

RESPONSIBLE INVESTMENT

Investment trusts revisited



Introduction and scope

In 2023, we published the first of three reviews of the investment trusts held within Quilter Cheviot's centrally monitored universe, focused on the equity asset class. We followed up with two further reports in 2024 which focused on other asset classes (alternatives and property). As with the previous iterations, this report focuses solely on these holdings rather than the wider investment trust universe, however, the themes that it addresses will have resonance across the industry.

Our investment universe

As at 30 June 2026, there were 59 investment trusts where Quilter Cheviot held £2.5 billion within the centrally monitored universe, this excludes those that are in a wind-up situation. This is referred to as the engagement universe. Holdings within the centrally monitored universe are under coverage with our Fund Research team. Quilter Cheviot has positions in other investment trusts which are in the investment-manager led or 'other' category.

- Centrally monitored holdings form the majority of Quilter Cheviot's holdings; these are investment ideas generated by the in-house research teams. Engagement, voting, and ESG integration activities are focused primarily on these investments.
- Investment-manager-led ideas are investments that are researched and monitored by investment managers. Quilter Cheviot will only engage or vote with these holdings where more than £2m or 0.2% of a UK-listed company is owned.
- 'Other' represents a long tail of legacy holdings, which is a consequence of the nature of the client base. In some cases, the position will only be held by one client.

On behalf of our clients, we have significant exposure to the investment trust market. There are fundamental differences between an investment trust and an open-ended fund. When we invest in an investment trust, we become shareholders of the company, and, as such, our expectations for the governance of that company are much higher than they would be for an open-ended fund. An investment trust is a listed company, and like other listed companies, it has a board of non-executive directors (NEDs) whose job is to ensure that the investment adviser (manager) is acting in the best interest of the shareholders. The board appoints the manager to run the day-to-day operations of the investment trust.

Since we published the last report, there have not been any investment trust initial public offerings (IPOs), an activist investor has entered the marketplace, and the Financial Conduct Authority launched the Sustainable Disclosure Requirements regulation.

For the purposes of this report, we have relied on the content of Annual Reports and Accounts (ARA), rather than 1-1 meetings with boards. Of course, we have met boards over the period and will continue to do so but our focus for this report was to take a more quantitative approach to assessing boards based on publicly and hopefully easily accessible information.

As in the previous reports¹, we have decided to anonymise investment trusts within this engagement framework as our intention is to work with the investment trusts to engender better governance and disclosure and we feel that disclosing names would not necessarily help with this.

The three factors

In reviewing the engagement universe, we established three factors of interest to us. We have refined the characteristics of these factors for this iteration of the report and have not separated the investment trusts by asset class as the factors have commonality across asset classes. Our focus is not on the investment management of the trust but the governance and disclosure. We then RAG² rate each of the factors.

Factor	Detail
Board composition	Independent: We expect a board to be independent, diverse and have the right skillset. Regarding independence there are two areas of primary focus: • we do not believe it is acceptable for an investment trust to have a board member who has been appointed or is employed by the investment adviser; • we believe that tenure does impede independence and expect boards to adhere to the nine-year rule unless there are mitigating circumstances. Additionally, going forward, we believe that representatives of shareholders are non-independent. This applies to any shareholder, not just an activist investor. Succession planning and tenure: We agree that best practice is a maximum of nine years tenure. We understand that a director will not automatically become non-independent after nine years, and in some cases a limited extension of the tenure might be a requirement to ensure appropriate succession. We expect boards to have solid succession plans in place to avoid director cliffs and excessively long tenures. Skills: The board's skillset should be appropriate to challenge and support the investment adviser as well as representing shareholders. Diversity: We expect boards to be diverse and to meet the FTSE Women Leaders and Parker Review targets. In terms of representation, as we understand that given the small size of most investment trust boards, having senior positions may be difficult. Over-boarding: NEDs should dedicate sufficient time to the oversight of the investment trust, and we expect NEDs to attend to 100% of their designated board meetings unless there are mitigating circumstances. We appreciate that being a NED of an investment trust (particularly in the equity space) is very different to being on the board of an operating company; however, we monitor the number of board positions and will vote against NEDs where we believe there is a capacity issue. Recruitment: We have added a new criterion: we expect boards to appoint an independent executive search firm³ which manages the end-to-end recruitment process including any personal recommendations from the board or the manager. The board should disclose within the ARA the firm used and note any connections or potential conflicts of interest. The manager should not take an active role in the process - a reactive review of the shortlist is sufficient.

