

Japan visit

In September 2012, we participated in an Asian Corporate Governance Association investor delegation to Japan, meeting Government and regulatory agencies, including companies from various sectors with different ownership and governance structures.

The meetings provided us with an excellent opportunity to update our knowledge of corporate governance in Japan, especially in light of recent corporate frauds and insider trading scandals. Such meetings improve our understanding of changes to regulation and help us assess the risks for long-term investors. Engaging with companies also gives us insight into how management and boards are using their governance structures to enhance their competitiveness and manage risk.

We found a determination among Government and regulatory agencies to restore confidence in the Japanese market. For example, the Democratic Party of Japan (DPJ) has set up a working group to review insider trading laws in Japan. We also discussed the recent introduction of new 'comply or explain' rules, which are

unprecedented in Japan. Under revised listing rules to be implemented in 2013, the Tokyo Stock Exchange (TSE) and the FSA will require TSE listed companies to make efforts to appoint outside directors or explain why this is inappropriate for their business model.

Although we are encouraged by the various initiatives and proposals by the Government and regulatory agencies, there is still scope to make improvements and increase shareholder rights. For example, we believe that shareholders in Japan – in keeping with most developed markets – should routinely have a vote on significant capital raisings which could result in dilution. We have communicated our views to the Ministry of Justice and the TSE. We were particularly encouraged by the TSE's comments that shareholder feedback is very important in helping to shape future regulation and listing rules.

Our Head of Developed Asian Equities is visiting Japan later this year to meet several outside directors. Since we believe that outside directors in Japan have an increasingly important role to play in representing minority investors and in improving corporate governance, the meetings will give us some useful insight into their roles and responsibilities.



UK Stewardship Code

The Stewardship Code was introduced in the UK in 2010 and aims to enhance the quality of engagement between companies and investors in order to increase long-term investment returns.

We met the Financial Reporting Council (FRC) in September to discuss changes to the Code effective from October 1 2012. Since the Code is in its infancy, the FRC is keen not to change or add to the Principles. It has, however, proposed changes to some parts of the Code in order to place greater emphasis on enhancing and protecting shareholder value. For example, the FRC has toughened the wording on assurance reporting following the development of new accounting standards, as it believes that stewardship activities should be audited by an external auditor.

The Kay Review

Following the final report of the Kay Review that was published in July this year, we have spent some time reviewing the implications for Baillie Gifford and the wider investment community. We are supportive of the overarching principles defined within it and will keep you up-to-date with ongoing developments.

UK Government’s consultation on revised remuneration reporting regulations

The UK Government announced in June that, from October 2013, shareholders in UK companies will have enhanced voting rights on executive remuneration, including a binding shareholder vote on executive remuneration policy.

In September, we responded to the Department for Business Innovation and Skills’ (BIS) consultation on revised remuneration reporting regulations which, from October 2013, will require UK incorporated companies to reformat their remuneration reports. We are broadly supportive of the proposals which will increase transparency on remuneration reporting and should make it easier for investors to assess the link between pay and performance. Nevertheless, we have advised BIS that companies should improve disclosure of their annual bonus performance targets, in particular the details of how executives have performed against the metrics.

The introduction of the enhanced voting rights and revised reporting on remuneration are significant changes which illustrate the increased regulatory scrutiny of executive remuneration. We expect our engagements with UK companies to increase as a consequence of these changes.



The team

This has been a busy quarter for the Corporate Governance team with investment trips to Japan, Brazil and Chile as well as two secondments to the European and US investment teams. The purpose of these trips and secondments is twofold. First, they provide an opportunity to visit companies’ head offices, operations, and regional regulators to gather background cultural, operational and regulatory information that is not available in documents or annual reports. Second, both allow more time to understand and discuss the relative importance of broader ESG factors with investors, and develop ideas and processes to enhance the integration of materially relevant matters into Baillie Gifford’s investment process.

Images:
 © iStockphoto.com
 © Jack Star/PhotoLink/Getty Images
 © Gettyimages.com

Voting Activity

| Votes Cast in Favour | | Votes Cast Against | | Votes Abstained/Withheld | |
|----------------------|----|--------------------|------|--------------------------|------|
| Companies | 2 | Companies | None | Companies | None |
| Resolutions | 23 | Resolutions | None | Resolutions | None |

Government and regulatory agencies in Japan are working on various corporate governance initiatives to restore confidence among investors

Proposed changes to the UK Stewardship Code aim to place greater emphasis on enhancing and protecting shareholder value

The UK Government has introduced enhanced voting rights for shareholders

Company Engagement

| Engagement Type | Company |
|----------------------|---|
| Corporate Governance | Amazon.com , New Oriental Education & Technology Group Inc. |
| AGM or EGM Proposals | Inditex |

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

Votes Cast in Favour

| Companies | Voting Rationale |
|---------------|---|
| HDFC, Inditex | 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.

| Company | Engagement Report |
|--|--|
| Amazon.com | <p>Amazon.com is an online retailer that sells a range of products from books and DVDs to white goods. We had a conference call with the company's Vice President and Associate General Counsel to discuss succession planning, executive remuneration, and engagement with employees. Amazon has a stable corporate governance structure with the Chairman and CEO, Jeffrey Bezos, also being the company's largest shareholder. This helps to ensure that the company is managed for the long term. It has made some positive changes to its governance structures in recent years including the introduction of majority voting (all directors require at least 50% shareholder support to be elected) and the appointment of a lead director. It has also increased disclosure on succession planning, a sign of its importance throughout the company. We welcome the proposal to consider removing the Remuneration Committee's ability to reprice share options in its Stock Incentive Plan, following a large vote against at the 2012 AGM. We look forward to further discussions with the company prior to its next AGM.</p> |
| New Oriental Education & Technology Group Inc. | <p>New Oriental Education is a Chinese education provider. It announced that it is being investigated by the SEC and indicated that this may be a result of changes to the corporate structure. Short selling firm Muddy Waters subsequently accused the company of accounting manipulation. We spoke to Muddy Waters regarding the allegations and also spoke with the CEO and CFO of the company. There is a limit to what management can say whilst the SEC process is ongoing, but it would appear that the prompt for the investigation is some corporate restructuring which management believed to be in the interests of shareholders. There was a strong rebuttal of the points raised by Muddy Waters. We will await the outcome of the SEC investigation and will take this as an opportunity to engage with the company to see if further improvements could be made to the structure for the benefit of shareholders.</p> |