SARASIN
& PARTNERS

Policy outreach, company engagement and voting report

Q1 2019

April 2019

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: Swedbank

We continued our engagement with Swedbank this quarter, after allegations aired on Swedish television linking it to suspicious customers implicated in the Danske Bank money-laundering scandal.

Based on our engagement with executives and the Deputy Chair of the Board, we formed the view that potential shortcomings in the bank's controls were unlikely to be systemic.

Among the factors leading to that assessment, data from the Estonian Central Bank showed that Swedbank's share of cross-border payments was significantly lower than its market share by balance sheet. This was in contrast to Danske Bank, which also differed in generating outsize profits from the banking services it provided to non-resident customers. This potential red flag did not exist at Swedbank, and the relatively small size of the latter's non-resident customer portfolio meant that it should have been able to manage risks effectively.

At the time of writing, it remains unclear whether there is substance to the allegations. However, the bank's response has failed to quell and, if anything, exacerbated concerns. The Board expressed unequivocal confidence in internal controls, yet we found the independent review it commissioned insufficiently conclusive and transparent. The Board also signalled support for the bank's management, but days later dismissed the CEO, apparently under pressure from large domestic shareholders.

The bank has not been receptive to our calls for greater transparency, principally through a comprehensive review of its internal controls, and, in the meantime, regulatory risk is mounting. Given our lack of confidence in the Board's ability to respond appropriately to the money-laundering allegations, we have decided to sell the shares we hold on behalf of our clients.

We are continuing to engage with other European banks on their exposure to money-laundering risks, including ING Groep and Erste Bank.

Company Engagement: Just Eat

Corporate governance issues at Just Eat were under the spotlight after a large shareholder wrote several public letters to the Board questioning the company's remuneration structure, capital allocation and the search for a new Chief Executive Officer (CEO). The shareholder highlighted that 1) the long-term incentives granted in 2018 had a heavy emphasis on revenue growth; 2) the company should initiate a process to sell its iFood investment in Brazil; and 3) Just Eat should consider merging with other industry participants as a means of securing a new CEO, on the basis that the Board has a poor record of executive selection.

We had met both the Chair of the Board and the vocal shareholder to discuss the points raised. We agree that it is appropriate for the company to have profitability target in its pay structure and, upon engagement with the Chair, we are glad to hear that a target will be reinstated in its 2019 incentive scheme. We also support Just Eat's retention of iFood; while not an easy business to value, we consider it will ultimately be accretive to the group. Finally, we disagree with the suggestion that Just Eat should seek opportunities for a merger, and we believe the Board should have sufficient time to carry out a thorough search for a new CEO. We will continue to engage with the Board where needed as this process progresses.

Company Engagement: EssilorLuxottica

The merger of lens maker Essilor and glasses frame maker Luxottica presents an attractive investment opportunity as the combined entity is expected to create synergies of up to EUR 600million and will dominate an industry which is growing but fragmented. However, the joint company's unorthodox and complex governance structure raises concerns that the leadership will fail to realise promised synergies. Under the new governance structure, Essilor and Luxottica representatives share equal executive power, with each side occupying half of the expanded 16-person Board. Recently, disagreements over the search of the future Chief Executive Officer (CEO) have become public and the share price of EssilorLuxottica has suffered.

We have particular concerns over the power exerted by Luxottica's founder, Del Vecchio, who owns about 30% of EssilorLuxottica and Executive Chair. For the three years prior to the merger, as Chair of Luxottica, Del Vecchio replaced the CEO three times. Against this backdrop, we have written to all independent directors of the company to ask them to 1) accelerate the transition to a new CEO and demonstrate his/her independence from Del Vecchio; 2) appoint a lead independent director who minority investors can turn to for future dialogues, and 3) ensure an explicit link to synergy delivery in executive remuneration. We have not yet heard back from the company and are reaching out to other minority shareholders to explore whether our concerns are shared.

Market Outreach

Accounting & audit

In spite of Brexit, the attention on accounting and audit failures continues to occupy politicians' time due to continued news on corporate failures. Following the collapse of Carillion last year, we have seen accounting problems linked to capital weakness or insolvency at the government contractor Interserve, outsourcer Kier, and financing company London Capital & Finance. Against this backdrop, our calls for reform of the audit market as well as the accounting standards continue to gain material traction.