¹ [qc-investment-trust-engagement-report.pdf](#)

[qc-investment-trust-engagement-report-phase-2.pdf](#)

[qc-investment-trust-engagement-report-phase-3.pdf](#)

² To assess and label the progress, health, or priority of a task using a three-color system of Red, Amber, and Green

³ AIC Corporate Governance Code 2024: Open advertising and/or an external search consultancy should generally be used for the appointment of the chair and non-executive directors. If an external search consultancy is engaged, it should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors. (UK Code Provision 20)

Factor	Detail
Board effectiveness	Director shareholdings: We believe that NEDs investing in the investment trust is one of the best ways of aligning NEDs with the shareholder experience. However, setting a strict threshold of shares might deter NEDs from different socio-economic backgrounds from joining the board. Therefore, we encourage boards to allow flexibility in this area. External board evaluations: External board evaluations should be carried out every three years and the firm undertaking this work should be disclosed⁴ within the ARA. We also believe that an interview-led approach is more productive. Additional elements which are more qualitative in nature include: • Communication with shareholders • Board responsiveness • One-off payments to NEDs
Responsible investment disclosures	Voting disclosure (equity investment trusts only): We expect the ARA to include the voting record or a trust-specific document which is readily available on the website. Signposting to the manager's overall voting activity is not helpful as it is not specific to the trust. A link to the Shareholder Rights Directive (SRD) II report is not sufficient. Voting rationale (equity investment trusts only): Examples of how the manager determined how to vote on a particular company or resolution. Ideally this would include details of the engagement activity linked to the decision-making. As above, a link to the SRD II report is not sufficient. Engagement (all): Engagement or case study examples with underlying investments to provide evidence of the manager's approach to integrating responsible investment factors. Environmental, Social and Governance (ESG) integration (all): An overview of the ESG integration process as it applies to the trust – this may be at the firm level. Without supporting evidence this is insufficient as a barometer of how the manager applies responsible investment principles within the investment process. Metrics (all): Inclusion of relevant ESG metrics for the strategy, this goes beyond (the soon to be defunct) Task Force on Climate-related Financial Disclosures (TCFD) product reports, or the number of engagements or votes. For some trusts including such metrics may be misleading as these are not core to the trust's investment philosophy and given the implications of Sustainability Disclosure Requirements (SDR) it may lead to the requirement to produce a customer facing disclosure (CFD). RI activity at a firm level (all): An overview of the firm's responsible investment infrastructure. Additional considerations include the use of UN Sustainable Development Goals (SDG) alignment. In some cases, this may be a negative if the alignment is questionable – for example alignment to Climate Action (Goal 13).

4 AIC Corporate Governance Code 2024: There should be a formal and rigorous annual review of the performance of the board, its committees, the chair and individual directors. The chair should consider having a regular externally facilitated board performance review. In FTSE 350 companies this should happen at least every three years. The external reviewer should be identified in the annual report and a statement made about any other connection it has with the company or individual directors. (Incorporates relevant content from UK Code Provision 21).

Our scoring matrix and voting intentions

There will be exceptions to this where we have engaged with the board and agreed to support management on a particular issue, usually within a defined timeframe.

