P.

120 East Liberty Drive, Suite 400
Wheaton, IL 60187
(Name and address of agent for service)

registrant's telephone number, including area code: (630) 765-8000

Date of fiscal year end: December 31

Date of reporting period: December 31, 2018

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the

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burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

Item 1. Reports to Stockholders.

The Report to Shareholders is attached herewith.

First Trust
Enhanced Equity Income Fund (FFA)
Annual Report
For the Year Ended
December 31, 2018

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First Trust Enhanced Equity Income Fund (FFA)

Annual Report

December 31, 2018

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Caution Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements regarding the goals, beliefs, plans or current expectations of First Trust Advisors L.P. (“First Trust” or the “Advisor”) and/or Chartwell Investment Partners, LLC (“Chartwell” or the “Sub-Advisor”) and their respective representatives, taking into account the information currently available to them. Forward-looking statements include all statements that do not relate solely to current or historical fact. For example, forward-looking statements include the use of words such as “anticipate,” “estimate,” “intend,” “expect,” “believe,” “plan,” “may,” “should,” “would” or other words that convey uncertainty of future outcomes.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of First Trust Enhanced Equity Income Fund (the “Fund”) to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. When evaluating the information included in this report, you are cautioned not to place undue reliance on these forward-looking statements, which reflect the judgment of the Advisor and/or Sub-Advisor and their respective representatives only as of the date hereof. We undertake no obligation to publicly revise or update these forward-looking statements to reflect events and circumstances that arise after the date hereof.

Managed Distribution Policy

The Board of Trustees of the Fund has approved a managed distribution policy for the Fund (the “Plan”) in reliance on exemptive relief received from the Securities and Exchange Commission which permits the Fund to make periodic distributions of long-term capital gains more frequently than otherwise permitted with respect to its common shares subject to certain conditions. Under the Plan, the Fund currently intends to pay a quarterly distribution in the amount of \$0.285 per share. A portion of this quarterly distribution may include realized capital gains. This may result in a reduction of the long-term capital gain distribution necessary at year end by distributing realized capital gains throughout the year. The annual distribution rate is independent of the Fund’s performance during any particular period but is expected to correlate with the Fund’s performance over time. Accordingly, you should not draw any conclusions about the Fund’s investment performance from the amount of any distribution or from the terms of the Plan. The Board of Trustees may amend or terminate the Plan at any time without prior notice to shareholders.

Performance and Risk Disclosure

There is no assurance that the Fund will achieve its investment objective. The Fund is subject to market risk, which is the possibility that the market values of securities owned by the Fund will decline and that the value of the Fund shares may therefore be less than what you paid for them. Accordingly, you can lose money by investing in the Fund. See “Risk Considerations” in the Additional Information section of this report for a discussion of certain other risks of investing in the Fund.

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month-end performance figures, please visit www.ftportfolios.com or speak with your financial advisor. Investment returns, net asset value and common share price will fluctuate and Fund shares, when sold, may be worth more or less than their original cost. The Advisor may also periodically provide additional information on Fund performance on the Fund’s web page at www.ftportfolios.com.

How to Read This Report

This report contains information that may help you evaluate your investment in the Fund. It includes details about the Fund and presents data and analysis that provide insight into the Fund’s performance and investment approach. By reading the portfolio commentary by the portfolio management team of the Fund, you may obtain an understanding of how the market environment affected the Fund’s performance. The statistical information that follows may help you understand the Fund’s performance compared to that of relevant market benchmarks. It is important to keep in mind that the opinions expressed by personnel of First Trust and Chartwell are just that: informed opinions. They should not be considered to be promises or advice. The opinions, like the statistics, cover the period through the date on the cover of this report. The material risks of investing in the Fund are spelled out in the prospectus, the statement of additional information, this report and other Fund regulatory filings.

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Shareholder Letter

First Trust Enhanced Equity Income Fund (FFA)

Annual Letter from the Chairman and CEO

December 31, 2018

Dear Shareholders,

First Trust is pleased to provide you with the annual report for the First Trust Enhanced Equity Income Fund (the “Fund”), which contains detailed information about the Fund for the twelve months ended December 31, 2018, including a market overview and performance analysis. We encourage you to read this report carefully and discuss it with your financial advisor.

As I wrote in my June 2018 letter, investors were hoping for another strong year in the markets for 2018. For the entire year, however, increased market volatility was the norm for U.S. and global markets. Despite the volatility, August was a strong month for stocks, and the Dow Jones Industrial Average (“DJIA”) finished the month just under its previous high in January 2018. At the close of the third quarter in September, the markets had moved higher into positive territory. In fact, all three major U.S. indices (the Nasdaq Composite Index, the DJIA and the S&P 500[®] Index) hit record levels during the third quarter. Yet, in October, markets were again very volatile, surprising analysts and investors alike. Both global markets and U.S. markets fell on fears of slowing growth, trade wars and higher interest rates. The DJIA was down 5% for October and the MSCI EAFE Index, an index of stocks in 21 developed markets (excluding the U.S. and Canada), was down 9% for the month. However, investors cheered as November ended, and the DJIA climbed 617 points (2.5%) to its biggest one-day gain in eight months. The MSCI EAFE Index ended November down slightly. December held its own shocks as it became the worst December for stocks since the Great Depression. The DJIA and the MSCI EAFE Index ended December with year-to-date returns of -3.48% and -13.79%, respectively.

Based on continued strong job growth and the economic outlook in the U.S., the Federal Reserve (the “Fed”) raised interest rates in March, June and September. At their September meeting, the Fed indicated the possibility of one additional rate hike in 2018 and three more in 2019. At their November meeting, the Fed did not raise interest rates. However, at their December 19th meeting, the Fed did raise interest rates by 25 basis points. Analysts and investors will be watching to see what the Fed does with rates in 2019.

While trade tensions have had an impact on markets around the world and could continue to do so in the future, our economists believe that the long-term impact of U.S. tariffs will be to encourage countries to come back to the table and talk about more equal trade. Despite market volatility, we continue to believe that the combination of low interest rates, low inflation and strong corporate earnings still point to a positive economic environment and further growth, though we understand that past performance can never guarantee future performance.

We continue to believe that you should invest for the long term and be prepared for market movements, which can happen at any time. You can do this by keeping current on your portfolio and by speaking regularly with your investment professional. Markets go up and they also go down, but savvy investors are prepared for either through careful attention to investment goals.

Thank you for giving First Trust the opportunity to be a part of your financial plan. We value our relationship with you and will report on the Fund again in six months.

Sincerely,

James A. Bowen

Chairman of the Board of Trustees

Chief Executive Officer of First Trust Advisors L.P.

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First Trust Enhanced Equity Income Fund (FFA)

“AT A GLANCE”

As of December 31, 2018 (Unaudited)

Fund Statistics

Symbol on New York Stock Exchange	FFA
Common Share Price	\$12.92
Common Share Net Asset Value (“NAV”)	\$13.89
Premium (Discount) to NAV	(6.98)%
Net Assets Applicable to Common Shares	\$277,443,007
Current Quarterly Distribution per Common Share ⁽¹⁾	\$0.2850
Current Annualized Distribution per Common Share	\$1.1400
Current Distribution Rate on Common Share Price ⁽²⁾	8.82%
Current Distribution Rate on NAV ⁽²⁾	8.21%
Common Share Price & NAV (weekly closing price)	

Performance

	Average Annual Total Return			
	1 Year Ended 12/31/18	5 Years Ended 12/31/18	10 Years Ended 12/31/18	Inception (8/26/04) to 12/31/18
Fund Performance ⁽³⁾				
NAV	-9.19%	5.37%	10.20%	6.16%
Market Value	-13.86%	6.69%	11.96%	5.29%
Index Performance				
S&P 500 [®] Index	-4.38%	8.49%	13.12%	8.10%
CBOE S&P 500 BuyWrite Monthly Index ⁽⁴⁾	-4.77%	5.08%	7.96%	5.03%

Top Ten Holdings **% of Total Investments**

Microsoft Corp.	5.8%
Apple, Inc.	4.3
JPMorgan Chase & Co.	3.3
UnitedHealth Group, Inc.	2.8
Merck & Co., Inc.	2.8
Thermo Fisher Scientific, Inc.	2.6
Pfizer, Inc.	2.3
Chevron Corp.	2.3
Intel Corp.	2.2
Carnival Corp.	2.0
Total	30.4%

Sector Allocation **% of Total Investments**

Information Technology	22.8%
Health Care	15.2
Financials	14.1
Consumer Discretionary	11.1
Communication Services	9.1
Industrials	8.0
Energy	6.7
Consumer Staples	6.3

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Utilities	3.0
Real Estate	2.8
Materials	0.9
Total	100.0%

(1) Most recent distribution paid or declared through 12/31/2018. Subject to change in the future.

(2) Distribution rates are calculated by annualizing the most recent distribution paid or declared through the report date and then dividing by Common Share Price or NAV, as applicable, as of 12/31/2018. Subject to change in the future.

(3) Total return is based on the combination of reinvested dividend, capital gain, and return of capital distributions, if any, at prices obtained by the Dividend Reinvestment Plan and changes in NAV per share for NAV returns and changes in Common Share Price for market value returns. Total returns do not reflect sales load and are not annualized for periods of less than one year. Past performance is not indicative of future results.

(4) BXM is the ticker for this index and was how the index was referenced in previous reports.

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Portfolio Commentary

First Trust Enhanced Equity Income Fund (FFA)

Annual Report

December 31, 2018 (Unaudited)

Advisor

First Trust Advisors L.P. (“First Trust” or the “Advisor”) is the investment advisor to the First Trust Enhanced Equity Income Fund (the “Fund”). First Trust is responsible for the ongoing monitoring of the Fund’s investment portfolio, managing the Fund’s business affairs and providing certain administrative services necessary for the management of the Fund.

Sub-Advisor

Chartwell Investment Partners, LLC (“Chartwell”), a wholly-owned subsidiary of TriState Capital Holdings, Inc., is a research-based equity and fixed-income manager with a disciplined, team-oriented investment process. Chartwell is the portfolio manager of the Fund.

Portfolio Management Team

Douglas W. Kugler, CFA

Principal, Senior Portfolio Manager

Peter M. Schofield, CFA

Principal, Senior Portfolio Manager

Commentary

First Trust Enhanced Equity Income Fund

The Fund’s investment objective is to provide a high level of current income and gains and, to a lesser extent, capital appreciation. The Fund pursues its investment objective by investing in a diversified portfolio of equity securities.

Under normal market conditions, the Fund pursues an integrated investment strategy in which the Fund invests substantially all of its Managed Assets in a diversified portfolio of common stocks of U.S. corporations and U.S. dollar-denominated equity securities of non-U.S. issuers in each case that are traded on U.S. securities exchanges. In addition, on an ongoing and consistent basis, the Fund writes (sells) covered call options on a portion of the Fund’s Managed Assets. “Managed Assets” means the total asset value of the Fund minus the sum of the Fund’s liabilities, including the value of call options written (sold). There can be no assurance that the Fund’s investment objective will be achieved. The Fund may not be appropriate for all investors.

Market Recap

The S&P 500[®] Index (the “Index”) declined -4.38% (inclusive of dividends) for the 12-month period ended December 31, 2018, breaking a streak of nine consecutive years of positive total returns. This was despite the Index reaching an all-time high of 2,930.75 on September 20, 2018. From that high the market proceeded to decline 19.8% reaching its low for the year on December 24, 2018 and barely avoiding entering into the first “bear” market (off more than 20% from its high) in over a decade. While there were many factors that drove this precipitous decline, two stood out to us. First, we believe there were fears of a global economic slowdown driven by the “trade war” with China and weakness in Europe stemming from the ongoing “Brexit” negotiations. Second, we believe the market became worried that the Federal Reserve (the “Fed”), by continuing to increase short-term interest rates along with reversing their “quantitative easing” policies, could possibly drive the domestic economy into a recession. In our view, the combination of these (and other) factors drove the Index to its worst December performance since 1931. In our June 30, 2018 letter in the Semi-Annual Report, we described the extreme volatility of the Index in the first quarter of 2018. That level of volatility returned in the fourth quarter of 2018 with the Index seeing price only moves of: -6.9%, +1.8%, -9.2% in October, November, and December, respectively. Another measure of volatility shows that during 2018 the Index moved more than 1% up or down from its previous day’s close 64 times, including 20 times when the market moved by 2% up or down from the previous close. In all of 2017, 1% moves occurred only eight times while there were no 2% moves. Meanwhile, the domestic economy and corporate earnings continued on solid footing. The employment picture continued to be strong, the consumer continued to spend and corporations benefited from strong sales, relatively tame wage inflation and the lower tax rates which were passed late last year. The 10-year U.S. Treasury yield saw volatility as well but generally rose during the first three quarters of the year. However, as recession fears began to rise, the yield retreated. The yield rose from 2.43% at the start of the year and reached a high of 3.23% in

early November before the aforementioned recession fears drove it down to close at 2.68% on December 31, 2018. The Fed continued raising the Fed Funds rate, increasing it by 1.0% over the course of the year to a still relatively low range of 2.25% to 2.50%. However, these increases combined with a slower increase in longer-term rates brought about a flattening of the yield curve which exacerbated fears of a possible domestic recession. Meanwhile, the price of a barrel of West Texas Intermediate (WTI), the domestic benchmark price for oil, started the year at \$60.42 per barrel. And, while it generally rose through October, reaching a high of \$76.41 per barrel, increasing fears of a possible global economic slowdown occurring sooner than expected and excess inventories brought the price down significantly to close at \$45.41 per barrel at year end.

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Portfolio Commentary (Continued)

First Trust Enhanced Equity Income Fund (FFA)

Annual Report

December 31, 2018 (Unaudited)

An OPEC meeting in late November where the cartel decided to reduce production helped the price of oil find a bottom during the last weeks of the year.

Performance Summary

For the 12-month period ended December 31, 2018, the Fund's net asset value ("NAV") and market value total returns were -9.19% and -13.86%, respectively, on a total return basis. The Index returned -4.38% on a total return basis over the same period. The covered call options program had a negative influence on the Fund's return during the period. As we've discussed, there were several periods of very rapid and large price movements in the market during the year which made it difficult for the program to perform up to our expectations. As discussed in the past, the Fund's portfolio tends to favor higher-yielding and value-oriented stocks given our emphasis on providing high current income and our predilection to invest in stocks which we believe to be undervalued when compared to their fundamentals. These leanings caused the Fund to face several broad-based headwinds that hurt the portfolio's relative performance. While the headwind impacting higher-yielding stocks was not as strong as previous years, the headwind facing value-oriented stocks when compared to growth-oriented stocks was still significant. As an example of this, the Russell 1000[®] Growth Index returned -1.52% while the Russell 1000[®] Value Index returned -8.28% for the year (both inclusive of dividends). Within the portfolio, the largest detractor to relative performance was stock selection within the Consumer Discretionary and Communication Services sectors. Not holding Amazon.com was the largest negative contributor, while holdings in Carnival Corp., Alibaba Group Holding Ltd., Lions Gate Entertainment Corp., and Electronic Arts, Inc. were weak. Also hurting relative performance were holdings in the Technology firm, Applied Materials, Inc. and the Transportation firm, FedEx Corp. Positive contributions to relative performance came from stock selection in the Bank sector where not holding either Citigroup Inc. or Wells Fargo & Company helped along with holding SVB Financial Group. In addition, stock selection in the Health Care sector with holdings of Merck & Co., Inc., Thermo Fisher Scientific, Inc. and Pfizer, Inc. was beneficial.

Market Outlook

The year 2018 was the first negative total return year for the Index in the last 10 years. It has been quite a rally over those last 10 years with the market up just over 13% annualized (inclusive of dividends). The question then for 2019 is can the Index get back to its 'winning' ways? While recession fears have grown, from the indicators we watch, we do not believe a recession is imminent. However, the longevity of this economic expansion combined with slowing growth internationally (China, Europe) does give us some concern that something could tip the U.S. economy into recession. At this point, the largest risk we see to the economic expansion is if the current trade tensions between the United States and China grow into something more significant. Among other risks, in our opinion, are the Fed raising rates too fast and Europe slowing more dramatically if the "Brexit" issue continues to drag on or is resolved in a manner which significantly disrupts business on the Continent. While corporate earnings have been very strong during the first three quarters of 2018, exceeding 20%, it appears as if the fourth quarter's growth will slow and expectations for earnings growth in 2019 have also declined. Despite the apparent slowing in corporate earnings growth, earnings are still rising, and when combined with the market's decline, valuations have become more reasonable. We believe these reductions in valuation and growth expectations have been good for the overall market and may well form a base from which the market could rise. In our view, absent any unexpected significant economic slowing, corporate earnings should continue to improve this year on the back of lower taxes and solid consumer spending, but corporations could slow down investment due to uncertainty surrounding global trade and that would likely have ripple effects that could further slow earnings growth. Overall though, we believe that companies have learned how to operate well in the low gross domestic product growth environment and that the uptick in mergers and acquisitions will continue as will strong stock repurchases which should help companies in their search for earnings growth.

Our belief is that without any significant global trade reducing actions being taken by the United States (or any of its larger trading partners), or a policy mistake by the Fed, the economy should continue to grow at a reasonable, but not overly strong rate, and corporate profits should continue to grow as well. We believe this could provide a solid backdrop for the market going forward despite the uncertainties surrounding geopolitics, fears of recession, and

possible future actions by the Fed. And, in our opinion, should the specter of the fears we have enumerated decline, market valuations could increase providing for an even better backdrop for the market. No matter the outcome of these issues, we will manage the Fund with the objective of providing a high level of current income and gains and, to a lesser extent, capital appreciation over the market cycle.

Total return is based on the combination of reinvested dividend, capital gain and return of capital distributions, if any, at prices obtained by the Dividend Reinvestment Plan and changes in NAV per share for NAV returns and changes in Common Share Price for market value returns. Total returns do not reflect sales load and are not annualized for periods of less than one year. Past performance is not indicative of future results.

