



2018 **Annual Investor** **Corporate** **Governance** **Report**

*Corporate governance:
trends and issues for
2018 and beyond*

The CMi2i 2018 Annual Investor Corporate Governance Report surveyed institutional shareholders representing \$8 trillion of Assets under Management (“AUM”). The objective of the report is to find out which Environmental, Social and Governance (“ESG”) areas they believe will be key issues of focus in 2018 and beyond, and the impact of this on shareholder behaviour. Respondents comprised of individuals responsible for corporate governance, responsible investment and proxy voting from US and European institutions.

Covering over

1,200

*funds in Europe
and the US*

Accounting for over

\$8t

*funds under
management...*

***...the Report tracks the
ongoing evolution of
shareholder corporate
governance issues and activity***

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**Increasing Shareholder
Accountability Precipitates
Increasing Board Accountability**

Increasing engagement with non-executive board members, increasing “active” style voting, increasing integration of ESG factors into the investment process, wider issues on the ESG Agenda including Human Capital and Corporate Culture are key themes in the CMi2i 2018 Annual Investor Corporate Governance Report.

Covering over 1,200 funds in Europe and the US, accounting for over \$8 trillion of funds under management, the Report tracks the ongoing evolution of shareholder corporate governance issues and activity in light of changing regulatory, accountability and broader societal trends such as inequality, diversity and the breakdown in trust of traditional institutions following the financial crisis.

EXECUTIVE SUMMARY

2 ESG Is an Integral Part of the Investment Process

The impact of ESG as an integral part of the investment decision making process continues to rise. With 71% of respondents increasing their stewardship teams over the last five years, ESG is increasingly considered to be a fiduciary duty of investors (further reflected in the increased number of signatories to the Principles of Responsible Investment, where in 2017, those signatories represented \$68 trillion in AUM).

The research shows that asset managers are facing increasing pressure from their clients to demonstrate that they have assessed fundamental ESG risk and opportunity within their investment strategies, as well as how their portfolio companies make positive contributions to sustainable development. 88% of investors *systematically integrate* ESG factors into the investment decision-making process. This integration strategy is followed by *negative/exclusionary screening* (76%). *Maximising Risk Adjusted Returns* is cited as the primary reason behind this development (88%) closely followed by *Client Demand* (65%) and *Contributing to Sustainable Development* (65%).

3 Greater Non-Executive Board Accountability and Engagement

With the growth of shareholder accountability and the role of ESG in investment decisions, the research shows that there is strong interest from respondents to hold dialogue with their portfolio companies on a range of ESG areas, but that issuers are not fielding the relevant representatives during these meetings. Respondents want Boards to hear unfiltered and unvarnished views from their shareholders. Consequently, there is strong shareholder demand to meet with the non-executive Board members including the *Chairperson* (94%), *Senior Independent Director* (76%) and *Committee Chairs* (71%).

In addition, a common theme throughout the Report is that institutions will look to *hold Board directors accountable* through expressing their concerns by *voting against their re-election* at AGMs if they do not feel issuers are responding adequately to dialogue. 59% of respondents claim that ESG issues would impact how they vote around director re-elections.

59%

of respondents claim that ESG issues would impact how they vote

4 Increasing Investor Collaboration and Escalation in Forcing Change

Shareholder engagement is not limited to direct individual interaction with issuers. It is also taking place increasingly in the form of collaborative engagement with other shareholders. To form a consensus of opinion as to what constitutes best practice, investors will pool their resources and share ideas. All our respondents *have led or supported collaborative engagement in the past*, with 50% of them expecting this to increase in the future. Their collective objective is to explore how they can *positively influence company corporate governance standards*.

At the same time, *escalation is rising*. Last year only 13% of our respondents would have considered escalating their engagement by requisitioning a shareholder meeting or by supporting others that did. However, this year, the number has jumped to 59%. This would suggest that strategies previously perceived as '*shareholder activism*' could now just be considered '*constructive investing*'.

EXECUTIVE SUMMARY

CONTINUED

It is also worth noting that in the case of passive investors, for example those managing Index Funds, the only way to minimise investment risk or unlock value is by using their voice and their vote. Escalation policies are therefore of paramount importance to them, and with the substantive presence of such passive investors on share registers, issuers should expect escalation to be a growing risk if investor transparency and/or ESG policy expectations are not met.

5 Human Capital and Corporate Culture Join the Dynamic ESG Agenda

With ESG investing progressing into the mainstream, so has the range of subjects that are coming within its scrutiny. This year, for example, saw *Gender Diversity* increasing from ninth position in 2017 to second in 2018, with *Human Capital* and *Corporate Culture* coming on to the agenda for the first time. The Survey also highlights that companies are still not providing adequate disclosure on environmental and social impact. For example, 94% of respondents “Very Often” or “Often” request further disclosure on climate change policies. The same number of respondents would prefer to see the responsibility of sustainability oversight shared across the entire Board rather than just by a standalone committee. With the ESG agenda in such a dynamic state, the need and desire for investor engagement with the Board is only likely to become stronger.

