BAILLIE GIFFORD

BCSSS BG Long-Term Global Growth Equity

Report for the quarter ended 31 December 2017

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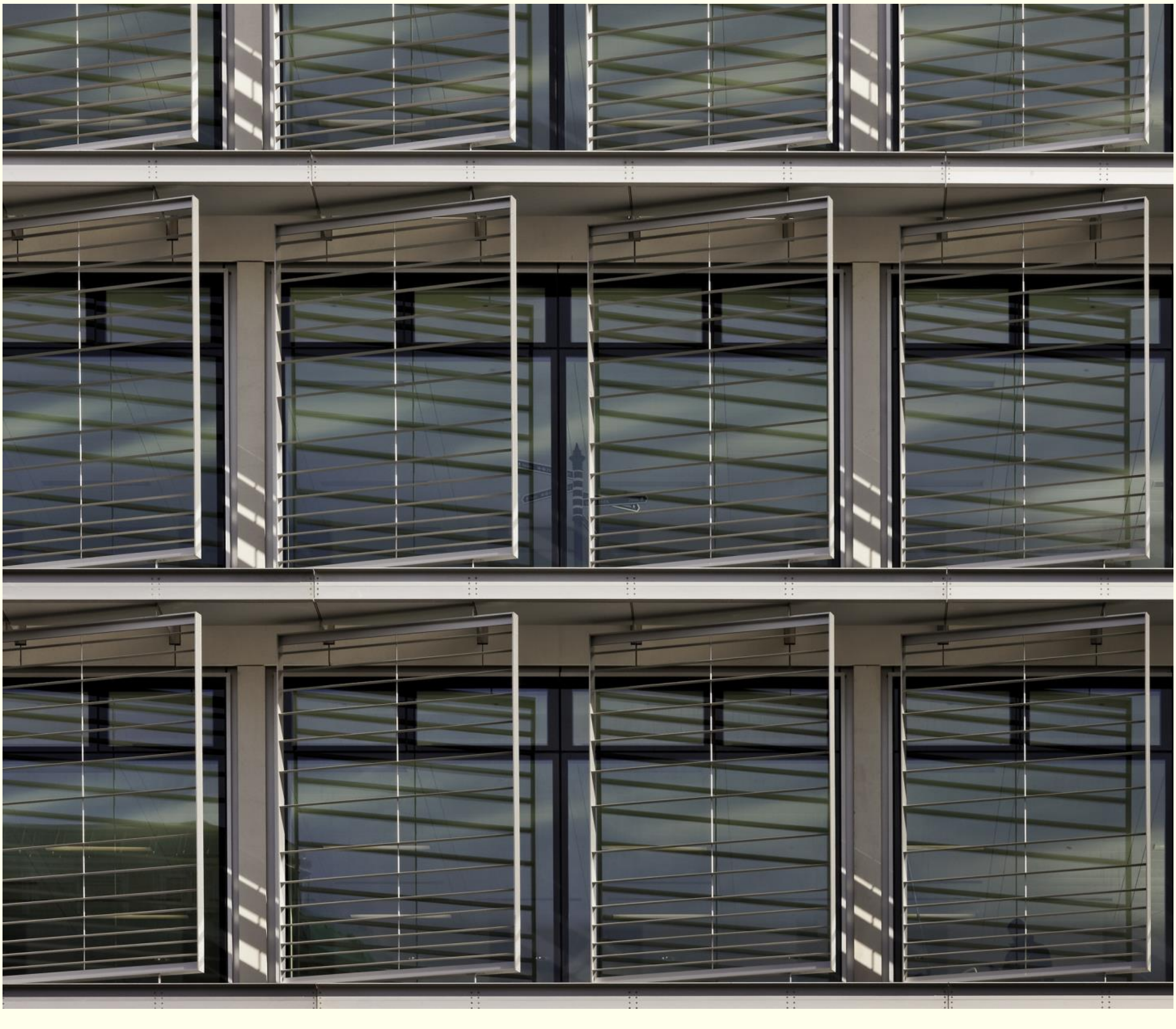