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First Trust Enhanced Equity Income Fund (FFA)

Portfolio of Investments

December 31, 2018

Shares	Description	Value
	COMMON STOCKS – 93.3%	
	Aerospace & Defense – 1.7%	
31,000	Raytheon Co. (a)	\$4,753,850
	Air Freight & Logistics – 0.9%	
15,000	FedEx Corp.	2,419,950
	Automobiles – 1.2%	
95,000	General Motors Co.	3,177,750
	Banks – 6.2%	
94,000	JPMorgan Chase & Co. (a)	9,176,280
200,000	KeyCorp	2,956,000
55,000	SunTrust Banks, Inc. (a)	2,774,200
12,000	SVB Financial Group (b)	2,279,040
		17,185,520
	Beverages – 2.8%	
85,000	Coca-Cola (The) Co.	4,024,750
23,500	Constellation Brands, Inc., Class A	3,779,270
		7,804,020
	Biotechnology – 1.0%	
42,500	Celgene Corp. (b)	2,723,825
	Capital Markets – 1.2%	
80,000	Charles Schwab (The) Corp.	3,322,400
	Chemicals – 0.8%	
15,000	Linde PLC	2,340,600
	Communications Equipment – 2.0%	
127,500	Cisco Systems, Inc. (a)	5,524,575
	Diversified Telecommunication Services – 2.0%	
190,000	AT&T, Inc. (a)	5,422,600
	Electric Utilities – 3.0%	
100,000	Exelon Corp.	4,510,000

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135,000	PPL Corp. (a)	3,824,550
		8,334,550
	Electronic Equipment, Instruments & Components – 1.0%	
45,000	Keysight Technologies, Inc. (b)	2,793,600
	Energy Equipment & Services – 1.0%	
137,500	TechnipFMC PLC (a)	2,692,250
	Entertainment – 4.1%	
115,000	Cinemark Holdings, Inc. (a)	4,117,000
33,000	Electronic Arts, Inc. (b)	2,604,030
135,000	Lions Gate Entertainment Corp., Class B	2,008,800
26,500	Take-Two Interactive Software, Inc. (b)	2,727,910
		11,457,740
	Food & Staples Retailing – 1.7%	
23,000	Costco Wholesale Corp. (a)	4,685,330
	Health Care Equipment & Supplies – 1.0%	
80,000	Boston Scientific Corp. (b)	2,827,200
	Health Care Providers & Services – 2.8%	
31,600	UnitedHealth Group, Inc. (a)	7,872,192

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See Notes to Financial Statements

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First Trust Enhanced Equity Income Fund (FFA)

Portfolio of Investments (Continued)

December 31, 2018

Shares	Description	Value
COMMON STOCKS (Continued)		
	Hotels, Restaurants & Leisure – 3.9%	
112,500	Carnival Corp. (a)	\$5,546,250
52,000	Restaurant Brands International, Inc.	2,719,600
45,000	Six Flags Entertainment Corp.	2,503,350
		10,769,200
	Industrial Conglomerates – 1.7%	
35,000	Honeywell International, Inc.	4,624,200
	Insurance – 4.8%	
67,500	Arthur J. Gallagher & Co. (a)	4,974,750
39,000	Chubb, Ltd. (a)	5,038,020
40,000	Prudential Financial, Inc. (a)	3,262,000
		13,274,770
	Interactive Media & Services – 2.3%	
4,500	Alphabet, Inc., Class C (b)	4,660,245
14,000	Facebook, Inc., Class A (b)	1,835,260
		6,495,505
	Internet & Direct Marketing Retail – 1.0%	
21,000	Alibaba Group Holding Ltd., ADR (a) (b)	2,878,470
	IT Services – 2.7%	
21,000	MasterCard, Inc., Class A (a)	3,961,650
42,000	PayPal Holdings, Inc. (a) (b)	3,531,780
		7,493,430
	Life Sciences Tools & Services – 2.6%	
32,500	Thermo Fisher Scientific, Inc. (a)	7,273,175
	Machinery – 2.5%	
22,000	Caterpillar, Inc.	2,795,540
35,000	Stanley Black & Decker, Inc.	4,190,900

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		6,986,440
	Media – 0.6%	
39,000	CBS Corp., Class B	1,705,080
	Oil, Gas & Consumable Fuels – 4.9%	
57,500	Chevron Corp. (a)	6,255,425
42,500	Hess Corp.	1,721,250
52,000	Occidental Petroleum Corp.	3,191,760
19,000	Pioneer Natural Resources Co.	2,498,880
		13,667,315
	Pharmaceuticals – 6.8%	
102,000	Merck & Co., Inc. (a)	7,793,820
144,000	Pfizer, Inc. (a)	6,285,600
55,000	Zoetis, Inc.	4,704,700
		18,784,120
	Road & Rail – 1.2%	
55,000	CSX Corp.	3,417,150
	Semiconductors & Semiconductor Equipment – 4.6%	
127,000	Intel Corp. (a)	5,960,110
10,000	Lam Research Corp. (a)	1,361,700
100,000	Micron Technology, Inc. (b)	3,173,000

See Notes to Financial Statements

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First Trust Enhanced Equity Income Fund (FFA)

Portfolio of Investments (Continued)

December 31, 2018

Shares	Description	Value
COMMON STOCKS (Continued)		
Semiconductors & Semiconductor Equipment (Continued)		
16,000	NVIDIA Corp.	\$2,136,000
		<hr/>
		12,630,810
	Software – 8.2%	
17,000	Adobe Systems, Inc. (a) (b)	3,846,080
		<hr/>
158,000	Microsoft Corp. (a)	16,048,060
		<hr/>
15,000	Palo Alto Networks, Inc. (a) (b)	2,825,250
		<hr/>
		22,719,390
	Specialty Retail – 3.9%	
22,000	Burlington Stores, Inc. (b)	3,578,740
		<hr/>
30,000	Home Depot (The), Inc. (a)	5,154,600
		<hr/>
8,800	Ulta Beauty, Inc. (a) (b)	2,154,592
		<hr/>
		10,887,932
	Technology Hardware, Storage & Peripherals – 4.3%	
76,000	Apple, Inc. (a)	11,988,240
		<hr/>
	Textiles, Apparel & Luxury Goods – 1.1%	
40,000	NIKE, Inc., Class B	2,965,600
		<hr/>
	Tobacco – 1.8%	
100,000	Altria Group, Inc.	4,939,000
		<hr/>
	Total Common Stocks	258,837,779
		<hr/>
	(Cost \$242,092,797)	
REAL ESTATE INVESTMENT TRUSTS – 2.8%		
Equity Real Estate Investment Trusts – 2.8%		
45,000	Crown Castle International Corp. (a)	4,888,350
		<hr/>
40,000	Lamar Advertising Co., Class A (a)	2,767,200
		<hr/>
	Total Real Estate Investment Trusts	7,655,550
		<hr/>
	(Cost \$6,464,415)	
COMMON STOCKS – BUSINESS DEVELOPMENT COMPANIES - 1.8%		
	Capital Markets – 1.8%	

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325,000 Ares Capital Corp. (a) 5,063,500
 (Cost \$5,628,495)

Shares	Description	Stated Rate	Stated Maturity (c)	Value
CONVERTIBLE PREFERRED SECURITIES – 1.7%				
Health Care Equipment & Supplies – 0.9%				
45,000	<u>Becton Dickinson and Co., Series A</u>	6.13%	05/01/20	2,595,150
Oil, Gas & Consumable Fuels – 0.8%				
45,500	<u>Hess Corp.</u>	8.00%	02/01/19	2,259,075
<u>Total Convertible Preferred Securities</u>				4,854,225
(Cost \$5,301,118)				

Total Investments – 99.6% 276,411,054
 (Cost \$259,486,825) (d)

Number of Contracts	Description	Notional Amount	Exercise Price	Expiration Date	Value
CALL OPTIONS WRITTEN – (0.2)%					
75	<u>Adobe Systems, Inc.</u>	\$1,696,800	\$230.00	Jan 2019	(43,650)
70	<u>Burlington Stores, Inc.</u>	1,138,690	170.00	Jan 2019	(16,660)

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 See Notes to Financial Statements

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First Trust Enhanced Equity Income Fund (FFA)

Portfolio of Investments (Continued)

December 31, 2018

Number of Contracts	Description	Notional Amount	Exercise Price	Expiration Date	Value
CALL OPTIONS WRITTEN (Continued)					
200	<u>CSX Corp.</u>	\$1,242,600	\$70.00	Jan 2019	\$(4,000)
70	<u>Mastercard, Inc., Class A</u>	1,320,550	200.00	Jan 2019	(11,060)
300	<u>Micron Technology, Inc.</u>	951,900	40.00	Jan 2019	(900)
100	<u>NIKE, Inc., Class B</u>	741,400	77.50	Jan 2019	(8,200)
40	<u>NVIDIA Corp.</u>	534,000	145.00	Jan 2019	(8,720)
300	<u>Pfizer, Inc.</u>	1,309,500	45.00	Jan 2019	(11,100)
150	<u>S&P 500[®] Index (e)</u>	37,602,750	2,625.00	Jan 2019	(135,000)
200	<u>S&P 500[®] Index (e)</u>	50,137,000	2,650.00	Jan 2019	(100,000)
250	<u>S&P 500[®] Index (e)</u>	62,671,250	2,675.00	Jan 2019	(68,500)
150	<u>Six Flags Entertainment Corp.</u>	834,450	62.50	Jan 2019	(2,250)
80	<u>Take-Two Interactive Software, Inc.</u>	823,520	115.00	Jan 2019	(7,200)
25	<u>Ulta Beauty, Inc.</u>	612,100	270.00	Jan 2019	(2,875)
75	<u>UnitedHealth Group, Inc.</u>	1,868,400	260.00	Jan 2019	(19,200)
	<u>Total Call Options Written</u>				(439,315)
	(Premiums received \$574,947)				
	<u>Net Other Assets and Liabilities – 0.6%</u>	1,471,268			
	<u>Net Assets – 100.0%</u>	\$277,443,007			

(a) All or a portion of these securities are pledged to cover index call options written.

(b) Non-income producing security.

(c) Stated maturity represents the mandatory conversion date.

(d)

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Aggregate cost for federal income tax purposes was \$259,776,968. As of December 31, 2018, the aggregate gross unrealized appreciation for all investments in which there was an excess of value over tax cost was \$39,516,455 and the aggregate gross unrealized depreciation for all investments in which there was an excess of tax cost over value was \$23,321,684. The net unrealized appreciation was \$16,194,771. The amounts presented are inclusive of derivative contracts.

- (e) Call options on securities indices were written on a portion of the common stock positions that were not used to cover call options written on individual equity securities held in the Fund's portfolio.

ADR American Depositary Receipt

Valuation Inputs

A summary of the inputs used to value the Fund's investments as of December 31, 2018 is as follows (see Note 3A - Portfolio Valuation in the Notes to Financial Statements):

ASSETS TABLE

	Total Value at 12/31/2018	Level 1 Quoted Prices	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
Common Stocks*	\$ 258,837,779	\$ 258,837,779	\$ —	\$ —
Real Estate Investment Trusts*	7,655,550	7,655,550	—	—
Common Stocks - Business Development Companies*	5,063,500	5,063,500	—	—
Convertible Preferred Securities*	4,854,225	4,854,225	—	—
Total Investments	\$ 276,411,054	\$ 276,411,054	\$ —	\$ —

LIABILITIES TABLE

	Total Value at 12/31/2018	Level 1 Quoted Prices	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
Call Options Written	\$ (439,315)	\$ (439,315)	\$ —	\$ —

* See Portfolio of Investments for industry breakout.

See Notes to Financial Statements

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First Trust Enhanced Equity Income Fund (FFA)

Statement of Assets and Liabilities

December 31, 2018

ASSETS:

Investments, at value

(Cost \$259,486,825)	\$ 276,411,054
<hr/>	
Cash	3,538,929
<hr/>	
Receivables:	
Investment securities sold	4,871,456
<hr/>	
Dividends	397,597
<hr/>	
Dividend reclaims	1,980
<hr/>	
Prepaid expenses	3,296
<hr/>	
Total Assets	285,224,312
<hr/>	
LIABILITIES:	
Options written, at value (Premiums received \$574,947)	439,315
<hr/>	
Payables:	
Investment securities purchased	6,984,420
<hr/>	
Investment advisory fees	247,782
<hr/>	
Audit and tax fees	43,523
<hr/>	
Shareholder reporting fees	29,355
<hr/>	
Administrative fees	15,346
<hr/>	
Custodian fees	10,385
<hr/>	
Transfer agent fees	5,300
<hr/>	
Legal fees	2,428
<hr/>	
Financial reporting fees	771
<hr/>	
Trustees' fees and expenses	23
<hr/>	
Other liabilities	2,657
<hr/>	

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Total Liabilities	7,781,305
<hr/>	
NET ASSETS	\$277,443,007
<hr/>	
NET ASSETS consist of:	
Paid-in capital	\$ 263,723,651
<hr/>	
Par value	199,732
<hr/>	
Accumulated distributable earnings (loss)	13,519,624
<hr/>	
NET ASSETS	\$277,443,007
<hr/>	
NET ASSET VALUE, per Common Share (par value \$0.01 per Common Share)	\$13.89
<hr/>	
Number of Common Shares outstanding (unlimited number of Common Shares has been authorized)	19,973,164
<hr/>	

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See Notes to Financial Statements

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First Trust Enhanced Equity Income Fund (FFA)

Statement of Operations

For the Year Ended December 31, 2018

INVESTMENT

INCOME:

Dividends (net
of foreign
withholding tax \$ 7,331,575
of \$14,805)

Interest 11,320

Total
investment
income 7,342,895

EXPENSES:

Investment
advisory fees 3,227,607

Administrative
fees 158,161

Shareholder
reporting fees 108,136

Audit and tax
fees 43,406

Transfer agent
fees 32,258

Custodian fees 31,312

Listing expense 21,250

Legal fees 17,826

Trustees' fees
and expenses 16,301

Financial
reporting fees 9,250

Other 16,905

Total expenses 3,682,412

NET
INVESTMENT
INCOME 3,660,483
(LOSS)

NET
REALIZED
AND
UNREALIZED
GAIN (LOSS):
Net realized
gain (loss) on:
Investments 24,540,491

Written options (3,783,010)

Net realized
gain (loss) 20,757,481

Net change in
unrealized
appreciation
(depreciation)
on:
Investments (53,769,404)

Written options (270,672)

Net change in
unrealized
appreciation (54,040,076)
(depreciation)

NET
REALIZED
AND
UNREALIZED (33,282,595)
GAIN (LOSS)

NET
INCREASE
(DECREASE)
IN NET
ASSETS \$(29,622,112)
RESULTING
FROM
OPERATIONS

See Notes to Financial Statements

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Table of ContentsFirst Trust Enhanced Equity Income Fund (FFA)
Statements of Changes in Net Assets

	Year Ended 12/31/2018	Year Ended 12/31/2017
OPERATIONS:		
Net investment income (loss)	\$ 3,660,483	\$ 3,899,407
Net realized gain (loss)	20,757,481	18,016,167
Net increase from payment by the sub-advisor	—	17,250
Net change in unrealized appreciation (depreciation)	(54,040,076)	25,857,799
Net increase (decrease) in net assets resulting from operations	(29,622,112)	47,790,623
DISTRIBUTIONS TO SHAREHOLDERS FROM:		
Investment operations	(22,769,407)	
Net investment income		(4,539,880)
Net realized gain		(17,530,466)
Total distributions to shareholders	(22,769,407)	(22,070,346)
Total increase (decrease) in net assets	(52,391,519)	25,720,277
NET ASSETS:		
Beginning of period	329,834,526	304,114,249
End of period	\$ 277,443,007	\$ 329,834,526
Accumulated net investment income (loss) at end of period		\$681,322
COMMON SHARES:		
Common Shares at end of period *	19,973,164	19,973,164

On September 15, 2016, the Fund commenced a share repurchase program. The program originally expired on March 15, 2017, but the Board of Trustees of the Fund has subsequently authorized the continuation of the Fund's *share repurchase program until March 15, 2019. From September 15, 2016 through December 31, 2018, the Fund has not repurchased any Common Shares. The Fund expects to continue the share repurchase program until the earlier of (i) the repurchase of 998,658 Common Shares or (ii) March 15, 2019.

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First Trust Enhanced Equity Income Fund (FFA)

Financial Highlights

For a Common Share outstanding throughout each period

	Year Ended December 31,				
	2018	2017	2016	2015	2014 (a)
Net asset value, beginning of period	\$ 16.51	\$ 15.23	\$ 14.99	\$ 15.95	\$ 15.24
Income from investment operations:					
Net investment income (loss)	0.19	0.20	0.19	0.20	0.24
Net realized and unrealized gain (loss)	(1.67)	2.19	1.01	(0.22)	1.39
Total from investment operations	(1.48)	2.39	1.20	(0.02)	1.63
Distributions paid to shareholders from:					
Net investment income	(0.19)	(0.23)	(0.18)	(0.60)	(0.92)
Net realized gain	(0.95)	(0.88)	(0.48)	(0.34)	—
Return of capital	—	—	(0.30)	—	—
Total distributions paid to Common Shareholders	(1.14)	(1.11)	(0.96)	(0.94)	(0.92)
Net asset value, end of period	\$13.89	\$16.51	\$15.23	\$14.99	\$15.95
Market value, end of period	\$12.92	\$16.19	\$13.51	\$13.20	\$14.34
Total return based on net asset value (b)	(9.19)%	16.53%	(c)9.18%	0.72%	11.63%
Total return based on market value (b)	(13.86)%	28.82%	9.98%	(1.35)%	14.83%
Ratios to average net assets/supplemental data:					
Net assets, end of period (in 000's)	\$ 277,443	\$ 329,835	\$ 304,114	\$ 299,389	\$ 318,640
Ratio of total expenses to average net assets	1.14%	1.14%	1.13%	1.12%	1.18%
Ratio of net investment income (loss) to average net assets	1.13%	1.21%	1.27%	1.33%	1.54%
Portfolio turnover rate	45%	36%	32%	45%	44%

On February 20, 2014, the Fund's Board of Trustees approved an interim and new sub-advisory agreement with Chartwell Investment Partners, LLC ("Chartwell"), which became the Fund's sub-advisor on March 5, 2014, under (a) the interim sub-advisory agreement. On July 2, 2014, the Fund's shareholders voted to approve the new sub-advisory agreement.