6 Conclusion

The evolution of ESG issues in the investment process is proving to be both fast and dynamic. In the first instance it is manifesting itself in a desire for increased transparency and engagement across a dynamic range of subjects. If these demands are not met, then direct, potentially collaborative, action through divestment and/or escalation is highly likely. Already in 2018, two of the world’s largest passive investors, Blackrock and Vanguard, publicly stated their commitment to increasing their ESG teams, and committing to hold companies to account on ESG issues. Similarly, the recent events surrounding Carillion in the UK have seen both shareholders and Board members brought before a Parliamentary Select committee and accused of being ‘asleep on the job.’

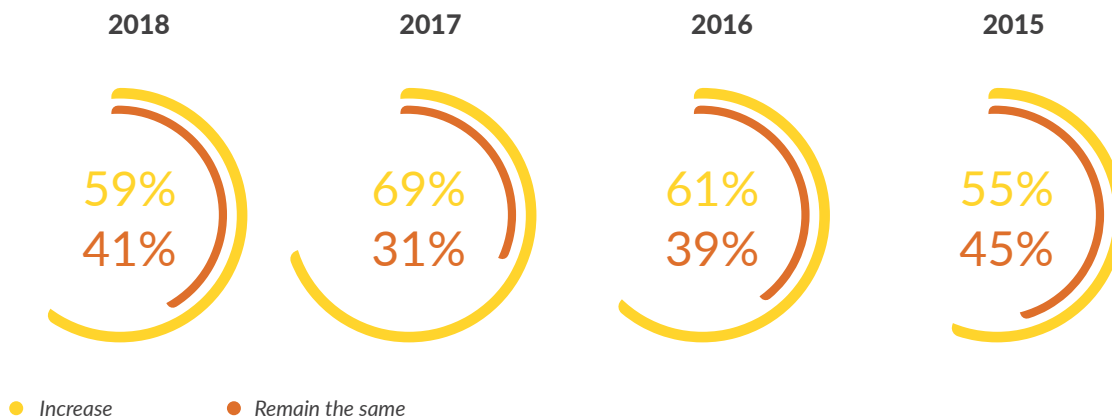
Non-executive Board members therefore need to keep themselves more informed than ever and be prepared to ensure that they inform their shareholders and other stakeholders on how they are approaching, assessing and managing their ESG risk and opportunities.

ENGAGEMENT

OUTLOOK

This section of the report will focus on recent engagement trends and outline practical steps on how companies can improve from the perspective of their shareholders.

How do respondents expect their level of engagement with companies to change in comparison to the previous year?



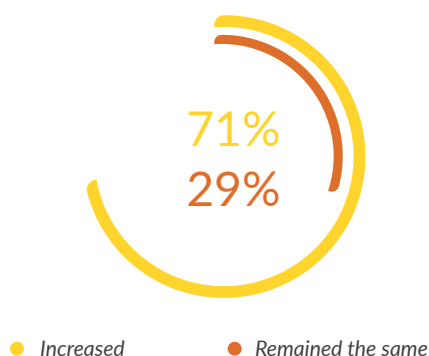
Continuing with previous trends, shareholders expect greater levels of engagement in 2018 than in 2017. The levels of expected engagement have been gradually increasing though there was a slight slowdown in 2018. This can be explained by the baseline engagement activity which has increased in recent years. This trend has been driven by matters such as regulatory pressure, availability of better tools and accessibility to information. Such drivers have become integral to how shareholders' approach governance evaluation and have led to year-round engagement. Increasingly shareholders are seeing themselves as agents for change.

The Shareholder Rights Directive encourages long-term active shareholder engagement through i) promoting company powers to identify shareholders from intermediaries; ii) ensuring that intermediaries facilitate the exercise of shareholder rights to vote in general meetings; and iii) requesting institutional shareholders provide further transparency on their shareholder engagement activities on a 'comply-or-explain' basis.

This will impact the resources required at an investor level. In practice, we can see that shareholders are already preparing themselves for increased levels of engagement. 71% of respondents have increased their stewardship teams in the last 5 years.

ENGAGEMENT CONTINUED

Have respondents' stewardship/engagement team size increased, decreased or remained the same over the last 5 years?



COLLABORATIVE ENGAGEMENT

Shareholder engagement is not limited to direct interaction with issuers. It can also take place in the form of collaborative engagement with other shareholders. To form a consensus of opinion as to what constitutes best practice, shareholders will pool their resources and share ideas. Their collective objective is to explore how they can positively influence company's corporate governance standards.

The UK Stewardship Code encourages this form of engagement, as it recommends shareholders should be *"willing to act collectively with other shareholders where appropriate"*. All of our respondents have led or supported collaborative engagement in the past, with 50% of shareholders expecting this to increase in the future. On page 8 we will discuss how respondents use this as an engagement escalation strategy.

