SARASIN & PARTNERS

Policy outreach, company engagement and voting report

Q3 2019

October 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: Aramark

We started to engage with Aramark, the US provider of food services, facilities services and uniform services company this quarter on a number of issues linked to its strategy, remuneration and communication.

We have significant concerns over Aramark's unclear strategy. It has not articulated well its growth drivers and margin performance, or related targets for the future. In short, the company needs to make clear whether it is prioritising growth or margin.

We also question whether the company is the appropriate owner of its Uniforms business and the international business, which are sub-scale. We are keen for Aramark to focus on contract catering where the company has scale, expertise, and a leading position.

When it comes to remuneration, while Aramark has had a weaker operational and financial performance than its direct peers (Compass and Sodexo), the Chief Executive Officer (CEO) was paid materially more than them. There are several reasons for this including a higher maximum annual bonus of more than 500% of salary (versus 200% for Compass and Sodexo); a higher long-term incentive (roughly six times salary in 2018, compared with less than five times for Compass and Sodexo); and a lack of appropriate peer benchmark in assessing performance. We are also concerned about the large severance package in change-in-control situation ($41.8 million) and its potential impact on company's strategy.

Recently, Aramark's CEO announced his plan to retire and we believe this is a good opportunity to push for overhaul of the remuneration structure for the incoming CEO and also to address the issues in its strategy and communication to the market.

Company Engagements: DS Smith

This quarter we met with the Chair of DS Smith, a leading packaging company with operations in Europe and the United States. This meeting was an introductory meeting (please see our recently published Ownership Discipline) as we have recently significantly increased our holding in DS Smith. As a company that places the circular economy at the heart of its business model, offering closed loop packaging solutions to clients, we view the company as having enormous opportunities for growth as governments tighten waste and recycling requirements.

The key topics on our agenda were a request for the company to commit to align its strategy with the Paris Climate Accord by setting an explicit net zero emissions target by 2050; the possibility for DS Smith to promote others to sign up the zero plastics targets (they are a founding signatory to the Ellen MacArthur foundation plastics commitment); as well as its remuneration policy and the need for a higher shareholding requirement for senior executives. The dialogue was extremely constructive and we are hopeful that we will see DS Smith public announce its own Climate Pledge in the next Annual Report if not before.

Market Outreach

Capital maintenance – is Thomas Cook another canary in the coal mine?

As we write this quarterly update, news of the fall-out from the travel company Thomas Cook's insolvency is attracting increasingly critical commentary. Over 100,000 stranded passengers had to be repatriated, at a cost of tens of millions of pounds to government. Thousands of staff face an uncertain future and it is unclear how well protected their pensions will be.

All this has happened while senior management received high rewards. The government has asked the Insolvency Service to investigate. Not to be outdone the Financial Reporting Council issued a statement "in light of recent developments at Thomas Cook we are considering whether there is any case for investigation and enforcement action as a matter of urgency and in cooperation with the Insolvency Service".

The truth will be revealed in due course, but one thing is already clear from their 2018 year end accounts, which points once again to our long-standing concerns over the UK's failure to enforce its capital maintenance regime. While the Group (consolidated) accounts continued to accumulate losses, leaving a total negative retained earnings of almost £2 billion (up from £1.9bn in 2017), they paid a £9mn dividend. This was possible because the dividend is paid by the Parent company, which produced accounts with a far stronger balance sheet than the consolidated subsidiary accounts. Whereas the Group reported net assets of £291mn, the Parent had almost ten times this at £2.78bn.

What is concerning about this picture is the significantly higher capital strength of the Parent than the Group, given that the main assets held by the Parent are its investments in the underlying group subsidiaries. Logically, we would expect the net asset levels to be rather similar, or the Parent to have a lower net asset number to the Group. There are a number of technical accounting reasons why the Parent could be larger than the Group, but we consider this to be a red flag. Indeed, for most of the recent corporate failures including Carillion, Interserve, Kier and London Capital & Finance, the Parent reported higher equity than the Group.

While we were not invested in Thomas Cook, this story reminds us yet again why the UK needs to urgently address its flawed accounting and audit model. We will continue to press the Government to act on this matter, and specifically urge them to ensure rigorous enforcement of our capital maintenance regime. While insolvencies are a natural feature of a dynamic economy, proper and prudent accounting with robust external audit is vital to avoid unnecessary risk taking by executives, and thus hardship for those who can least afford it.

Auditor engagements on climate risk bearing fruit

Ensuring company accounts incorporate material climate risks is vital to ensuring that companies avoid a misallocation of capital, and management is held to account for performance that factors in these risks. Overstated accounts that leave out climate risks can lead to excessive bonuses for executives. While there has been a growing focus on the importance of climate risk reporting, for instance through the Task Force for Climate-related Financial Disclosures, far less scrutiny is being given to company accounts. This needs to change.