(b) Total return is based on the combination of reinvested dividend, capital gain and return of capital distributions, if any, at prices obtained by the Dividend Reinvestment Plan, and changes in net asset value per share for net asset

value returns and changes in Common Share Price for market value returns. Total returns do not reflect sales load and are not annualized for periods of less than one year. Past performance is not indicative of future results.

(c) The Fund received a reimbursement from Chartwell in the amount of \$17,250, which represents less than \$0.01 per share. Since the Fund was reimbursed, there was no effect on the Fund's total return.

See Notes to Financial Statements

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Notes to Financial Statements

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018

1. Organization

First Trust Enhanced Equity Income Fund (the “Fund”) is a diversified, closed-end management investment company organized as a Massachusetts business trust on May 20, 2004, and is registered with the Securities and Exchange Commission (“SEC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). The Fund trades under the ticker symbol FFA on the New York Stock Exchange (“NYSE”).

The Fund’s investment objective is to provide a high level of current income and gains and, to a lesser extent, capital appreciation. The Fund pursues its investment objective by investing in a diversified portfolio of equity securities. Under normal market conditions, the Fund pursues an integrated investment strategy in which the Fund invests substantially all of its Managed Assets in a diversified portfolio of common stocks of U.S. corporations and U.S. dollar-denominated equity securities of non-U.S. issuers, in each case that are traded on U.S. securities exchanges. In addition, on an ongoing and consistent basis, the Fund writes (sells) covered call options on a portion of the Fund’s Managed Assets. “Managed Assets” means the total asset value of the Fund minus the sum of the Fund’s liabilities, including the value of call options written (sold). There can be no assurance that the Fund will achieve its investment objective. The Fund may not be appropriate for all investors.

2. Managed Distribution Policy

The Board of Trustees of the Fund has approved a managed distribution policy for the Fund (the “Plan”) in reliance on exemptive relief received from the SEC that permits the Fund to make periodic distributions of long-term capital gains more frequently than otherwise permitted with respect to its common shares subject to certain conditions. Under the Plan, the Fund currently intends to pay a quarterly distribution in the amount of \$0.285 per share. A portion of this quarterly distribution may include realized capital gains. This may result in a reduction of the long-term capital gain distribution necessary at year end by distributing realized capital gains throughout the year. The annual distribution rate is independent of the Fund’s performance during any particular period but is expected to correlate with the Fund’s performance over time. Accordingly, you should not draw any conclusions about the Fund’s investment performance from the amount of any distribution or from the terms of the Plan. The Board of Trustees may amend or terminate the Plan at any time without prior notice to shareholders.

3. Significant Accounting Policies

The Fund is considered an investment company and follows accounting and reporting guidance under Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 946, “Financial Services-Investment Companies.” The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of the financial statements. The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

A. Portfolio Valuation

The net asset value (“NAV”) of the Common Shares of the Fund is determined daily as of the close of regular trading on the NYSE, normally 4:00 p.m. Eastern time, on each day the NYSE is open for trading. If the NYSE closes early on a valuation day, the NAV is determined as of that time. The Fund’s NAV per Common Share is calculated by dividing the value of all assets of the Fund (including accrued interest and dividends), less all liabilities (including accrued expenses, the value of call options written (sold) and dividends declared but unpaid) by the total number of Common Shares outstanding.

The Fund’s investments are valued daily at market value or, in the absence of market value with respect to any portfolio securities, at fair value. Market value prices represent last sale or official closing prices from a national or foreign exchange (i.e., a regulated market) and are primarily obtained from third-party pricing services. Fair value prices represent any prices not considered market value prices and are either obtained from a third-party pricing service or are determined by the Pricing Committee of the Fund’s investment advisor, First Trust Advisors L.P. (“First Trust” or the “Advisor”), in accordance with valuation procedures adopted by the Fund’s Board of Trustees, and in accordance with provisions of the 1940 Act. Investments valued by the Advisor’s Pricing Committee, if any, are

footnoted as such in the footnotes to the Portfolio of Investments. The Fund's investments are valued as follows: Common stocks, real estate investment trusts ("REITs"), exchange-traded funds, convertible preferred stocks, and other equity securities listed on any national or foreign exchange (excluding The Nasdaq Stock Market LLC ("Nasdaq") and the London Stock Exchange Alternative Investment Market ("AIM")) are valued at the last sale price on the exchange on which they are principally traded or, for Nasdaq and AIM securities, the official closing price. Securities traded on more than one securities exchange are valued at the last sale price or official closing price, as applicable, at the close of the securities exchange representing the principal market for such securities.

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Notes to Financial Statements (Continued)

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018

Securities traded in an over-the-counter market are fair valued at the mean of their most recent bid and asked price, if available, and otherwise at their closing bid price.

Exchange-traded options contracts are valued at the closing price in the market where such contracts are principally traded. If no closing price is available, exchange-traded options contracts are fair valued at the mean of their most recent bid and asked price, if available, and otherwise at their closing bid price. Over-the-counter options contracts are fair valued at the mean of their most recent bid and asked price, if available, and otherwise at their closing bid price.

Certain securities may not be able to be priced by pre-established pricing methods. Such securities may be valued by the Fund's Board of Trustees or its delegate, the Advisor's Pricing Committee, at fair value. These securities generally include, but are not limited to, restricted securities (securities which may not be publicly sold without registration under the Securities Act of 1933, as amended) for which a third-party pricing service is unable to provide a market price; securities whose trading has been formally suspended; a security whose market or fair value price is not available from a pre-established pricing source; a security with respect to which an event has occurred that is likely to materially affect the value of the security after the market has closed but before the calculation of the Fund's NAV or make it difficult or impossible to obtain a reliable market quotation; and a security whose price, as provided by the third-party pricing service, does not reflect the security's fair value. As a general principle, the current fair value of a security would appear to be the amount which the owner might reasonably expect to receive for the security upon its current sale. When fair value prices are used, generally they will differ from market quotations or official closing prices on the applicable exchanges. A variety of factors may be considered in determining the fair value of such securities, including, but not limited to, the following:

- 1) the type of security;
- 2) the size of the holding;
- 3) the initial cost of the security;
- 4) transactions in comparable securities;
- 5) price quotes from dealers and/or third-party pricing services;
- 6) relationships among various securities;
- 7) information obtained by contacting the issuer, analysts, or the appropriate stock exchange;
- 8) an analysis of the issuer's financial statements; and
- 9) the existence of merger proposals or tender offers that might affect the value of the security.

The Fund is subject to fair value accounting standards that define fair value, establish the framework for measuring fair value and provide a three-level hierarchy for fair valuation based upon the inputs to the valuation as of the measurement date. The three levels of the fair value hierarchy are as follows:

- Level 1 – Level 1 inputs are quoted prices in active markets for identical investments. An active market is a market in which transactions for the investment occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Level 2 inputs are observable inputs, either directly or indirectly, and include the following:
 - o Quoted prices for similar investments in active markets.
 - o Quoted prices for identical or similar investments in markets that are non-active. A non-active market is a market where there are few transactions for the investment, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly.
 - o Inputs other than quoted prices that are observable for the investment (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates).
 - o Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 – Level 3 inputs are unobservable inputs. Unobservable inputs may reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the investment.

The inputs or methodologies used for valuing investments are not necessarily an indication of the risk associated with investing in those investments. A summary of the inputs used to value the Fund's investments as of December 31, 2018, is included with the Fund's Portfolio of Investments.

B. Option Contracts

The Fund is subject to equity price risk in the normal course of pursuing its investment objective and may write (sell) options to hedge against changes in the value of equities. Also, the Fund seeks to generate additional income, in the form of premiums received, from

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Notes to Financial Statements (Continued)

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018

writing (selling) the options. The Fund may write (sell) covered call options (“options”) on all or a portion of the equity securities held in the Fund’s portfolio and on securities indices as determined to be appropriate by Chartwell Investment Partners, LLC (“Chartwell” or the “Sub-Advisor”), consistent with the Fund’s investment objective. The number of options the Fund can write (sell) is limited by the amount of equity securities the Fund holds in its portfolio. Options on securities indices are designed to reflect price fluctuations in a group of securities or segment of the securities market rather than price fluctuations in a single security and are similar to options on single securities, except that the exercise of securities index options requires cash settlement payments and does not involve the actual purchase or sale of securities. The Fund will not write (sell) “naked” or uncovered options. If certain equity securities held in the Fund’s portfolio are not covered by a related call option on the individual equity security, securities index options may be written on all or a portion of such uncovered securities. When the Fund writes (sells) an option, an amount equal to the premium received by the Fund is included in “Options written, at value” on the Fund’s Statement of Assets and Liabilities. Options are marked-to-market daily and their value will be affected by changes in the value and dividend rates of the underlying equity securities, changes in interest rates, changes in the actual or perceived volatility of the securities markets and the underlying equity securities and the remaining time to the options’ expiration. The value of options may also be adversely affected if the market for the options becomes less liquid or trading volume diminishes.

Options the Fund writes (sells) will either be exercised, expire or be canceled pursuant to a closing transaction. If the price of the underlying equity security exceeds the option’s exercise price, it is likely that the option holder will exercise the option. If an option written (sold) by the Fund is exercised, the Fund would be obligated to deliver the underlying equity security to the option holder upon payment of the strike price. In this case, the option premium received by the Fund will be added to the amount realized on the sale of the underlying security for purposes of determining gain or loss and is included in “Net realized gain (loss) on investments” on the Statement of Operations. If the price of the underlying equity security is less than the option’s strike price, the option will likely expire without being exercised. The option premium received by the Fund will, in this case, be treated as short-term capital gain on the expiration date of the option. The Fund may also elect to close out its position in an option prior to its expiration by purchasing an option of the same series as the option written (sold) by the Fund. Gain or loss on options is presented separately as “Net realized gain (loss) on written options” on the Statement of Operations.

The options that the Fund writes (sells) give the option holder the right, but not the obligation, to purchase a security from the Fund at the strike price on or prior to the option’s expiration date. The ability to successfully implement the writing (selling) of covered call options depends on the ability of the Sub-Advisor to predict pertinent market movements, which cannot be assured. Thus, the use of options may require the Fund to sell portfolio securities at inopportune times or for prices other than current market value, which may limit the amount of appreciation the Fund can realize on an investment, or may cause the Fund to hold a security that it might otherwise sell. As the writer (seller) of a covered option, the Fund foregoes, during the option’s life, the opportunity to profit from increases in the market value of the security covering the option above the sum of the premium and the strike price of the option, but has retained the risk of loss should the price of the underlying security decline. The writer (seller) of an option has no control over the time when it may be required to fulfill its obligation as a writer (seller) of the option. Once an option writer (seller) has received an exercise notice, it cannot effect a closing purchase transaction in order to terminate its obligation under the option and must deliver the underlying security to the option holder at the exercise price.

Over-the-counter options have the risk of the potential inability of counterparties to meet the terms of their contracts. The Fund’s maximum equity price risk for purchased options is limited to the premium initially paid. In addition, certain risks may arise upon entering into option contracts including the risk that an illiquid secondary market will limit the Fund’s ability to close out an option contract prior to the expiration date and that a change in the value of the option contract may not correlate exactly with changes in the value of the securities hedged.

C. Securities Transactions and Investment Income

Securities transactions are recorded as of the trade date. Realized gains and losses from securities transactions are recorded on the identified cost basis. Dividend income is recorded on the ex-dividend date. Interest income, if any, is

recorded on the accrual basis, including the amortization of premiums and accretion of discounts.

Distributions received from the Fund's investments in REITs may be comprised of return of capital, capital gains, and investment income. The actual character of the amounts received during the year are not known until after the REITs' fiscal year end. The Fund records the character of distributions received from the REITs during the year based on estimates available. The characterization of distributions received by the Fund may be subsequently revised based on information received from the REITs after their tax reporting periods conclude.

Distributions received from the Fund's investments in MLPs generally are comprised of return of capital and investment income. The Fund records estimated return of capital and investment income based on historical information available from each MLP. These estimates may subsequently be revised based on information received from the MLPs after their tax reporting periods are concluded.

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Notes to Financial Statements (Continued)

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018

For the fiscal year ended December 31, 2018, distributions of \$42,500 received from MLPs have been reclassified as return of capital. The cost basis of applicable MLPs has been reduced accordingly.

D. Dividends and Distributions to Shareholders

Dividends from net investment income of the Fund are declared and paid quarterly or as the Board of Trustees may determine from time to time. Distributions of any net realized capital gains earned by the Fund are distributed at least annually. Distributions will automatically be reinvested into additional Common Shares pursuant to the Fund's Dividend Reinvestment Plan unless cash distributions are elected by the shareholder.

Distributions from income and realized capital gains are determined in accordance with federal income tax regulations, which may differ from U.S. GAAP. Certain capital accounts in the financial statements are periodically adjusted for permanent differences in order to reflect their tax character. These permanent differences are primarily due to the varying treatment of income and gain/loss on portfolio securities held by the Fund and have no impact on net assets or NAV per share. Temporary differences, which arise from recognizing certain items of income, expense and gain/loss in different periods for financial statement and tax purposes, will reverse at some point in the future. Permanent differences incurred during the year ended December 31, 2018, primarily as a result of the difference between book and tax treatments of income and gains on various investment securities held by the Fund, have been reclassified at year end to reflect an increase in accumulated net investment income (loss) of \$160,968, a decrease in accumulated net realized gain (loss) on investments and written options of \$90,388 and a decrease to paid-in-capital of \$70,580. Accumulated distributable earnings (loss) consists of accumulated net investment income (loss), accumulated net realized gain (loss) on investments, and unrealized appreciation (depreciation) on investments. Net assets were not affected by this reclassification.

The tax character of distributions paid by the Fund during the fiscal years ended December 31, 2018 and 2017, was as follows:

Distributions paid from:	2018	2017
Ordinary income	\$3,729,518	\$6,872,737
Capital gains	19,039,889	15,197,609
Return of capital	—	—

As of December 31, 2018, the components of distributable earnings and net assets on a tax basis were as follows:

Undistributed ordinary income	\$811,475
Undistributed capital gains	—
Total undistributed earnings	811,475
Accumulated capital and other losses	—
Net unrealized appreciation (depreciation)	16,194,771
Total accumulated earnings (losses)	17,006,246
Other	(3,486,622)
Paid-in capital	263,923,383

Total net assets	\$277,443,007
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E. Income Taxes

The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under Subchapter M of the Internal Revenue Code of 1986, as amended, which includes distributing substantially all of its net investment income and net realized gains to shareholders. Accordingly, no provision has been made for federal and state income taxes. However, due to the timing and amount of distributions, the Fund may be subject to an excise tax of 4% of the amount by which approximately 98% of the Fund's taxable income exceeds the distributions from such taxable income for the calendar year.

The Fund intends to utilize provisions of the federal income tax laws, which allow it to carry a realized capital loss forward indefinitely following the year of the loss and offset such loss against any future realized capital gains. The Fund is subject to certain limitations under U.S. tax rules on the use of capital loss carryforwards and net unrealized built-in losses. These limitations apply when there has been a 50% change in ownership. At December 31, 2018, for federal income tax purposes, the Fund had no non-expiring capital loss carryforwards that may be carried forward indefinitely.

The Fund is subject to accounting standards that establish a minimum threshold for recognizing, and a system for measuring, the benefits of a tax position taken or expected to be taken in a tax return. Taxable years ended 2015, 2016, 2017, and 2018 remain open to

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Notes to Financial Statements (Continued)

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018

federal and state audit. As of December 31, 2018, management has evaluated the application of these standards to the Fund, and has determined that no provision for income tax is required in the Fund's financial statements for uncertain tax positions.

F. Expenses

The Fund will pay all expenses directly related to its operations.

G. New Accounting Pronouncement

On August 28, 2018, the FASB issued Accounting Standards Update ("ASU") 2018-13, "Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement," which amends the fair value measurement disclosure requirements of ASC 820. The amendments of ASU 2018-13 include new, eliminated, and modified disclosure requirements of ASC 820. In addition, the amendments clarify that materiality is an appropriate consideration of entities when evaluating disclosure requirements. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods therein. Early adoption is permitted for any eliminated or modified disclosures upon issuance of this ASU. The Fund has early adopted ASU 2018-13 for these financial statements, which did not result in a material impact.

4. Investment Advisory Fee, Affiliated Transactions and Other Fee Arrangements

First Trust, the investment advisor to the Fund, is a limited partnership with one limited partner, Grace Partners of DuPage L.P., and one general partner, The Charger Corporation. The Charger Corporation is an Illinois corporation controlled by James A. Bowen, Chief Executive Officer of First Trust. First Trust is responsible for the ongoing monitoring of the Fund's investment portfolio, managing the Fund's business affairs and providing certain administrative services necessary for the management of the Fund. For these services, First Trust is entitled to a monthly fee calculated at an annual rate of 1.00% of the Fund's Managed Assets. First Trust also provides fund reporting services to the Fund for a flat annual fee in the amount of \$9,250.

Chartwell manages the Fund's portfolio subject to First Trust's supervision. Chartwell receives a monthly portfolio management fee calculated at an annual rate of 0.50% of the Fund's Managed Assets that is paid monthly by First Trust out of its investment advisory fee.

During the year ended December 31, 2017, the Fund received a payment from the Sub-Advisor of \$17,250 in connection with a trade error.

BNY Mellon Investment Servicing (US) Inc. ("BNYM IS") serves as the Fund's transfer agent in accordance with certain fee arrangements. As transfer agent, BNYM IS is responsible for maintaining shareholder records for the Fund. The Bank of New York Mellon ("BNYM") serves as the Fund's administrator, fund accountant, and custodian in accordance with certain fee arrangements. As administrator and fund accountant, BNYM is responsible for providing certain administrative and accounting services to the Fund, including maintaining the Fund's books of account, records of the Fund's securities transactions, and certain other books and records. As custodian, BNYM is responsible for custody of the Fund's assets. BNYM IS and BNYM are subsidiaries of The Bank of New York Mellon Corporation, a financial holding company.

Each Trustee who is not an officer or employee of First Trust, any sub-advisor or any of their affiliates ("Independent Trustees") is paid a fixed annual retainer that is allocated equally among each fund in the First Trust Fund Complex. Each Independent Trustee is also paid an annual per fund fee that varies based on whether the fund is a closed-end or other actively managed fund, or is an index fund.

