RESPONSIBLE INVESTMENT AT QUILTER CHEVIOT INVESTMENT MANAGEMENT

VOTING AND ENGAGEMENT
QUARTER 2, 2017

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

INTRODUCTION

This is our first quarterly report outlining our engagement and voting activity with companies we invest in. We implemented our formalised approach to voting and engagement at the beginning of March 2017 and this report encompasses the period to the end of June 2017. Prior to this, aside from our usual regular meetings with management, we have voted and engaged with companies on a number of issues on an ad hoc basis.

Our client base is a mix of private client portfolios, small pension funds, trusts and charities; given this we have a long tail of small holdings which represent legacy and cherished positions. It would be impractical to vote on all our equity and investment trust positions and therefore we have chosen to focus on our largest and most widely held positions where we can have most influence. Given the nature of our predominantly UK client base, these are UK listed equities and investment trusts. We may look to expand the voting universe in the future.

Where clients wish to vote their holdings in a specific way we will do so on a reasonable endeavours basis; this applies whether the investment is in the core universe or not, and also to overseas holdings. Over the past quarter we have ensured that 56 clients have been able to execute their votes and/or attend annual general meetings.

We use the ISS proxy voting service in order to inform our decision making, however we will not automatically implement its recommendations. When we meet a company to discuss governance issues the relevant analyst does so alongside the Director of Responsible Investment as we are committed to ensuring that responsible investment operates within our investment process rather than apart from it.

For information regarding our approach to responsible investment, including our response to the UK Stewardship Code and our voting principles, please visit our website:

https://www.quiltercheviot.com/uk/private-client/why-quilter-cheviot/responsible-business/responsible-business-for-investment/

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ENGAGEMENT

We actively engage with companies on a number of issues, particularly those relating to remuneration and board composition. Before we started formally voting our core holdings for discretionary clients on 1 March 2017 we engaged with a number of companies on different topics. Below we have outlined some examples of our engagement with companies, both during the last quarter and in the months prior to this.

UK technology company
We met the chairman of the remuneration committee to discuss a number of issues particularly the composition of the board. We felt that the board needed a more diverse membership and specifically more UK corporate experience, and urged the company to seek a new non-executive director (NED) who would have the requisite experience. We were delighted when the company announced a new NED who met these requirements.

UK financial services company
We met the chairman of the board to discuss the proposed remuneration policy; we felt that the hurdle price for the award was not aligned in shareholders' interests and that the company should reconsider this, which it duly did and therefore we were happy to support the new policy. The company has a standard listing on the London Stock Exchange and therefore it is not required to comply with the UK Corporate Governance Code, however we raised concerns regarding the composition of the remuneration committee which only has one independent NED; the company has subsequently appointed a new NED.

UK house-building company
The chairman of the remuneration committee met with us to discuss the new remuneration policy. The policy itself was not controversial however we commented that we would like to see more transparency on performance metrics; we also discussed how best the company might incorporate customer care metrics into performance measurement. It was acknowledged that this is a difficult aspect to measure and that the company had more work to do in order to deliver customer satisfaction. We also discussed board composition and the independence (or not) of one of the NEDs.

UK financial services company
We met the company as part of its consultation with shareholders ahead of the new remuneration policy being published. The nature of the underlying business means that the incentive structure is different to other businesses and therefore we spent some time understanding how these are calculated whilst ensuring that there was an appropriate split between short and long-term variable pay. One issue for us was that no maximum compensation had been set for the executive directors, the company has addressed that.

UK telecom company
We were concerned that a bonus was being paid despite not all underlying metrics having been met, as well as the inclusion on the remuneration committee of a NED who may be deemed no longer independent. We engaged with the company and discussed our position which was that we felt that the performance of the company over the period did not warrant the award being made, and that changing the hurdle is not appropriate. In this instance we voted against both the remuneration report and the re-election of the NED.

UK household goods company

Owing to significant issues relating to a product being sold in one of its markets, we gave consideration to voting against the re-election of the NED who headed the audit committee as well as an abstention vote regarding the chairman. We discussed this with the company and expressed concerns regarding the composition of the board which was in need of refreshment. We determined we would abstain on both re-election resolutions and would monitor the composition of the board.