Board composition metric	Impact on RAG rating	Board effectiveness metric	Impact on RAG rating	RI disclosures	Impact on RAG rating
Manager representative on board		External evaluation – firm used not disclosed		Disclosure of all these elements:	
% women on board between 30-40%		External evaluation – no triennial evaluation		• Voting disclosure • Voting rationale – Engagement • ESG integration • Metrics • RI activity at firm level	
% women on board less than 30%		NED shareholdings ⁵ – less than 70% of the NEDs have a shareholding		Zero disclosure or only reporting one element of either voting disclosure or ESG integration	
One NED with over nine years' tenure		NED shareholdings – less than 60% of the NEDs have a shareholding		All other disclosures	
More than one NED with over nine years' tenure		Additional considerations: • Poor communication with shareholders • Lack of board responsiveness • One-off payments to NEDs		Additional considerations: • SDG alignment concerns	
Over-boarded NED with more than four board positions					
Over-boarded NED with significant other positions					
Executive search firm not disclosed					
Parker Review – no ethnic minority representation on the board					

Where a trust has scored two AMBERS in a category this is then rated as RED.

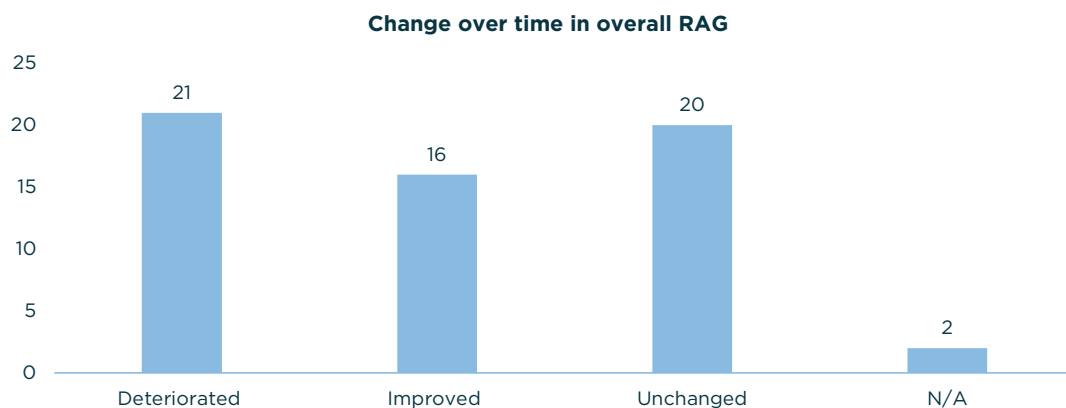
We have historically focused our votes against management on manager representatives on the board and over-tenured NEDs. We will continue to do so but will also place votes against management in other scenarios as well, unless we are satisfied with the board's rationale. Our voting intentions are:

- Manager representative on the board = vote against the relevant NED
- Shareholder representative = vote against the relevant NED
- Below 30% female representation on the board = vote against the chair of the Nomination Committee
- Over-tenured NED = vote against the relevant NED
- More than one over-tenured NED = vote against the relevant NEDs and the chair of the Nomination Committee and the chair of the board
- Over-boarded NED = vote against the relevant NED following investigation into the type of boards they are on as not all boards have the same workload
- Lack of an external board evaluation within the last four years⁶ = vote against the chair

⁵ Grace period of one year for new NEDs

⁶ The Association of Investment Companies (AIC) requirement for FTSE 350 trusts is every three years; we are giving forbearance for a further year and we set this requirement for all trusts

