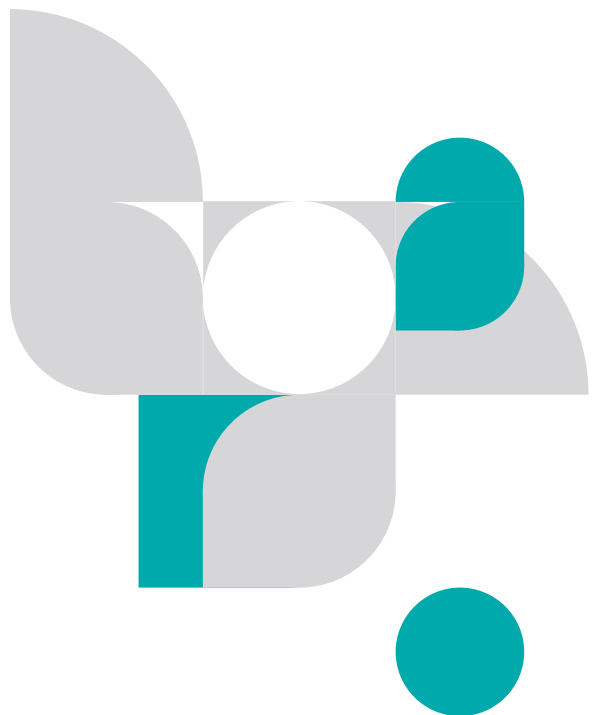


Corporate governance and stewardship activities 2017

Rathbones
Look forward



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Contents

About us	2
Corporate governance and stewardship at Rathbones	3
Our core stewardship principles	4
The stewardship committee	5
Proxy voting policy	5
2016 voting review	7
Engagement	9
Case studies	10

About us

Rathbone Investment Management is one of the UK's largest and longest-established providers of personalised discretionary investment management 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.

Rathbone Unit Trust Management is the unit trust management arm of Rathbone Brothers Plc. It offers a range of equity

and bond unit trusts and a multi-asset portfolio (consisting of four sub-funds) to meet clients' capital growth and income requirements. It specialises in investment management for the retail investor and segregated institutional accounts. Rathbone Unit Trust Management is a signatory to the UK Stewardship Code, being the only part of the group which is covered by this area of voluntary regulation. Its approach to stewardship and proxy voting is reported separately via its website: rutm.com

The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance. You should always seek advice from a qualified professional if you have any doubt as to the suitability of any aspect of your financial affairs.

Corporate governance and stewardship at Rathbones

We believe it is in the best interests of our clients if the companies in which we invest adopt best practice in corporate governance. This provides a framework within which each company can be managed in alignment with the long-term interests of its shareholders.

Mindful of our responsibilities to our clients, we seek to be good, long-term stewards of the investments we manage on their behalf. Our major responsibility in this regard is to ensure that company boards are functioning well in their role of independently overseeing 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 explains our approach to proxy voting and engagement within the context of our stewardship activities over 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

We recognise that governance and stewardship risks can be material to the performance and valuation of companies.

2. Active voting

We actively consider proxy votes for client holdings.

3. Engagement

Active engagement with companies on governance issues is an important adjunct to voting activities.

4. Transparency

We report annually on our stewardship activities.

The stewardship committee

Proxy voting and shareholder engagement at Rathbones are overseen by a committee of investment professionals from across the business, supported by the stewardship director and an external proxy voting consultant.

We aim to target our resources where they can make the most difference to the greatest number of clients. Therefore, we actively consider our proxy voting on the top 200 companies we hold by value and on those companies where we own more than 3% of the share capital. Active voting covers a significant proportion of listed company holdings by value.

Proxy voting policy

The stewardship committee is responsible for developing and maintaining a bespoke corporate governance policy, which builds on established best practice, compliant with and inspired by the provisions of the UK Corporate Governance Code (which covers UK companies) and the AIC Code of Corporate Governance (which covers investment trusts).

Voting in line with the policy on our most widely-held stocks helps us to execute our responsibilities under the UN-backed Principles for Responsible Investment, of which we have been signatories to since 2010.

