Corporate governance and stewardship activities report 2019

The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance. You should always seek advice from a qualified professional if you have any doubt as to the suitability of any aspect of your financial affairs.

Corporate governance and stewardship activities report 2019 (relating to 2018 activity)

Contents

About us

Rathbone Investment Management is one of the leading providers of high-quality personalised investment management services for private clients, charities and trustees.

Rathbone Investment Management is a subsidiary of Rathbones Brothers Plc, which provides investment management services, financial planning, offshore investment management, trust and tax services, ethical investment and banking services. Rathbone Brothers Plc is a FTSE 250 listed company employing over 1,300 people across 14 UK locations and Jersey.

This report covers our voting and stewardship activities relating to Rathbone Investment Management, referred to as Rathbones, which reported £38.5 billion in assets under management as at 31 December 2018.

This report does not cover the voting and engagement activities of Rathbone Unit Trust Management, the unit trust arm of Rathbone Brothers Plc. Rathbone Unit Trust Management is a signatory to the UK Stewardship Code, being the only part of the group which is covered by this area of voluntary regulation. Rathbone Unit Trust Management's approach to stewardship is reported separately from that of Rathbone Investment Management via our website **rathbonefunds.com**

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 Principles for Responsible Investment reporting which can be found on the PRI website at unpri.org/signatories/rathbone-brothers-plc/1700.article

For more information, please email stewardship@rathbones.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, as expressed in our 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 during 2018.

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, a full time governance and voting analyst (new in 2018) 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. 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.

Active voting covers a significant proportion of listed company holdings by value and those most widely held by our clients.

Our core stewardship principles

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

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

Active voting
Principle: We actively consider proxy votes for client holdings.

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

Transparency
Principle: We report annually on our stewardship activities.

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 are exploring different ways in which governance risk data can be included within our core research.

Governance risk screening is provided to members of the equity research team for all companies listed on the MSCI World Index via a third party research provider. 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 governance and voting analyst sits on all relevant internal stock selection committees to provide governance risk insights. In the course of their analysis, the research team build up detailed company specific knowledge and can hence uncover governance risks. These are then fed back into the proxy voting process.

Finally, we continue to invest time in training our staff on the issue of governance and stewardship risk, running sessions for investment professionals across our UK offices in aspects of corporate governance and stewardship policy. A particular emphasis was placed on understanding the principles of executive pay in the last 12 months. In 2018 we trained over 50 investment professionals across our UK offices in aspects of corporate governance and stewardship policy.

Our progress in this area has resulted in an improvement in a major external benchmarking of our approach to governance and stewardship issues. In 2018 (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. Currently we meet best practice requirements for our listed equity incorporation activities, attaining a C grade in the last year. However, we hope to make further progress in this area and have identified several initiatives to help drive better performance in future. We will voluntarily report on the fixed income area in 2019.

Summary scorecard

AUM	Module name	Your score	Your score / Median score
	01. Strategy and governance	A+	A
Direct and active ownership modules			
>50%	10. Listed equity — incorporation	C	B
>50%	11. Listed equity — active ownership	A	B

A summary of our performance in key areas versus the average for our peer group.

Voting

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 the impact of the business 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, including 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 this 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.

As a result of the 2018 review, we have taken firmer stances on a number of issues including ‘overboarding’ (the issue of directors holding too many positions at different companies) and addressing lack of diversity on listed company boards.

2018 voting review

In 2018 we voted on 4,897 resolutions at 388 company meetings (2017: 5,046 resolutions at 398 meetings) – 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.

2018 voting

	For	Abstain	Against	Meetings	Resolutions
Jan	97.8%	0.0%	2.2%	17	180
Feb	98.6%	1.4%	0.0%	26	210
Mar	99.5%	0.0%	0.5%	24	187
Apr	98.4%	1.4%	0.2%	43	624
May	96.3%	1.9%	1.8%	74	1,242
Jun	90.1%	4.8%	5.1%	43	476
Jul	99.3%	0.2%	0.5%	54	840
Aug	99.4%	0.0%	0.6%	19	161
Sep	99.0%	0.0%	1.0%	23	300
Oct	100.0%	0.0%	0.0%	15	149
Nov	99.7%	0.0%	0.3%	30	335
Dec	99.5%	0.0%	0.5%	20	193
Year AVG / total	98.1%	0.8%	1.1%	388	4,897

NB The data provided are 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 votable 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, 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. As more attentions has been paid to this area in recent years, so our proportion of votes against management has increased. A summary of the issues where votes against management were entered in 2018 is summarised below.