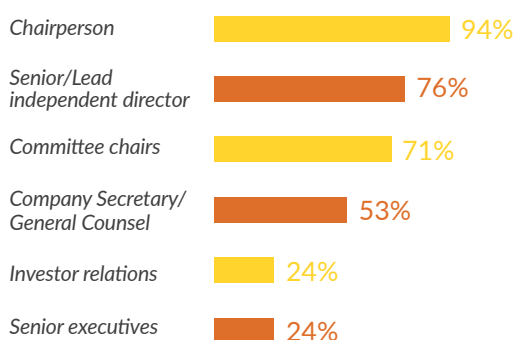
... "willing to act collectively with other shareholders where appropriate".

Various initiatives and communication channels have been created to promote collective stewardship, including the UK Investor Forum, Principles for Responsible Investment (PRI), the International Corporate Governance Network (ICGN) and Investor's Group on Climate Change (IIGCC).

EFFECTIVE ENGAGEMENT

From a shareholder's point of view, issuers can take a number of steps to enable better assessment of corporate governance risk. Having access to the relevant individuals is of high importance to our respondents. The landscape for engagement has evolved – shareholder corporate governance teams also expect to engage with the independent elements of the Board. This can include access to the chairperson, committee chairs and non-executive directors, as illustrated by the chart on the following page.

Who do respondents prefer to talk to regarding governance issues?

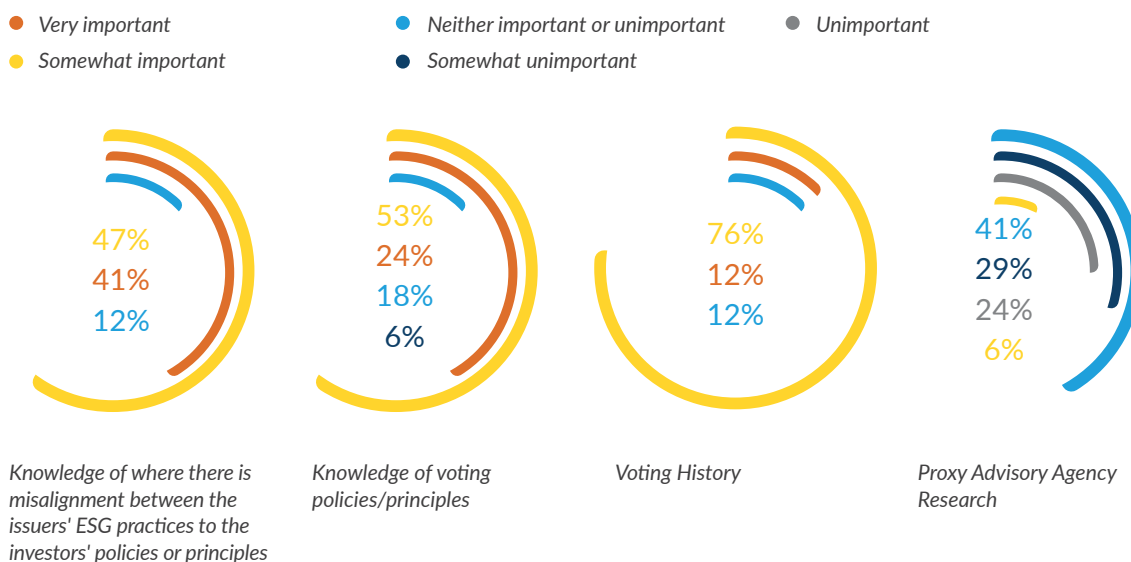


Shareholders want to communicate directly with the independent elements of the Board so that they can express their unfiltered/unvarnished views and discuss concerns with them. Investor Relations and Senior Executive Board members are classified as the 'least preferable' to engage with about governance matters. Respondents highlighted the challenges of gaining access to the non-executive Board members. However, Investor Relations, as well as company secretarial teams, are still seen as a "gatekeeper" to the non-executive Board members. In reality, the chairperson and/or the chairs of committees may not have the time to open a dialogue with all interested shareholders. The Investor Relations teams, as well as the company secretarial teams, can help filter, prioritise and escalate engagement where relevant.

It is important to note that in certain markets, it is not yet customary for non-executive Board members to engage with shareholders, which is an issue that is fully understood by some respondents.

Shareholders expect a company to demonstrate an understanding of their shareholders' corporate governance policies and principles – in particular where there is a misalignment with the company's corporate governance standards. In addition to fielding the relevant individuals, shareholders expect companies to be better prepared for engagement on the subjects relevant to them.

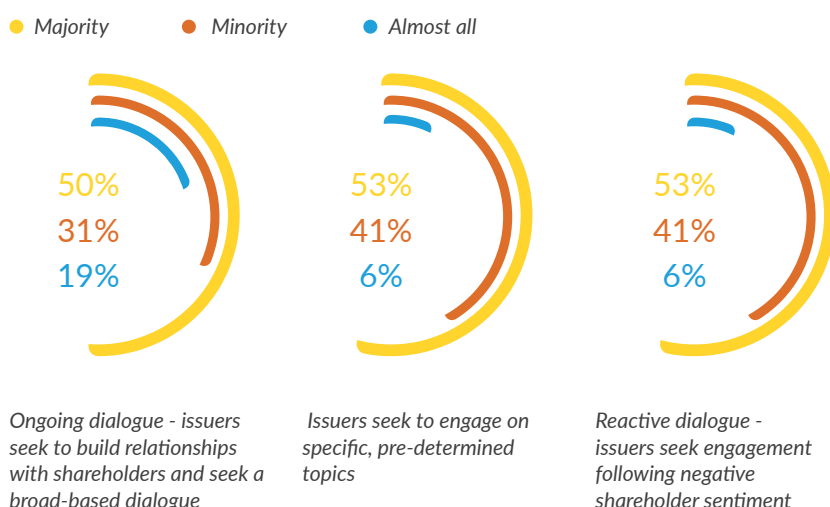
What information should issuers be equipped with prior to a meeting, so they can be better prepared?



