Rathbone Unit Trust Management Limited stewardship report 2017

(covering 2016 activity)

Rathbones
Look forward

This report has been compiled in accordance with the Financial Reporting Council's (FRC) Stewardship Code, details of which can be found at frc.org.uk/investors/uk-stewardship-code

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About us

Rathbone Unit Trust Management Limited is the unit trust management arm of Rathbone Brothers Plc. Rathbone Unit Trust Management offers a range of equity and bond unit trusts, a multi-asset portfolio (consisting of four sub funds) and two charity funds to meet investors' capital growth and income requirements. We specialise in investment management for the retail investor and segregated institutional accounts. Rathbone Unit Trust Management's approach to stewardship and proxy voting is reported via our website rathbonefunds.com

Rathbone Investment Management is one of the UK's largest and longest-established providers of personalised discretionary investment services. We manage funds for individuals, charities and trustees, and are part of Rathbone Brothers Plc, an independent company with a listing on the London Stock Exchange. Due to the unique features of Rathbone Investment Management, our approach to stewardship and proxy voting is reported separately via the website Rathbones.com

Rathbones has been a signatory to the Principles of Responsible Investment (PRI) since 2009, the world's leading proponent of responsible investment. We believe in being active stewards of our assets and regularly report on our activities, receiving 'A' grades for our Strategy and Governance and Stewardship activities for the first time in 2017.

Corporate governance and stewardship at Rathbones

We believe it is in the best interests of our investors 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 investors, we seek to be good, long-term stewards of the investments which we manage on their behalf.

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 Rathbone Unit Trust Management's approach to proxy voting and engagement within the context of our activities in this regard in the last 12 months.

Our core stewardship principles

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

1. **Materiality**
   Principle: We recognise that governance and stewardship risks can be material to the performance and valuation of companies. Governance is therefore taken into consideration by our internal research teams when reviewing a company.

2. **Active voting**
   Principle: We actively vote all shares held within Rathbone Unit Trust Management except where for practical reasons, such as share-blocking or in the event of any conflicts, this is not appropriate.

3. **Engagement**
   Principle: Active engagement with companies on governance issues is an important adjunct to voting activities. From 2017 we will endeavour to write to all companies when voting against management outlining our specific concerns and offering further engagement on the issues.

4. **Transparency**
   Principle: We will report annually on our stewardship activities. Periodic reports covering stewardship activities and full voting records are available on our website.

The Stewardship Committee

Proxy voting and shareholder engagement at Rathbones is overseen by a committee of investment professionals from across the business, supported by the stewardship team and an external proxy voting consultant. The committee also meet quarterly to discuss market developments and any proposed policy amendments.

Proxy voting policy

All shares held within Rathbone Unit Trust Management are now voted except in instances where market restrictions such as share-blocking, power of attorney or share registration requirements, make voting impracticable. In 2016 we voted 98.5% of possible meetings.

To ensure consistency, all voting is overseen by a stewardship analyst who is responsible for reviewing proxy research and applying the Rathbone Unit Trust Management voting policy. All meetings where Rathbone Unit Trust Management holds over 1% of the issued share capital and meetings where there is a potential vote against/abstain management will be reviewed by the fund manager(s) who holds shares in that company.

(From 2018 we will disclose summaries of our voting activity on our website. Full voting records are available to clients on request).

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 long-term quality of the business rather than simply short-term performance
- develop appropriate checks and balances to deal with conflicts of interest
- 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 impacts on all stakeholders.

In order for boards to deliver on these goals, we believe that boards should demonstrate the following key features:

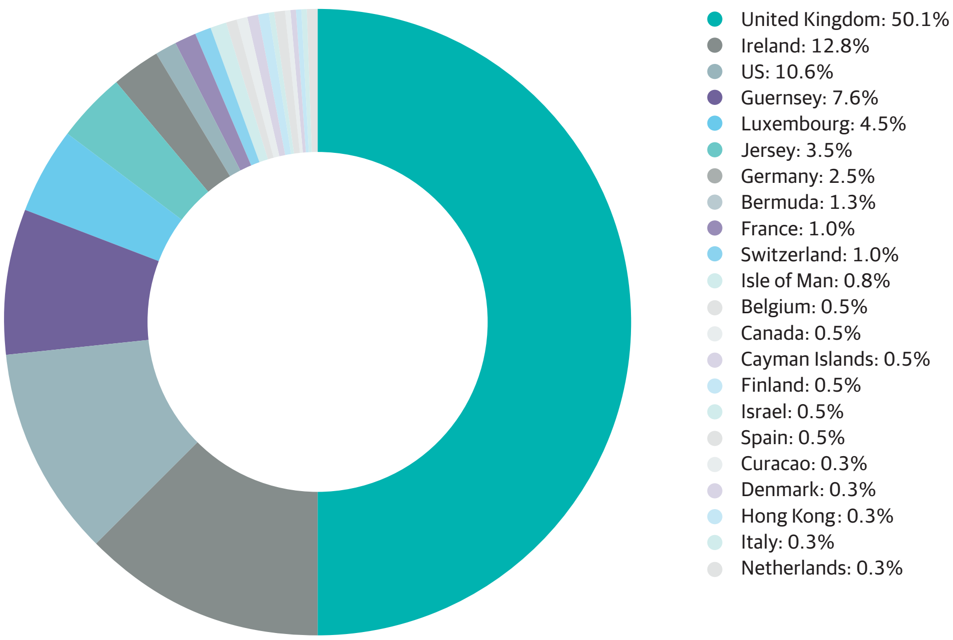
- be led by an independent chairman
- the chairman and the CEO roles should be separate and not exercised by the same individual
- the board and its committees should retain the requisite balance of skills, experience, knowledge and independence. This includes adequate attempts to address the level of 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 the area. Standards naturally vary by market and whilst recognising this we will also encourage the adoption of global best-practice. 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.