Additionally, the Lead Independent Trustee and the Chairmen of the Audit Committee, Nominating and Governance Committee and Valuation Committee are paid annual fees to serve in such capacities, with such compensation allocated pro rata among each fund in the First Trust Fund Complex based on net assets. Independent Trustees are reimbursed for travel and out-of-pocket expenses in connection with all meetings. The Lead Independent Trustee and Committee Chairmen rotate every three years. The officers and "Interested" Trustee receive no compensation from the Fund for acting in such capacities.

5. Purchases and Sales of Securities

The cost of purchases and proceeds from sales of securities, excluding short-term investments, for the fiscal year ended December 31, 2018, were \$143,620,672 and \$166,313,844, respectively.

6. Derivative Transactions

The following table presents the types of derivatives held by the Fund at December 31, 2018, the primary underlying risk exposure and the location of these instruments as presented on the Statement of Assets and Liabilities.

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Notes to Financial Statements (Continued)
 First Trust Enhanced Equity Income Fund (FFA)
 December 31, 2018

Derivative Instrument	Risk Exposure	Asset Derivatives		Liability Derivatives	
		Statement of Assets and Liabilities Location	Value	Statement of Assets and Liabilities Location	Value
Written Options	Equity Risk	—	\$ —	Options written, at value	\$ 439,315

The following table presents the amount of net realized gain (loss) and change in net unrealized appreciation (depreciation) recognized for the fiscal year ended December 31, 2018, on derivative instruments, as well as the primary underlying risk exposure associated with each instrument.

Statement of Operations Location

Equity Risk Exposure

Net realized gain (loss) on written options	\$(3,783,010)
Net change in unrealized appreciation (depreciation) on written options	(270,672)

During the fiscal year ended December 31, 2018, the premiums for written options opened were \$21,812,114, and the premiums for written options closed, exercised and expired were \$22,100,934.

The Fund does not have the right to offset financial assets and liabilities related to option contracts on the Statement of Assets and Liabilities.

7. Indemnification

The Fund has a variety of indemnification obligations under contracts with its service providers. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not had prior claims or losses pursuant to these contracts and expects the risk of loss to be remote.

8. Subsequent Events

Management has evaluated the impact of all subsequent events to the Fund through the date the financial statements were issued, and has determined that there were no subsequent events requiring recognition or disclosure in the financial statements that have not already been disclosed.

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Report of Independent Registered Public Accounting Firm

To the shareholders and the Board of Trustees of First Trust Enhanced Equity Income Fund:

Opinion on the Financial Statements and Financial Highlights

We have audited the accompanying statement of assets and liabilities, including the portfolio of investments, of First Trust Enhanced Equity Income Fund (the "Fund"), as of December 31, 2018, the related statement of operations for the year then ended, the statements of changes in net assets for each of the two years in the period then ended, the financial highlights for each of the five years in the period then ended, and the related notes. In our opinion, the financial statements and financial highlights present fairly, in all material respects, the financial position of the Fund as of December 31, 2018, and the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on the Fund's financial statements and financial highlights based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Fund in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement, whether due to error or fraud. The Fund is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements and financial highlights, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements and financial highlights. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and financial highlights. Our procedures included confirmation of securities owned as of December 31, 2018, by correspondence with the custodian and brokers; when replies were not received from brokers, we performed other auditing procedures. We believe that our audits provide a reasonable basis for our opinion.

Chicago, Illinois

February 22, 2019

We have served as the auditor of one or more First Trust investment companies since 2001.

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Additional Information

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018 (Unaudited)

Dividend Reinvestment Plan

If your Common Shares are registered directly with the Fund or if you hold your Common Shares with a brokerage firm that participates in the Fund's Dividend Reinvestment Plan (the "Plan"), unless you elect, by written notice to the Fund, to receive cash distributions, all dividends, including any capital gain distributions, on your Common Shares will be automatically reinvested by BNY Mellon Investment Servicing (US) Inc. (the "Plan Agent"), in additional Common Shares under the Plan. If you elect to receive cash distributions, you will receive all distributions in cash paid by check mailed directly to you by the Plan Agent, as the dividend paying agent.

If you decide to participate in the Plan, the number of Common Shares you will receive will be determined as follows:

- If Common Shares are trading at or above net asset value ("NAV") at the time of valuation, the Fund will issue
- (1) new shares at a price equal to the greater of (i) NAV per Common Share on that date or (ii) 95% of the market price on that date.

- If Common Shares are trading below NAV at the time of valuation, the Plan Agent will receive the dividend or distribution in cash and will purchase Common Shares in the open market, on the NYSE or elsewhere, for the participants' accounts. It is possible that the market price for the Common Shares may increase before the Plan Agent has completed its purchases. Therefore, the average purchase price per share paid by the Plan
- (2) Agent may exceed the market price at the time of valuation, resulting in the purchase of fewer shares than if the dividend or distribution had been paid in Common Shares issued by the Fund. The Plan Agent will use all dividends and distributions received in cash to purchase Common Shares in the open market within 30 days of the valuation date except where temporary curtailment or suspension of purchases is necessary to comply with federal securities laws. Interest will not be paid on any uninvested cash payments.

You may elect to opt-out of or withdraw from the Plan at any time by giving written notice to the Plan Agent, or by telephone at (866) 340-1104, in accordance with such reasonable requirements as the Plan Agent and the Fund may agree upon. If you withdraw or the Plan is terminated, you will receive a certificate for each whole share in your account under the Plan, and you will receive a cash payment for any fraction of a share in your account. If you wish, the Plan Agent will sell your shares and send you the proceeds, minus brokerage commissions.

The Plan Agent maintains all Common Shareholders' accounts in the Plan and gives written confirmation of all transactions in the accounts, including information you may need for tax records. Common Shares in your account will be held by the Plan Agent in non-certificated form. The Plan Agent will forward to each participant any proxy solicitation material and will vote any shares so held only in accordance with proxies returned to the Fund. Any proxy you receive will include all Common Shares you have received under the Plan.

There is no brokerage charge for reinvestment of your dividends or distributions in Common Shares. However, all participants will pay a pro rata share of brokerage commissions incurred by the Plan Agent when it makes open market purchases.

Automatically reinvesting dividends and distributions does not mean that you do not have to pay income taxes due upon receiving dividends and distributions. Capital gains and income are realized although cash is not received by you. Consult your financial advisor for more information.

If you hold your Common Shares with a brokerage firm that does not participate in the Plan, you will not be able to participate in the Plan and any dividend reinvestment may be effected on different terms than those described above. The Fund reserves the right to amend or terminate the Plan if in the judgment of the Board of Trustees the change is warranted. There is no direct service charge to participants in the Plan; however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants. Additional information about the Plan may be obtained by writing BNY Mellon Investment Servicing (US) Inc., 301 Bellevue Parkway, Wilmington, Delaware 19809.

Proxy Voting Policies and Procedures

A description of the policies and procedures that the Fund uses to determine how to vote proxies and information on how the Fund voted proxies relating to portfolio investments during the most recent 12-month period ended June 30 is available (1) without charge, upon request, by calling (800) 988-5891; (2) on the Fund's website at www.ftportfolios.com; and (3) on the Securities and Exchange Commission's ("SEC") website at www.sec.gov.

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Additional Information (Continued)

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018 (Unaudited)

Portfolio Holdings

The Fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The Fund's Form N-Qs are available (1) by calling (800) 988-5891; (2) on the Fund's website at www.ftportfolios.com; and (3) on the SEC's website at www.sec.gov.

Beginning in April 2019, the Fund will cease to disclose its holdings on Form N-Q and will file Form N-PORT with the SEC on a monthly basis. Part F of Form N-PORT, which contains the complete schedule of the Fund's portfolio holdings, will be made available in the same manner as Form N-Q discussed above.

Federal Tax Information

For the year ended December 31, 2018, the amount of long-term capital gain distributions designated by the Fund was \$19,039,889 which is taxable at the applicable capital gain tax rates for federal income tax purposes.

Of the ordinary income (including short-term capital gain, if applicable) distributions made by the Fund during the year ended December 31, 2018, 43.76% qualified for the corporate dividends received deduction available to corporate shareholders. The Fund hereby designates as qualified dividend income 48.13% of its ordinary income distributions (including short-term capital gain, if applicable), for the year ended December 31, 2018.

NYSE Certification Information

In accordance with Section 303A-12 of the New York Stock Exchange ("NYSE") Listed Company Manual, the Fund's President has certified to the NYSE that, as of April 26, 2018, he was not aware of any violation by the Fund of NYSE corporate governance listing standards. In addition, the Fund's reports to the SEC on Forms N-CSR and N-Q contain certifications by the Fund's principal executive officer and principal financial officer that relate to the Fund's public disclosure in such reports and are required by Rule 30a-2 under the 1940 Act.

Submission of Matters to a Vote of Shareholders

The Fund held its Annual Meeting of Shareholders (the "Annual Meeting") on April 23, 2018. At the Annual Meeting, Richard E. Erickson and Thomas R. Kadlec were elected by the Common Shareholders of First Trust Enhanced Equity Income Fund as Class II Trustees for a three-year term expiring at the Fund's annual meeting of shareholders in 2021. The number of votes cast in favor of Mr. Erickson was 18,516,583, the number of votes against was 220,044 and the number of broker non-votes was 1,236,537. The number of votes cast in favor of Mr. Kadlec was 18,494,001, the number of votes against was 242,626 and the number of broker non-votes was 1,236,537. James A. Bowen, Robert F. Keith and Niel B. Nielson are the other current and continuing Trustees.

Risk Considerations

The following discussion summarizes certain (but not all) of the principal risks associated with investing in the Fund. The Fund is subject to the informational requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940 and, in accordance therewith, files reports, proxy statements and other information that is available for review.

Cyber Security Risk. As the use of Internet technology has become more prevalent in the course of business, the Fund has become more susceptible to potential operational risks through breaches in cyber security. A breach in cyber security refers to both intentional and unintentional events that may cause the Fund to lose proprietary information, suffer data corruption or lose operational capacity. Such events could cause the Fund to incur regulatory penalties, reputational damage, additional compliance costs associated with corrective measures and/or financial loss. Cyber security breaches may involve unauthorized access to the Fund's digital information systems through "hacking" or malicious software coding, but may also result from outside attacks such as denial-of-service attacks through efforts to make network services unavailable to intended users. In addition, cyber security breaches of the Fund's third-party service providers, such as its administrator, transfer agent, custodian, or sub-advisor, as applicable, or issuers in which the Fund invests, can also subject the Fund to many of the same risks associated with direct cyber security breaches. The Fund has established risk management systems designed to reduce the risks associated with cyber security. However, there is no guarantee that such efforts will succeed, especially because the Fund does not directly control the cyber security systems of issuers or third party service providers.

Equity Securities Risk. The Fund invests in equity securities. An adverse event affecting an issuer, such as an unfavorable earnings report, may depress the value of a particular equity security held by the Fund. Also, the prices of equity securities are sensitive to general movements in the stock market and a drop in the stock market may depress the prices of equity securities to which the Fund has exposure. Equity securities prices fluctuate for several reasons, including changes in investors' perceptions of the financial

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Additional Information (Continued)

First Trust Enhanced Equity Income Fund (FFA)

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condition of an issuer or the general condition of the relevant stock market, or when political or economic events affecting the issuers or their industries occur.

Income Risk. Net investment income paid by the Fund to its Common Shareholders is derived from the premiums it receives from writing (selling) call options and from the dividends and interest it receives from the equity securities and other investments held in the Fund's portfolio and short-term gains thereon. Premiums from writing (selling) call options and dividends and interest payments made by the securities in the Fund's portfolio can vary widely over time. Dividends on equity securities are not fixed but are declared at the discretion of an issuer's board of directors. There is no guarantee that the issuers of the equity securities in which the Fund invests will declare dividends in the future or that if declared they will remain at current levels. The Fund cannot assure as to what percentage of the distributions paid on the Common Shares, if any, will consist of qualified dividend income or long-term capital gains, both of which are taxed at lower rates for individuals than are ordinary income and short-term capital gains.

Industry and Sector Risk. The Fund may not invest 25% or more of its total assets in securities of issuers in any single industry. If the Fund is focused in an industry, it may present more risks than if it were broadly diversified over numerous industries of the economy. Individual industries may be subject to unique risks which may include, among others, governmental regulation, inflation, technological innovations that may render existing products and equipment obsolete, competition from new entrants, high research and development costs, and rising interest rates.

The Fund may invest 25% or more of its total assets in securities of issuers in a single sector. Currently, the Fund makes significant investments in equity securities of companies in the technology sector. The technology sector may include, for example, companies that rely extensively on technology, science or communications in their product development or operations. Technology companies are generally subject to the risks of rapidly changing technologies; short product life cycles; fierce competition; aggressive pricing and reduced profit margins; the loss of patent, copyright and trademark protections; cyclical market patterns; and evolving industry standards and frequent new product introductions. Technology companies may be smaller and less experienced companies, with limited product lines, markets or financial resources and fewer experienced management or marketing personnel. Technology company stocks have experienced extreme price and volume fluctuations that are often unrelated to the operating performance of the respective company.

Investment and Market Risk. An investment in the Fund's Common Shares is subject to investment risk, including the possible loss of the entire principal invested. An investment in Common Shares represents an indirect investment in the securities owned by the Fund. The value of these securities, like other market investments, may move up or down, sometimes rapidly and unpredictably. Common Shares at any point in time may be worth less than the original investment, even after taking into account the reinvestment of Fund dividends and distributions. Security prices can fluctuate for several reasons including the general condition of the securities markets, or when political or economic events affecting the issuers occur. When the Advisor or Sub-Advisor determines that it is temporarily unable to follow the Fund's investment strategy or that it is impractical to do so (such as when a market disruption event has occurred and trading in the securities is extremely limited or absent), the Fund may take temporary defensive positions.

Management Risk and Reliance on Key Personnel. The implementation of the Fund's investment strategy depends upon the continued contributions of certain key employees of the Advisor and Sub-Advisor, some of whom have unique talents and experience and would be difficult to replace. The loss or interruption of the services of a key member of the portfolio management team could have a negative impact on the Fund.

Market Discount from Net Asset Value. Shares of closed-end investment companies such as the Fund frequently trade at a discount from their net asset value. The Fund cannot predict whether its common shares will trade at, below or above net asset value.

Non-U.S. Securities Risk. The Fund may invest a portion of its assets in the equity securities of issuers domiciled in jurisdictions other than the U.S. Investments in the securities and instruments of non-U.S. issuers involve certain considerations and risks not ordinarily associated with investments in securities and instruments of U.S. issuers.

Non-U.S. companies are not generally subject to uniform accounting, auditing and financial standards and requirements comparable to those applicable to U.S. companies. Non-U.S. securities exchanges, brokers and listed

companies may be subject to less government supervision and regulation than exists in the United States. Dividend and interest income may be subject to withholding and other non-U.S. taxes, which may adversely affect the net return on such investments. A related risk is that there may be difficulty in obtaining or enforcing a court judgment abroad.

Option Risk. The Fund may write (sell) covered call options on all or a portion of the equity securities held in the Fund's portfolio as determined to be appropriate by the Fund's Sub-Advisor, consistent with the Fund's investment objective. The ability to successfully implement the Fund's investment strategy depends on the Sub-Advisor's ability to predict pertinent market movements, which cannot be assured. Thus, the use of options may require the Fund to sell portfolio securities at inopportune times or for prices other than current market values, may limit the amount of appreciation the Fund can realize on an investment, or may cause the Fund to hold an equity security that it might otherwise sell. There can be no assurance that a liquid market for the options will exist when the Fund

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Additional Information (Continued)

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018 (Unaudited)

seeks to close out an option position. Additionally, to the extent that the Fund purchases options pursuant to a hedging strategy, the Fund will be subject to additional risks.

Potential Conflicts of Interest Risk. First Trust, Chartwell and the portfolio managers have interests which may conflict with the interests of the Fund. In particular, First Trust and Chartwell currently manage and may in the future manage and/or advise other investment funds or accounts with the same or substantially similar investment objectives and strategies as the Fund.

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Board of Trustees and Officers

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018 (Unaudited)

The following tables identify the Trustees and Officers of the Fund. Unless otherwise indicated, the address of all persons is 120 E. Liberty Drive, Suite 400, Wheaton, IL 60187.

Name, Year of Birth and Position with the Fund	Term of Office and Year First Elected or Appointed ⁽¹⁾	Principal Occupations During Past 5 Years	Number of Portfolios in the First Trust Fund Complex Overseen by Trustee	Other Trusteeships or Directorships Held by Trustee During Past 5 Years
INDEPENDENT TRUSTEES				
Richard E. Erickson, Trustee (1951)	<ul style="list-style-type: none"> • Three Year Term • Since Fund Inception 	Physician; Officer, Wheaton Orthopedics; Limited Partner, Gundersen Real Estate Limited Partnership (June 1992 to December 2016); Member, Sportsmed LLC (April 2007 to November 2015)	161	None
Thomas R. Kadlec, Trustee (1957)	<ul style="list-style-type: none"> • Three Year Term • Since Fund Inception 	President, ADM Investor Services, Inc. (Futures Commission Merchant)	161	Director of ADM Investor Services, Inc., ADM Investor Services International, Futures Industry Association, and National Futures Association
Robert F. Keith, Trustee (1956)	<ul style="list-style-type: none"> • Three Year Term • Since June 2006 	President, Hibs Enterprises (Financial and Management Consulting)	161	Director of Trust Company of Illinois
Niel B. Nielson, Trustee (1954)	<ul style="list-style-type: none"> • Three Year Term • Since Fund Inception 	Senior Advisor (August 2018 to Present), Managing Director and Chief Operating Officer (January 2015 to August 2018), Pelita Harapan Educational Foundation (Educational Products and Services); President and Chief Executive Officer (June 2012 to September 2014), Servant Interactive LLC (Educational Products and Services); President and Chief Executive Officer (June 2012 to September 2014), Dew Learning LLC (Educational Products and Services)	161	Director of Covenant Transport, Inc. (May 2003 to May 2014)
INTERESTED TRUSTEE				
James A. Bowen ⁽²⁾ , Trustee and Chairman of the Board (1955)	<ul style="list-style-type: none"> • Three Year Term • Since Fund Inception 	Chief Executive Officer, First Trust Advisors L.P. and First Trust Portfolios L.P.; Chairman of the Board of Directors, BondWave LLC (Software Development Company) and Stonebridge Advisors LLC (Investment Advisor)	161	None

⁽¹⁾Currently, James A. Bowen and Niel B. Nielson, as Class III Trustees, are serving as trustees until the Fund's 2019 annual meeting of shareholders. Robert F. Keith, as a Class I Trustee, is serving as a trustee until the Fund's 2020 annual meeting of shareholders. Richard E. Erickson and Thomas R. Kadlec, as Class II Trustees, are serving as

trustees until the Fund's 2021 annual meeting of shareholders.