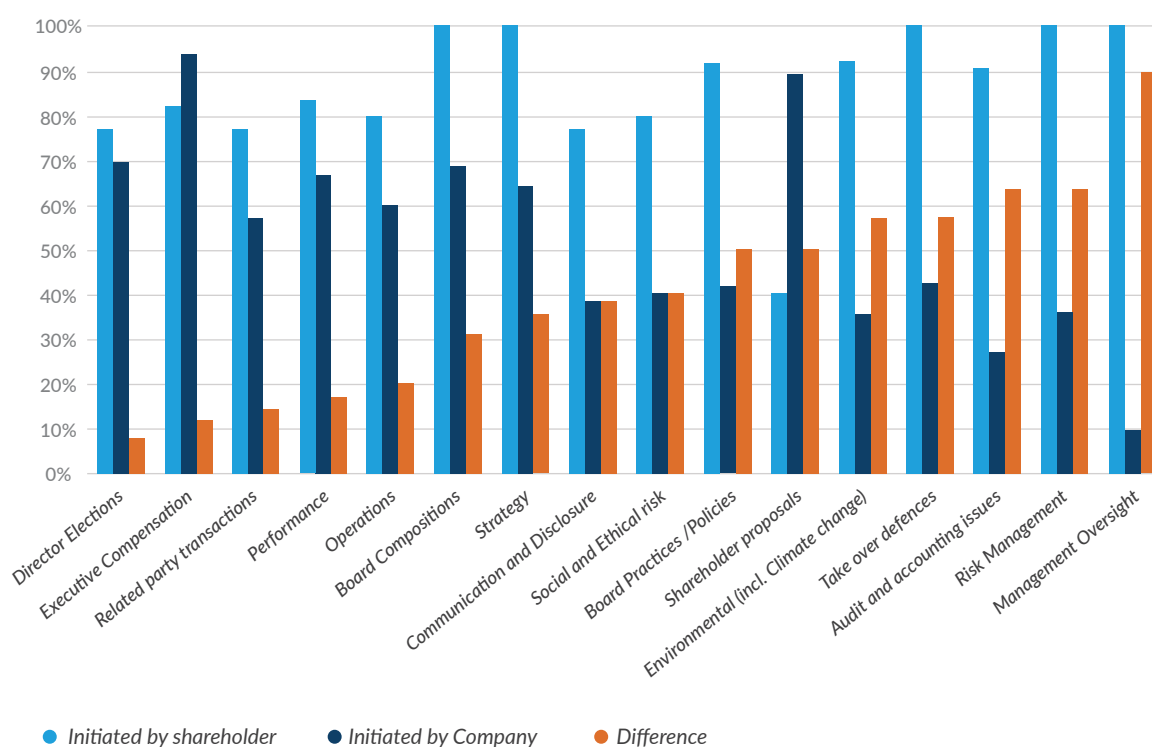
It is recommended that companies actively research the corporate governance policies and principles of their existing and potential shareholders, for which there are multiple sources of information. The primary source of information is often published by the fund itself.

ENGAGEMENT CONTINUED

What proportion of issuers seek the following types of engagement with our respondents?



It is important to understand to what extent issuers are effectively responding to the increased demand in shareholder dialogue. Historically, Issuers only tended to engage with an investor once concerns had surfaced. Issuers are now engaging more proactively, with 69% of respondents stating that 'Almost All' or the 'Majority' of their portfolio companies seek to conduct a broad-based dialogue on an ongoing basis.



Engagement Topics: Companies versus Shareholders

In keeping with our previous surveys, there continues to be significant differences between shareholders and companies surrounding the topics of interest for discussion. The above chart indicates the topics where shareholders initiate engagement with companies versus the topics shareholders are approached by companies. In 2017 the biggest difference was where 88% of respondents wanted to discuss 'Takeover Defence Provisions' as opposed to only 30% of companies. This year this has been replaced by 'Management Oversight' where 100% of respondents wanted to discuss this topic, but only 13% of companies.

100%

of respondents wanted to discuss 'Management Oversight', but only 13% of companies.

Interestingly, Accounting and Audit strength are seen as a prime concern when the company is underperforming and will trigger a closer investigation by the investor. However, the results show that companies are not necessarily anticipating and preparing for this as a topic for discussion. There have been numerous examples in the media where accounting and audit practices have been called into question.