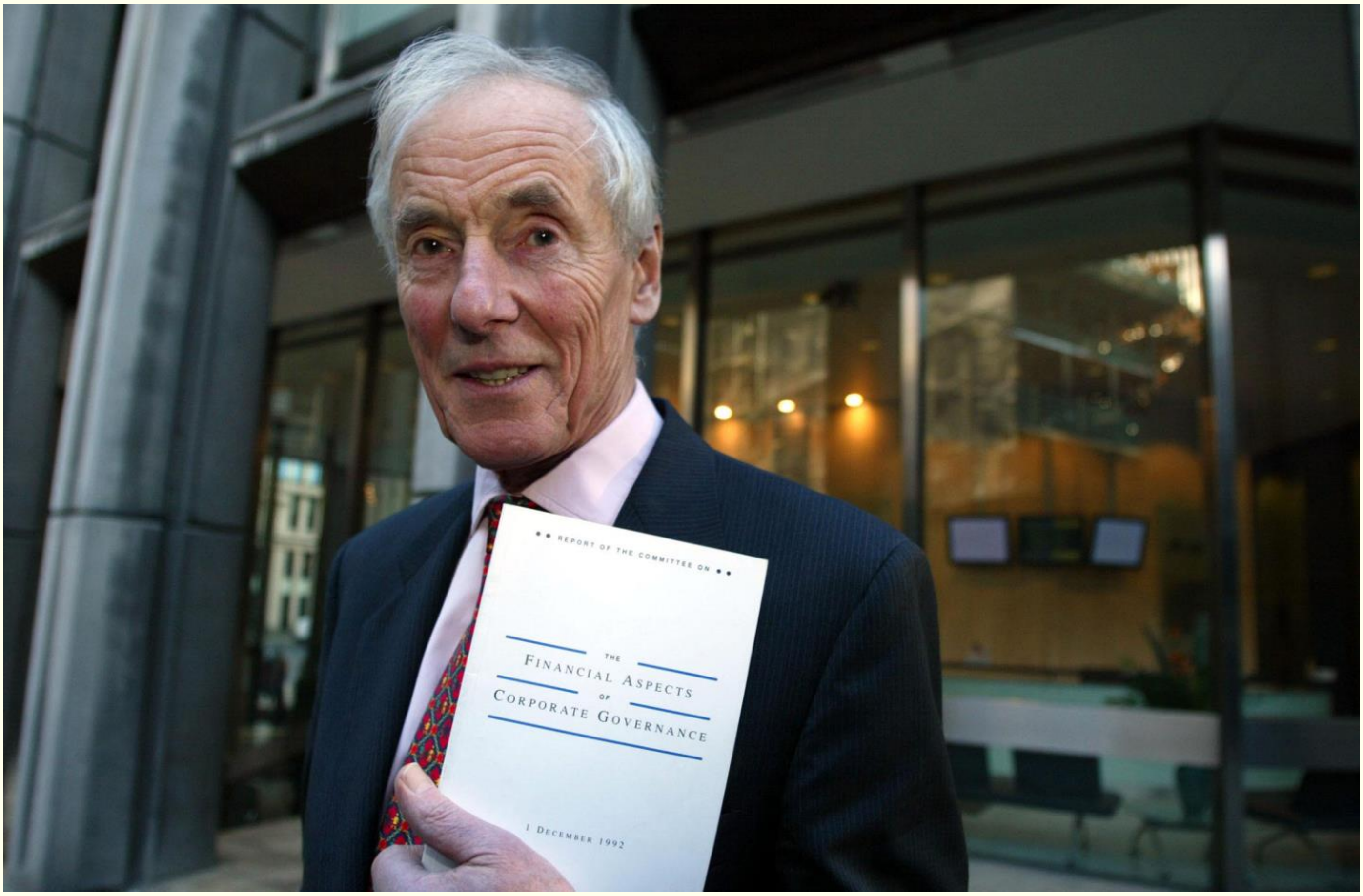

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Sir Adrian Cadbury, Chairman of the UK Committee on the Financial Aspects of Corporate Governance which published its Report and Code of Best Practice in 1992.

Corporate governance – 25 years on

It is now 25 years since the Cadbury Report was published. That document was the first significant step along a pot-holed road towards improved corporate governance, so we have taken this opportunity to reflect on the journey so far.

On the face of it, subsequent progress appears to have been slow. Executive pay remains a challenge today, as it was then, and we continue to have corporate scandals. On closer inspection, though, standards of boardroom behaviour have clearly moved on. For example, it is uncommon these days for executive directors to set their own pay without any independent oversight and the role of the independent director has been professionalised.

There have also been advances in other areas of governance, driven to a large extent by responses to events ranging from Enron to the global financial crisis. Governance codes were followed by stewardship codes, shifting the emphasis from companies to asset owners and managers. Such codes now exist in 18 countries, and efforts to improve sustainability are becoming more widespread.

Progress over the years

— 1992: The first corporate governance code, the Cadbury Report, was introduced in the UK. The code was a response to a series of scandals including Polly Peck, BCCI and Maxwell. This impressively concise document focused on the roles of board members and on financial reporting and controls. It was later combined with the Greenbury Report on executive pay to form the UK’s Combined Code on Corporate Governance.

— 2002: US Congress passed the Sarbanes-Oxley Act as a direct response to accounting malpractices at Enron, Tyco and Worldcom. There were mandated reforms intended to protect investors from further corporate accounting fraud.
— 2007–09: The global financial crisis sent shockwaves around the globe and was the catalyst for a new era of governance and stewardship initiatives, e.g. the UK Stewardship Code in 2010.
— 2012: The concept of stewardship started to gain traction with the emergence of stewardship codes in various parts of the world. Despite being enacted in countries with very different political systems and business environments, and at varying stages of economic development, there are striking similarities across these codes.

Looking ahead

Corporate governance, sustainability and stewardship are increasingly at the forefront of our clients' minds. We have long considered it essential to engage with the companies in which we invest, and we are finding that clients in turn are engaging more and more with us about our discussions. And it's not just clients: our regulators are also examining our corporate governance work, and assessing us against the Stewardship Principles.