⁽²⁾ Mr. Bowen is deemed an "interested person" of the Fund due to his position as CEO of First Trust Advisors L.P., investment advisor of the Fund.

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Board of Trustees and Officers (Continued)
 First Trust Enhanced Equity Income Fund (FFA)
 December 31, 2018 (Unaudited)

Name and Year of Birth	Position and Offices with Fund	Term of Office and Length of Service	Principal Occupations During Past 5 Years
OFFICERS⁽³⁾			
James M. Dykas (1966)	President and Chief Executive Officer	<ul style="list-style-type: none"> • Indefinite Term • Since January 2016 	Managing Director and Chief Financial Officer (January 2016 to Present), Controller (January 2011 to January 2016), Senior Vice President (April 2007 to January 2016), First Trust Advisors L.P. and First Trust Portfolios L.P.; Chief Financial Officer (January 2016 to Present), BondWave LLC (Software Development Company) and Stonebridge Advisors LLC (Investment Advisor)
Donald P. Swade (1972)	Treasurer, Chief Financial Officer and Chief Accounting Officer	<ul style="list-style-type: none"> • Indefinite Term • Since January 2016 	Senior Vice President (July 2016 to Present), Vice President (April 2012 to July 2016), First Trust Advisors L.P. and First Trust Portfolios L.P.
W. Scott Jardine (1960)	Secretary and Chief Legal Officer	<ul style="list-style-type: none"> • Indefinite Term • Since Fund Inception 	General Counsel, First Trust Advisors L.P. and First Trust Portfolios L.P.; Secretary and General Counsel, BondWave LLC; Secretary, Stonebridge Advisors LLC
Daniel J. Lindquist (1970)	Vice President	<ul style="list-style-type: none"> • Indefinite Term • Since December 2005 • Indefinite Term 	Managing Director, First Trust Advisors L.P. and First Trust Portfolios L.P.
Kristi A. Maher (1966)	Chief Compliance Officer and Assistant Secretary	<ul style="list-style-type: none"> • Chief Compliance Officer • Since January 2011 • Assistant Secretary • Since Fund Inception 	Deputy General Counsel, First Trust Advisors L.P. and First Trust Portfolios L.P.

⁽³⁾ The term “officer” means the president, vice president, secretary, treasurer, controller or any other officer who performs a policy making function.

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Privacy Policy

First Trust Enhanced Equity Income Fund (FFA)

December 31, 2018 (Unaudited)

Privacy Policy

First Trust values our relationship with you and considers your privacy an important priority in maintaining that relationship. We are committed to protecting the security and confidentiality of your personal information.

Sources of Information

We collect nonpublic personal information about you from the following sources:

- Information we receive from you and your broker-dealer, investment advisor or financial representative through interviews, applications, agreements or other forms;
- Information about your transactions with us, our affiliates or others;
- Information we receive from your inquiries by mail, e-mail or telephone; and
- Information we collect on our website through the use of “cookies”. For example, we may identify the pages on our website that your browser requests or visits.

Information Collected

The type of data we collect may include your name, address, social security number, age, financial status, assets, income, tax information, retirement and estate plan information, transaction history, account balance, payment history, investment objectives, marital status, family relationships and other personal information.

Disclosure of Information

We do not disclose any nonpublic personal information about our customers or former customers to anyone, except as permitted by law. In addition to using this information to verify your identity (as required under law), the permitted uses may also include the disclosure of such information to unaffiliated companies for the following reasons:

- In order to provide you with products and services and to effect transactions that you request or authorize, we may disclose your personal information as described above to unaffiliated financial service providers and other companies that perform administrative or other services on our behalf, such as transfer agents, custodians and trustees, or that assist us in the distribution of investor materials such as trustees, banks, financial representatives, proxy services, solicitors and printers.
- We may release information we have about you if you direct us to do so, if we are compelled by law to do so, or in other legally limited circumstances (for example to protect your account from fraud).

In addition, in order to alert you to our other financial products and services, we may share your personal information within First Trust.

Use of Website Analytics

We currently use third party analytics tools, Google Analytics and AddThis, to gather information for purposes of improving First Trust’s website and marketing our products and services to you. These tools employ cookies, which are small pieces of text stored in a file by your web browser and sent to websites that you visit, to collect information, track website usage and viewing trends such as the number of hits, pages visited, videos and PDFs viewed and the length of user sessions in order to evaluate website performance and enhance navigation of the website. We may also collect other anonymous information, which is generally limited to technical and web navigation information such as the IP address of your device, internet browser type and operating system for purposes of analyzing the data to make First Trust’s website better and more useful to our users. The information collected does not include any personal identifiable information such as your name, address, phone number or email address unless you provide that information through the website for us to contact you in order to answer your questions or respond to your requests. To find out how to opt-out of these services click on: Google Analytics and AddThis.

Confidentiality and Security

With regard to our internal security procedures, First Trust restricts access to your nonpublic personal information to those First Trust employees who need to know that information to provide products or services to you. We maintain physical, electronic and procedural safeguards to protect your nonpublic personal information.

Policy Updates and Inquiries

As required by federal law, we will notify you of our privacy policy annually. We reserve the right to modify this policy at any time, however, if we do change it, we will tell you promptly. For questions about our policy, or for additional copies of this notice, please go to www.ftportfolios.com, or contact us at 1-800-621-1675 (First Trust Portfolios) or 1-800-222-6822 (First Trust Advisors).

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FUND ACCOUNTANT, AND
CUSTODIAN

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New York, NY 10286

INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM

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111 S. Wacker Drive

Chicago, IL 60606

LEGAL COUNSEL

Chapman and Cutler LLP

111 W. Monroe Street

Chicago, IL 60603

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Item 2. Code of Ethics.

The registrant, as of the end of the period covered by this report, has adopted a code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or (a) persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party.

There have been no amendments, during the period covered by this report, to a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or (c) controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, and that relates to any element of the code of ethics description.

The registrant has not granted any waivers, including an implicit waiver, from a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or (d) controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, that relates to one or more of the items set forth in paragraph (b) of this item's instructions.

(e) Not applicable.

Item 3. Audit Committee Financial Expert.

As of the end of the period covered by the report, the registrant's board of trustees has determined that Thomas R. Kadlec and Robert F. Keith are qualified to serve as audit committee financial experts serving on its audit committee and that each of them is "independent," as defined by Item 3 of Form N-CSR.

Item 4. Principal Accountant Fees and Services.

(a) *Audit Fees (Registrant)* — The aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of the registrant's annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements were \$38,000.00 for 2017 and \$38,000.00 for 2018.

(b) *Audit-Related Fees (Registrant)* — The aggregate fees billed in each of the last two fiscal years, for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported under paragraph (a) of this Item were \$0 for 2017 and \$0 for 2018.

Audit-Related Fees (Investment Adviser) — The aggregate fees billed in each of the last two fiscal years of the registrant for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported under paragraph (a) of this Item were \$0 for 2017 and \$0 for 2018.

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(c) *Tax Fees (Registrant)* — The aggregate fees billed in each of the last two fiscal years for professional services rendered by the principal accountant for tax compliance, tax advice, and tax planning to the registrant were \$5,200 for 2017 and \$5,200 for 2018. These fees were for tax preparation.

Tax Fees (Investment Adviser) — The aggregate fees billed in each of the last two fiscal years of the registrant for professional services rendered by the principal accountant for tax compliance, tax advice, and tax planning to the registrant's adviser were \$0 for 2017 and \$0 for 2018.

(d) *All Other Fees (Registrant)* — The aggregate fees billed in each of the last two fiscal years for products and services provided by the principal accountant to the registrant, other than the services reported in paragraphs (a) through (c) of this Item were \$0 for 2017 and \$0 for 2018.

All Other Fees (Investment Adviser) — The aggregate fees billed in each of the last two fiscal years for products and services provided by the principal accountant to the registrant's investment adviser, other than services reported in paragraphs (a) through (c) of this Item were \$0 for 2017 and \$0 for 2018.

(e)(1) Disclose the audit committee's pre-approval policies and procedures described in paragraph (c)(7) of Rule 2-01 of Regulation S-X.

Pursuant to its charter and its Audit and Non-Audit Services Pre-Approval Policy, the Audit Committee (the "Committee") is responsible for the pre-approval of all audit services and permitted non-audit services (including the fees and terms thereof) to be performed for the registrant by its independent auditors. The Chairman of the Committee is authorized to give such pre-approvals on behalf of the Committee up to \$25,000 and report any such pre-approval to the full Committee.

The Committee is also responsible for the pre-approval of the independent auditor's engagements for non-audit services with the registrant's adviser (not including a sub-adviser whose role is primarily portfolio management and is sub-contracted or overseen by another investment adviser) and any entity controlling, controlled by or under common control with the investment adviser that provides ongoing services to the registrant, if the engagement relates directly to the operations and financial reporting of the registrant, subject to the *de minimis* exceptions for non-audit services described in Rule 2-01 of Regulation S-X. If the independent auditor has provided non-audit services to the registrant's adviser (other than any sub-adviser whose role is primarily portfolio management and is sub-contracted with or overseen by another investment adviser) and any entity controlling, controlled by or under common control with the investment adviser that provides ongoing services to the registrant that were not pre-approved pursuant to its policies, the Committee will consider whether the provision of such non-audit services is compatible with the auditor's independence.

(e)(2) The percentage of services described in each of paragraphs (b) through (d) for the registrant and the registrant's investment adviser of this Item that were approved by the audit committee pursuant to the pre-approval exceptions included in paragraph (c)(7)(i)(c) or paragraph (c)(7)(ii) of Rule 2-01 of Regulation S-X are as follows:

(b) 0%

(c) 0%

(d) 0%

(f)

The percentage of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees was less than fifty percent.

(g) The aggregate non-audit fees billed by the registrant's accountant for services rendered to the registrant, and rendered to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the adviser that provides ongoing services to the Registrant for 2017 were \$5,200 and \$44,000 for the Registrant and the Registrant's investment adviser, respectively, and for 2018 were \$5,200 and \$48,190, for the Registrant and the Registrant's investment adviser, respectively.

(h) The Registrant's audit committee of its Board of Trustees determined that the provision of non-audit services that were rendered to the Registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the Registrant that were not pre-approved pursuant to paragraph (c)(7)(ii) of Rule 2-01 of Regulation S-X is compatible with maintaining the principal accountant's independence.

Item 5. Audit Committee of Listed registrants.

(a) The Registrant has a separately designated audit committee consisting of all the independent trustees of the Registrant. The members of the audit committee are: Thomas R. Kadlec, Niel B. Nielson, Richard E. Erickson and Robert F. Keith.

Item 6. Investments.

(a) Schedule of Investments in securities of unaffiliated issuers as of the close of the reporting period is included as part of the report to shareholders filed under Item 1 of this form.

(b) Not applicable.

Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.

The Proxy Voting Policies are attached herewith.

CHARTWELL INVESTMENT PARTNERS

Proxy Voting Policies and Procedures

- **Adopted April 11, 1997**
- **As Amended February 2018**

Purpose. Chartwell Investment Partners ("Chartwell") has adopted these Proxy Voting Policies and Procedures ("Policies") to seek to ensure that it exercises voting authority on behalf of Chartwell clients in a manner consistent with the best interests of each client and its agreement with the client.

Scope. These Policies apply where clients have delegated the authority and responsibility to Chartwell to decide how to vote proxies. Chartwell does not accept or retain authority to vote proxies in accordance with individual client guidelines with the exception of those clients who wish their proxies voted in accordance with Taft-Hartley Proxy Voting Guidelines and who have instructed Chartwell to do so. In addition, Clients who wish to instruct Chartwell not to vote in accordance with AFL-CIO Key Vote Survey recommendations, as described below, retain that authority. Clients who wish to arrange to vote proxies in accordance with their own guidelines may elect to do so at any time by notifying Chartwell. Chartwell generally will follow these Policies if asked to make recommendations about proxy voting to clients who request that advice but have not delegated proxy voting responsibility to Chartwell.

Guiding Principles. Chartwell believes that voting proxies in the best interests of each client means making a judgment as to what voting decision is most likely to maximize total return to the client as an investor in the securities being voted, and casting the vote accordingly. For this reason, Chartwell's evaluation of the possible impact of a proxy vote on the economic interests of company shareholders similarly situated to Chartwell's clients will be the primary factor governing Chartwell's proxy voting decisions.

Use of Independent Proxy Voting Service. Chartwell has retained ISS, an independent proxy voting service, to assist it in analyzing specific proxy votes with respect to securities held by Chartwell clients and to handle the mechanical aspects of casting votes. Historically, Chartwell has placed substantial reliance on ISS' analyses and recommendations and generally gives instructions to ISS to vote proxies in accordance with ISS' recommendations, unless Chartwell reaches a different conclusion than ISS about how a particular matter should be voted. ISS' proxy voting recommendations typically are made available to Chartwell about a week before the proxy must be voted, and are reviewed and monitored by members of the Proxy Voting Committee (and, in certain cases, by Chartwell portfolio managers), with a view to determining whether it is in the best interests of Chartwell's clients to vote proxies as recommended by ISS, or whether client proxies should be voted on a particular proposal in another manner. In addition, Chartwell generally votes in accordance with AFL-CIO Key Votes Survey, a list of proposals and meetings based on recommendations by the AFL-CIO Office of Investment. To the extent that any of the proxy voting positions stated in these Policies are inconsistent with a Key Vote Survey recommendation, Chartwell will generally vote in accordance with the Key Vote Survey recommendation on all impacted securities unless any client has chosen to instruct Chartwell to refrain from doing so. In that case, Chartwell will vote the client's securities position in accordance with these Policies (which may or may not cause the vote to be the same as the Key Vote Survey recommendation).

Administration of Policies. Chartwell has established a Proxy Voting Committee to oversee and administer the voting of proxies on behalf of clients, comprised of approximately five representatives of the firm's compliance and operations departments. The Committee's responsibilities include reviewing and updating these Policies as may be appropriate from time to time; identifying and resolving any material conflicts of interest on the part of Chartwell or its personnel that may affect particular proxy votes; evaluating and monitoring, on an ongoing basis, the analyses, recommendations and other services provided by ISS or another third party retained to assist Chartwell in carrying out its proxy voting responsibilities; when deemed appropriate by the Committee, consulting with Chartwell portfolio managers and investment professionals on particular proposals or categories of proposals presented for vote; and determining when and how client proxies should be voted other than in accordance with the general rules and criteria set forth in Chartwell's Proxy Voting Guidelines or with the recommendations of ISS or another independent proxy voting service retained by Chartwell.

Conflicts of Interest. It is Chartwell's policy not to exercise its authority to decide how to vote a proxy if there is a material conflict of interest between Chartwell's interests and the interests of the client that owns the shares to be voted that could affect the vote on that matter. To seek to identify any such material conflicts, a representative of the Proxy Voting Committee screens all proxies and presents any potential conflicts identified to the Committee for determination of whether the conflict exists and if so, whether it is material.

Conflicts of interest could result from a variety of circumstances, including, but not limited to, significant personal relationships between executive officers of an issuer and Chartwell personnel, a current or prospective investment adviser-client relationship between an issuer or a pension plan sponsored by an issuer and Chartwell, a significant ownership interest by Chartwell or its personnel in the issuer and various other business, personal or investment relationships. Generally, a current or prospective adviser-client relationship will not be considered material for these purposes if the net advisory revenues to Chartwell have not in the most recent fiscal year and are not expected in the current fiscal year to exceed ½ of 1 percent of Chartwell's annual advisory revenue.

Currently, the Proxy Voting Committee has determined that voting in accordance with AFL-CIO Key Votes Survey recommendations is not a material conflict of interest. In reaching this decision, the Committee recognized that Chartwell has many union clients and many clients that are not union-oriented. By voting all impacted securities positions in accordance with AFL-CIO recommendations, it could be said that Chartwell is attempting to retain or attract existing and prospective union clients. However, the overall number of proxy issues in the AFL-CIO Key Votes Survey on which Chartwell has historically voted is approximately 14 – 30 out of a total of approximately 500 company meetings and thousands of proxy votes cast by Chartwell each year. Chartwell does not use its AFL-CIO Key Votes Survey rankings for marketing purposes, so to the extent any client or prospect becomes aware of how Chartwell votes in the Surveys, it does so on its own. In addition, Union Clients have the ability to instruct Chartwell to vote their proxies entirely in accordance with the Taft-Hartley policy. Recognizing that deciding this is not a material conflict of interest is fundamentally subjective, Chartwell nonetheless discloses its practices to clients and invites clients to instruct Chartwell not to change any vote in these Policies to be consistent with an AFL-CIO Key Votes Survey recommendation (even though voting consistently with these Policies may result in voting the same way).

In the event the Committee determines that there is a material conflict of interest that may affect a particular proxy vote, Chartwell will *not* make the decision how to vote the proxy in accordance with these Policies unless the Policies specify how votes shall be cast on that particular type of matter, i.e., "for" or "against" the proposal. Where the Policies provide that the voting decision will be made on a "case-by-case" basis, Chartwell will either request the client to make the voting decision, or the vote will be cast in accordance with the recommendations of ISS or another independent proxy voting service retained by Chartwell for that purpose. Chartwell also will not provide advice to clients on proxy votes without first disclosing any material conflicts to the client requesting such advice.

When Chartwell Does Not Vote Proxies. Chartwell may not vote proxies respecting client securities in certain circumstances, including, but not limited to, situations where (a) the securities are no longer held in a client's account; (b) the proxy and other relevant materials are not received in sufficient time to allow analysis or an informed vote by the voting deadline; (c) Chartwell concludes that the cost of voting the proxy will exceed the expected potential

benefit to the client; or (d) the securities have been loaned out pursuant to a client's securities lending program and are unavailable to vote.

