Corporate governance and stewardship activities 2016

Rathbones
Look forward

Corporate governance and stewardship activities 2016

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 independent company with a listing on the London Stock Exchange.

Rathbone Unit Trust Management Limited is the unit trust management arm of Rathbone Brothers Plc. Rathbone Unit Trust Management offers a range of equity and bond unit trusts and a multi asset portfolio (consisting of four sub-funds) to meet clients' capital growth and income requirements. We specialise in investment management for the retail investor and segregated institutional accounts. We are a signatory to the UK Stewardship Code, being the only part of the group which is covered by this area of voluntary regulation. Our approach to stewardship and proxy voting is reported separately via our website **rutm.com**

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. Our major responsibility in this regard is to ensure that company boards are functioning well in their role as independent scrutinisers of 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.

The corporate governance committee

Proxy voting at Rathbones is overseen by a committee of investment professionals from across the business, supported by a governance manager and an external proxy voting consultant. This is consistent with the collegiate approach typified in the group's process management structures.

We aim to target our resources where they can make the most difference to the greatest number of clients. Therefore, we actively consider our proxy voting on the top 200 companies we hold by value, and on those companies where we own more than 3% of the share capital. By our estimation, active voting covers in excess of 90% of our funds under management.

Proxy voting policy

The 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 UN-backed Principles for Responsible Investment, 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
- 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.

2015 voting review

In 2015 we voted on 4,894 resolutions at 443 company meetings (2014: 4,281 resolutions at 396 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.

2015	% For	% Abstain	% Against	Meetings	No. of resolutions
January	100	0	0	20	183
February	97.9	0.0	1.5	23	236
March	98.5	0.8	0.8	30	132
April	98.5	0.4	1.1	58	840
May	96.3	1.5	2.2	63	927
June	97.8	1.0	1.2	38	412
July	99.2	0.6	0.2	59	879
August	98.9	1.1	0.0	12	87
September	98.2	0.8	1.0	35	381
October	100.0	0.0	0.0	20	171
November	97.5	0.7	1.7	36	408
December	95.8	1.7	2.5	29	238
Year Avg/Total	**98.2**	**0.7**	**1.0**	**423**	**4894**

Source: Rathbones

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 2015 is summarised below.

2015 votes against management – category breakdown

Issue	% Of votes not in favour of management
Elect director	31.8%
Capital structure	17.0%
Remuneration	14.8%
Auditor election	9.1%
Approve political donations	6.8%
Takeover / Merger / Reorganisation	6.8%
Shareholder board nominees	5.7%
General governance	3.4%
Financial statements	2.3%
Voting rights	2.3%

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

Where deemed appropriate, engagement may be conducted in collaboration with other investment managers.

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 & structure, recruitment awards, malus or clawback provisions
Capital structure	Share issues, issues of shares without pre-emption rights
Accounting and audit	Auditor independence & non-audit fees, rotation of auditor, account misstatements

Case study
Alliance Trust

Issue: Leadership, effectiveness, board independence

Process:
The company was the target of an activist investor during the last year. Elliot Advisors built up a significant stake in the company, and sought to nominate three directors to the group's board at the 2015 AGM. We met with the chairman and the CEO of Alliance Trust and representatives from Elliot. The management were of the view that the three nominees should not be considered independent because of their links to Elliott Advisors, and due to the unusual process surrounding their nomination. We wrote to the independent members of the board to encourage renewed dialogue, and expressed our support for more independent oversight in order to better promote shareholders' interests.

The management stated its belief that Elliott Advisors were intending to exit their investment on favourable terms by forcing through a tender to the detriment of tax constrained longer term holders such as Rathbones' clients. Even if such a tender were proposed by the three nominees, the remaining seven directors should be able to ensure that due process is followed. We sought assurances from the independent members of the board that the best interests of all shareholders will be considered in the event of a tender.

Outcome:
We intended to support the election of the three nominees at the 2015 AGM. However, a compromise deal was reached under which two of the nominees were invited to join the board. Additionally, the management were given until the 2016 AGM to resolve the board and performance issues. We met with the chairman in July 2015 to further discuss our concerns, and make suggestions for the reform of the board's structure in order to restore faith in the independence of the management.

