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## EdenTree Expert SRI Briefing – January 2015

# Review of the 2014 Proxy Voting Season

2014 may come to be seen as the landmark voting season that never was! Nearly a decade after securing an advisory vote on executive remuneration, shareholders finally got a binding vote on remuneration policy – not that it seems to have set the world alight!

**A Binding Vote on Remuneration**

New rules came into effect in October 2013 that changed the way UK shareholders vote on remuneration. Instead of an advisory vote on remuneration, shareholders would now be offered two votes; a binding vote on Policy every three years (forward-looking), and an annual advisory vote on the remuneration report (backward-looking). The Policy vote would need to pass a simple majority, and failure to achieve this would necessitate the company returning with new proposals.

The 2014 season was always going to be remarkable as shareholders sought to 'bed down' the new proposals and ingest more detail on remuneration policy and process. Companies are expected to have a remuneration policy for three years, so in most cases we expect the 2015 season to revert to a single advisory vote on the remuneration report, which should reflect (and honour) the policy voted on by shareholders in 2014.

At EdenTree Investment Management (EIM), incorporating these new proposals and voting every UK company in accordance with them has been time consuming. We amended our UK Corporate Governance Policy in January 2014 to reflect these important changes. In essence our historic approach of taking disclosure, the link to performance and any potential for excess remains unchanged: however, our revised policy sets out some guiding principles around the two votes:

- *EIM will support the advisory vote on implementation where we have supported the binding vote on pay policy, and this has been followed without unreasonable levels of Committee discretion being applied. The Remuneration Report will be considered in the context of our general principles on remuneration: the quality of disclosure allowing an informed judgement to be made; whether performance hurdles are stretching and tiered towards delivering superior out-performance, and any potential for excess.*

In practice, in the majority of cases where we took action against Remuneration Policy, we also either opposed or voted to abstain the advisory (backward-looking) vote. In rarer cases where on performance grounds bonuses or long-term incentives had been scaled back, we found it admissible to support the Remuneration Report whilst opposing pay policy.

It is fair to say that the new power invested in shareholders did not lead to a second 'shareholder spring'. We rather anticipated some subtle ratcheting in pay levels overall as companies set bonus and incentive levels for three years and this has certainly happened. The other noticeable outcome is the reluctance shown by shareholders to exercise the authority vested in these hard-won powers.

One test case came late in the year when BG Group proposed setting remuneration for its incoming CEO outside of the pay policy approved by shareholders in May. We were opposed to the package on excess grounds; in total the package could have been worth £30m in bonus, grants and other benefits in the first year.

The consequent shareholder rebellion led to the company withdrawing its proposal to make a conditional award worth up to £2m per year over five years, and which departed from remuneration policy. This represented a line in the sand for investors as to whether the binding vote on policy would have teeth. As we wrote in a Blog post – the outcome was a 'nil-score draw', in so far as shareholders forced the company to re-think, but the resulting package, is, in our view, still excessive, with the Board effectively overpaying.

The first year of operating the new pay reporting and voting arrangements did not lead to any major surprises. Few companies saw their proposals overturned or voted down; however there were some significant revolts. Around 40% of investors failed to back pay policy at AstraZeneca and more than a third at Barclays, where the size of the bonus pool continued to be controversial. Other notable revolts included 41% opposing pay at Standard Chartered, and 30% at Experian. Sir John Pease, Chairman of Experian found himself at the apex of three shareholder revolts where he was the Board Chair. As well as significant revolts at Experian and Standard Chartered, Sir John was under fire as Chair of Burberry where the package awarded to its incoming Chief Executive was widely criticised for its excessive nature. The Burberry Remuneration Report was defeated, with 53% of investors opposing, but the Board secured its overall pay proposals with the binding vote on Policy easily passing. The one-off award of shares worth in the region of £15m attracted particular criticism. EIM opposed all of these proposals, finding a poor long-term link to performance as well as it being excessive in aggregate. Burberry seemed to affirm the reluctance of shareholders to vote down Pay Policy even where there was clearly sizeable disquiet.

Shareholders voted down the pay policy at engineering firm Kentz, forcing the company to return with new pay proposals after 51% of proxies cast opposed its plans; this rose to 57% including abstentions.