- **Proxy Voting Guidelines**

Generally, Chartwell votes all proxies in accordance with the following guidelines provided by Institutional Shareholder Services (ISS). These guidelines may be changed or supplemented from time to time. Votes on matters not covered by these guidelines will be determined in accordance with the principles set forth above. Client guidelines may be inconsistent with these guidelines and may cause Chartwell to vote differently for different clients on the same matter.

1. **BOARD OF DIRECTORS**

Voting on Director Nominees in Uncontested Elections

Four fundamental principles apply when determining votes on director nominees:

Independence: Boards should be sufficiently independent from management (and significant shareholders) to ensure that they are able and motivated to effectively supervise management's performance for the benefit of all shareholders, including in setting and monitoring the execution of corporate strategy, with appropriate use of shareholder capital, and in setting and monitoring executive compensation programs that support that strategy. The chair of the board should ideally be an independent director, and all boards should have an independent leadership position or a similar role in order to help provide appropriate counterbalance to executive management, as well as having sufficiently independent committees that focus on key governance concerns such as audit, compensation, and nomination of directors.

Composition: Companies should ensure that directors add value to the board through their specific skills and expertise and by having sufficient time and commitment to serve effectively. Boards should be of a size appropriate to accommodate diversity, expertise, and independence, while ensuring active and collaborative participation by all members. Boards should be sufficiently diverse to ensure consideration of a wide range of perspectives.

Responsiveness: Directors should respond to investor input, such as that expressed through significant opposition to management proposals, significant support for shareholder proposals (whether binding or non-binding), and tender offers where a majority of shares are tendered.

Accountability: Boards should be sufficiently accountable to shareholders, including through transparency of the company's governance practices and regular board elections, by the provision of sufficient information for

shareholders to be able to assess directors and board composition, and through the ability of shareholders to remove directors.

General Recommendation: Generally vote for director nominees, except under the following circumstances:

Independence

Vote against¹ or withhold from non-independent directors (Executive Directors and Non-Independent Non-Executive Directors per ISS' Categorization of Directors) when:

› Independent directors comprise 50 percent or less of the board;

› The non-independent director serves on the audit, compensation, or nominating committee;

› The company lacks an audit, compensation, or nominating committee so that the full board functions as that committee; or

› The company lacks a formal nominating committee, even if the board attests that the independent directors fulfill the functions of such a committee.

In general, companies with a plurality vote standard use "Withhold" as the contrary vote option in director elections; companies with a majority vote standard use "Against". However, it will vary by company and the proxy must be checked to determine the valid contrary vote option for the particular company.

ISS U.S. Categorization of Directors

1. Executive Director

1.1. Current employee or current officer¹ of the company or one of its affiliates².

2. Non-Independent Non-Executive Director

Board Identification

2.1. Director identified as not independent by the board. Controlling/Significant Shareholder

2.2. Beneficial owner of more than 50 percent of the company's voting power (this may be aggregated if voting power is distributed among more than one member of a group).

Former CEO/Interim Officer

- 2.3. Former CEO of the company.^{3, 4}
- 2.4. Former CEO of an acquired company within the past five years.⁴
- 2.5. Former interim officer if the service was longer than 18 months. If the service was between 12 and 18 months an assessment of the interim officer's employment agreement will be made.⁵

Non-CEO Executives

- 2.6. Former officer¹ of the company, an affiliate², or an acquired firm within the past five years.
- 2.7. Officer¹ of a former parent or predecessor firm at the time the company was sold or split off from the parent/predecessor within the past five years.
- 2.8. Officer¹, former officer, or general or limited partner of a joint venture or partnership with the company.

Family Members

- 2.9. Immediate family member⁶ of a current or former officer¹ of the company or its affiliates² within the last five years.
- 2.10. Immediate family member⁶ of a current employee of company or its affiliates² where additional factors raise concern (which may include, but are not limited to, the following: a director related to numerous employees; the company or its affiliates employ relatives of numerous board members; or a non- Section 16 officer in a key strategic role).

Transactional, Professional, Financial, and Charitable Relationships

- 2.11. Currently provides (or an immediate family member⁶ provides) professional services⁷ to the company, to an affiliate² of the company or an individual officer of the company or one of its affiliates in excess of \$10,000 per year.
- 2.12. Is (or an immediate family member⁶ is) a partner in, or a controlling shareholder or an employee of, an organization which provides professional services⁷ to the company, to an affiliate² of the company, or an individual officer of the company or one of its affiliates in excess of \$10,000 per year.
- 2.13. Has (or an immediate family member⁶ has) any material transactional relationship⁸ with the company or its affiliates² (excluding investments in the company through a private placement).
- 2.14. Is (or an immediate family member⁶ is) a partner in, or a controlling shareholder or an executive officer of, an organization which has any material transactional relationship⁸ with the company or its affiliates² (excluding investments in the company through a private placement).
- 2.15. Is (or an immediate family member⁶ is) a trustee, director, or employee of a charitable or non-profit organization that receives material grants or endowments⁸ from the company or its affiliates².

Other Relationships

- 2.16. Party to a voting agreement⁹ to vote in line with management on proposals being brought to shareholder vote.
- 2.17. Has (or an immediate family member⁶ has) an interlocking relationship as defined by the SEC involving members of the board of directors or its Compensation Committee.¹⁰

- 2.18. Founder¹¹ of the company but not currently an employee.
- 2.19. Any material¹² relationship with the company.
3. Independent Director
- 3.1. No material¹² connection to the company other than a board seat.

Footnotes:

- The definition of officer will generally follow that of a “Section 16 officer” (officers subject to Section 16 of the Securities and Exchange Act of 1934) and includes the chief executive, operating, financial, legal, technology, and accounting officers of a company (including the president, treasurer, secretary, controller, or any vice president in charge of a principal business unit, division, or policy function). Current interim officers are included in this
1. category. For private companies, the equivalent positions are applicable. A non-employee director serving as an officer due to statutory requirements (e.g. corporate secretary) will generally be classified as a Non-Independent Non-Executive Director under 2.19: “Any material relationship with the company.” However, if the company provides explicit disclosure that the director is not receiving additional compensation exceeding \$10,000 per year for serving in that capacity, then the director will be classified as an Independent Director.
 2. “Affiliate” includes a subsidiary, sibling company, or parent company. ISS uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation.
 3. Includes any former CEO of the company prior to the company’s initial public offering (IPO).
When there is a former CEO of a special purpose acquisition company (SPAC) serving on the board of an acquired company, ISS will generally classify such directors as independent unless determined otherwise taking into account
 4. the following factors: the applicable listing standards determination of such director’s independence; any operating ties to the firm; and the existence of any other conflicting relationships or related party transactions.
ISS will look at the terms of the interim officer’s employment contract to determine if it contains severance pay,
 5. long-term health and pension benefits, or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. ISS will also consider if a formal search process was under way for a full-time officer at the time.
 6. “Immediate family member” follows the SEC’s definition of such and covers spouses, parents, children, step-parents, step- children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.
Professional services can be characterized as advisory in nature, generally involve access to sensitive company information or to strategic decision-making, and typically have a commission- or fee-based payment structure. Professional services generally include, but are not limited to the following: investment banking/financial advisory services, commercial banking (beyond deposit services), investment services, insurance services, accounting/audit services, consulting services, marketing services, legal services, property management services, realtor services, lobbying services, executive search services, and IT consulting services. The following would generally be considered transactional relationships and not professional services: deposit services, IT tech support services,
 7. educational services, and construction services. The case of participation in a banking syndicate by a non-lead bank should be considered a transactional (and hence subject to the associated materiality test) rather than a professional relationship. “Of Counsel” relationships are only considered immaterial if the individual does not receive any form of compensation (in excess of \$10,000 per year) from, or is a retired partner of, the firm providing the professional service. The case of a company providing a professional service to one of its directors or to an entity with which one of its directors is affiliated, will be considered a transactional rather than a professional relationship. Insurance services and marketing services are assumed to be professional services unless the company explains why such services are not advisory.
 - 8.

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A material transactional relationship, including grants to non-profit organizations, exists if the company makes annual payments to, or receives annual payments from, another entity, exceeding the greater of: \$200,000 or 5 percent of the recipient's gross revenues, for a company that follows NASDAQ listing standards; or the greater of \$1,000,000 or 2 percent of the recipient's gross revenues, for a company that follows NYSE listing standards. For a company that follows neither of the preceding standards, ISS will apply the NASDAQ-based materiality test. (The recipient is the party receiving the financial proceeds from the transaction).

9. Dissident directors who are parties to a voting agreement pursuant to a settlement or similar arrangement may be classified as Independent Directors if an analysis of the following factors indicates that the voting agreement does not compromise their alignment with all shareholders' interests: the terms of the agreement; the duration of the standstill provision in the agreement; the limitations and requirements of actions that are agreed upon; if the dissident director nominee(s) is subject to the standstill; and if there any conflicting relationships or related party transactions.

10. Interlocks include: executive officers serving as directors on each other's compensation or similar committees (or, in the absence of such a committee, on the board); or executive officers sitting on each other's boards and at least one serves on the other's compensation or similar committees (or, in the absence of such a committee, on the board).

Composition

Attendance at Board and Committee Meetings: Generally vote against or withhold from directors (except new nominees, who should be considered case-by-case²) who attend less than 75 percent of the aggregate of their board and committee meetings for the period for which they served, unless an acceptable reason for absences is disclosed in the proxy or another SEC filing. Acceptable reasons for director absences are generally limited to the following:

Medical issues/illness;
Family emergencies; and
Missing only one meeting (when the total of all meetings is three or fewer).

If the proxy disclosure is unclear and insufficient to determine whether a director attended at least 75 percent of the aggregate of his/her board and committee meetings during his/her period of service, vote against or withhold from the director(s) in question.

Overboarded Directors: Generally vote against or withhold from individual directors who:

Sit on more than five public company boards; or
> Are CEOs of public companies who sit on the boards of more than two public companies besides their own—
withhold only at their outside boards³.

Diversity: Highlight boards with no gender diversity. However, no adverse vote recommendations will be made due to any lack of gender diversity.

Responsiveness

Vote case-by-case on individual directors, committee members, or the entire board of directors as appropriate if:

The board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year. Factors that will be considered are:

Disclosed outreach efforts by the board to shareholders in the wake of the vote;

Rationale provided in the proxy statement for the level of implementation;

The subject matter of the proposal;

The level of support for and opposition to the resolution in past meetings;

Actions taken by the board in response to the majority vote and its engagement with shareholders;

The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and

Other factors as appropriate.

The board failed to act on takeover offers where the majority of shares are tendered;

2 New nominees who served for only part of the fiscal year are generally exempted from the attendance policy.

Although all of a CEO's subsidiary boards will be counted as separate boards, ISS will not recommend a withhold vote for the CEO of a parent company board or any of the controlled (>50 percent ownership) subsidiaries of that parent, but may do so at subsidiaries that are less than 50 percent controlled and boards outside the parent/subsidiary relationships.

At the previous board election, any director received more than 50 percent withhold/against votes of the shares cast and the company has failed to address the issue(s) that caused the high withhold/against vote.

Vote case-by-case on Compensation Committee members (or, in exceptional cases, the full board) and the Say on Pay proposal if:

The company's previous say-on-pay received the support of less than 70 percent of votes cast. Factors that will be considered are:

The company's response, including:

Disclosure of engagement efforts with major institutional investors, including the frequency and timing of engagements and the company participants (including whether independent directors participated);

Disclosure of the specific concerns voiced by dissenting shareholders that led to the say-on-pay opposition;

Disclosure of specific and meaningful actions taken to address shareholders' concerns;

Other recent compensation actions taken by the company;

Whether the issues raised are recurring or isolated;

The company's ownership structure; and

Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness. The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received the plurality of votes cast.

Accountability

Vote against or withhold from the entire board of directors (except new nominees⁴, who should be considered case-by-case) for the following:

Problematic Takeover Defenses/Governance Structure

Poison Pills: Vote against or withhold from all nominees (except new nominees, who should be considered case-by-case) if:

The company has a poison pill that was not approved by shareholders⁵. However, vote case-by-case on nominees if the board adopts an initial pill with a term of one year or less, depending on the disclosed rationale for the adoption, and other factors as relevant (such as a commitment to put any renewal to a shareholder vote).

The board makes a material adverse modification to an existing pill, including, but not limited to, extension, renewal, or lowering the trigger, without shareholder approval.

Classified Board Structure: The board is classified, and a continuing director responsible for a problematic governance issue at the board/committee level that would warrant a withhold/against vote recommendation is not up for election. All appropriate nominees (except new) may be held accountable.

Removal of Shareholder Discretion on Classified Boards: The company has opted into, or failed to opt out of, state laws requiring a classified board structure.

A “new nominee” is any current nominee who has not already been elected by shareholders and who joined the board after the problematic action in question transpired. If ISS cannot determine whether the nominee joined the board before or after the problematic action transpired, the nominee will be considered a “new nominee” if he or she joined the board within the 12 months prior to the upcoming shareholder meeting.

⁵Public shareholders only, approval prior to a company’s becoming public is insufficient.

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Director Performance Evaluation: The board lacks mechanisms to promote accountability and oversight, coupled with sustained poor performance relative to peers. Sustained poor performance is measured by one- and three-year total shareholder returns in the bottom half of a company's four-digit GICS industry group (Russell 3000 companies only). Take into consideration the company's five-year total shareholder return and operational metrics. Problematic provisions include but are not limited to:

- ⌘ A classified board structure;
- ⌘ A supermajority vote requirement;
- ⌘ Either a plurality vote standard in uncontested director elections, or a majority vote standard in contested elections;
- ⌘ The inability of shareholders to call special meetings;
- ⌘ The inability of shareholders to act by written consent;
- ⌘ A multi-class capital structure; and/or
- ⌘ A non-shareholder-approved poison pill.

Unilateral Bylaw/Charter Amendments and Problematic Capital Structures: Generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors:

- ⌘ The board's rationale for adopting the bylaw/charter amendment without shareholder ratification;
- ⌘ Disclosure by the company of any significant engagement with shareholders regarding the amendment;
- ⌘ The level of impairment of shareholders' rights caused by the board's unilateral amendment to the bylaws/charter;
- ⌘ The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions;
- ⌘ The company's ownership structure;
- ⌘ The company's existing governance provisions;
- ⌘ The timing of the board's amendment to the bylaws/charter in connection with a significant business development; and
- ⌘ Other factors, as deemed appropriate, that may be relevant to determine the impact of the amendment on shareholders.

Unless the adverse amendment is reversed or submitted to a binding shareholder vote, in subsequent years vote case-by-case on director nominees. Generally vote against (except new nominees, who should be considered case-by-case) if the directors:

- ⌘ Classified the board;
- ⌘ Adopted supermajority vote requirements to amend the bylaws or charter; or
- ⌘ Eliminated shareholders' ability to amend bylaws.

Problematic Governance Structure - Newly public companies: For newly public companies, generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board

adopted bylaw or charter provisions materially adverse to shareholder rights, or implemented a multi-class capital structure in which the classes have unequal voting rights considering the following factors:

~~The level of impairment of shareholders' rights;~~
~~The disclosed rationale;~~
> The ability to change the governance structure (e.g., limitations on shareholders' right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
> The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure;
~~Any reasonable sunset provision; and~~
Other relevant factors.

Unless the adverse provision and/or problematic capital structure is reversed or removed, vote case-by-case on director nominees in subsequent years.

Restrictions on Shareholders' Rights

Restricting Binding Shareholder Proposals: Generally vote against or withhold from the members of the governance committee if:

The company's governing documents impose undue restrictions on shareholders' ability to amend the bylaws. Such restrictions include, but are not limited to: outright prohibition on the submission of binding shareholder proposals, or share ownership requirements or time holding requirements in excess of SEC Rule 14a-8. Vote against on an ongoing basis.

Problematic Audit-Related Practices

Generally vote against or withhold from the members of the Audit Committee if:

~~The non-audit fees paid to the auditor are excessive;~~
> The company receives an adverse opinion on the company's financial statements from its auditor; or
There is persuasive evidence that the Audit Committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm.

Vote case-by-case on members of the Audit Committee and potentially the full board if:

Poor accounting practices are identified that rise to a level of serious concern, such as: fraud; misapplication of GAAP; and material weaknesses identified in Section 404 disclosures. Examine the severity, breadth, chronological sequence, and duration, as well as the company's efforts at remediation or corrective actions, in determining whether withhold/against votes are warranted.

Problematic Compensation Practices

In the absence of an Advisory Vote on Executive Compensation (Say on Pay) ballot item or in egregious situations, vote against or withhold from the members of the Compensation Committee and potentially the full board if:

- ⌘ There is a significant misalignment between CEO pay and company performance (pay for performance);
- ⌘ The company maintains significant problematic pay practices; or
 - ⌘ The board exhibits a significant level of poor communication and responsiveness to shareholders.

Generally vote against or withhold from the Compensation Committee chair, other committee members, or potentially the full board if:

- ⌘ The company fails to include a Say on Pay ballot item when required under SEC provisions, or under the company's declared frequency of say on pay; or
- ⌘ The company fails to include a Frequency of Say on Pay ballot item when required under SEC provisions.

Generally vote against members of the board committee responsible for approving/setting non-employee director compensation if there is a pattern (i.e. two or more years) of awarding excessive non-employee director compensation without disclosing a compelling rationale or other mitigating factors.

Problematic Pledging of Company Stock:

Vote against the members of the committee that oversees risks related to pledging, or the full board, where a significant level of pledged company stock by executives or directors raises concerns. The following factors will be considered:

- ⌘ The presence of an anti-pledging policy, disclosed in the proxy statement, that prohibits future pledging activity;

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The magnitude of aggregate pledged shares in terms of total common shares outstanding, market value, and trading volume;

Disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;

Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and

Any other relevant factors.

Governance Failures

Under extraordinary circumstances, vote against or withhold from directors individually, committee members, or the entire board, due to:

Material failures of governance, stewardship, risk oversight⁶, or fiduciary responsibilities at the company;

Failure to replace management as appropriate; or

- › Egregious actions related to a director's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Voting on Director Nominees in Contested Elections

Vote-No Campaigns

General Recommendation: In cases where companies are targeted in connection with public "vote-no" campaigns, evaluate director nominees under the existing governance policies for voting on director nominees in uncontested elections. Take into consideration the arguments submitted by shareholders and other publicly available information.