Votes against management 2018

Anti-takeover related	1.1%
Capitalisation and shareholder rights	13.3%
Directors related (board independence)	38.9%
Executive pay	26.7%
Mergers, acquistions and takeovers	4.5%
Routine/business	10.0%
Environmental and social	1.1%
Miscellaneous	2.2%
Audit related	2.2%
	100.0%

Of particular note here is the increased focus on audit and the role of the auditors, following the high profile collapse of Carillion. We discuss this issue in more detail in the case studies section.

Engagement

Engagement with the companies in which we can invest takes 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:

Engagement topics in rank order 2018

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, accounts misstatements

PRI engagements

2019 marks the 10th anniversary of our PRI membership. We have to date been involved in a number of ESG themed engagement projects as part of this initiative.

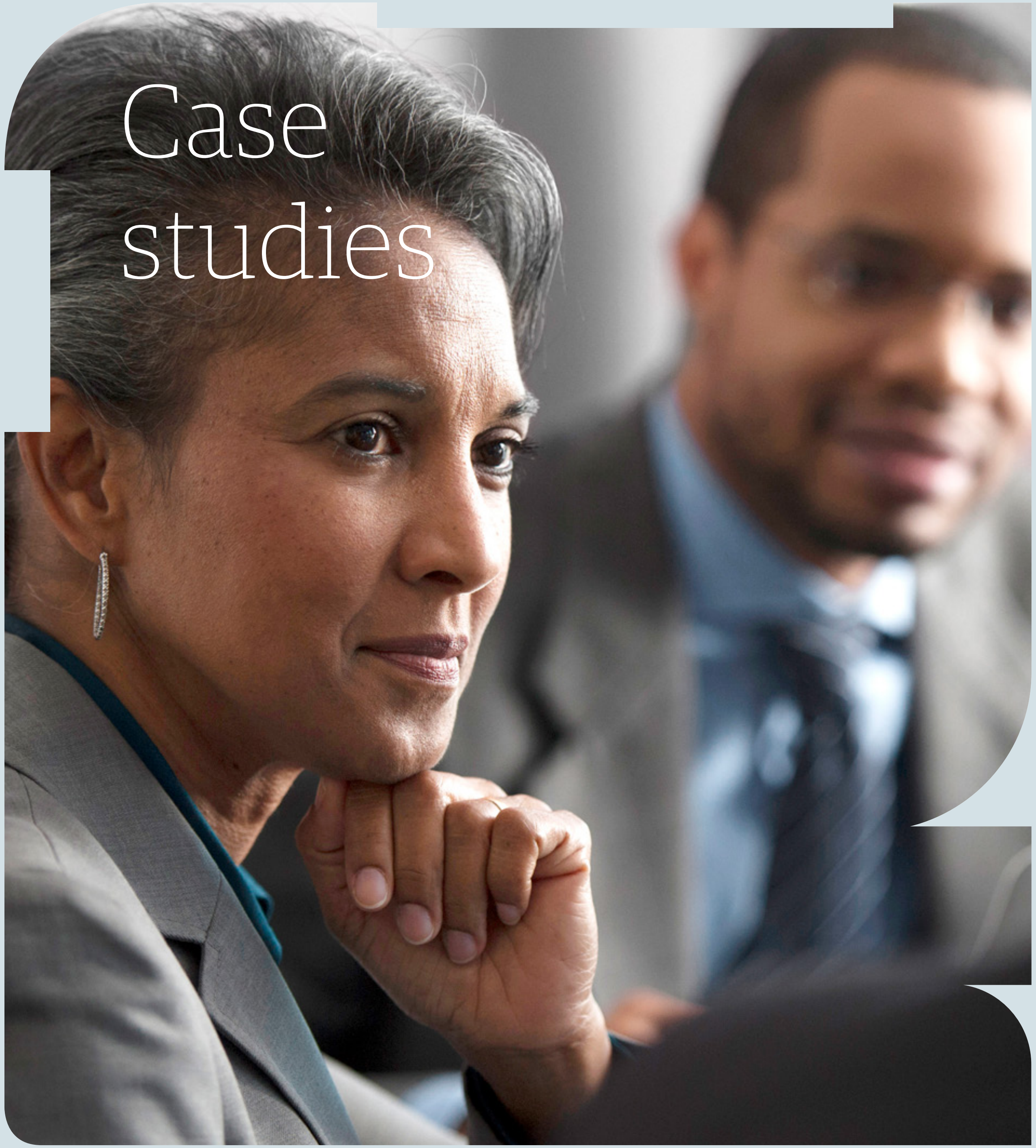
In 2018 we played a major role in the following PRI coordinated engagements:

Cybersecurity — Since 2017, we have been involved in an engagement that is focusing on cybersecurity governance within 100 global companies from the consumer healthcare, IT and financial sector. We are currently the lead investor on an engagement with Vodafone. This engagement will conclude in April 2019.