To fill this gap, we are coordinating a collective investor engagement with the largest UK audit firms. In January we sent a letter to the lead audit partners at the Big Four firms, Ernst & Young, Deloitte, PWC and KPMG setting out investor expectation that auditors ensure material climate risks are incorporated in company accounts as well as narrative disclosures in the Annual Report to shareholders. This letter was signed by about 30 investors, including several Sarasin clients. Since sending the letter we have held group face-to-face meetings with senor partners at KPMG, PWC and Deloitte, and have a scheduled meeting with Ernst & Young in October. In June, we also spoke to an international audience of investors and auditors, hosted by the Global Auditor-Investor Dialogue.

Following these exchanges, we have been pleased not only to see growing interest in these dialogues internationally, but that we are having an impact. Both KPMG and Deloitte have reported to us that they have responded to rising investor interest in climate risks by:

1. Issuing an alert to all senior partners that they should be considering climate risks where potentially material.

2. Enhancing audit partner training on climate risks to consider in their review of company accounts

3. Incorporating reference to climate risks in regular outreach to Audit Committee clients.

In addition, we have seen Ernst & Young in the case of Shell and Pioneer Oil, and Deloitte for BP explicitly include a reference in the latest Annual Reports to decarbonisation or climate risks as part of their review of assumptions used by management in impairment testing.

We intend to follow up on these letters to the audit firms with company-specific engagements involving Audit Committee Chairs, which also involve the relevant lead audit partner. This will help to ensure our high level dialogues continue to filter into company Annual Reports. We are also feeding this work into the Financial Reporting Lab work on climate risk reporting, which will help to ensure our work is further amplified.

Meeting with IEA on a 1.5°C scenario

In April, we joined a delegation from the Institutional Investor Group on Climate Change in a meeting with the Chief Executive of the International Energy Agency (IEA). This meeting followed a written request to the IEA asking it to produce a routine 1.5°C scenario to complement its existing three scenarios published annually and seen as a key reference point by oil and gas companies and policy makers in formulating strategy. A 1.5°C scenario is critical to providing a credible third party basis for evaluating company capital deployment plans against the Paris goals. It is, in our view, a pressure point for driving Paris-alignment and we will continue to support this dialogue alongside our bilateral engagement with the IEA.

Key votes and engagements Q3 2019

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 take seriously our voting responsibilities as we believe voting provides shareholders with an important lever for ensuring proper corporate accountability and responsible stewardship, which is a critical input into delivering better returns over the long term.

This table shows samples of how we voted on company resolutions during the period under review. It also explains the way we voted, and whether the resolutions were approved by shareholders or not.

Key votes for 3rd Quarter 2019

Company	Date	Resolution	How we voted for you	Result
Alibaba Group Holding Limited	15 Jul 2019	Elect executive director	Against	Passed

We continue to vote against the non-independent directors because the majority of the Board are not independent. Additionally the governance structure (the "Alibaba Partnership" structure and related voting agreements with other larger shareholders) does not support the principle of one-share-one vote, limiting directors' accountability to shareholders. Minority shareholders do not have an effective mechanism to hold the board to account, something we take account of in our investment analysis.

Percentage of votes cast for the resolution: 90% for, 10% against

Company	Date	Resolution	How we voted for you	Result
Halma plc	25 Jul 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 two 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: 97% for, 3% against

Company	Date	Resolution	How we voted for you	Result
Neuberger Berman Uncorrelated Strategies Fund	19 Sep 2019	Ratify appointment of auditor and authorise their remuneration	Against	Passed

We voted against the ratification of the company auditor because the size of non-audit fees has been greater than 25% of audit fees for the past three years. We believe the independence of the auditor could be compromised by excessive payments for non-audit services.

Percentage of votes cast for the resolution: Not disclosed

Voting Summary Q3 2019

		2014	2015	2016	2017	2018	Q1 2019	Q2 2019	Q3 2019
Total number of company meetings		741	969	968	1,165	1,072	203	678	205
Total number of proposals		8,090	11,102	10,387	13,244	13,433	1,849	8,544	1,975
Votes cast	for	5,807	8,288	7,728	8,570	11,152	1,309	5,306	1,366
	against	1,332	1,631	1,681	2,354	2,611	287	1,889	421
	abstain	63	118	61	101	181	8	103	13
	withhold	126	85	84	83	79	0	96	2
	did not vote[1]	762	980	833	2,136	1,420	245	1,150	173

[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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