Corporate Governance, Voting and Stewardship, October – December 2012

This note comments on corporate governance issues and provides examples of corporate governance and engagement activity by the UK office of Schroders during the period October to December 2012. The examples cover activity linked to voting and engagement with companies outside day-to-day investment contact.

General approach to engagement and corporate governance

As in previous reports, the following paragraphs illustrate our approach to engagement with companies and our views regarding disclosure of that engagement.

The aim of all engagement on governance by Schroders is to enhance the value of the funds managed for clients. To achieve this aim, we find it essential to take a pragmatic approach in terms of how we deal with companies and how we report our engagement with them. We believe that additional value is created by engaging with and if necessary encouraging change at companies but recognise asset allocation and selection of individual stocks may have a greater impact on the returns in a client's portfolio.

Our reports on voting, engagement and corporate governance are necessarily brief and generally hide the names of the companies involved and only provide a sample of activity. We believe it necessary to avoid conducting public discussions if change might involve a climb-down by the company: it is generally preferable for companies (indeed, for any person) to accept and agree with change rather than to have it forced upon them. Publicising concerns about a director or the board of an organisation will be destabilising to the company, may damage our ability to conduct constructive discussions with any company, may damage the value of a company and may discourage talented individuals from becoming members of listed company boards. Further, particularly where Schroders manages shares comprising a significant proportion of a company's share capital, it is not in clients' interests to disclose details of the engagement Schroders must inevitably have with these companies.

There are occasions, however, where it is appropriate to reveal contact with companies, particularly in high profile cases or where we have taken a stance that requires explanation and justification.

Schroders also produces reports on engagement with companies on corporate and social responsibility. These reports are available from client directors or our SRI specialists.

Corporate Governance Policy

The Schroders corporate governance policy and our statement regarding our compliance with the UK Stewardship Code are both available on the Schroders' Internet site.

Selection of Company Contacts

Company A

It was reported in newspapers that a company was planning extensive changes to a board and potential candidates to the board were named. If the article was accurate, we thought the changes may be destabilising. Accordingly, we called the company. We were pleased that the company confirmed the article was inaccurate. New non-executives were to be appointed but primarily to replace directors who had or were due to retire in any event.

We noted, for the company's information, that we hoped the company would not consider one of the names mentioned in the article. We had experience of the individual as a director and had little faith in their ability to be a suitable director.

Company B: Trinity Mirror plc

We received enquiries from the press regarding the extent, if any, of 'phone hacking at the Daily Mirror and the company's reaction to threats of litigation.

On the day we received the enquiries, by coincidence we were having our first meeting with the recently appointed CEO.

Even ignoring that the company has a new chairman and a new CEO – with, it is emphasised, neither of their predecessors leaving for any reason connected with 'phone hacking – and ignoring the motives of newspaper journalists relishing the prospect of criticising their competitors, the CEO provided an entirely satisfactory answer regarding the position of the company and the steps it will take. Amongst the comments, we note that most managers and journalists at the time of alleged hacking had long since left the company and that the company will investigate allegations as they are made.

We made it clear that we will not undermine the board or our clients by commenting to the press on the allegations.

Discussions then moved on to the business and the strategy of Trinity Mirror.

Company C

The company has a long-serving chief executive. Other members of the management team have also been with the company for many years and as the chief executive approaches retirement, so questions arise regarding succession at the company. The company has performed consistently well and we are not seeking the replacement of the leadership team. However, the prominent role played by the current management team make the succession issue an important one for the

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future of the company. Accordingly, we spoke to the company's senior independent director. He is very aware of the succession problem and is working to address the issue.

Company D

We met the chairman regarding succession planning in the light of the forthcoming retirement of the chief executive. Performance had been mixed recently and we therefore welcomed that the board was considering appointing an individual from outside the group. A chief executive from outside the firm would, we considered, provide an opportunity to review the strategy, portfolio and operations of the company.

Company E

We contacted the executives of a business following some press coverage regarding a potential acquisition.

The company has made encouraging progress and we respect and value the management team. However, given our concerns about the damage that can be caused by acquisitions, we contacted the management team to reiterate those views and encourage the company to continue to maintain a strong balance sheet. We added that we did not rule out acquisitions entirely but that there had to be a convincing case with clear signs of value creation. The company responded that it has invested in assets and would consider acquiring another company in order to acquire further assets. All investments are subject to strict investment hurdles with additional risk attached to corporate vehicles. In response to our view that the company should maintain a prudent balance sheet, the company's managers confirmed they still followed the same strategy regarding gearing and notwithstanding some room to increase gearing, they did not consider it appropriate.

Company F

An activist shareholder acquired a stake in a company. We were contacted regarding their proposals but whilst of interest, we did not agree with all aspects of their proposals.

Our fund managers, in connection with regular meetings held with companies, subsequently met the CEO and finance director. Amongst the issues discussed were

i) the company limiting – or reducing, if necessary – exposure to one particular sector of business. Evidence indicated that companies relying on this sector for business activity faced significantly increased risks to sustainability;

ii) it would be helpful for greater disclosure of the performance of divisions in the company;

iii) the company generates cash. We are keen that the cash is not then used for acquisitions. With cash earning little interest in the current environment, there is a temptation for any company to buy earnings, notwithstanding that acquisitions often fail;

iv) in connection with efficient use of capital, we suggested that the company use economic profit as a measure for bonuses and |LTIP awards.

We also met the chairman, covering broadly the same points and adding that when moving to new premises in lower-cost countries, the company needed to account for closure of those premises if/when business was moved to yet lower-cost countries.

Company G

After engagement running over several years with executives and non-executives, a company completed a disposal and return of cash to shareholders in the quarter. The engagement had included the operational performance of the company and the management of portfolio of activities. In particular, it was unclear whether the company would benefit as much as other potential owners from some of the operations. The company, eventually, determined it was not the best owner of some assets and obtained a good price in the subsequent sale.

UK Banks

We have met, individually or with other shareholders, representatives of a selection of UK listed bank boars regarding the remuneration arrangements for senior executives and the forthcoming bonus round generally.

Regarding remuneration for senior executives, the structure will broadly remain the same as in previous years.

For bonuses at investment banks, it is clear that not only will financial results lead to a fall in bonuses but there is some evidence that banks are taking account of the need to at least rebalance the proportion of rewards between shareholders and executives. This is a difficult area because the businesses rely heavily on certain people to generate business and returns. Recognising this, we have encouraged banks with investment banking arms to reward the individuals who truly generate returns but consider carefully the extent to which bonuses will otherwise be paid throughout the organisation.