Corporate governance and stewardship activities 2018

Rathbones
Look forward

Corporate governance and stewardship activities 2018
(relating to 2017 activity)

Contents

About us

Rathbone Investment Management is one of the UK's largest and longest-established providers of personalised discretionary investment services. We manage funds for individuals, charities and trustees, and are part of Rathbone Brothers Plc, an independently-owned company with a listing on the London Stock Exchange.

Rathbone Unit Trust Management Limited (RUTM), is the unit trust management arm of Rathbone Brothers Plc. RUTM offers a range of equity and bond unit trusts and a multi asset portfolio (consisting of four subfunds) to meet clients' capital growth and income requirements.

We specialise in investment management for the retail investor and segregated institutional accounts. RUTM are a signatory to the UK Stewardship Code, being the only part of the group which is covered by this area of voluntary regulation. RUTM's approach to stewardship and proxy voting is reported separately via our website rutm.com. This report covers our voting and stewardship activities relating to Rathbone Investment Management, which reported £33.8 billion in assets under management as at 31 December 2017.

Corporate governance and stewardship at Rathbones

We believe it is in the best interests of our clients for the companies in which we invest to adopt best practice in corporate governance. This provides a framework in which each company can be managed for the long-term interests of its shareholders. Mindful of our responsibilities to our clients, we seek to be good, long-term stewards of the investments which we manage on their behalf, as expressed in our stewardship policy, which you can review at rathbones.com/stewardship-policy.

Our major responsibility in this regard is to ensure that company boards are functioning well in their role to independently oversee the activities of companies and their management. We have developed a robust approach to proxy voting as a fundamental expression of our stewardship responsibilities.

However, stewardship is not limited to this activity. Engagement with companies on governance issues is an important adjunct to voting activities. This report will explain Rathbones' approach to proxy voting and engagement within the context of our activities in this regard in the last 12 months.

Our core stewardship principles

We have developed a core set of guiding principles which apply to our governance and stewardship related activities:

1. **Materiality**
   Principle: We recognise that governance and stewardship risks can be material to the performance and valuation of companies.

2. **Active Voting**
   Principle: We actively consider proxy votes for client holdings.

3. **Engagement**
   Principle: Active engagement with companies on governance issues is an important adjunct to voting activities.

4. **Transparency**
   Principle: We report annually on our stewardship activities.

The Stewardship Committee

The implementation of the stewardship policy is overseen by the Stewardship Committee — a committee of investment professionals from across the business.

Proxy voting and shareholder engagement at Rathbones is overseen by the ten full members of the committee, supported by a stewardship director and an external proxy voting consultant.

We aim to target our resources where they can make the most difference to the greatest number of clients. Active voting covers a significant proportion of listed company holdings by value and those most widely held by our clients.

Integration with the research process

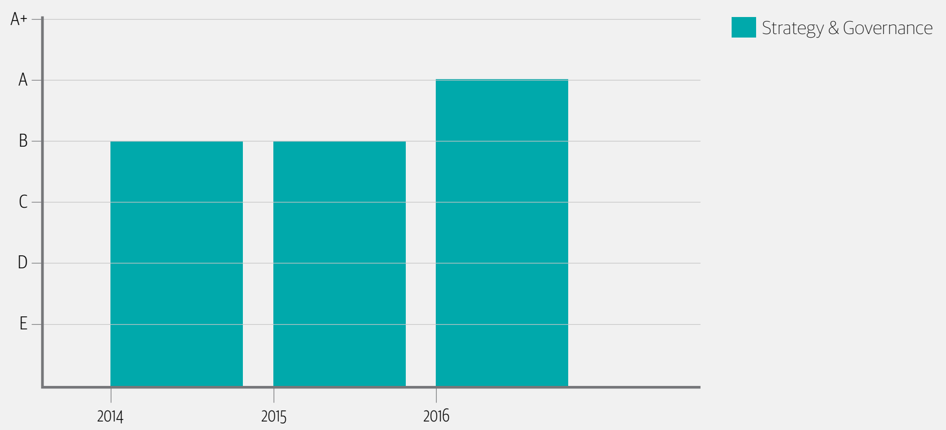
Our active consideration of governance risks in the proxy voting process gives rise to useful insights which are integrated into the investment research process. Since we assert that governance and stewardship risks can be material to the valuation of companies, we incorporate governance risk data into our investment research process.