Proxy Contests/Proxy Access — Voting for Director Nominees in Contested Elections

General Recommendation: Vote case-by-case on the election of directors in contested elections, considering the following factors:

Long-term financial performance of the company relative to its industry;

Management's track record;

Background to the contested election;

Nominee qualifications and any compensatory arrangements;

Strategic plan of dissident slate and quality of the critique against management;

Likelihood that the proposed goals and objectives can be achieved (both slates); and

Stock ownership positions.

6 Examples of failure of risk oversight include, but are not limited to: bribery; large or serial fines or sanctions from regulatory bodies; significant adverse legal judgments or settlement; or hedging of company stock.

In the case of candidates nominated pursuant to proxy access, vote case-by-case considering any applicable factors listed above or additional factors which may be relevant, including those that are specific to the company, to the nominee(s) and/or to the nature of the election (such as whether or not there are more candidates than board seats).

Other Board-Related Proposals

Adopt Anti-Hedging/Pledging/Speculative Investments Policy

General Recommendation: Generally vote for proposals seeking a policy that prohibits named executive officers from engaging in derivative or speculative transactions involving company stock, including hedging, holding stock in a margin account, or pledging stock as collateral for a loan. However, the company's existing policies regarding responsible use of company stock will be considered.

Age/Term Limits

General Recommendation: Vote against management and shareholder proposals to limit the tenure of outside directors through mandatory retirement ages.

Vote against management proposals to limit the tenure of outside directors through term limits. However, scrutinize boards where the average tenure of all directors exceeds 15 years for independence from management and for sufficient turnover to ensure that new perspectives are being added to the board.

Board Size

General Recommendation: Vote for proposals seeking to fix the board size or designate a range for the board size.

Vote against proposals that give management the ability to alter the size of the board outside of a specified range without shareholder approval.

Classification/Declassification of the Board

General Recommendation: Vote against proposals to classify (stagger) the board.

Vote for proposals to repeal classified boards and to elect all directors annually.

CEO Succession Planning

General Recommendation: Generally vote for proposals seeking disclosure on a CEO succession planning policy, considering, at a minimum, the following factors:

- ∅The reasonableness/scope of the request; and
- ∅The company's existing disclosure on its current CEO succession planning process.

Cumulative Voting

General Recommendation: Generally vote against management proposals to eliminate cumulate voting, and for shareholder proposals to restore or provide for cumulative voting, unless:

- ∅The company has proxy access⁷, thereby allowing shareholders to nominate directors to the company's ballot; and
- ∅The company has adopted a majority vote standard, with a carve-out for plurality voting in situations where there are more nominees than seats, and a director resignation policy to address failed elections.

⁷A proxy access right that meets the recommended guidelines.

Vote for proposals for cumulative voting at controlled companies (insider voting power > 50%).

Director and Officer Indemnification and Liability Protection

General Recommendation: Vote case-by-case on proposals on director and officer indemnification and liability protection.

Vote against proposals that would:

Eliminate entirely directors' and officers' liability for monetary damages for violating the duty of care.

Expand coverage beyond just legal expenses to liability for acts that are more serious violations of fiduciary obligation than mere carelessness.

Expand the scope of indemnification to provide for mandatory indemnification of company officials in connection with acts that previously the company was permitted to provide indemnification for, at the discretion of the company's board (i.e., "permissive indemnification"), but that previously the company was not required to indemnify.

Vote for only those proposals providing such expanded coverage in cases when a director's or officer's legal defense was unsuccessful if both of the following apply:

If the director was found to have acted in good faith and in a manner that s/he reasonably believed was in the best interests of the company; and

If only the director's legal expenses would be covered.

Establish/Amend Nominee Qualifications

General Recommendation: Vote case-by-case on proposals that establish or amend director qualifications. Votes should be based on the reasonableness of the criteria and the degree to which they may preclude dissident nominees from joining the board.

Vote case-by-case on shareholder resolutions seeking a director nominee who possesses a particular subject matter expertise, considering:

The company's board committee structure, existing subject matter expertise, and board nomination provisions relative to that of its peers;

The company's existing board and management oversight mechanisms regarding the issue for which board oversight is sought;

>

The company's disclosure and performance relating to the issue for which board oversight is sought and any significant related controversies; and
The scope and structure of the proposal.

Establish Other Board Committee Proposals

General Recommendation: Generally vote against shareholder proposals to establish a new board committee, as such proposals seek a specific oversight mechanism/structure that potentially limits a company's flexibility to determine an appropriate oversight mechanism for itself. However, the following factors will be considered:

Existing oversight mechanisms (including current committee structure) regarding the issue for which board oversight is sought;
Level of disclosure regarding the issue for which board oversight is sought;
Company performance related to the issue for which board oversight is sought;
Board committee structure compared to that of other companies in its industry sector; and
The scope and structure of the proposal.

Filling Vacancies/Removal of Directors

General Recommendation: Vote against proposals that provide that directors may be removed only for cause. Vote for proposals to restore shareholders' ability to remove directors with or without cause.

Vote against proposals that provide that only continuing directors may elect replacements to fill board vacancies. Vote for proposals that permit shareholders to elect directors to fill board vacancies.

Independent Chair (Separate Chair/CEO)

General Recommendation: Generally vote for shareholder proposals requiring that the chairman's position be filled by an independent director, taking into consideration the following:

The scope of the proposal;
The company's current board leadership structure;
The company's governance structure and practices;
Company performance; and
Any other relevant factors that may be applicable.

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Regarding the scope of the proposal, consider whether the proposal is precatory or binding and whether the proposal is seeking an immediate change in the chairman role or the policy can be implemented at the next CEO transition.

Under the review of the company's board leadership structure, ISS may support the proposal under the following scenarios absent a compelling rationale: the presence of an executive or non-independent chair in addition to the CEO; a recent recombination of the role of CEO and chair; and/or departure from a structure with an independent chair. ISS will also consider any recent transitions in board leadership and the effect such transitions may have on independent board leadership as well as the designation of a lead director role.

When considering the governance structure, ISS will consider the overall independence of the board, the independence of key committees, the establishment of governance guidelines, board tenure and its relationship to CEO tenure, and any other factors that may be relevant. Any concerns about a company's governance structure will weigh in favor of support for the proposal.

The review of the company's governance practices may include, but is not limited to, poor compensation practices, material failures of governance and risk oversight, related-party transactions or other issues putting director independence at risk, corporate or management scandals, and actions by management or the board with potential or realized negative impact on shareholders. Any such practices may suggest a need for more independent oversight at the company thus warranting support of the proposal.

ISS' performance assessment will generally consider one-, three-, and five-year TSR compared to the company's peers and the market as a whole. While poor performance will weigh in favor of the adoption of an independent chair policy, strong performance over the long term will be considered a mitigating factor when determining whether the proposed leadership change warrants support.

Majority of Independent Directors/Establishment of Independent Committees

General Recommendation: Vote for shareholder proposals asking that a majority or more of directors be independent unless the board composition already meets the proposed threshold by ISS' definition of Independent Director (See Categorization of Directors).

Vote for shareholder proposals asking that board audit, compensation, and/or nominating committees be composed exclusively of independent directors unless they currently meet that standard.

Majority Vote Standard for the Election of Directors

General Recommendation: Generally vote for management proposals to adopt a majority of votes cast standard for directors in uncontested elections. Vote against if no carve-out for a plurality vote standard in contested elections is included.

Generally vote for precatory and binding shareholder resolutions requesting that the board change the company's bylaws to stipulate that directors need to be elected with an affirmative majority of votes cast, provided it does not conflict with the state law where the company is incorporated. Binding resolutions need to allow for a carve-out for a plurality vote standard when there are more nominees than board seats.

Companies are strongly encouraged to also adopt a post-election policy (also known as a director resignation policy) that will provide guidelines so that the company will promptly address the situation of a holdover director.

Proxy Access

General Recommendation: Generally vote for management and shareholder proposals for proxy access with the following provisions:

Ownership threshold: maximum requirement not more than three percent (3%) of the voting power;
Ownership duration: maximum requirement not longer than three (3) years of continuous ownership for each member of the nominating group;
Aggregation: minimal or no limits on the number of shareholders permitted to form a nominating group;
Cap: cap on nominees of generally twenty-five percent (25%) of the board.

Review for reasonableness any other restrictions on the right of proxy access. Generally vote against proposals that are more restrictive than these guidelines.

Require More Nominees than Open Seats

General Recommendation: Vote against shareholder proposals that would require a company to nominate more candidates than the number of open board seats.

Shareholder Engagement Policy (Shareholder Advisory Committee)

General Recommendation: Generally vote for shareholder proposals requesting that the board establish an internal mechanism/process, which may include a committee, in order to improve communications between directors and shareholders, unless the company has the following features, as appropriate:

Established a communication structure that goes beyond the exchange requirements to facilitate the exchange of information between shareholders and members of the board;
Effectively disclosed information with respect to this structure to its shareholders;
Company has not ignored majority-supported shareholder proposals or a majority withhold vote on a director nominee; and
The company has an independent chairman or a lead director, according to ISS' definition. This individual must be made available for periodic consultation and direct communication with major shareholders.

2. AUDIT-RELATED

Auditor Indemnification and Limitation of Liability

General Recommendation: Vote case-by-case on the issue of auditor indemnification and limitation of liability. Factors to be assessed include, but are not limited to:

The terms of the auditor agreement—the degree to which these agreements impact shareholders' rights;
The motivation and rationale for establishing the agreements;
The quality of the company's disclosure; and
The company's historical practices in the audit area.

Vote against or withhold from members of an audit committee in situations where there is persuasive evidence that the audit committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm.

Auditor Ratification

General Recommendation: Vote for proposals to ratify auditors unless any of the following apply:

An auditor has a financial interest in or association with the company, and is therefore not independent;
There is reason to believe that the independent auditor has rendered an opinion that is neither accurate nor indicative of the company's financial position;

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Poor accounting practices are identified that rise to a serious level of concern, such as fraud or misapplication of GAAP; or
Fees for non-audit services (“Other” fees) are excessive.

Non-audit fees are excessive if:

> Non-audit (“other”) fees > audit fees + audit-related fees + tax compliance/preparation fees

Tax compliance and preparation include the preparation of original and amended tax returns and refund claims, and tax payment planning. All other services in the tax category, such as tax advice, planning, or consulting, should be added to “Other” fees. If the breakout of tax fees cannot be determined, add all tax fees to “Other” fees.

In circumstances where "Other" fees include fees related to significant one-time capital structure events (such as initial public offerings, bankruptcy emergence, and spin-offs) and the company makes public disclosure of the amount and nature of those fees that are an exception to the standard "non-audit fee" category, then such fees may be excluded from the non-audit fees considered in determining the ratio of non-audit to audit/audit-related fees/tax compliance and preparation for purposes of determining whether non-audit fees are excessive.

Shareholder Proposals Limiting Non-Audit Services

General Recommendation: Vote case-by-case on shareholder proposals asking companies to prohibit or limit their auditors from engaging in non-audit services.

Shareholder Proposals on Audit Firm Rotation

General Recommendation: Vote case-by-case on shareholder proposals asking for audit firm rotation, taking into account:

• The tenure of the audit firm;
• The length of rotation specified in the proposal;
• Any significant audit-related issues at the company;
• The number of Audit Committee meetings held each year;
• The number of financial experts serving on the committee; and
• Whether the company has a periodic renewal process where the auditor is evaluated for both audit quality and competitive price.

3. SHAREHOLDER RIGHTS & DEFENSES

Advance Notice Requirements for Shareholder Proposals/Nominations

General Recommendation: Vote case-by-case on advance notice proposals, giving support to those proposals which allow shareholders to submit proposals/nominations as close to the meeting date as reasonably possible and within the broadest window possible, recognizing the need to allow sufficient notice for company, regulatory, and shareholder review.

To be reasonable, the company's deadline for shareholder notice of a proposal/nominations must not be more than 60 days prior to the meeting, with a submittal window of at least 30 days prior to the deadline. The submittal window is the period under which a shareholder must file his proposal/nominations prior to the deadline.

In general, support additional efforts by companies to ensure full disclosure in regard to a proponent's economic and voting position in the company so long as the informational requirements are reasonable and aimed at providing shareholders with the necessary information to review such proposals.

Amend Bylaws without Shareholder Consent

General Recommendation: Vote against proposals giving the board exclusive authority to amend the bylaws.

Vote case-by-case on proposals giving the board the ability to amend the bylaws in addition to shareholders, taking into account the following:

- ✗ Any impediments to shareholders' ability to amend the bylaws (i.e. supermajority voting requirements);
- ✗ The company's ownership structure and historical voting turnout;
- ✗ Whether the board could amend bylaws adopted by shareholders; and
- ✗ Whether shareholders would retain the ability to ratify any board-initiated amendments.

Control Share Acquisition Provisions

Control share acquisition statutes function by denying shares their voting rights when they contribute to ownership in excess of certain thresholds. Voting rights for those shares exceeding ownership limits may only be restored by approval of either a majority or supermajority of disinterested shares. Thus, control share acquisition statutes

effectively require a hostile bidder to put its offer to a shareholder vote or risk voting disenfranchisement if the bidder continues buying up a large block of shares.

General Recommendation: Vote for proposals to opt out of control share acquisition statutes unless doing so would enable the completion of a takeover that would be detrimental to shareholders.

Vote against proposals to amend the charter to include control share acquisition provisions. Vote for proposals to restore voting rights to the control shares.

Control Share Cash-Out Provisions

Control share cash-out statutes give dissident shareholders the right to "cash-out" of their position in a company at the expense of the shareholder who has taken a control position. In other words, when an investor crosses a preset threshold level, remaining shareholders are given the right to sell their shares to the acquirer, who must buy them at the highest acquiring price.

General Recommendation: Vote for proposals to opt out of control share cash-out statutes.

Disgorgement Provisions

Disgorgement provisions require an acquirer or potential acquirer of more than a certain percentage of a company's stock to disgorge, or pay back, to the company any profits realized from the sale of that company's stock purchased 24 months before achieving control status. All sales of company stock by the acquirer occurring within a certain period of time (between 18 months and 24 months) prior to the investor's gaining control status are subject to these recapture-of-profits provisions.

General Recommendation: Vote for proposals to opt out of state disgorgement provisions.

Fair Price Provisions

General Recommendation: Vote case-by-case on proposals to adopt fair price provisions (provisions that stipulate that an acquirer must pay the same price to acquire all shares as it paid to acquire the control shares), evaluating factors such as the vote required to approve the proposed acquisition, the vote required to repeal the fair price provision, and

the mechanism for determining the fair price.

Generally vote against fair price provisions with shareholder vote requirements greater than a majority of disinterested shares.

Freeze-Out Provisions

General Recommendation: Vote for proposals to opt out of state freeze-out provisions. Freeze-out provisions force an investor who surpasses a certain ownership threshold in a company to wait a specified period of time before gaining control of the company.

Greenmail

Greenmail payments are targeted share repurchases by management of company stock from individuals or groups seeking control of the company. Since only the hostile party receives payment, usually at a substantial premium over the market value of its shares, the practice discriminates against all other shareholders.

General Recommendation: Vote for proposals to adopt anti-greenmail charter or bylaw amendments or otherwise restrict a company's ability to make greenmail payments.

Vote case-by-case on anti-greenmail proposals when they are bundled with other charter or bylaw amendments.

Litigation Rights (including Exclusive Venue and Fee-Shifting Bylaw Provisions)

Bylaw provisions impacting shareholders' ability to bring suit against the company may include exclusive venue provisions, which provide that the state of incorporation shall be the sole venue for certain types of litigation, and fee-shifting provisions that require a shareholder who sues a company unsuccessfully to pay all litigation expenses of the defendant corporation.

General Recommendation: Vote case-by-case on bylaws which impact shareholders' litigation rights, taking into account factors such as:

The company's stated rationale for adopting such a provision;
Disclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or shareholder lawsuits outside the jurisdiction of incorporation;
The breadth of application of the bylaw, including the types of lawsuits to which it would apply and the definition of key terms; and
Governance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the bylaws) and their ability to hold directors accountable through annual director elections and a majority vote standard in uncontested elections.

Generally vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits (i.e., in cases where the plaintiffs are partially successful).

Unilateral adoption by the board of bylaw provisions which affect shareholders' litigation rights will be evaluated under ISS' policy on Unilateral Bylaw/Charter Amendments.

Net Operating Loss (NOL) Protective Amendments

General Recommendation: Vote against proposals to adopt a protective amendment for the stated purpose of protecting a company's net operating losses (NOL) if the effective term of the protective amendment would exceed the shorter of three years and the exhaustion of the NOL.

Vote case-by-case, considering the following factors, for management proposals to adopt an NOL protective amendment that would remain in effect for the shorter of three years (or less) and the exhaustion of the NOL:

The ownership threshold (NOL protective amendments generally prohibit stock ownership transfers that would result in a new 5-percent holder or increase the stock ownership percentage of an existing 5-percent holder);
The value of the NOLs;
Shareholder protection mechanisms (sunset provision or commitment to cause expiration of the protective amendment upon exhaustion or expiration of the NOL);
The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
Any other factors that may be applicable.

Poison Pills (Shareholder Rights Plans)

Shareholder Proposals to Put Pill to a Vote and/or Adopt a Pill Policy

General Recommendation: Vote for shareholder proposals requesting that the company submit its poison pill to a shareholder vote or redeem it unless the company has: (1) A shareholder approved poison pill in place; or (2) The company has adopted a policy concerning the adoption of a pill in the future specifying that the board will only adopt a shareholder rights plan if either:

Shareholders have approved the adoption of the plan; or

The board, in its exercise of its fiduciary responsibilities, determines that it is in the best interest of shareholders under the circumstances to adopt a pill without the delay in adoption that would result from seeking stockholder approval (i.e., the “fiduciary out” provision). A poison pill adopted under this fiduciary out will be put to a shareholder ratification vote within 12 months of adoption or expire. If the pill is not approved by a majority of the votes cast on this issue, the plan will immediately terminate.

If the shareholder proposal calls for a time period of less than 12 months for shareholder ratification after adoption, vote for the proposal, but add the caveat that a vote within 12 months would be considered sufficient implementation.