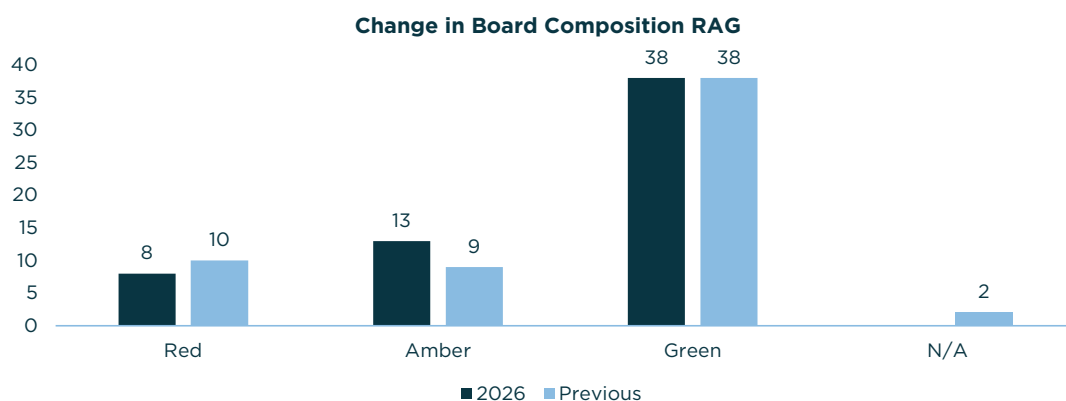
RAG outcomes over time



If we look at the composite RAG score i.e. how many RED, AMBER or GREEN indicators a trust has (rather than at the factor level) and compare the current RAG rating for the 59 trusts in our centrally monitored universe to the previous RAG rating⁷, 'deteriorated' is the largest category. However, this is not as surprising or disappointing as it might seem as we have strengthened our scoring matrix with more specific (and in some cases, higher) expectations. There are only two trusts which are red across all three categories, whereas previously it was four.

If we then look at this at the factor level, 17 of the 57 trusts included in both assessments had the same RAG rating across all three factors:

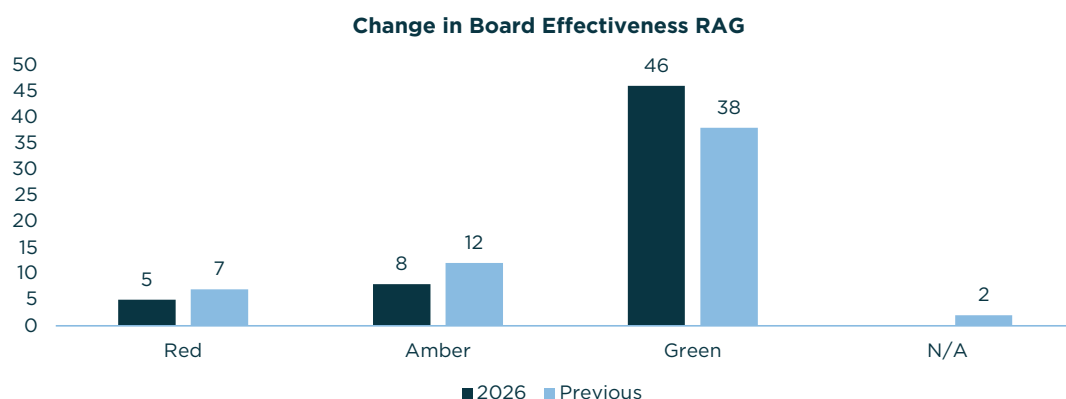
- Three maintained their all-GREEN rating
- 12 remained GREEN for board effectiveness and board composition and AMBER for responsible investment disclosures
- One remained GREEN for board effectiveness and AMBER for board composition and responsible investment disclosures
- One remained RED across all three factors



Within the board composition factor, over the period we have seen a minor improvement, with a reduction in RED ratings and a slight increase in AMBER ratings, whilst the GREEN rating remains static. The key concerns remain - manager representation on boards, over-tenure and not meeting the FCA diversity targets.

Notably, we have seen significant progress in the reduction of manager representatives on boards, although some remain entrenched in the view that the manager must have a representative on the board. What is particularly galling is that in one case, the NED fee is paid to the manager.