In the last year we have significantly expanded the coverage of governance risk screening to include all companies listed on the MSCI World Index. Our UK Equity team makes use of a screening database comprising 29 governance risk indicators across three broad areas – accounting, board structure and executive pay. A composite governance risk score also forms part of the basic information on company factsheets provided by the research team for use by investment managers.

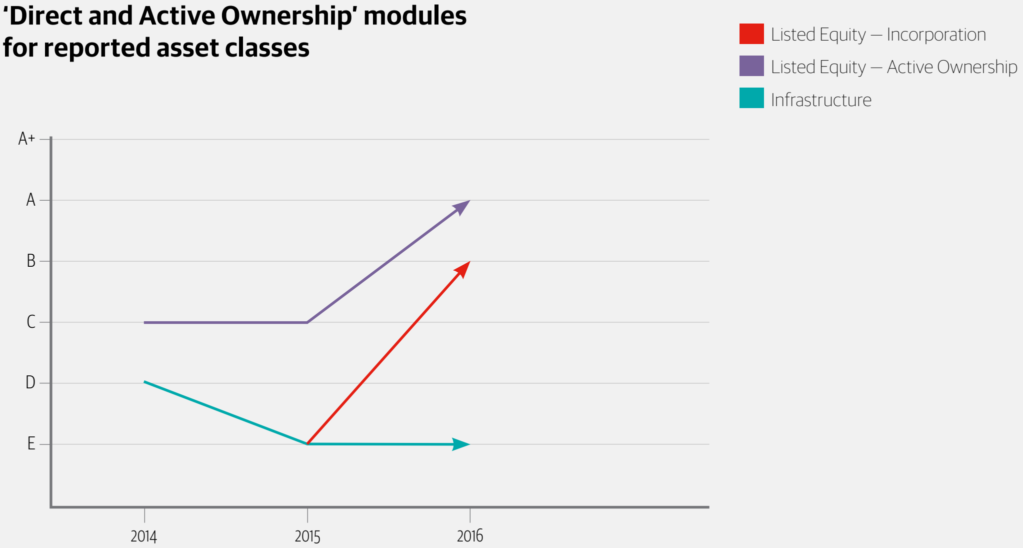
Our progress in this area has resulted in an improvement in a major external benchmarking of our approach to governance and stewardship issues. In 2016 (the latest year for which an assessment has been carried out) the UN-backed Principles of Responsible Investment (PRI) ranked us in the 'A' band with regard to our strategy and governance linked to the Responsible Investment agenda. Our approach to integrating governance insights into our listed equity ownership was also ranked in the 'A' band. We hope to make further progress in the coming years.

Rathbones performance on the PRI assessment

'Strategy and Governance' module



'Direct and Active Ownership' modules for reported asset classes



Source: PRI Assessment Report 2016

Proxy voting policy

The Stewardship Committee is responsible for developing and maintaining a bespoke corporate governance policy which builds on established best practice, compliant with and inspired by the provisions of the UK Corporate Governance Code (which covers UK companies) and the AIC Code of Corporate Governance (which covers investment trusts).

Voting in line with the policy on our most widely held stocks helps us execute our responsibilities under the PRI, of which we have been signatories to since 2010.

Primary governance goals as expressed in our policy are to encourage boards to:

- adopt clear values and standards in business dealings throughout the organisation
- develop a culture of transparency and accountability
- focus on strategic issues and the quality of the business rather than simply short-term performance
- develop appropriate checks and balances to deal with conflicts of interests
- maintain effective systems of internal control and risk management
- create fair remuneration structures that reward the achievement of business objectives at all levels
- recognise and responsibly manage impacts on all stakeholders.

In order for boards to deliver on these goals, we believe that boards should demonstrate the following key features:

- be led by an independent chairman
- the chairman and the CEO roles should be separate and not exercised by the same individual
- the board and its committees should retain the requisite balance of skills, experience, knowledge and independence. This includes an adequate level of gender diversity
- develop clear and fair remuneration arrangements which incentivise shared value creation
- for larger companies, at least half of the board should be composed of non-executive directors considered to be independent.

Whilst the core principles of corporate governance are relatively well established, we observe emerging trends in the area. In order to ensure that our policy remains fit for purpose, we ensure that it is reviewed against benchmark standards and principles and updated accordingly on an annual basis.

