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& PARTNERS

Policy outreach, company engagement and voting report

Q1 2018

April 2018

Introduction

Investors in companies have an important shared responsibility in holding the board to account for the management of the business.

On behalf of our clients we are active in voting on matters put to shareholders, and we closely monitor investee companies and engage on issues of concern relating to corporate governance, capital structure and strategy. We do this because we believe that poor governance can adversely affect the returns for investors and, equally, good stewardship can lead to better returns over the long term.

As long-term investors, we also take an interest in the broader market environment in which companies operate. Where we perceive problems, and believe we can catalyse positive change, we will reach out to policy-makers and other key market participants to promote reform. Our objective is to shape the regulatory and market environment to support more sustainable economic growth.

Given the emphasis we place on responsible and active ownership, we aim to communicate openly with our clients and other interested parties about our activities. This report offers a window into our recent company engagement, policy outreach and voting activities.

Stewardship: Policy and company engagement

Our engagement work with companies aims to address governance failures or strategic challenges with a view to protecting and enhancing shareholder value. It often takes place in confidence, but we aim to share key points and goals of recent engagements to ensure transparency and insights on our stewardship activities to our clients.

Alongside our company dialogues, we often have a unique opportunity to engage with policy makers to improve the regulatory and market environment in which companies operate. In these cases our aim is to promote rules and market-wide practices which encourage long-term and sustainable behaviour, which in turn will underpin sustained and equitable wealth creation.

Company Engagements

Royal Dutch Shell

We are pleased to report significant progress this quarter in our engagement with Royal Dutch Shell. As part of our analysis of climate risk, we assess the extent to which companies are adequately reflecting material exposure in their Annual Report and Accounts, including whether the long-term oil and gas price assumptions underpinning their financial statements reflect foreseeable reductions in demand due to decarbonisation.

Shell has been unique among UK oil and gas companies in failing to disclose the long-range price assumptions underpinning its forecasts and current equity book value. We have written twice to the Chairman of the Board requesting that Shell improve its disclosure, so that investors can assess whether it is truly aligned with the Paris Accord goal to limit global temperature increase to below two degrees. The company initially declined our request but, following a constructive meeting with the Chairman earlier this quarter, we were pleased to see it publish the price assumptions ($70/barrel) in the latest Annual Report and Accounts.

By way of next steps, we have followed up with the Chair in writing to explore how the now-disclosed price assumption underpinning the financial statements relates to the lower price of $60/bbl assumed as part of Shell's strategy, as well as the $40/bbl price adopted as a threshold for new investments.

Public Policy Outreach

Our ongoing work on accounting standards and audit has continued to gain traction this quarter.

Although our clients did not hold Carillion shares, the collapse of this large FTSE-listed outsourcing and construction company - whilst devastating for a number of stakeholders - has provided a critical reminder to politicians and wider society around the weaknesses in our accounting and audit system. In particular, it demonstrates that these vital shareholder protections do not seem to be providing the early warnings to investors or the public about solvency risks.

Several articles published by The Times and the Financial Times this quarter made reference to our work on audit and accounting. The latter featured Natasha Landell-Mills, our Head of Stewardship, in a 'head-to-head' debate on splitting the Big Four's audit and consulting activities, alongside other market reforms.

Given less public attention, but no less important, have been the drip-feed of revelations from Government responses to Parliamentary questions tabled by Baroness Bowles on the ongoing confusion over the Financial Reporting Council's (FRC) legal status, and how this has impacted its operations in practice. Bowles has specifically drilled into why the FRC appears to have operated outside public entity rules, when they had been designated as a public body of the Office of National Statistics. Bowles is also seeking clarity over the FRC's treatment of the Bompas QC legal opinion which was highly critical the Government's interpretation of the true and fair standard for accounts in Company Law.

Following Carillion's bankruptcy, in March we were pleased to see the UK Secretary of State for Business, Energy & Industrial Strategy announce his intention to initiate an independent review into the operations of the FRC. We have been calling for such a review since last year, including in our submission to the UK Government's Green Paper consultation on corporate governance and the position paper we published alongside several other investors last quarter.

Our core concern is that the FRC is too heavily influenced by the audit profession that it is tasked with regulating, and this has undermined its effectiveness in ensuring a strong and reliable accounting and audit system. It is vital that shareholders can trust company accounts to provide a true and fair view of underlying performance and capital. Not only does this underpin decisions on capital allocation, but it drives remuneration and ensures that dividends are not paid out of capital. Our next step is to write to the Secretary of State with recommendations on the nature and scope of this review.

In related activity, we submitted a consultation response to the Monitoring Group, which comprises the Basel Committee on Banking Supervision, the European Commission and the Financial Stability Board, amongst others.

The consultation focuses on strengthening the governance of audit-related standard-setting in the public interest, and touches on many of our long-standing concerns regarding the excessive influence of the accounting profession over standards and their oversight. Our response makes a number of proposals to mitigate this influence and safeguard the interests of investors and the wider public. These are highly topical in the context of recent audit failures.

Climate Change and Auditors

Auditors also play a central role in the reporting of climate risks and preventing misrepresentation, including challenging assumptions that oil and gas prices will remain at recent levels even in the face of decarbonisation. Yet our review of extended auditor reports in the UK suggests that stress testing for long-term demand decline is not being undertaken, or at least not being reported to shareholders. We are therefore also engaging with auditors to set out our expectations for such stress testing, and our intention to vote against their reappointment where these are not met.

In addition to our engagement with oil and gas companies on their disclosure and mitigation of climate risks, we have written to the chairs of over 30 companies seeking assurances that they are aligning their strategies with the Paris Climate Accord commitment to limit temperature increases to below 2 degrees above pre-industrial levels, as well as stressing the importance of appointing directors who share this commitment. We intend to use the responses to inform future voting and engagement.