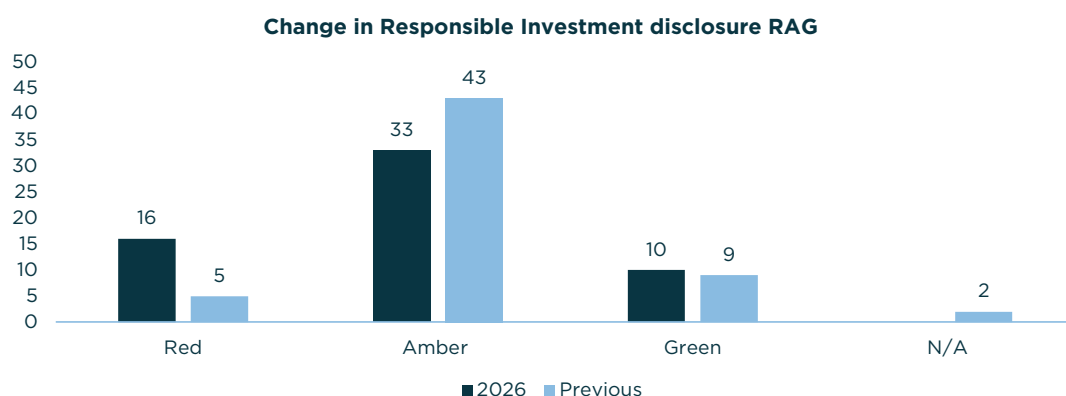
⁷ Two trusts were recently added to the centrally monitored universe and therefore do not have a previous RAG rating hence these are marked as N/A



There has been significant improvement in the board effectiveness rating, however, it is disappointing that some trusts continue to fail to disclose the details of which firm was employed to undertake the external evaluation, or in some cases do not have an external evaluation at all or far exceed the triennial requirement. As we opined previously, we believe an externally facilitated evaluation is critical to an effective board – NEDs are far more likely to discuss potential issues with an external person, rather than do so through the perhaps formulaic internal questionnaire-based assessment.

This is the factor where there are more qualitative assessments to be made. We have also seen some innovative actions from some boards including:

- shareholder surveys targeted at the retail and then the institutional / wealth manager audiences to gather information around client communication;
- undertaking a dormant assets review and using these to make charitable donations;
- driving the marketing strategy with a focus on investment platforms; and
- using section 793 notices to enable the trust to identify beneficial owners to hopefully communicate directly with them.



There has been a marked deterioration in the RI disclosure RAG rating, with more trusts in the RED category than previously. This reflects the new scoring matrix where we have established specific requirements around the RI disclosure and ensuring that it is fully focused on the trust's holdings. We have also determined to only award a GREEN rating where a trust meets all the requirements – this includes producing relevant metrics related to the strategy. As we noted above given the new SDR regulation in the UK, some trusts may be deterred from including metrics in the fear that this means that under the SDR Naming & Marketing Rule, a CFD must be produced. This may also be the driver of poorer responsible investment disclosure for a handful of trusts. We have identified a handful of trusts which include SDG alignment metrics within their responsible investment reporting. In some instances, we would question the alignment with the Climate Action goal.

Climate Action (Goal 13) and rainbow washing

The concept of rainbow washing in relation to the SDGs is about companies signalling that they are aligned with one or more of the SDGs. As you can see below – the SDGs are very colourful – hence the term rainbow washing, which is a form of green-washing.

SUSTAINABLE DEVELOPMENT GOALS



The Climate Action goal is often a victim of this; it has five underlying targets:

1. Strengthen resilience and adaptation
2. Integrate climate change into policies and planning
- Both are at a country not company level.
3. Improve education and capacity
4. Mobilise climate finance (supporting developing countries)
5. Support vulnerable countries

These are rarely truly achievable by a listed company or investment trust.

Other thoughts

www.what?