2017 voting review

In 2017 we voted on 5,046 resolutions at 398 company meetings (2016: 5,326 resolutions at 465 meetings). Since best practice now requires boards of directors to be re-elected annually, the majority of these resolutions concern the election of boards. However, they also cover important issues such as executive pay and the appointment of the firm's auditors. The number of meetings can vary each year determined by a number of factors, not least the level of merger and acquisition activity in the year.

2017	% For	% Abstain	% Against	Meetings	Resolutions
January	98.8%	1.2%	0.0%	17	166
February	99.1%	0.0%	0.9%	22	217
March	95.6%	0.0%	4.4%	22	202
April	98.7%	0.6%	0.7%	47	690
May	96.9%	3.5%	2.5%	78	1187
June	96.9%	0.7%	2.4%	45	534
July	99.2%	0.6%	0.2%	53	832
August	98.4%	0.8%	0.8%	15	128
September	99.4%	0.3%	0.3%	25	328
October	98.5%	0.0%	1.5%	14	135
November	98.8%	0.5%	0.7%	36	423
December	97.0%	3.0%	0.0%	24	204
Year Avg/Total	**98.1%**	**0.9%**	**1.2%**	**398**	**5,046**

Source: Rathbones

NB The data provided is in summary form for general information about voting trends and do not reflect the specific votes entered at a specific company. For example, given our status as a private client asset manager with very close links to our clients, it is entirely plausible (if not frequent) for us to enter three different votes for each item, or some combination of For / Against / Abstain. Hence the numbers of items voted For, Against and Abstain would not be expected to add up to the total number of resolutions on which we voted.

On the face of it, the votes in favour of company management may seem high. However, a little context can be helpful in explaining our voting outcomes. Firstly, good governance is a pre-requisite for any company to be considered for inclusion in our portfolios. If there were severe concerns over corporate governance at a company, they would not be preferred for investment, and hence the worst examples never actually come to a vote.

Secondly, the data concerns the total number of resolutions voted. It is now best practice for companies to seek annual re-election for their boards, and hence each board member is covered by an individual resolution in addition to the standard two agenda items on remuneration policy and other standard items. Most company agendas have around 20 resolutions on their agendas, of which the majority are routine.

Failing to back management (whether through a vote against, an abstention or withholding a vote) is a relatively serious step and tends to happen only where dialogue has failed or serious concerns need to be raised. In the minority of cases where we vote against management, most attention has been paid to the issue of executive remuneration, followed by the independence of group directors. A summary of the issues where votes against management were entered in 2017 is summarised below.

2017 votes against management — category breakdown

Issue	% of votes not in favour of management
Anti-takeover related	0.9
Capitalisation and shareholder rights	7.5
Directors related (board independence)	26.4
Executive pay	20.8
Mergers, acquisitions and takeovers	22.6
Routine/business	18.9
Environmental and social	0.9
Other routine business	1.9

Source: Rathbones

Engagement

We are in ongoing contact with the companies in which we invest. Engagement can take a number of forms, including (but not limited to):

- regular and ad hoc face-to-face meetings with management
- teleconferences with senior management
- formal written correspondence
- informal written correspondence.

Engagement may cover a wide range of issues. The following topics are ranked in order of the frequency and intensity with which we engaged with companies:

Issue	Typical content of engagement
Board and directors	Leadership, effectiveness, committee composition, succession planning, diversity, independence
Remuneration	Pay policy, disclosure on pay policy and structure, recruitment awards, malus or clawback provisions
Capital structure	Share issues, issues of shares without pre-emption rights
Accounting and audit	Auditor independence and non-audit fees, rotation of auditor, account misstatements

Case study
BT Group Plc

Issue: In October 2016, BT made public its discovery of historic accounting errors in its Italian operations, resulting in an initial write-down of £145 million as an estimate of the financial impact. The review was triggered by a whistleblower, who alleged that staff had colluded with suppliers to inflate their accounts. An independent investigation uncovered improper practices involving sales, purchase and leasing transactions, resulting in an overstatement of its Italian division's profits over a number of years. Furthermore, in January 2017, it was discovered that these practices were more widespread than previously identified and, consequently, a further write-down of around £530 million was announced, triggering a formal profit warning.