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 quality of the business rather than simply short-term performance
- develop appropriate checks and balances to deal with conflicts of interests
- 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 an adequate level of gender diversity
- develop clear and fair remuneration arrangements that incentivise shared value creation
- for larger companies, at least half of the board should be composed of non-executive directors considered to be independent.

While the core principles of corporate governance are relatively well established, we observe emerging trends in the area. In order to ensure that our policy remains fit for purpose, it is reviewed against benchmark standards and principles (and updated accordingly) on an annual basis.

2016 voting review

In 2016 we voted on 5,326 resolutions at 465 company meetings (2015: 4,894 resolutions at 443 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.

2016	% For	% Abstain	% Against	Meetings	Resolutions
January	94.0	2.5	3.5	21	203
February	99.0	0.5	0.5	28	245
March	96.0	2.0	2.0	20	142
April	98.5	0.5	1.0	60	808
May	96.9	1.5	1.6	81	1,199
June	96.5	1.0	2.5	46	512
July	98.9	0.5	0.6	61	963
August	98.6	1.4	0.0	22	141
September	99.0	0.3	0.7	31	296
October	100.0	0.0	0.0	24	188
November	98.2	1.0	0.8	43	378
December	94.8	2.4	2.8	28	251
Year Avg/Total	97.5	1.1	1.3	465	5,326

Source: Rathbones

On the face of it, the votes in favour of company management may seem high. However, a little context may be helpful to explain our voting outcomes. Firstly, good governance is a pre-requisite for any company to be considered for inclusion in our portfolios. If there were severe concerns over corporate governance at a company, they would not be preferred for investment; 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, so each board member is covered by an individual resolution, in addition to the usual 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 these areas in recent years, our proportion of votes against management has increased. The issues where votes against management were entered in 2016 are summarised below.

2016 votes against management – category breakdown

Issue	% of votes not in favour of management
Anti-takeover related	0.9
Capitalisation and shareholder rights	7.5
Directors related (board independence)	26.4
Executive pay	20.8
Mergers, acquisitions and takeovers	22.6
Routine/business	18.9
Environmental and social	0.9
Other routine business	1.9

Source: Rathbones

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 \$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 £13m 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 were affected. The general rule for investors is that exceptional variable pay 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.

Case study

BACIT

Issue: The Battle Against Cancer Investment Trust (BACIT) was launched in order to boost drug discoveries in the fight against cancer, both as a donor and as an investor. The company was launched as an innovative investment company which provided investors with access to leading alternative investment managers on a gross return basis, while also making an annual charitable donation and committing a small portion of its assets to life science investments. After a period of indifferent performance, the company considered that it had a unique opportunity to make a transformational change to its exposure to, and financing of, life science investments by aligning with two of the UK's leading medical research charities, Wellcome Trust and Cancer Research UK Ltd (CR UK). The company sought approval to change its investment policy in order to make investments in an unlimited number of life science businesses (including private and quoted companies) and single asset projects with a view, over time, to becoming predominantly a life science investment company. The proposed change in strategy was very significant from an investment management perspective, constituting a major change in risk profile.

Process:

Having met with representatives from the board, we expressed our concern for our longer-term shareholders. For many of our holders the rationale for investment has been removed and the new vehicle will be unsuitable for their financial needs. It is most unusual for a fund trading at a premium to net asset value to undergo such wholesale change and we sought assurances from the company that existing shareholders would be given an opportunity to exit the vehicle on reasonable terms.

Outcome:


Following our engagement with the company, we welcomed the board's decision to offer existing shareholders the chance to sell their existing ordinary shares at a fair price. We expressed our desire to have the best interests of existing shareholders respected throughout the process by voting against various proposals relating to the reorganisation at the EGM.


Looking forward


We are committed to transparency in our proxy voting activities. You can read more about our approach to the management of governance risks in our public PRI reporting which can be found on the PRI website.

For more information please contact [Matt Crossman](#), Stewardship Director at matt.crossman@rathbones.com

Rathbones
Look forward

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