'Risk Management' and 'Management Oversight' were areas which have seen an increasing disconnect compared to 2017. 'Risk Management' has increased from 33% to 64%, whilst 'Management Oversight' has increased from 60% to 90%. In both cases the level of issuers' willingness to engage

has dropped significantly, whereas the expectations of respondents have remained approximately the same.

40% ▼

... 'Social and Ethical Risk' has decreased from 80% in 2017 to 40% in 2018.

There has been a significant improvement in some areas, such as for 'Director Elections', where the 'disconnect' has decreased from 67% in 2017, to 8% in 2018. It is now more common for issuers to conduct consultation exercises regarding potential Board changes. Interestingly, the 'disconnect' for 'Social and Ethical Risk' has decreased from 80% in 2017 to 40% in 2018. In 2017 all respondents wanted to discuss this topic but now only 80%. This is consistent with the feedback we have received from respondents, who have expressed more interest in the 'governance' of a company than 'Social and Ethical' factors, (although, Social and Ethical failures are ultimately seen as Governance failures).

ENGAGEMENT ESCALATION POLICIES

As outlined earlier in the report, levels of engagement have been increasing and this is expected to continue through 2018 and beyond. The following section of the report discusses the likely escalation procedures that shareholders will take when their requests for engagement have not been dealt with appropriately. Engagement escalation is not seen as a systematic routine exercise, but a tactical one to be used on a case-by-case basis.

ENGAGEMENT CONTINUED

What escalation approaches do respondents use when they feel engagement efforts have not been successful?

| Escalation Engagement Approaches | % of respondents |
|--|------------------|
| Expressing concerns by voting against or abstain directors | 100% |
| Collaborating with other investors to press for change | 100% |
| Requesting additional meetings with board members | 94% |
| Making portfolio decisions (divesting) | 71% |
| Requisitioning meetings or supporting others who are doing so | 59% |
| Expressing concerns through the company's brokers and advisors | 35% |
| Filing resolutions at shareholder meetings | 29% |
| Expressing concerns by making a statement or asking questions at the AGM | 24% |
| Making public statements | 18% |
| Making a formal complaint to a regulator | 6% |

The join most common tactic used by respondents to escalate engagement, is by voting against directors (or abstaining) at shareholder meetings. This indicates that shareholders are not afraid to hold directors accountable. Voting at shareholder meetings is no longer seen by shareholders as merely a fiduciary duty.

Another common approach is to request additional meetings with non-executive members of the Board. Shareholders expect Executive Directors and Investor Relations teams to relay messages to the non-executive members of the Board. However, if shareholders believe their concerns and views are not being communicated, they will look to directly contact the non-executive members of the Board themselves.

It is worth remembering that everyone we spoke to has either led or supported collaborative engagement with other shareholders. Therefore, it is no longer safe to assume that shareholders work in isolation and that their concerns are not representative of other shareholders' opinions.

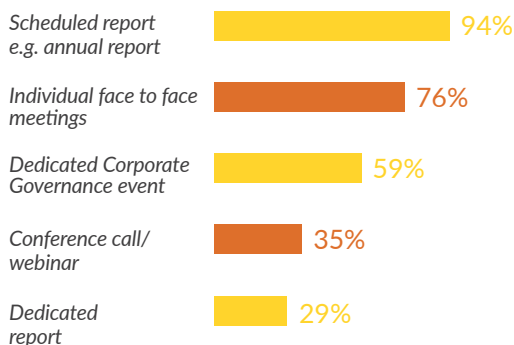
It is also worth noting that Active Investment Managers can make a portfolio divestment if they don't get the engagement necessary to evaluate their investment risk. The escalation procedures are of great value to active investment managers, as it gives them the opportunity to communicate changes that will be required for them to remain invested.

Passive shareholders, for example those managing Index Funds, cannot typically

divest a stock even when they would choose to not hold it. The only way for them to minimise investment risk or unlock value is by using their voice and their vote. Therefore, escalation policies are of paramount importance to them.

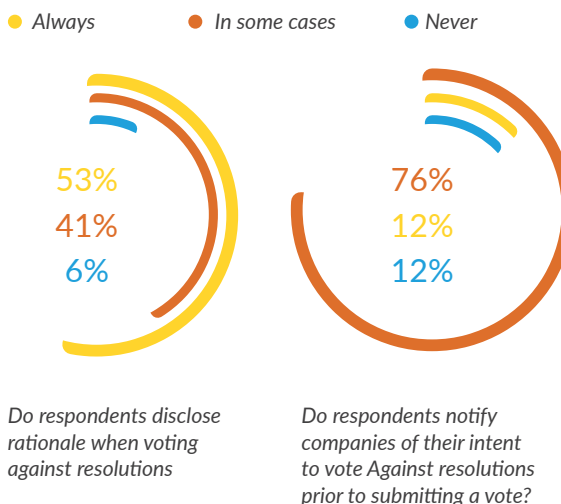
Last year only 13% of our respondents would have considered escalating their engagement by requisitioning a shareholder meeting or by supporting others that did. This year that number has jumped to 59% which would suggest that strategies previously perceived as 'shareholder activism' could now just be considered 'being an active investor'.

How do respondents prefer governance information should be communicated?