UK financial services company

We raised our concerns with the company regarding the behaviour of the CEO which is now subject to a regulatory investigation, as well as the construct of the new long-term incentive plan (LTIP). We had to balance this with our view that the CEO has been a positive force for the business in terms of execution and cultural change. Given that the regulator's investigation is ongoing and it is appropriate that the decision about the CEO's future rests with the FCA and PRA, we supported his re-election. In regards to LTIP we wanted to understand that poor performance in a previous year would result in a reduced award, and that the CEO's remuneration would be subject to clawback once the investigation was completed. The company assured us that this was true in both cases. We therefore supported management; however we will review this ahead of the next AGM and vote against the remuneration report if these actions have not taken place.

UK commercial real estate closed-end investment company

The company was looking to raise funds via new share issuance; however we were concerned that:

- no reference had been made to the issue price relative to the fund's net asset value
- 10% would be with pre-emptive rights however a further 10% would be without pre-emptive rights and the company had not provided any detail on what these funds would be used for.

We discussed this with the chairman (and have subsequently followed this up with both the chairman and another NED) and determined that we would vote in favour of the resolutions. This decision was informed by our positive views on the quality of the investment management team who we believe will continue to execute the investment strategy successfully.

UK REIT

We met with the chairman to discuss the upcoming AGM and specifically a resolution to issue shares without pre-emption rights which exceeds 5% of issued share capital. We outlined our concerns as we do when any company looks to issue more than 5% of share capital, and explained that we would only support such a resolution if we understood the rationale for doing so. We were satisfied with the explanation and given our regard for the management team, we supported the resolution.

UK general industrials company

As part of its shareholder consultation process ahead of the publication of the new remuneration policy we discussed this with the company. We sought comfort that the change to the LTIP to include more 'headroom' was in order to future-proof the policy for any new executives; we also suggested that more consideration might be given to link the business strategy objectives more closely with the remuneration metrics. We particularly felt that the company's objective to lead the way in sustainability should be more overtly incorporated into the performance indicators, whilst acknowledging that bestowing too great a weight on non-financial metrics is not ideal as it may be seen as lacking in transparency as well as being overly discretionary in nature.

OTHER ENGAGEMENT

Association of Investment Companies (AIC)
We met with the AIC to discuss the change to legislation under the EU prospectus legislation which will allow companies to issue up to 20% of new share capital without a prospectus. Our views are that in principal we understand and support the rationale behind this however we urged the AIC to issue guidance to companies to engender better communication of the plans they might have for the new monies, particularly when dis-applying pre-emptive rights as well as the price of issuance.

VOTING

We voted at:

79 company meetings

8 meetings where we voted against or abstained on at least one resolution

4 votes against reappointment of NEDs who are over-boarded/ independence concerns

2 abstention votes against re-appointment of NEDs (including chairman)

2 votes against remuneration reports where targets had not been met but awards were being made

2 votes against changes to the capital structure

1 vote against specific LTIP resolutions

1 vote against remuneration policy

1 vote against the amendment to articles of association

GLOSSARY

Long-term incentive plan: Different companies will give different names to these – essentially these are equity-based variable awards which are subject to meeting specified performance metrics. The performance period should be at least three years and it is preferred that there is an additional holding period

Clawback (and malus): Incentive plans should include provisions that allow the company, in specified circumstances, to ensure that a recipient: -

- forfeits all or part of a bonus or long-term incentive award before it has vested and been paid – this is called 'malus'

and/or

- pays back sums already paid – this is called 'clawback'

Pre-emption rights: These give shareholders first refusal when a company is issuing shares

Disapplication of pre-emption rights: Existing shareholders do not have first refusal on new shares and therefore their holdings will be diluted

Over-boarded: Where non-executive directors are deemed to have a potentially excessive number of non-executive positions and the concern is whether they have sufficient time to contribute to the board of the company

Investors should remember that the value of investments, and the income from them, can go down as well as up and that past performance is no guarantee of future returns. You may not recover what you invest.

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