Management Proposals to Ratify a Poison Pill

General Recommendation: Vote case-by-case on management proposals on poison pill ratification, focusing on the features of the shareholder rights plan. Rights plans should contain the following attributes:

No lower than a 20 percent trigger, flip-in or flip-over;

A term of no more than three years;

No dead-hand, slow-hand, no-hand, or similar feature that limits the ability of a future board to redeem the pill;

Shareholder redemption feature (qualifying offer clause); if the board refuses to redeem the pill 90 days after a qualifying offer is announced, 10 percent of the shares may call a special meeting or seek a written consent to vote on rescinding the pill.

In addition, the rationale for adopting the pill should be thoroughly explained by the company. In examining the request for the pill, take into consideration the company’s existing governance structure, including: board independence, existing takeover defenses, and any problematic governance concerns.

Management Proposals to Ratify a Pill to Preserve Net Operating Losses (NOLs)

General Recommendation: Vote against proposals to adopt a poison pill for the stated purpose of protecting a company’s net operating losses (NOL) if the term of the pill would exceed the shorter of three years and the

exhaustion of the NOL.

Vote case-by-case on management proposals for poison pill ratification, considering the following factors, if the term of the pill would be the shorter of three years (or less) and the exhaustion of the NOL:

The ownership threshold to transfer (NOL pills generally have a trigger slightly below 5 percent);

The value of the NOLs;

Shareholder protection mechanisms (sunset provision, or commitment to cause expiration of the pill upon exhaustion or expiration of NOLs);

The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and

Any other factors that may be applicable.

Proxy Voting Disclosure, Confidentiality, and Tabulation

General Recommendation: Vote case-by-case on proposals regarding proxy voting mechanics, taking into consideration whether implementation of the proposal is likely to enhance or protect shareholder rights. Specific issues covered under the policy include, but are not limited to, confidential voting of individual proxies and ballots, confidentiality of running vote tallies, and the treatment of abstentions and/or broker non-votes in the company's vote-counting methodology.

While a variety of factors may be considered in each analysis, the guiding principles are: transparency, consistency, and fairness in the proxy voting process. The factors considered, as applicable to the proposal, may include:

The scope and structure of the proposal;

The company's stated confidential voting policy (or other relevant policies) and whether it ensures a "level playing field" by providing shareholder proponents with equal access to vote information prior to the annual meeting;

The company's vote standard for management and shareholder proposals and whether it ensures consistency and fairness in the proxy voting process and maintains the integrity of vote results;

Whether the company's disclosure regarding its vote counting method and other relevant voting policies with respect to management and shareholder proposals are consistent and clear;

Any recent controversies or concerns related to the company's proxy voting mechanics;

Any unintended consequences resulting from implementation of the proposal; and

Any other factors that may be relevant.

Reimbursing Proxy Solicitation Expenses

General Recommendation: Vote case-by-case on proposals to reimburse proxy solicitation expenses.

When voting in conjunction with support of a dissident slate, vote for the reimbursement of all appropriate proxy solicitation expenses associated with the election.

Generally vote for shareholder proposals calling for the reimbursement of reasonable costs incurred in connection with nominating one or more candidates in a contested election where the following apply:

¶The election of fewer than 50 percent of the directors to be elected is contested in the election;
One or more of the dissident's candidates is elected;
Shareholders are not permitted to cumulate their votes for directors; and
¶The election occurred, and the expenses were incurred, after the adoption of this bylaw.

Reincorporation Proposals

General Recommendation: Management or shareholder proposals to change a company's state of incorporation should be evaluated case-by-case, giving consideration to both financial and corporate governance concerns including the following:

Reasons for reincorporation;
Comparison of company's governance practices and provisions prior to and following the reincorporation; and
Comparison of corporation laws of original state and destination state.

Vote for reincorporation when the economic factors outweigh any neutral or negative governance changes.

Shareholder Ability to Act by Written Consent

General Recommendation: Generally vote against management and shareholder proposals to restrict or prohibit shareholders' ability to act by written consent.

Generally vote for management and shareholder proposals that provide shareholders with the ability to act by written consent, taking into account the following factors:

~~Shareholders' current right to act by written consent;~~
~~The consent threshold;~~
~~The inclusion of exclusionary or prohibitive language;~~
~~Investor ownership structure; and~~
~~Shareholder support of, and management's response to, previous shareholder proposals.~~

Vote case-by-case on shareholder proposals if, in addition to the considerations above, the company has the following governance and antitakeover provisions:

~~An unfettered⁸ right for shareholders to call special meetings at a 10 percent threshold;~~
~~A majority vote standard in uncontested director elections;~~
~~No non-shareholder-approved pill; and~~
~~An annually elected board.~~

8 "Unfettered" means no restrictions on agenda items, no restrictions on the number of shareholders who can group together to reach the 10 percent threshold, and only reasonable limits on when a meeting can be called: no greater than 30 days after the last annual meeting and no greater than 90 prior to the next annual meeting.

Shareholder Ability to Call Special Meetings

General Recommendation: Vote against management or shareholder proposals to restrict or prohibit shareholders' ability to call special meetings.

Generally vote for management or shareholder proposals that provide shareholders with the ability to call special meetings taking into account the following factors:

~~Shareholders' current right to call special meetings;~~
~~Minimum ownership threshold necessary to call special meetings (10 percent preferred);~~
~~The inclusion of exclusionary or prohibitive language;~~
~~Investor ownership structure; and~~
~~Shareholder support of, and management's response to, previous shareholder proposals.~~

Stakeholder Provisions

General Recommendation: Vote against proposals that ask the board to consider non-shareholder constituencies or other non-financial effects when evaluating a merger or business combination.

State Antitakeover Statutes

General Recommendation: Vote case-by-case on proposals to opt in or out of state takeover statutes (including fair price provisions, stakeholder laws, poison pill endorsements, severance pay and labor contract provisions, and anti-greenmail provisions).

Supermajority Vote Requirements

General Recommendation: Vote against proposals to require a supermajority shareholder vote.

Vote for management or shareholder proposals to reduce supermajority vote requirements. However, for companies with shareholder(s) who have significant ownership levels, vote case-by-case, taking into account:

Ownership structure;
Quorum requirements; and
Vote requirements.

4. CAPITAL/RESTRUCTURING

Capital Adjustments to Par Value of Common Stock

General Recommendation: Vote for management proposals to reduce the par value of common stock unless the action is being taken to facilitate an anti-takeover device or some other negative corporate governance action.

Vote for management proposals to eliminate par value.

Common Stock Authorization

General Recommendation: Vote for proposals to increase the number of authorized common shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote against proposals at companies with more than one class of common stock to increase the number of authorized shares of the class of common stock that has superior voting rights.

Vote against proposals to increase the number of authorized common shares if a vote for a reverse stock split on the same ballot is warranted despite the fact that the authorized shares would not be reduced proportionally.

Vote case-by-case on all other proposals to increase the number of shares of common stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

Past Board Performance:

• The company's use of authorized shares during the last three years;

• The Current Request:

• Disclosure in the proxy statement of the specific purposes of the proposed increase;

• Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request; and

• The dilutive impact of the request as determined relative to an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns.

ISS will apply the relevant allowable increase below to requests to increase common stock that are for general corporate purposes (or to the general corporate purposes portion of a request that also includes a specific need):

- A. Most companies: 100 percent of existing authorized shares.
- B. Companies with less than 50 percent of existing authorized shares either outstanding or reserved for issuance: 50 percent of existing authorized shares.
- C. Companies with one- and three-year total shareholder returns (TSRs) in the bottom 10 percent of the U.S. market as of the end of the calendar quarter that is closest to their most recent fiscal year end: 50 percent of existing authorized shares.
- D. Companies at which both conditions (B and C) above are both present: 25 percent of existing authorized shares.

If there is an acquisition, private placement, or similar transaction on the ballot (not including equity incentive plans) that ISS is recommending FOR, the allowable increase will be the greater of (i) twice the amount needed to support

the transactions on the ballot, and (ii) the allowable increase as calculated above.

Dual Class Structure

General Recommendation: Generally vote against proposals to create a new class of common stock unless:

∅The company discloses a compelling rationale for the dual-class capital structure, such as:

∅The company's auditor has concluded that there is substantial doubt about the company's ability to continue as a going concern; or

∅The new class of shares will be transitory;

∅The new class is intended for financing purposes with minimal or no dilution to current shareholders in both the short term and long term; and

∅The new class is not designed to preserve or increase the voting power of an insider or significant shareholder.

Issue Stock for Use with Rights Plan

General Recommendation: Vote against proposals that increase authorized common stock for the explicit purpose of implementing a non-shareholder-approved shareholder rights plan (poison pill).

Preemptive Rights

General Recommendation: Vote case-by-case on shareholder proposals that seek preemptive rights, taking into consideration:

∅The size of the company;

∅The shareholder base; and

∅The liquidity of the stock.

Preferred Stock Authorization

General Recommendation: Vote for proposals to increase the number of authorized preferred shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote against proposals at companies with more than one class or series of preferred stock to increase the number of authorized shares of the class or series of preferred stock that has superior voting rights.

Vote case-by-case on all other proposals to increase the number of shares of preferred stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

Past Board Performance:

• The company's use of authorized preferred shares during the last three years;

The Current Request:

• Disclosure in the proxy statement of the specific purposes for the proposed increase;

• Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request;

• In cases where the company has existing authorized preferred stock, the dilutive impact of the request as determined by an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns; and

• Whether the shares requested are blank check preferred shares that can be used for antitakeover purposes.

Recapitalization Plans

General Recommendation: Vote case-by-case on recapitalizations (reclassifications of securities), taking into account the following:

• More simplified capital structure;

• Enhanced liquidity;

• Fairness of conversion terms;

• Impact on voting power and dividends;

• Reasons for the reclassification;

• Conflicts of interest; and

• Other alternatives considered.

Reverse Stock Splits

General Recommendation: Vote for management proposals to implement a reverse stock split when the number of authorized shares will be proportionately reduced.

Vote against proposals when there is not a proportionate reduction of authorized shares, unless:

A stock exchange has provided notice to the company of a potential delisting; or
The effective increase in authorized shares is equal to or less than the allowable increase calculated in accordance
> with ISS' Common Stock Authorization policy.

Share Repurchase Programs

General Recommendation: Vote for management proposals to institute open-market share repurchase plans in which all shareholders may participate on equal terms.

Stock Distributions: Splits and Dividends

General Recommendation: Generally vote for management proposals to increase the common share authorization for stock split or stock dividend, provided that the effective increase in authorized shares is equal to or is less than the allowable increase calculated in accordance with ISS' Common Stock Authorization policy.

Tracking Stock

General Recommendation: Vote case-by-case on the creation of tracking stock, weighing the strategic value of the transaction against such factors as:

Adverse governance changes;
Excessive increases in authorized capital stock;
Unfair method of distribution;
Diminution of voting rights;
Adverse conversion features;
Negative impact on stock option plans; and
Alternatives such as spin-off.

Restructuring Appraisal Rights

General Recommendation: Vote for proposals to restore or provide shareholders with rights of appraisal.

Asset Purchases

General Recommendation: Vote case-by-case on asset purchase proposals, considering the following factors:

- Purchase price;
- Fairness opinion;
- Financial and strategic benefits;
- How the deal was negotiated;
- Conflicts of interest;
- Other alternatives for the business;
- Non-completion risk.

Asset Sales

General Recommendation: Vote case-by-case on asset sales, considering the following factors:

- Impact on the balance sheet/working capital;
- Potential elimination of diseconomies;
- Anticipated financial and operating benefits;
- Anticipated use of funds;
- Value received for the asset;
- Fairness opinion;
- How the deal was negotiated;
- Conflicts of interest.

Bundled Proposals

General Recommendation: Vote case-by-case on bundled or “conditional” proxy proposals. In the case of items that are conditioned upon each other, examine the benefits and costs of the packaged items. In instances when the joint effect of the conditioned items is not in shareholders’ best interests, vote against the proposals. If the combined effect is positive, support such proposals.

Conversion of Securities

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General Recommendation: Vote case-by-case on proposals regarding conversion of securities. When evaluating these proposals the investor should review the dilution to existing shareholders, the conversion price relative to market value, financial issues, control issues, termination penalties, and conflicts of interest.

Vote for the conversion if it is expected that the company will be subject to onerous penalties or will be forced to file for bankruptcy if the transaction is not approved.

Corporate Reorganization/Debt Restructuring/Prepackaged Bankruptcy Plans/Reverse Leveraged Buyouts/Wrap Plans

General Recommendation: Vote case-by-case on proposals to increase common and/or preferred shares and to issue shares as part of a debt restructuring plan, after evaluating:

Dilution to existing shareholders' positions;

Terms of the offer - discount/premium in purchase price to investor, including any fairness opinion; termination penalties; exit strategy;

> Financial issues - company's financial situation; degree of need for capital; use of proceeds; effect of the financing on the company's cost of capital;

> Management's efforts to pursue other alternatives;

> Control issues - change in management; change in control, guaranteed board and committee seats; standstill provisions; voting agreements; veto power over certain corporate actions; and

> Conflict of interest - arm's length transaction, managerial incentives.

Vote for the debt restructuring if it is expected that the company will file for bankruptcy if the transaction is not approved.

Formation of Holding Company

General Recommendation: Vote case-by-case on proposals regarding the formation of a holding company, taking into consideration the following:

The reasons for the change;

Any financial or tax benefits;

Regulatory benefits;

Increases in capital structure; and

Changes to the articles of incorporation or bylaws of the company.

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Absent compelling financial reasons to recommend for the transaction, vote against the formation of a holding company if the transaction would include either of the following:

Increases in common or preferred stock in excess of the allowable maximum (see discussion under “Capital”); or
Adverse changes in shareholder rights.

Going Private and Going Dark Transactions (LBOs and Minority Squeeze-outs)

General Recommendation: Vote case-by-case on going private transactions, taking into account the following:

Offer price/premium;
Fairness opinion;
How the deal was negotiated;
Conflicts of interest;
Other alternatives/offers considered; and
Non-completion risk.

Vote case-by-case on going dark transactions, determining whether the transaction enhances shareholder value by taking into consideration:

Whether the company has attained benefits from being publicly-traded (examination of trading volume, liquidity, and market research of the stock);
Balanced interests of continuing vs. cashed-out shareholders, taking into account the following:
Are all shareholders able to participate in the transaction?
Will there be a liquid market for remaining shareholders following the transaction?
Does the company have strong corporate governance?
Will insiders reap the gains of control following the proposed transaction?
Does the state of incorporation have laws requiring continued reporting that may benefit shareholders?

Joint Ventures

General Recommendation: Vote case-by-case on proposals to form joint ventures, taking into account the following:

Percentage of assets/business contributed;
Percentage ownership;
Financial and strategic benefits;

Governance structure;
Conflicts of interest;
Other alternatives; and
Non-completion risk.

Liquidations

General Recommendation: Vote case-by-case on liquidations, taking into account the following:

Management's efforts to pursue other alternatives;
Appraisal value of assets; and
The compensation plan for executives managing the liquidation.

Vote for the liquidation if the company will file for bankruptcy if the proposal is not approved.

Mergers and Acquisitions

General Recommendation: Vote case-by-case on mergers and acquisitions. Review and evaluate the merits and drawbacks of the proposed transaction, balancing various and sometimes countervailing factors including:

Valuation - Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? While the fairness opinion may provide an initial starting point for assessing valuation reasonableness, emphasis is placed on the offer premium, market reaction, and strategic rationale.

Market reaction - How has the market responded to the proposed deal? A negative market reaction should cause closer scrutiny of a deal.

Strategic rationale - Does the deal make sense strategically? From where is the value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favorable track record of successful integration of historical acquisitions.

Negotiations and process - Were the terms of the transaction negotiated at arm's-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders. Significant negotiation "wins" can also signify the deal makers' competency. The comprehensiveness of the sales process (e.g., full auction, partial auction, no auction) can also affect shareholder value.

- > Conflicts of interest - Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers of the company may be more likely to vote to approve a merger than if they did not hold these interests. Consider whether these interests may have influenced these directors and officers to support or recommend the merger. The CIC figure presented in the "ISS Transaction Summary" section of this report is an aggregate figure that can in certain cases be a misleading indicator of the true value transfer from shareholders to insiders. Where such figure appears to be excessive, analyze the underlying

assumptions to determine whether a potential conflict exists.

Governance - Will the combined company have a better or worse governance profile than the current governance profiles of the respective parties to the transaction? If the governance profile is to change for the worse, the burden is on the company to prove that other issues (such as valuation) outweigh any deterioration in governance.

Private Placements/Warrants/Convertible Debentures

General Recommendation: Vote case-by-case on proposals regarding private placements, warrants, and convertible debentures taking into consideration:

Dilution to existing shareholders' position: The amount and timing of shareholder ownership dilution should be weighed against the needs and proposed shareholder benefits of the capital infusion. Although newly issued common stock, absent preemptive rights, is typically dilutive to existing shareholders, share price appreciation is often the necessary event to trigger the exercise of "out of the money" warrants and convertible debt. In these instances from a value standpoint, the negative impact of dilution is mitigated by the increase in the company's stock price that must occur to trigger the dilutive event.

Terms of the offer (discount/premium in purchase price to investor, including any fairness opinion, conversion features, termination penalties, exit strategy):

The terms of the offer should be weighed against the alternatives of the company and in light of company's financial condition. Ideally, the conversion price for convertible debt and the exercise price for warrants should be at a premium to the then prevailing stock price at the time of private placement.

When evaluating the magnitude of a private placement discount or premium, consider factors that influence the discount or premium, such as, liquidity, due diligence costs, control and monitoring costs, capital scarcity, information asymmetry, and anticipation of future performance.

Financial issues:

The company's financial condition;

Degree of need for capital;

Use of proceeds;

Effect of the financing on the company's cost of capital;

Current and proposed cash burn rate;

Going concern viability and the state of the capital and credit markets.

- > Management's efforts to pursue alternatives and whether the company engaged in a process to evaluate alternatives: A fair, unconstrained process helps to ensure the best price for shareholders.

Financing alternatives can include joint ventures, partnership, merger, or sale of part or all of the company.

Control issues:

Change in management;

Change in control;