2016 voting review

In 2016 we voted on 5075 resolutions at 397 company meetings. Since best-practice now requires boards of directors to be re-elected annually, 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.

Votes by market



2016 voting overview

2016	% For	% Abstain	% Against	Meetings	Resolutions
January	98.5	0.5	1.0	18	187
February	99.5	0.0	0.5	20	149
March	94.0	0.5	5.5	18	209
April	95.0	0.4	4.6	68	1,061
May	96.0	0.5	3.5	96	1,456
June	91.4	2.9	5.7	42	462
July	98.6	0.0	1.4	54	744
August	91.7	0.0	8.3	2	36
September	96.0	1.5	2.5	18	200
October	93.3	0.0	6.7	13	105
November	97.2	0.6	2.2	32	356
December	95.0	1.0	4.0	15	100
Year average/total	**95.95**	**0.42**	**3.39**	**396**	**5,075**

Source: Rathbones

Numbers

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 range of funds. 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 attention 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 2016 is summarised below.

2016 votes against management — category breakdown

Issue	% of votes not in favour of management
Anti-takeover related	1.0
Capitalization and shareholder rights	13.3
Directors related (board independence)	30.2
Executive pay	24.3
Mergers, acquisitions and takeovers	1.9
Routine/business	23.4
Environmental and social	5.9

Source: Rathbones

Notable votes in 2016
Shareholder resolutions

Rathbone Unit Trust Management supported numerous shareholder resolutions at companies such as The Walt Disney Company, Johnson & Johnson, Pfizer, Verizon, Chevron Corporation, Amazon.com, Alphabet (Google) and Exxon Mobil. These resolutions spanned a range of issues including; improving shareholder access, improving reporting on lobbying payments in the USA; Sustainability, Gender Pay Gap and Human Rights reporting, and Environmental reporting linked to the Paris Climate Agreement.

Anheuser-Busch InBev (ABI)
Rathbone Unit Trust Management voted against the remuneration report at ABI. Numerous features of the remuneration policy go against local best-practice, including the granting of matching share awards without performance conditions. Additionally the company continues to grant performance-related pay to non-executive directors, which may compromise their independence and goes against global best-practice provisions.

Circassia Pharmaceuticals
Rathbone Unit Trust Management voted against both the remuneration report and two directors at the AGM. Both directors are non-independent members of the Audit and Remuneration Committees which is contrary to the provisions of the UK Corporate Governance Code. The remuneration structure at the company is also highly irregular with very limited disclosure and constitutes poor standards for a FTSE 250 index company.

Facebook, Inc.
The principle concern at Facebook was the creation of a third class of shares (Class C) absent voting rights. It is established market practice that one share should equal one vote. Facebook already has an unequal voting structure with Class A and Class B shares. The creation of this third class of shares is highly detrimental to shareholder rights and would allow founder Mark Zuckerberg to sell a large portion of his shareholding whilst retaining majority voting power. Rathbone Unit Trust Management voted against all changes associated with this proposal; additionally abstaining on the re-election of six of the eight board directors due to the serious nature of these concerns.

Engagement

We are in ongoing contact with the companies in which we invest. Engagement can take 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:

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, account misstatements

Case study
BP

Issue:
Executive pay.

Process:
Despite BP reporting a record annual loss of USD 6.5 billion for 2015 as the industry suffered consistently low oil prices, the Executive Directors received maximum bonuses for the year, the highest bonus payouts since 2008. Particular concerns were expressed with regard to the pay package received by the CEO Bob Dudley who stood to receive a total remuneration in excess of £13 million for the year.

The Remuneration Committee applied some discretion to reduce the overall bonus score, this did not impact Executive Directors because their bonuses are capped: only less senior managers were affected. Hence, the most senior executives at the Company were exempt from the oil price downturn having an impact on their bonuses while those further down the organisation are affected. The general rule for investors is that exceptional variable is appropriate only when performance for shareholders has been exceptional. The Board argued that its senior team had done well in managing the company in a low oil price environment – to which concerned investors responded that this was its job, to be expected of the CEO and management team.

Outcome:
We determined to vote against the remuneration report for the year. We were backed in this move by 59% of shareholders who failed to back management, a very significant expression of shareholder dissent. Since the AGM we have been in contact with the company as they seek to review pay arrangements for the next year. Importantly BP's remuneration policy is up for review in 2017, a key opportunity for investors to engage on this important issue.

Case study
Smith & Nephew

Issue:
Our major issues with variable pay come when the experience of management and shareholders becomes misaligned. It is vital that remuneration policies be designed in such a way that investors can have confidence that exceptional variable pay will only come under certain prescribed circumstances, meeting performance conditions which are unambiguous and easily understood. However, most companies equip their remuneration committees with discretion to make awards even where performance conditions have not been met. In the year in question, the Remuneration Committee exercised discretion to provide for elements of a Long Term Incentive Plan to vest despite targets on total shareholder return not being met.

Process:
We wrote to the company expressing our concern over the use of discretion and the lack of convincing rationale for doing so. The performance targets were set by the Remuneration Committee, with full knowledge of the market conditions, and we consider it a matter of sound precedent that the company should be prepared to accept the outcome of the structure and incentives that it has chosen. Given the company's relative size and standing, we viewed the use of discretion in such a manner to fall short of best-practice.

Outcome:
We opposed the approval of the remuneration report at the 2016 AGM. We were joined in doing so by 53% of shareholders, a major expression of disapproval. The company said the committee was now undertaking a "thorough review" of remuneration arrangements for 2016, ahead of putting a new policy to a shareholder vote in 2017.

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