Following the publication of proposed reforms of the audit market by the Competition & Markets Authority (CMA), we were invited for a one-on-one discussion and made a formal written submission in January. We outlined our support for proposals to structurally separate audit from non-audit (and thus the creation fo pure audit firms); increased oversight of auditors and audit committees (e.g. through peer reviews by the government); and potentially for steps like market share caps to enhance competition.

We were clear, however, that these structural solutions will only improve audit quality if they go hand in hand with steps to ensure company accounts comply with the capital maintenance rules in Company Law. In essence, there is little point in increasing competition, if the product is flawed. We have specifically called for companies to disclose the split in profit between realised (in cash or near cash) and unrealised elements, as well as the part of capital that is not distributable. We believe this is key for shareholders to understand better the performance capital strength of the businesses in which they invest. We are also calling on the Government to own the guidance for calculating distributable (realised) profits, which is currently provided by the audit industry.

The points we emphasised to the CMA, we also made in written and oral evidence to the BEIS Select Committee in Parliament as it conducted its own review of the Future of Audit. In its final report, published on 2nd April, we were pleased to see our submissions repeatedly referenced and our core proposals embraced as central reform recommendations. In addition to calls for the audit firms to be split between audit and non-audit, they called on the Government to urgently address the weaknesses in the UK's capital maintenance regime. Critically, the Select Committee agreed that the problems in audit should not be characterised as an "expectations gap", but rather a "delivery gap". In essence, audit quality is substandard.

In recognition of our work on these issues, Natasha Landell-Mills has joined the Advisory Board for the Government's review of the effectiveness and purpose of audit, led by Sir Donald Brydon. We were also invited to speak on the Today Programme the morning of the BEIS report being released.

Significantly, our work has now also been supported by the International Accounting Standards Board (IASB). In an article published in February, a board member at the IASB sets out how the international accounting rules (IFRS) should not be relied upon to meet company law requirements. The audit firms have often equated compliance with IFRS as sufficient to ensure compliance with Company Law. We have questioned this assumption, and the IASB statement is helpful in supporting our position.

Climate Change

Sarasin's Climate Pledge - A Call to Action

In late January, Sarasin & Partners published our firm-wide Climate Pledge (see next page). This pledge sets out our commitment as a firm that we will align our business with the Paris Climate Accord of keeping temperature increases "well below 2°C". This alignment encompasses not only our own business emissions but critically our stewardship of the companies our clients invest in and our broader policy outreach. Specifically, the Pledge details our commitment to press investee companies to align with the Paris climate goals through proactive engagement, voting and divestment where we believe our clients' capital is at risk and leadership is failing to respond appropriately.

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Sarasin & Partners' Climate Pledge

Shareholders have a clear interest in encouraging companies to limit their exposure to the risks associated with climate change. A failure to do so puts shareholder capital at risk and, ultimately, may contribute to social and economic instability.

The Paris Climate Accord, agreed in 2015, provides our only global framework for responding to climate change. It sets a goal to limit the global average temperature increases to well below 2°C, and to pursue efforts to limit the temperature increase to 1.5°C ('the Paris goals'). To achieve these targets, the world must reach net-zero carbon emissions by 2075 or 2050, respectively [1].

Sarasin & Partners believes it is important to set out our commitment to support the Paris goals[2]. We do this not just by aligning our own business with the Paris goals[3], but critically, through our stewardship of the companies our clients invest in and our broader policy outreach.

Our Pledge

We commit to press investee companies to align with the Paris climate goals.

We support directors at investee companies materially exposed to climate risks to position their businesses for a net-zero emission world using the following tools[4]:

- Proactive engagement – We initiate and support dialogue with company boards to make clear our expectation for companies to publish Paris-aligned strategies, including measurable mid-term targets.
- Voting – We oppose director appointments where individuals are blocking the implementation of a Paris-aligned strategy. We will vote against auditors where we believe the Annual Report and Accounts fail to report material climate risks. We expect real action within three-years.
- Divestment – We sell a company's shares where we believe our clients' capital is at risk and leadership is failing to respond appropriately[5].

We also commit to promote policy reforms to drive alignment with the Paris goals.