Key votes and engagements Q1 2018

Investors in companies have an important shared responsibility in holding the board to account for the management of the business. On behalf of our clients we are active in voting on matters put to shareholders, and we closely monitor investee companies and engage with companies on issues of concern relating to corporate governance, capital structure and strategy.

Poor governance can adversely affect the returns for investors and, equally, good stewardship can lead to better returns over the long term. The table below shows how we voted on four company resolutions during the period under review. It also explains the way we voted, and whether the resolution was approved by the shareholders or not.

Key votes and engagements for 1st Quarter 2018

Company	Date	Resolution	How we voted for you	Result
Cineworld Group plc	2 February	Approve Acquisition of Regal Entertainment Group	Against	Passed

In December 2017, Cineworld announced a reverse takeover of the (much larger) Regal cinema chain in the US requiring a sizeable rights issue and debt raise. We were disappointed with this proposal because it will transform the company from a low-debt, steady compounder with sizeable exposure to structurally growing markets to a highly leverage turnaround play with the vast majority of exposure coming from a single, very mature market where the management had no experience (the US). We contacted the senior independent director to understand the independent directors' perspective on the deal. We were worried that there was insufficient challenge from the board and that only one independent board member (a lawyer by profession) had experience of the US market. We also shared our view with a proxy research provider – Institutional Shareholder Services (ISS) – who decided to recommend shareholders vote against this acquisition proposal. Shareholders approved the acquisition in February 2018 and, as a result, we have exited our position.

Percentage of votes cast for the resolutions: 87.3% for, 12.7% against

Company	Date	Resolution	How we voted for you	Result
AmerisourceBergen Corporation	1 March	Report on Governance Measures Implemented Related to Opioids	For	Failed

This is a shareholder resolution filed by the Sisters of St. Francis of Philadelphia asking the company to report on its governance measures implemented since 2012 to monitor and manage the financial and reputational risks relating to the opioid crisis in the US; including whether the board or a board committee had the ultimate responsibility, if compensation was revised and whether policies were altered in relation to political lobbying. We supported this shareholder resolution because opioid overdosing has become a national crisis in the US (41 states have already formed a coalition to investigate opioid makers and distributors for their potential legal liabilities in the opioid crisis). Distributors such as AmerisourceBergen are required to establish robust programmes to prevent the illicit use or sales of opioids and to report to regulators any suspicious opioid orders. In 2017, AmerisourceBergen paid $16 million to settle a 4-year lawsuit with the West Virginia state alleging that the company had benefited from opioid abuse. We expect more lawsuits and regulatory actions to come in the future. While the company disclosed that it has an effective programme to monitor opioid orders, we believed shareholders will benefit from the increased disclosure so that directors will be held accountable should any governance failure be found to contribute to the opioid crisis. Although the shareholder resolution was not passed because the 26% controlling shareholder voted against it, 62% of independent shareholders supported this proposal. The company should pay attention to investor demand.

Percentage of votes cast for this resolution: 39% for, 56% against, 5% abstain

Company	Date	Resolution	How we voted for you	Result
The Walt Disney Company	8 March	Advisory Vote to Ratify Named Executive Officers' Compensation	Against	Failed

Disney is the first US company in 2018 to receive a majority shareholder vote against its nonbinding remuneration vote. A failed remuneration vote remains uncommon among S&P 500 companies with only seven of them failing to receive majority shareholder support for their remuneration votes in 2017. Disney's shareholders disapproved the latest pay package offered to its CEO in relation to his contract extension and the upcoming acquisition of 21st Century Fox. We found three elements of Disney's remuneration package concerning: firstly, a sizable one-off $100 million equity grant (fully vested in 2021) was given to the CEO in relation to the acquisition. We rarely favour acquisition-based incentives as they tend to promote bad acquisitions that increase executive remuneration but destroy shareholder value. Secondly, the targets are weak. The target of Disney's long-term equity incentives is only the median performance of S&P 500. Shareholders should question why the management need to be incentivised to deliver a median performance. Finally, the quantum of CEO pay will increase substantially upon merger completion (40% increase in salary and a nearly 50% increase in long-term incentive). Any increase in executive pay as a result of acquisition should only be granted not when the acquisition is completed but after shareholder value is created. We believe the current model of executive pay is broken – it is too complex and all too frequently there is a disconnect between pay and performance. We believe it necessary to impose a large shareholding requirement and executives should hold their shares throughout their career plus a few years post-departure. This is a simple principle and will guide how we vote in executive remuneration in 2018.

Percentage of votes cast for this resolution: 44% for, 52% against, 4% abstain

Voting Summary Q1 2018

		2012	2013	2014	2015	2016	2017	Q1 2018
Total number of company meetings		636	638	741	969	968	1,165	188
Total number of proposals		7,448	7,184	8,090	11,102	10,387	13,244	1,881
Votes cast	for	4,720	4,986	5,807	8,288	7,728	8,570	1,182
	against	1,312	1,418	1,332	1,631	1,681	2,354	284
	abstain	5	56	63	118	61	101	15
	withhold	171	173	126	85	84	83	2
	did not vote[1]	1,240	551	762	980	833	2,136	398

[1]We do not currently vote in jurisdictions in which share blocking and power of attorney requirements apply.

Further details are available upon request.

Contact:

Natasha Landell-Mills
T: +44 (0)20 7038 7000
F: +44 (0)20 7038 6850
email: natasha.landell-mills@sarasin.co.uk

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Sarasin & Partners LLP

Juxon House
100 St. Paul's Churchyard
London EC4M 8BU

T: +44 (0)20 7038 7000
F: +44 (0)20 7038 6850

www.sarasinandpartners.com

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