Corporate Governance: March 2015 Review

We have observed a general trend towards improving governance and accountability and increased shareholder engagement in the US. Annual General Meetings are an important part of this and give shareholders a formal voice. A number of proposals have been put forward and adopted in the past few years: declassifying the board of directors, replacing plurality voting with a majority voting standard and introducing Say-on-Pay for executives' compensation.

These resolutions ensure the correct tools and processes are available to shareholders to challenge troubling governance practices such as excessive executive pay or directors who neglect their fiduciary duties. The most recent shareholder proposal is to allow proxy access and this is developing into the key governance topic for the 2015 US proxy voting season.

The role of selecting and nominating directors is usually the responsibility of the Nominating Committee. However, most mature markets – for example the UK, Australia and Scandinavia – also provide shareholders with the ability to select and nominate their own candidates. The US, however, is an outlier.

Given that shareholders are the owners of the companies in which they invest, it is therefore reasonable to expect that they have the ability to nominate directors. So, in November, the Comptroller for the New York City Pension Funds announced his intention to submit shareholder proposals at 75 US companies, requesting a by-law change to allow proxy access. The proposal outlines that a shareholder or group owning 3% of a company for three years will have the right to nominate director candidates representing up to 25% of the board, on the company's meeting ballot. This provision in company by-laws or market guidelines is aimed at enhancing board accountability and promoting engagement between the company and its shareholders.

Jeff Bezos, CEO and Founder of Amazon.

The 75 companies were targeted based on three issues: climate change, board diversity and excessive CEO pay. Of the companies identified, only one is held in your portfolio – Splunk. However, as expected with an initiative such as this, the proposal has been replicated by shareholders of other companies. We have recently spoken to Amazon and Whole Foods, both of which have received similar proposals.

Splunk made the Comptroller's focus list because its management received significant opposition to the 2014 advisory note on executive compensation. We abstained on this resolution at the AGM because of special equity awards to CEO, Godfrey Sullivan. Following the AGM, we continued our engagement with the company and subsequently Splunk has introduced performance-based equity awards, new stock ownership guidelines for executives and improved disclosure. Additionally, as a show of commitment, the CEO forfeited the unvested portion of his equity incentives.

Although Amazon's AGM is not until June, the company has been engaging with its largest shareholders. Amazon is happy to include the proposal in its AGM agenda, allowing shareholders to vote on the resolution as it stands. Pending the outcome, management intend to continue discussions before deciding on specific thresholds and shareholder tenure. At this stage, they are thinking 5% held for three years and 15%–20% of the board.

Whole Foods reacted differently. The company applied to the SEC in order to exclude the proposal from its AGM agenda. However, this was done on the basis that the company was intending to file its own proposal which set the bar at 9% and five years. This was subsequently amended to 5% and five years by a single shareholder (therefore no groups) and would allow 10% or one director to be nominated. The SEC initially permitted Whole Foods to exclude the shareholder proposal, but has since removed this ruling and stated that it will not be expressing any views on conflicting management and shareholder proposals this year. At the time of writing, our discussions with management continue and we are aware that the company has recently decided to postpone its AGM.

Burberry Fashion Show, London Fashion Week, Autumn/Winter 2014.

Critics of proxy access believe that a change in the rules would make it easier for activist investors and special interests, such as short sellers or hedge funds, to gain access to the board. If the board is 'co-opted', it could make decisions that favour the interests of one shareholder or stakeholder group over another and hurt the competitive advantage of the company. This was the concern of Whole Foods, which pointed to takeover rumours from recent years and the threat from special interest groups. By pre-empting shareholders' ability to vote on the original resolution, Whole Foods has received a lot of negative press.

We are supportive of proxy access in principle and consider the parameters proposed by New York City to be sensible. However, we do not believe in a one size fits all solution and therefore welcome the opportunity to engage with your portfolio companies to ensure that the proposal is implemented with the most appropriate thresholds, both for the company and its shareholders. Whilst we believe the current initiative will promote greater interaction between US companies and their shareholders, we continue to be proactive and foster open communication with your portfolio companies in order to develop productive long-term relationships.

Moving on from proxy access, our discussions with Burberry and Tesla on remuneration, reported in previous editions of this magazine, have been fruitful and we have made significant progress. Burberry Chairman, Sir John Peace, acknowledged that the board should have engaged with shareholders earlier. Action has now been taken. New long-term incentives aligned with the long-term business strategy have been introduced and will be based on profit, revenue growth and efficient capital management. Additionally, the new remuneration policy prohibits the use of one-off equity awards such as the one granted to Christopher Bailey which was a contentious issue ahead of the 2014 AGM. At Tesla, the company has decided to remove the re-pricing provision (for rewards which might have suffered due to a falling share price) from the stock option plan. The company's compensation policy is bespoke to its long-term strategy, and this change ensures further alignment with shareholders.

Our engagement with management is not limited to conversations about specific concerns or proposals; it is a continuous process which usually starts before an investment is made. In the past six months, we have met the CEO or CFO of roughly a third of your holdings, including the new CFO at Salesforce, keeping the lines of communication open and enhancing our understanding of their business, culture and long-term strategy.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	2	Companies	None	Companies	None
Resolutions	25	Resolutions	None	Resolutions	None

In the US, shareholders continue to use their voice to influence corporate governance practices

We have had fruitful discussions on remuneration with a number of your holdings, resulting in changes to compensation policy

Engagement is a continuous process, meeting management teams frequently and maintaining open lines of communication

Firm-Wide Company Engagement

Engagement Type	Company
AGM or EGM Proposals	Amazon.com, Intuitive Surgical, Splunk Inc, Stratasys, Whole Foods Market

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
Amazon.com	In preparation for its annual general meeting, the company invited us to discuss a shareholder proposal to introduce proxy access. The proposal was for a bylaw amendment that would permit a shareholder or group of shareholders owning 3% of the issued share capital for three years to nominate up to 25% of the board. We explained our support for proxy access, believing that long-term shareholders should be able to nominate directors. The proposal is non-binding and will not require the company to implement the requested changes if passed. However, Amazon is keen to speak to its largest shareholders to understand their perspective. The management do not consider the thresholds in the current proposal to be optimal, but intend to engage with shareholders to find a satisfactory solution. We are encouraged by the company's willingness to listen to shareholders and will continue our discussions with the company after the annual general meeting.
Whole Foods Market	Whole Foods received a shareholder proposal requesting amendments to the company bylaws to enable proxy access. This proposed that a shareholder or group owning 3% of the issued shares for three years could nominate up to 20% of the board. In response, Whole Foods put forward its own proposal requiring a 5% holding by a single shareholder for five years in order to nominate 10% of the board. It also received approval form the Securities and Exchange Commission (SEC) to exclude the shareholder resolution from the annual general meeting agenda. However, the SEC subsequently withdrew its ruling stating it would not be passing any further judgement during 2015 pending a review. We had two calls with the company; firstly with investor relations and secondly with the co-chief executives John Mackey and Walter Robb. The company was concerned that proxy access could be manipulated by self-interest groups who might disrupt management of the company. We explained our reservations over preventing shareholders from voting on the original proposal, our intention to abstain on the company's proposal and our support for proxy access in principle. Whole Foods has received a lot of negative media attention for the manner in which it dealt with the original proposal and has subsequently postponed its annual general meeting. We acknowledge that the company has suffered as a result of being one of the first firms to receive this proposal and we intend to continue our discussions in order to ensure the best outcome for the company and its shareholders.

Votes Cast in Favour

Companies	Voting Rationale
Novozymes, Stratasys	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.