Tax — We have been on the steering committee since 2014 and acted as a lead investor since the beginning of this engagement. It engages with high risk companies in the healthcare and IT sectors to enhance corporate income tax disclosure and encourages the development of responsible corporate tax strategies and relevant implementation.

Deforestation — We are part of an on-going engagement committed to eliminating deforestation within cattle supply chains, specifically targeting companies with direct and indirect exposure to deforestation driven by cattle, soy, timber, pulp and other forest risk commodities. This engagement aims to improve the transparency and quality of disclosure for the companies involved.

Case studies



Auditor independence

Issue

The role of the auditor in good corporate governance has come into sharp focus in 2018. Although the main trigger was the collapse of Carillion Plc, the audit industry has been facing growing criticism for many years. We believe that an independent audit of a company's financial reporting is vital for investors to maintain adequate oversight of company management. However, various factors have conspired to undermine the quality of this function.

The collapse of Carillion highlighted two issues in particular, that of the conflicts of interest generated when auditors use their position to generate income from additional, non-audit advice, and that of length of tenure. KPMG were Carillion's auditors for all 19 years of the company's existence from 1999. Such a long tenure inevitably calls into question whether they could provide the independence and objectivity that is crucial to high-quality audit. Over 19 years, KPMG charged Carillion £29 million in audit fees, alongside additional charges for taxation and other assurance services – never once raising an issue with the financial health of the company.

Process

We undertook a review of companies with lengthy audit tenure and began a process of engagement to encourage retender of audit contracts in good time. We also began exploring options to vote against the appointment of auditors where the lead audit partner had been involved in the Carillion contract.

Outcome

There have been two major outcomes from our increased focus on the audit industry.

Firstly, we tightened our voting policy, making it clear that we expect auditors to focus on the provision of the audit and not undertake inappropriate levels of additional work which may raise questions about their independence.

Perhaps more importantly, we began to engage with policy makers on the issues raised, since our engagement is limited in scope. To that end, we were one of only a few wealth managers to submit written evidence to the Business, Energy and Industrial Strategy Committee's 'Future of Audit' enquiry, calling for action to increase competition in the audit industry.

Persimmon

Issue
No review of the 2018 voting season would be complete without mentioning the pay arrangements at Persimmon, a UK housebuilder.

At the start of the year it emerged that executives in the company were in line for some truly staggering financial rewards under the terms of the 2012 Long Term Incentive Plan (LTIP). Whilst the company had done well in the period in question, the LTIP included no cap on potential rewards, hence the large sums vesting to senior executives.

There was a strong feeling that not only were the awards excessive purely in terms of their sheer size, but also that the company had benefitted from favourable government support for the housing market in the period during which the awards were earned.

Process
Outcry in the media was sharply critical and the company took steps to reduce the size of the overall awards. The pay arrangements were the subject of a major shareholder revolt in April 2018, with 48% of shareholders (including Rathbones) failing to back management.

CEO Jeff Fairburn eventually lost his job in November 2018, with the company stating that controversy over his pay "continued to have a negative impact on the reputation of the business".

Outcome
We have updated our voting policy to insist that all LTIPs include a clearly defined cap on maximum remuneration.

Unilever

Issue
In early 2018 the company announced plans to both simplify its legal structure and re-locate its head office from London to the Netherlands. Unilever had retained a dual legal structure since its formation by merger, maintaining both a UK PLC and a Dutch NV, with each entity listing shares in its respective domain.

As part of plans announced to the market, Unilever intended to simplify its structure into a single corporate entity, and in the process re-locate its head office and legal domicile to the Netherlands.

As part of the move, its shares would have traded solely in Europe. Investors had several issues with the proposal. Firstly, it was unclear as to whether the relocation away from one of the world's premier financial centres made strategic sense. Secondly, the move stood to potentially disadvantage long-term holders of the company who may have faced increased tax burdens.

Finally, the company was accused of failing to provide an adequate explanation for the need to simplify the structure at this time.

Process
We took a new approach in our engagement on this issue, for the first time availing ourselves of the advantages of working with the Investor Forum (IF). In addition to our own direct meetings with the finance director and chairman over the year, we worked with the IF in formulating a general collaborative engagement approach along with other like-minded investors.

Having conducted due diligence and having sought views from across the business, the stewardship committee made the recommendation that we should oppose the plans in the proposed EGM scheduled for October 2018.

Outcome
In the event, such was the severity of the negative commentary in the UK media, the company foresaw an embarrassing defeat at the UK EGM and promptly shelved plans for the simplification.

We met with the chairman in the aftermath, who expressed regret over the issue, and promised to take a much more conciliatory approach to the concerns of UK shareholders in future.

Important information

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Rathbones
Look forward

rathbones.com/investment-approach/stewardship
@Rathbones1742
Rathbone Brothers Plc