Shareholders continue to use the Annual Report as the first access point for corporate governance information, as backed by 94% of respondents. Issuers can communicate information effectively by ensuring that the annual report is shareholder-friendly by providing a good level of detail, visuals where relevant and easy to understand, non-legalistic language.

Voting disclosure



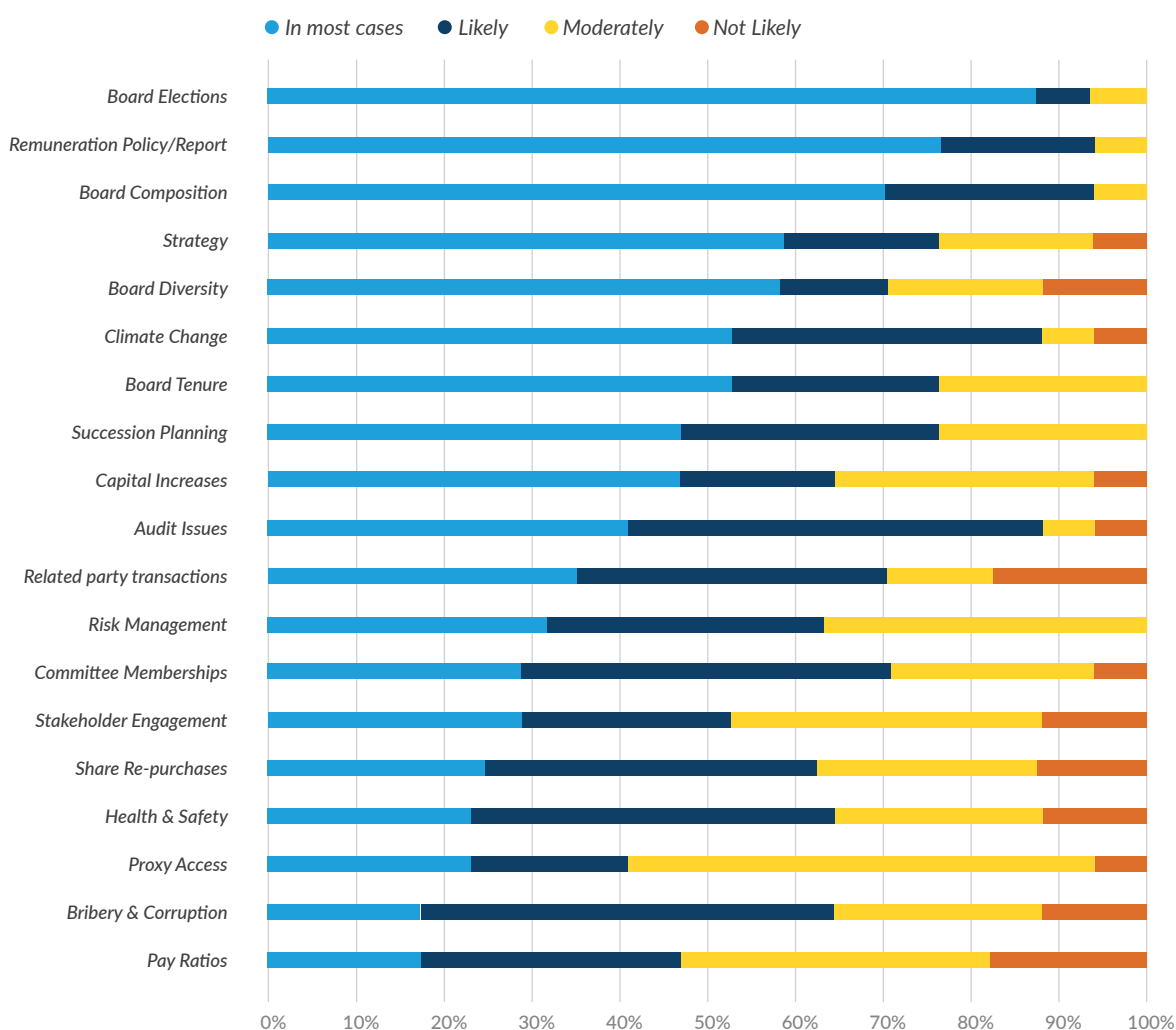
Whilst respondents are very active in voting, only 53% disclose their rationale for voting against resolutions to companies. Disclosing this information would bridge the gap in understanding why shareholders have taken such decisions. Shareholders can also notify their portfolio companies of their intention to vote against items at future shareholder meetings, allowing issuers to clearly understand the ramifications of not addressing shareholder concerns. This could also mitigate the risk of receiving "votes against" in cases where companies could have provided additional disclosure, but the company was unaware that there was an issue. Only 12% of respondents notify their portfolio companies of their intent to vote against their proposed resolutions at shareholder meetings.

12%

... of respondents notify their portfolio companies of their intent to vote against their proposed resolutions at shareholder meetings.

CORPORATE GOVERNANCE AREAS OF FOCUS IN 2018

Which corporate governance areas will Respondents focus on in 2018?