- Policy outreach – We engage with regulators and policy makers wherever we believe we can accelerate or improve action to combat climate change.
- Public statements – We speak out publicly, and build / support coalitions of like-minded investors and thought-leaders, to drive change where we believe this will be effective.

We believe this Pledge is in-line with our responsibility to protect and enhance our clients' capital.

[1]IPCC special report, "Global warming of 1.5°C", October 2018.
[2]We will update this commitment in line with any revised global commitment that results from new scientific research.
[3]Please see our commitment to align the business with a well below 2°C target in our Corporate Impact Report.
[4]Our approach is informed by the Oxford Martin School's Principles for Climate-Conscious Investment. See Millar, R. Hepburn, C. Beddington, J. and Allen, M., 'Principles to guide investment towards a stable climate', Nature Climate Change, 2 January 2018; Oxford Martin Principles for Climate-Conscious Investment, February 2018.
[5]For clients following our Climate Active Strategy, we apply a more stringent climate stress test in our divestment decision. See: https://www.sarasinandpartners.com/charities/investment-solutions/climate-active

January 2019

Engaging our auditors

Last quarter we drafted a letter to the Managing Partners of the UK's largest audit firms setting out investor expectations for auditor assurance that companies are accounting for material climate risks. The letter has been signed by over 25 institutional investors, including a number of clients, and will be sent out in early January.

The letter builds on our paper "Are oil and gas companies overstating their position?" released in July, and our earlier Briefing Paper written for the Institutional Investor Group on Climate Change "Voting for better climate risk reporting: the role of auditors and audit committees" – please contact your Account Director if you would like a copy of either paper. In simple terms our concern is that company annual reports and accounts are not necessarily properly reflecting the material climate risks the business faces, and this could mean that capital is being misallocated. Specifically, this can permit too much capital to be allocated to activities that are harmful to our climate.

For example, take a power company that has coal-fired power plants on its balance sheet. If the accounts assume a 25-year lifetime for these plants, questions may be asked as to whether this is consistent with the Paris goal of keeping temperature increases well below 2°C. We would like to see the auditor ask this question of management, and show what stress testing has been undertaken. A shorter lifetime could mean higher depreciation expenses, and lower reported profits. In other words, Paris aligned accounting matters to how profitable a company appears.

We hope our letter will be the start of a constructive dialogue with audit firms in coming months. We also intend to send a copy to the Financial Reporting Council to seek their support in pushing forward this dialogue, and we may share it with Chairs of Audit Committees at companies that face material climate risks.

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 for 1st Quarter 2019

Company	Date	Resolution	How we voted for you	Result
Compass Group plc	7 Feb 2019	Approve remuneration report	Against	Passed

We voted against the remuneration report as it does not require executives to continue to hold shares after their departure, and the shareholding requirement of three times the basic salary fails to ensure sufficient alignment with long-term shareholders. We look for a minimum four times shareholding requirement. A post-departure shareholding requirement also helps to discourage departing executives from sacrificing long-term performance for short-term gains.

Percentage of votes cast for the resolution: 98% for, 2% against, 1.2% abstain

Company	Date	Resolution	How we voted for you	Result
Deere & Company	27 Feb 2019	Elect the chair of the nomination committee	Against	Passed

We voted against the chair of the nomination committee due to the Board's lack of gender diversity. The Board has only two females out of a total of 11 directors, which falls below our expectation of 25%. We believe that shareholders' interests are best represented by a diverse and independently minded board of directors. As an investor member of the 30% Club, we expect at least one third of board members to be female by 2020. Where boards fall short of this, it raises concerns about 'groupthink' and the risk that appointments are not truly made on merit.

Percentage of votes cast for the resolution: 98.1% for, 1.9% against, 0.2% abstain

Voting Summary Q1 2019

		2013	2014	2015	2016	2017	2018	Q1 2019
Total number of company meetings		638	741	969	968	1,165	1,072	203
Total number of proposals		7,184	8,090	11,102	10,387	13,244	13,433	1,849
Votes cast	for	4,986	5,807	8,288	7,728	8,570	11,152	1,309
	against	1,418	1,332	1,631	1,681	2,354	2,611	287
	abstain	56	63	118	61	101	181	8
	withhold	173	126	85	84	83	79	0
	did not vote[1]	551	762	980	833	2,136	1,420	245

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

Further details are available upon request.

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