As outlined in the introduction the focus for this report was to take a more quantitative approach to assessing boards based on publicly and hopefully easily accessible information. Several trust websites are not very easy to navigate, and for some when you put 'annual report and accounts' in the search bar, nothing is found. Admittedly this may be an old-fashioned approach in an AI era. Other websites are frankly not enticing to an investor, particularly a retail investor. Another niggle is that often links included in the ARA tease that they might send you to a pertinent document (particularly in relation to responsible investment disclosures) simply send you back to the trust's homepage.

Timed out

Best practice is for a NED to have a nine-year term, in our view the board should manage succession effectively and there is a concern that NEDs might become 'stale' over a period of time and effectively quash ideas proffered by newer members with a 'been there, done that' attitude. Wording in ARAs varies significantly over this: one of the best examples is:

When considering its composition, the Board is strongly committed to striking the correct balance between the benefits of continuity, experience, and knowledge and those that come from the introduction of Directors with diversity of perspectives and skills. The Board has adopted a Tenure Policy confirming its intention that each Director will retire at the AGM immediately following the completion of their ninth year on the Board. It is acknowledged that there could be unusual circumstances in which a short extension of that time period could be appropriate. In that event, a comprehensive explanation of the circumstances would be provided to stakeholders.

This clearly acknowledges the nine-year rule whilst signalling that there may be circumstances where the board needs to extend tenure and if it needs to do so, will provide a rationale to shareholders.

One of the least favourites which fails to acknowledge the nine-year rule:

The Board is of the view that length of service will not necessarily compromise the independence or contribution of directors of an investment trust company, where continuity and experience can add significantly to the stability and strength of the Board.

Only a one-off

There were a few instances where NEDs were paid one-off fees on top of their annual fee in relation to additional work they undertook. In some cases, this was in relation to activist shareholders, in others it related to strategic development, legal matters and a change in listing. In one instance it was stated in the ARA that the NED who received the additional fee, bought shares in the trust with the monies.

On balance our view is that we would not encourage one-off payments, in any role the workload will vary at different times and therefore, is it right to pay the equivalent of overtime to NEDs?

Outcomes

We would not claim to be solely responsible for changes in the way that boards approach the three factors, however we know that in some cases, but not all, we have been instrumental in change. Ultimately, we believe that as shareholders we have a responsibility to hold boards to account and to use the voting mechanism to elicit change where appropriate. Examples include:

- after several years of engagement, a trust has agreed that it will no longer have a manager representative on the board post 2027;
- removal of the manager representative from the Nominations Committee, although they remain on the board;
- following two years of engagement regarding an over-tenured chair, we informed the trust we would vote against the chair's re-election and within days the chair stepped down from the position;
- the reinstatement of a discontinuation vote;
- the removal of a long-standing chair and manager representative;
- two manager representative NEDs resigning from a board; and
- after repeated requests to include a full holdings summary within its reporting, the trust included this within its half-year report.

Looking ahead

There are other areas which we intend to explore in the future:

- whether a trust has a Senior Independent Director (SID);
- the trust's marketing strategy and how it can attract new investors and potentially manage the discount to net asset value;
- do the NED fees look like value for money for shareholders? We are mindful that different types of trusts have different levels of board involvement and therefore we would approach this from an asset class perspective;
- whether sufficient opportunity is given to candidates who do not have existing investment trust experience. We have heard of at least one trust which is running "NED apprenticeships" where a person without previous director experience will attend board meetings as a way of gaining board experience;
- the appointment of NEDs at the time of an IPO (Initial Public Offering). From our brief discussions about this, it is common that the manager sources and appoints the NEDs at IPO; external executive search firms are not always used. We appreciate that the IPO market has been extremely quiet, however this still is a potential issue, and this has been validated by some of the conversations we have had where the NED has been appointed since IPO and sees their role as being at the manager's discretion; and
- if the trust is listed in the Channel Islands, how does it juggle the smaller talent pool available as well diversity constraints?



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