In October 2015, the company announced further changes, with the CEO stepping down from the board, making the group board entirely independent. Finally, the group also announced the establishment of separate, independent boards for its investment and savings arms.

Case study

Dixons Carphone plc

Issue: Executive remuneration

Process:
We were alerted to a number of potential issues with the company's remuneration arrangements in September 2015. Our advisors notified us of concerns regarding the use of discretion to award bonuses in addition to poor disclosure of performance conditions attached to bonuses. Transparency and accountability are vital in any variable pay award structure, notwithstanding the recent turnaround observed at the company.

Mindful of issues raised by investors regarding remuneration arrangements in previous years, we wrote to the chairman expressing our continued concerns. We noted that for the year in review, a pay rise granted to the CEO was not explained in the requisite level of detail for an institutional shareholder to make an adequate judgement regarding the necessity of the award, and how that award is aligned with the best interests of shareholders.

Further, we noted that the board's make-up fell short of UK best practice in a number of areas, most notably in the lack of a senior independent director, and the presence of non-independent directors on the remuneration committee. Whilst we note the company's opinion and explanation for these arrangements, our concerns over the lack of board independence were heightened by the poor disclosure made in recent years.

Outcome:
The chairman replied to our letter stating that the recruitment of a replacement senior independent director was well under way. Further, he committed the company to making much improved disclosure around the performance criteria for discretionary bonuses in future.

Case study
Tesco PLC

Issue: Auditor independence

Process:
In September 2014 the company uncovered major irregularities with its accounts. According to disclosure from the company, previous profit figures had been systematically and materially overstated to the order of £250m.

The AGM in June 2015 was the first opportunity presented to shareholders to respond to the issue. Significant changes to the board had been made, with three major, senior positions now being held by new appointees. Further, the previous incumbent auditor, PwC, was not seeking re-election at the 2015 AGM.

Outcome:
Whilst we supported the moves made by the company to address the accounting issues, the impact on the company and hence on shareholders was severe. However, our options for engagement were limited, in that the auditor was not seeking re-election and all major board roles were staffed by new hires. Therefore, we determined to voice our concerns over the damage done to the company by voting against the annual report for the year in question.

We wrote to the chairman in advance of the meeting to explain our position. The chair replied stating his regret that we were unable to support the company's report and accounts for the year, stating that the board had responded quickly and appropriately to the overstatement of profits. Further, the appointment of independent investigators from third party audit firms helped provide an additional level of accountability. The chairman stated that "effective remedial steps and appropriate interim measures were implemented to avoid any repetition of this issue".

Case study
Gender diversity on UK boards

Issue: Gender diversity

Process:
In order to fulfil its duties with regard to the oversight of management, it is critical that a board contain the right skills and voices capable of understanding and interrogating executive strategy. It is crucial that boards have the right make up of relevant experience and perspective. The gender balance of UK PLC's boards is one aspect of this issue.

A high quality board should encompass a wide range of voices, skill sets, backgrounds and life experiences in order to enhance its oversight of management. A diverse board is better able to understand the needs of its customers and shareholders, and consider issues in a more balanced way. Further, there is evidence that diverse boards can deliver superior financial performance. A recent Grant Thornton study demonstrated that companies with diverse boards outperform their male-only counterparts on a return-on-assets basis by 1.9% in the US (S&P 500); 0.5% in the UK (FTSE 350), and 0.9% in India (CNX 200).

In 2015, the Davies Review of Women on Boards released an update on the progress of UK companies in expanding the gender diversity of their boards. As the review outlines, women represented 18% of the members of FTSE 250 boards, up from 7.8% in 2011. This demonstrates the significant improvements made and profound culture change that has taken place across many UK company boards since Lord Davies and his steering group first published their review four years ago. However there remains much scope for progress.

Outcome:
We wrote to the ten remaining companies in the FTSE 350 whose boards lack any female representation to encourage future efforts by the chairman and nominations committee to increase the gender diversity on the company's board. In this vein, we would encourage moves to further develop internal initiatives to broaden talent search, to better identify a diverse range of qualified candidates for board positions. The outcome of this engagement initiative will be reported later in the calendar year 2016.

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**, corporate governance manager on **matt.crossman@rathbones.com**

Rathbones
Look forward

rathbones.com
@Rathbones1742
Rathbone Brothers Plc

T3-CGSA-03-16