Process
Following the issues outlined above, we declined to support votes on the Report and Accounts and the re-appointment of auditors PwC at the 2017 AGM. The company had taken a number of steps to address the issues, withholding bonus awards and applying malus to outstanding deferred bonus awards, however our ongoing concern meant that a vote to abstain was considered appropriate.

Outcome
While regulators consider whether to take formal action, BT appointed a new leadership team at its Italian business, as well as conducting detailed reviews at other operations. CEO Gavin Patterson's total pay was cut from £5.28 million to £1.34 million as a result of the scandal, while longstanding auditors PwC were dropped following the company's AGM and replaced by KPMG.

Case study
Burberry Plc

Issue: The luxury goods company has faced investor disquiet regarding the scale of its pay awards for several years, but 2017 saw an escalation. The trigger for investor outcry this year was the pay packet agreed regarding the recruitment of a new CFO. Burberry agreed to give the new recruit an award of Burberry shares worth £1.8 million set against £2.2 million worth of shares the recruit had supposedly forgone by leaving her role at Smith & Nephew Plc. The shares being awarded by Burberry were not subject to any additional performance conditions and there was no commitment to make any adjustments should the vesting outcome of the Smith & Nephew shares be different to the Burberry Remuneration Committee's estimates.

Process
We discussed the situation with our internal analyst who covers the sector. We considered that given the various issues with corporate governance at the company, we would be justified in voting against the adoption of the remuneration report at the 2017 AGM. It is vital that variable pay be linked to significant outperformance, and we simply considered that value of the awards had not been sufficiently reduced from the original Smith & Nephew levels to sufficiently compensate for the lack of performance conditions.

Outcome
We wrote to the company to outline our stance. In the end, 31% of investors decided to oppose the remuneration report, sending a very significant message of discontent to the board. Following a period of consultation, the company appointed a new non-executive director to take up the role of chair of the Remuneration Committee. The former chair of the committee who oversaw the controversial award remains on the board.

Case study

TR European Growth Trust Plc

Issue: Companies targeted for considered proxy voting includes investment companies. It is vital for the board to have a balance of skills, perspectives and length of tenure in order to successfully guide the decision making process. As investors in the Company we were unconvinced the succession planning strategy as detailed in the 2017 Annual Report was adequate and we were growing concerned at the length of service of the current chairman (17 years at the time of the engagement).

Process

We wrote to the company in order to spark further discussion regarding the Company's approach to the issue of tenure of the Directors. Within the context of a discussion about board make-up and the issue of succession planning, we noted that it is a specific recommendation of the AIC Code of Corporate Governance that the board consider the appointment of a Senior Independent Director (SID). From our perspective, the SID performs an important role, the purpose being to assist the chairman, take the lead during the annual performance evaluation of the chairman and provide an alternative avenue for shareholder communication. We strongly encouraged the recruitment of a SID or deputy chairman in the near future.

Outcome

The chairman responded to our letter and outlined his belief as to why the current makeup of the board is adequate to serve shareholders' best interest. However, the lack of a SID remains an issue on which we would value some progress.

Case study
Stagecoach Group

Issue: Executive pay is a controversial topic, never more so than when shareholder experience and management pay diverge, as was the case with Stagecoach in 2017. We noted that directors received relatively high variable in a year where the majority of financial targets were not met and the share price had fallen by 28%. In addition we were concerned by the limited degree of disclosure around the directors' personal performance targets in the company's remuneration report.

Process

We wrote to the company requesting additional information on these objectives and how performance is assessed, as pledged in previous Annual Reports. We also questioned the decision not to apply discretion to the relatively substantial bonuses in light of the fact that 2 of the 3 main financial targets for the group were not achieved, alongside the significant fall in share price over the period. We wrote to the company outlining our rationale for voting against the remuneration report. Whilst the company responded to our letter before the date of the AGM we did not consider there to be sufficient reason to change our vote.

Outcome

Almost 11% of shareholders voted against the remuneration report. The company committed to providing more information on performance against the directors' personal objectives and the Remuneration Committee's assessment of the extent to which each such objective has been met in the 2018 Annual Report.

Looking forward

We are committed to transparency in our proxy voting activities. You can read more about our approach to the management of governance risks in our public PRI reporting which can be found on the PRI website.

For more information please contact Matt Crossman, stewardship director at matt.crossman@rathbones.com

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Rathbones
Look forward

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