What happens next? Our daily task is unchanged: we should continue to engage with companies, to understand clients' evolving attitudes, and to discharge the responsibilities we have been entrusted with in a thoughtful and considered manner. But beyond that we also need to think about the long-term challenges facing our society and our economy. And we need to help the companies in which we invest on behalf of our clients to address those challenges and not make them worse. Because if you take a long-term view, sustainable investing is absolutely critical – not only because we think it leads to better outcomes but also for broader societal reasons. As Else Bos, the former CEO of Dutch pension fund PGGM, has said: "If we are going to pay pensions decades into the future then as an investor we should contribute to a world that is worth living in at that point.".

We have three specific hopes:

1) That we move away from a model that reacts to events and tries to prevent them happening again, and towards one that thinks from first principles about the sort of political economy we want and puts in place structures and incentives to help achieve it. We need to set our sights higher than simply fighting the last battle.
2) Related to this, that we have a well-informed and non-partisan debate about which elements of the capitalist model work, and which don't. We are fortunate to be exposed to many forms of capitalism: simplifying crudely, there is a social-democratic model in Northern Europe; a paternalistic one in Japan; a state-sanctioned one in China; and one focused on shareholder value in the United States. Each has its strengths and weaknesses – which to some degree are in the eye of the beholder – and it is only by examining them clearly, and questioning our sometimes unspoken assumptions, that we will make real progress.
3) That we move from aiming for standardisation to praising excellence, since the two are not always compatible. As we mentioned earlier, one of the achievements of the last 25 years has been a raising of governance standards, accompanied by the establishment of minimum criteria for behaviour. At a system-wide level this has been good. But as investors we look for the unusual and the unique – we want companies that stand out, that think independently, that have a distinctive culture. And one-size-fits-all governance standards sometimes clash with this desire to be different. So our final hope is that when thinking about ESG matters we don't lose sight of the fact that these judgements are qualitative, and that there needs to be consideration of the specific as well as a desire to standardise the general.

The world of corporate governance has come a long way in the last 25 years. Our hope is not only that this journey will continue over the coming decades, but that the rate of progress will accelerate. The way we invest clients' money directly shapes the world we live in, for good or ill. Asset owners, asset managers, and companies all have a responsibility to engage with these issues. If we are ambitious and work together, we can make a real difference.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	2	Companies	None	Companies	None
Resolutions	20	Resolutions	None	Resolutions	None

The Cadbury report was first published 25 years ago, and corporate governance has come a long way since then

Going forward, our aspiration is to move away from a model that reacts to events, and towards a forward looking system that will help us to consider things from first principles

Asset owners, asset managers, and companies all have a responsibility to engage with these issues

Firmwide Company Engagement

Engagement Type	Company
Corporate Governance	NVIDIA Corporation
Environmental/Social	Tesla Motors Inc.
AGM or EGM Proposals	Atlassian Corporation Plc

Notes on company engagements highlighted in blue can be found in this report. Notes on other company engagements are available on request.

Company	Engagement Report
NVIDIA Corporation	We participated in NVIDIA's annual shareholder engagement process which offers access to senior management and non-executive board members to discuss corporate governance. This is not common in the US market and is therefore a welcome opportunity to develop our understanding of the business and provide feedback. The company has had a very successful year and we asked how this influences board discussions, particularly the avoidance of complacency. It was explained that intellectual honesty was a core characteristic of the board, with the annual review process including an assessment of each member's continuing contribution to board discussions. Also, the granting of shares to non-executive directors and the requirement to maintain a shareholding was seen as a means of ensuring focus and aligning interests with those of shareholders. We also discussed executive pay. The board is considering a new form of equity award which is subject to specific performance conditions. We outlined our preference for stringent targets which ensure appropriate reward for performance, but stopped short of a prescriptive list of requirements. It was explained that fairness is a central consideration when deciding compensation across the workforce and would apply to any new awards. We look forward to reviewing the final proposals and to future engagement opportunities.
Tesla Motors Inc.	As part of an introductory meeting between Tesla's new investor relations contact and some of our investment managers, we discussed the company's approach to employee health and safety. This has been a prominent topic over the past year, with the company criticised for alleged poor workplace practices and its recordable injury rate. Much of this criticism has been poorly informed and a common theme of the company's responses has been to clarify its policies, procedures and corresponding performance. We are encouraged by information documenting the importance placed on employee well-being and the company's ambition to be an industry leader for safety. However, we also highlighted our belief that disclosure levels could be increased. We explained our willingness to provide constructive feedback on areas for improvement. The company was receptive to our suggestions and we agreed to follow up our discussions in the new year once full-year health and safety data is available.

Votes Cast in Favour

Companies	Voting Rationale
Alibaba, Atlassian Corp Plc	We voted in favour of routine proposals at the aforementioned meeting(s).

Votes Cast Against

We did not vote against any resolutions during the period.

Votes Abstained

We did not abstain on any resolutions during the period.

Votes Withheld

We did not withhold on any resolutions during the period.

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