**EIM Record on UK Voting**

EIM once again voted at all UK meetings across all Fund portfolios in 2014 in accordance with our published Corporate Governance Policy. In total we voted at 285 company meetings, representing 3,998 resolutions. We took action in approximately 6% of cases, but over two thirds of all action taken was in respect of remuneration. Among the UK's biggest blue-chip companies, we invariably find it challenging to support management on pay. We voted on 126 FTSE100 pay proposals (Policy and Report) of which we opposed or abstained 80 (63%). Of the very largest FTSE30 companies, we supported only three out of 22 company meetings voted, where we viewed remuneration to be appropriate, well-structured and linked to performance. Our fourth quarter Corporate Governance Report contains voting statistics for the whole year and more information on voting remuneration.

As a House we opposed all bank remuneration policies that sought to circumvent EU bonus rules by introducing fixed allowances. Under EU rules for key personnel, bonuses are now limited to 100% of salary, or 200% of salary with shareholder approval. Citing recruitment and retention challenges, all the main UK banks introduced a form of additional fixed allowance against which bonus would then be calculated. We viewed this as ethically dubious and opposed all votes to increase the bonus to 200% where such allowances had been introduced.

Over the course of the year we also voted to oppose or abstain 27 UK performance incentive schemes and 25 Board directors for various reasons.

**Board Diversity Progress**

We amended our UK Corporate Governance Policy back in 2012 to reflect the growing debate around diversity inspired by Lord Davies report 'Women on Boards'. He called for a target of 25% of all FTSE 100 company directorships to be held by women by 2015. EIM has now maintained diversity records across a three-year rolling period, and started reporting regularly on diversity from our March 2014 corporate governance report. The 2014 Annual Report ‘Women on Boards’ calculated that female representation stood at 20.7% up from 12.5% in 2011. Whilst significant progress has therefore been made, there is still some way to go before the 2015 target of 25% is secured. One significant development in 2014 saw the last remaining FTSE100 all male Board (Glencore) appoint its first female director. For mid-cap companies the record is patchier, with 15.6% of all Board positions held by women, up from 7.8% in 2011.

EIM routinely engages with companies that are some way from meeting the 2015 target. From the 2015 proxy voting season, we will take action against Nomination Committee members where there has been little progress, and continuing poor disclosure on the Board’s strategy for improving Board balance. This has been reflected in our 2015 UK Corporate Governance Policy, now online.

**External Auditors Facing Mandatory Re-tendering**

In late 2013, the UK was outvoted at European Union level on proposals that would significantly change the relationship between companies and their external auditor. The EU decision may, in time, lead to a requirement to change audit firm at least every 15 years. The UK has already adopted proposals put forward by the FRC (the Financial Reporting Council) that provide for voluntary tendering of the external audit every decade. The result of these proposals has been to improve disclosure around the length of audit tenure and strategies on future tendering. A situation where a company may have had the same auditor (or its predecessor company) for over five decades will eventually become a thing of the past. We welcome this: the audit provides statutory and regulatory sign off that company accounts can be trusted, and that there are no material issues found by the auditors. A ‘cozy’ arrangement based on long-term mutual interests (including the provision of non-audit services) may deflect from an impartial and unbiased audit statement. We amended our corporate governance policy so as to provide for voting against the re-appointment of auditors where ‘*no such process has taken place for at least ten years*’. EIM will normally vote to support the re-appointment of auditors where a company announces its intention to tender. We expect the audit partner to be rotated at least every five years, in accordance with market best practice.

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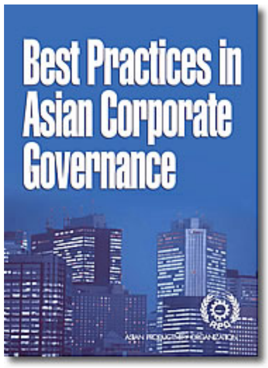
| Audit tender at least every 10 years | **For** |
| No tender, or intention to tender for up to 15 years | **Abstain** |
| No tender, or intention to tender for over 15 years | **Oppose** |

**Overseas Corporate Governance: Focus on Asia**

When investing overseas, the quality of corporate governance is a material consideration, and nowhere is this more important than when investing in Asia. As might be expected, governance practice varies considerably across the region, with some markets (Hong Kong, Singapore) having well developed, reliable governance principles, with less well developed practices elsewhere.




**Japan**, where good governance has been more of a challenge, took strong steps in 2014 to make the market more attractive to international investors. Japan published Asia’s first Stewardship Code in February 2014, and in August its first Corporate Governance Code. Japan is more than a decade behind much of Asia with independent directors, audit committees and even annual reports still not a mandatory requirement. In a country where tradition often out-ranks market best practice, the corporate sector has been slow to accept the need for reform and regulators still have to prove they will act in shareholder interests. The Tokyo Stock Exchange (TSE) is now 'strongly urging' companies to appoint outside directors, and in 2014 we saw a trickle of companies making international non-executive appointments (Sony 75%, Shinsei Bank and Hitachi 66.7% and Oracle 62.5%). However there are still 64 TOPIX500 companies with no outside directors at all.