Asset owners will assess a range of governance areas in 2018, particularly Board Elections, Remuneration and Board Composition. A clear observation from both our 2017 and 2018 findings is that there is strong interest in better transparency and disclosure in these areas. This is the first time where “Board Elections” has been the foremost focus area, second to “Remuneration” in previous reports. This could signal how shareholders are moving away from focusing on narrow issues to general

accountability to those that are responsible for making decisions.

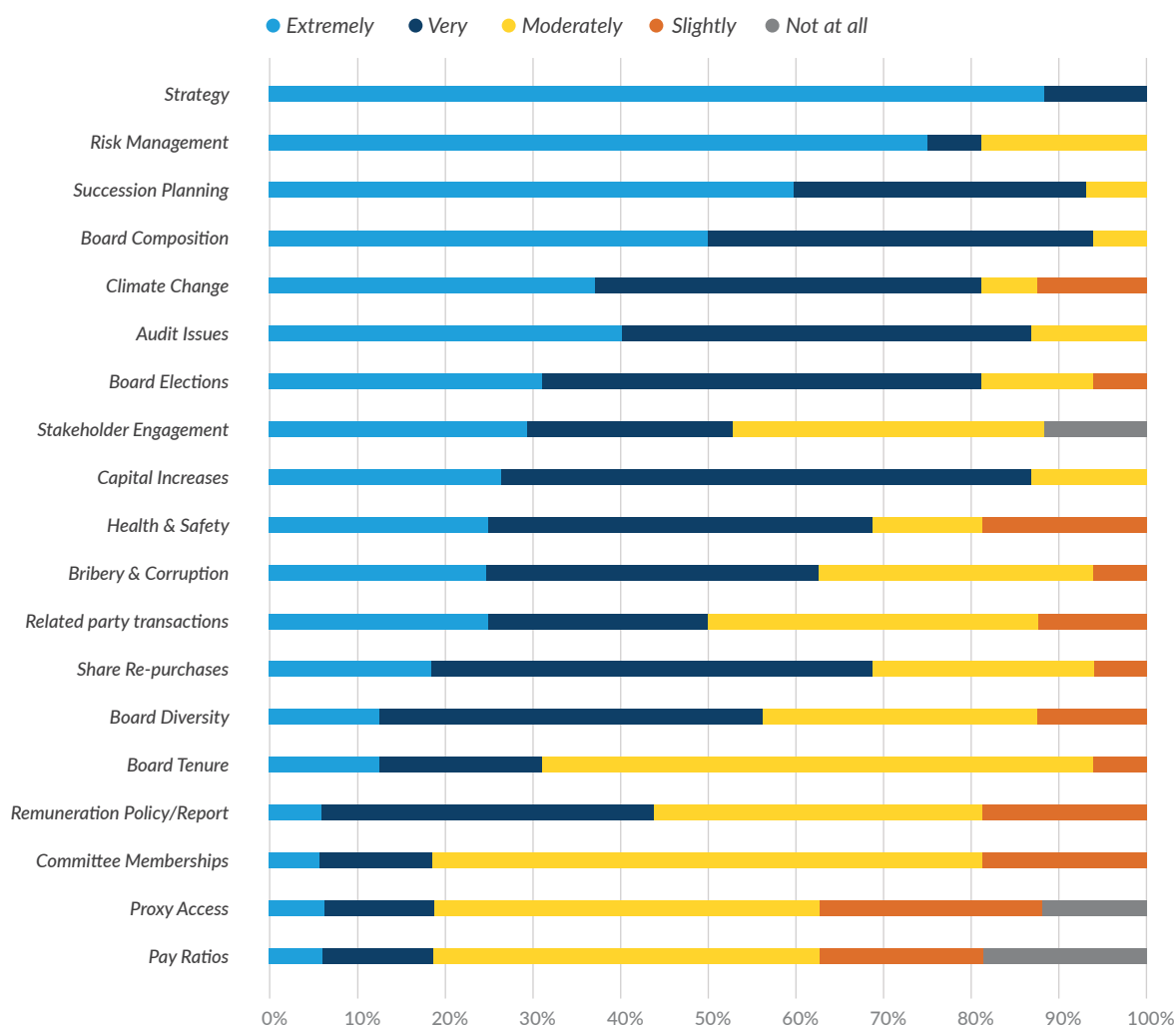
In 2017 only 50% of respondents considered diversity of Board composition to be a focus area. In 2018 that number has jumped to 88%, showing that it is increasingly important to have broad diversity among the directors represented on the Board. Several recent reports have raised awareness of Board Diversity, in particular the Davies Review

on the approach to increase representation of women on the FTSE 100 to at least 25% by 2015. The Hampton-Alexander Review followed this and set forth recommendations aimed at increasing the number of women in leadership positions of FTSE 350 companies.

Which corporate governance issues do respondents feel have the biggest impact on a company's value?

The top 5 corporate governance areas which shareholders feel have the biggest impact on a company's valuation are Strategy, Risk Management, Succession Planning, Board Composition and Climate Change. The above chart shows a variance in areas of investor focus and those which impacts a company

value. This could suggest that shareholders may feel that they are unable to impact the areas which have the most impact on a company's value directly, so they focus on board composition and how directors are incentivised.



