Schroders

Corporate Governance, Voting and Stewardship, Oct – Dec 2011

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 2011. 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 climbdown 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 the last report (Company G, Q3 2011) that we had been approached by another shareholder with a proposal that an individual be appointed to the board as a non-executive director. We considered there was a case for more widespread experience and suggested 2 new non-executives be appointed to the board and suggested a candidate. The other shareholder agreed and we both raised the suggestion of the 2 individuals with the chairman of the company. Both individuals have successful board and executive experience in the industry in which the company operates. We also discussed it with another shareholder who also raised the nominations with the company. We met the chairman and discussed the qualities of both individuals as well as drawing attention to our concerns that the existing board showed some signs of weakness. We learnt that the company was then consulting other shareholders: we then also contacted other investors and secured their support.
Given the extent of support from major shareholders for the individuals, it was positive that the company duly appointed both individuals to the board.

Company B: Charter International plc

As reported in our last note, following press coverage of our position, we were obliged by regulatory authorities to make a regulatory news disclosure regarding our views following the withdrawal of Melrose: the statement (released on 28 September) said:

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> SCHRODER STATEMENT RE CHARTER / MELROSE
> 'We are disappointed, though not altogether surprised, that Melrose has had to withdraw its potential offer for Charter.
> As long term shareholders in Charter, we believe there is substantial upside in the company which, in our view, would have been realised over the next 3-5 years under management by Melrose in a UK listed company. We were supportive of the Melrose offer as we never wished to be 'cashed out' of the long-term potential of the Charter businesses today, but to be able to participate in the future upside under the terms of the Melrose offer. In our view it is disappointing that the opportunity was not taken by the Charter board and its advisors to engage with Melrose and, instead, to solicit alternative approaches - to the extent of paying an inducement fee to their preferred US suitor. They may deem this outcome a satisfactory result for shareholders but we regard it as a victory for short-termism and a defeat for shareholders with a long term investment time horizon.'

We note that the chairman of Charter was reported to be criticising our position. We continue to stand by the statement release to the market.

Company C G4S

Schroders had a small interest in G4S but we were concerned regarding the proposed acquisition of ISS A/S. Our concerns included financial, execution and implementation risks. Particular issues included the integration of over half a million employees across over 100 countries, a history of acquisitions at ISS, financing (a GBP2bn rights issue which was proposed even if the proposed acquisition of ISS was not approved by shareholders).

Although we generally prefer to avoid our views o companies appearing in the press, (Stewardship Code-compliant) engagement with other shareholders led to our name appearing in news reports as objecting to the deal when another shareholder referred to our opposition.

G4S subsequently abandoned the deal and the rights issue. They offered a meeting with the chairman and the senior independent director. We anticipated a difficult meeting but the directors were constructive and provided a clear explanation of the process they followed leading up to the proposed deal. Whilst we did not agree with the proposed acquisition, the board appears to have been thorough in considering the rationale of details of the transaction but the company's clarity of communication with (to and from) shareholders appears to have been sub-functional. Following abandonment of the deal, the board has resolved to improve communication with shareholders, of which this meeting formed a part.

The experience was a costly lesson for the company but the board's response to the failure of the deal has been constructive and should see the company continue to seek to grow consistent with the current strategy.

Company E

Continuing engagement with a company regarding performance led to further discussions with the chairman and a meeting with the senior independent director. The meeting with the latter was productive and encouraging, indicating we could have a degree of optimism. Discussions with the chairman were slightly more challenging but will continue.

One issue under discussion is the use of cash to buy-back the company's shares. As with a number of companies, the current valuation of the company would permit the company to generate a significant return – and measurable benefits for remaining shareholders. The returns would be at far lower risk and at far higher levels than the company would be likely to achieve in the normal course of business.

The discussions also covered succession policy and process on the board, including planning the chairman's retirement which is likely to be in the next 2 years. Discussions on this and other areas regarding the operational and financial performance will continue.

Company F

We requested a meeting with the chairman of a company. The company's performance had recently under-performed. The chairman was relatively new in the role.

The chairman considered that the company had performed at a satisfactory level, but no more than that. He considered that one issue had been that the board was too close and dysfunctional. Accordingly, shortly after appointment, he had changed 2 of the other non-executive directors.

The chairman had tasked the CEO to identify whether under-performance arose from the product/market or poor execution.

The discussion chairman, who was until recently a respect executive at another company, provided assurance that the performance issues are being addressed.

Company G

We were concerned at suggestions from a company that it was moving listing from the UK to the United States. A move in

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the short term would cause loss to some shareholders by reason of restrictions in place on the markets in which shareholders may invest, including clients managed by Schroders. The chairman responded that the company was likely to move to the US because of a wider pool of investors with greater knowledge and understanding of the sector in which the company operates. The chairman agreed, however5, that a UK listing would be maintained for a suitable period.
We also discussed the size of the board and whether it may be too large for a relatively small company. The chairman responded that he wished to keep a sufficient number of independent directors: we welcomed the phrase he used - “erring on the side of the board challenging the executives”.
A further issue discussed with the chairman was the risk of the company issuing equity, at a current low valuation, for acquisitions. The chairman responded that it was appropriate to enhance the company’s product range by acquiring complementary products that would enhance the value of the company’s offering. He noted the company has cash, a strong balance sheet and is in an attractive part of the sector.
We found the meeting to be broadly reassuring and constructive.

Company H
We continued discussions with a company where a significant return can be generated by buying back shares but the company is not currently planning to implement an own share purchase. The board appears to be resolutely against the concept – including the chairman and the chief executive. We have some concerns that the incentive arrangements at the company are rewarding further investment in the business as opposed to the lower risk – and greater – benefit that would accrue from the company buying shares.
Discussions will continue.

Discussions with other companies included:

- A company proposing to increase the CEO’s salary by over 10%. The company provided clear reasons as to why the increase was justified, including that salary had been held at the same level for some time, the low level compared with other companies and the successful performance of the chief executive.
- A meeting with the new chairman of a company where we had successfully opposed the appointment of his predecessor.
- Consultation by a leading company regarding the appointment of a new chairman. We knew of the individual proposed to be appointed through his role as a non-executive at another company which had faced some difficulty. The company proposing his appointment had considered this issue and were able to provide satisfactory assurances. We supported their nomination.
- We met the chairmen of media companies regarding their views on the challenges facing their industry and the approach of their companies.