In general we have our greatest exposure in markets where governance has been ranked 'good' by the Asian Corporate Governance Association (ACGA). These are typically Hong Kong and Singapore (ranked equal first), Japan (3rd), Malaysia (equal 4th). We have no exposure to either Indonesia or Philippines, ranked equal 10th. Hong Kong has a robust governance regime that includes a strong legal regime around insider trading and market manipulation, remuneration disclosure and reasonable disclosure. Singapore mandates quarterly reporting and protection of minority shareholder rights. We are optimistic about the region in governance terms; most of the middle ranking markets are making efforts to improve corporate governance and regulatory enforcement. Most markets have converged in accepting a strong independent audit, and international accounting standards. Malaysia, a smaller market where we have some exposure, continues to benefit from government led reforms including the launch of a Malaysian Stewardship Code. The Malaysian Audit Oversight Board is proving an effective regulator and among the most focused in the region.

Asian corporate governance remains a 'work in progress', but we are encouraged that 15 years on from the Asian financial crisis of the late 1990s, much work has been done to overhaul and progress the quality of governance in the region. Asia has a body of new laws, regulations, codes, guidance and enforcement that provides greater comfort to international minority investors such as EIM. More can be done of course, and some markets remain laggards; we will continue to watch progress with engaged interest.

**Overseas Voting**

GLASS LEWIS & Co.

We take pride that our international proxy voting partner, Glass Lewis & Co. votes our holdings at all non-UK meetings based on our agreed voting template. Over the course of 2014, we voted at 216 meetings, comprising 2,287 resolutions. A full account of action taken and why is reported each quarter. The main reasons for taking action are mostly for Board balance and shareholder capital reasons. Where remuneration is disclosed, we take a similarly robust approach as in the UK. Most US 'say on pay' votes results in our opposing given the excessive nature of aggregate awards, and the poor overall link to performance in standard stock option plans. We support shareholder resolutions in the US where these appear reasonable and proportionate, and support our wider views on business ethics and sustainability. We routinely oppose the re-appointment of auditors where these have not been tendered or rotated for a substantial time, such as at General Electric Inc. (105 years) or Citigroup (45 years). EIM does not stock-lend and has a policy to vote at all meetings in the portfolio except where these are share-blocked. Whilst outlawed in the EU, share-blocking still exists in some markets such as Luxembourg, Belgium and Norway, and requires shareholders to waive their right to trade for a period ahead of the AGM in order to vote. We do not support this, and decline to waive our capital rights. During 2014 this resulted in our not voting at 15 meetings in several markets; this is fully reported in our online quarterly Corporate Governance Reports.

**Reporting**

We publish a variety of materials that support our approach to corporate governance. Our UK and Overseas Policies on Corporate Governance are updated annually and published online here. Hard copies are available on request. Our UK Stewardship Code Statement is updated annually and is also available online; there is a link to this on the FRC website at www.frc.org.uk .

We publish a corporate governance report each quarter, which records how we have exercised our proxies in the UK and internationally on behalf of clients, together with information on action taken.

We welcome feedback and comments on our approach to voting and on our reporting.

**EdenTree - Ethical Investment Specialist**

Best Ethical Investment Provider

Best Ethical Investment Provider

Since launching the **Amity UK Fund** in 1988, EdenTree has taken a leadership role in managing ethical investments through our research, engagement and strong fund performance. Consequently, we were delighted to receive the Moneyfacts Award for Best Ethical Investment Provider 2014, the sixth consecutive year of winning this award. We were particularly pleased to win as it is voted for by the Adviser community. In 2013, the **Amity UK Fund** was rated 'Highly Commended' in the Investment Week Climate Change and Ethical Investment Awards. We were also awarded Money Observer Best Ethical-SRI Bond Fund for the **Amity Sterling Bond Fund**; the **Amity UK Fund** won Best Equity Fund in the 2014 Money Observer Ethical/SRI category, and we were nominated for an award in the category of Best Thought Leadership Paper on Sustainable Investing, in the Investment Week Sustainable Investment Awards 2014. Today we offer six SRI funds under our Amity brand, four retail funds and two for charity investors, covering the major markets and investment classes.

**Further information**

For further information on EdenTree's SRI range of Amity Funds please contact your EdenTree Business Development Manager, visit www.edentreeim.com or call our IFA support team on 0800 011 3821.