EXECUTIVE REMUNERATION

The following section will explore shareholders' sentiment to the widely adopted Long-Term Incentive Plan ("LTIP") and alternative remuneration structures which are expected to become increasingly common, as well as discussing shareholders' preferences on greater powers to hold companies to account in relation to Say-on-Pay.

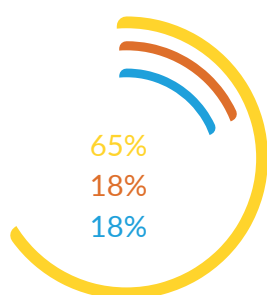
The LTIP was introduced to promote a greater alignment between executive pay and company performance, however it has received considerable criticism for its effectiveness. To illustrate this, the Executive Remuneration Working Group Paper by the

Investment Association argued that the LTIP (the granting of shares that vest based on performance measured against a series of pre-agreed targets) had led to remuneration structures becoming "too complex"; a statement backed by 59% of our respondents.

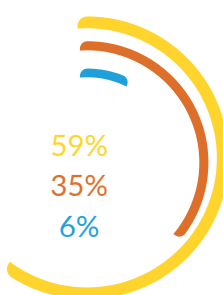
Instead, The Investment Association champions structures which are simple to understand. Only 59% of respondents agree that the LTIP is the most effective in aligning performance-related pay to a company's strategy.

LTIP Effectiveness

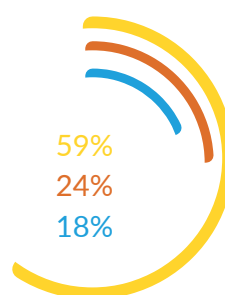
● Agree ● Neither agree or disagree ● Disagree



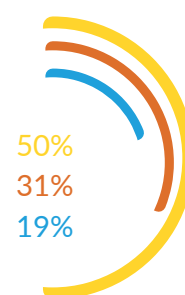
The deferred bonus plan will become increasingly common in the next 3 years



The LTIP has led to remuneration structures becoming too complex



The LTIP is currently the most effective in aligning performance related pay to a company's strategy



Companies are too reliant on the LTIP when other structures can be better suited to a company's long term strategy

The LTIP is still widely adopted because it is still considered to be common market practice, according to the Executive Remuneration Working Group Paper. However, it is expected that companies will increasingly transition away from this.

... “do not believe there is a one-size-fits-all solution”. Rather, “structures must be tailored to the needs of the individual company”.

Respondents to our survey commented that they “do not believe there is a one-size-fits-all solution”. Rather, “structures must be tailored to the needs of the individual company”. Thus, respondents are demonstrating their flexibility with the structures that companies can adopt. For these reasons, companies should focus on proposing structures specific to their long-term strategy and business or industry, rather than simply abiding by common market practice. Companies seeking to amend their structures are recommended to undertake a consultation exercise during the drafting stage, to gauge shareholder support.

One alternative considered to the LTIP is a Deferred Bonus Plan, which can provide certain advantages such as simpler structures without the need for performance conditions. 65% of respondents believe that this structure will become more common in the next three years. Regardless of which structure has been adopted, companies should provide clear justification for doing so.

Those companies who adopt an LTIP should impose “vesting and holding” periods over a longer-time horizon. For instance, certain global shareholders have recently adopted red-line voting policies for anything less than a three-year performance period. Our survey reveals that 93% of respondents expect to see a minimum combined “vesting and holding” period of three to five years, whilst the remaining respondents would expect to see a period of five years or more. It is interesting to note that the UK Corporate Governance Code has proposed provisions to increase this period from three to five years.

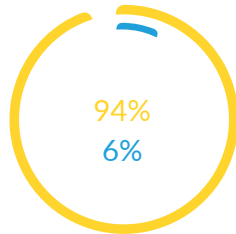
“Say-on-Pay” was introduced to give shareholders the opportunity to vote against excessive director remuneration. Whilst this vote is binding in certain markets, for others it is made on an advisory basis. However, there are discussions on whether shareholders should be given more powers to hold companies to account for awarding excessive remuneration packages. Our survey reveals that 53% of respondents agree that where there is a significant portion of minority shareholders voting against a Remuneration Report (i.e. 25% or more), a binding vote should be triggered. There are varying market practices on shareholder powers, for example Australia adopted the “two-strike system”, whereby if two consecutive Remuneration Reports received greater than 25% of votes against, shareholders have the option to vote on whether the entire Board of Directors must stand for re-election.

Whilst providing a binding vote on a Remuneration Report may provide shareholders with greater powers to hold companies to account, other shareholders have argued that they have all the tools in place to do this already, by holding Remuneration Committees accountable by being able to vote against their re-election.

EXECUTIVE REMUNERATION CONTINUED

Remuneration Committee Responsibility and Accountability

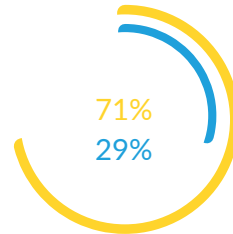
● Agree ● Neither agree or disagree ● Disagree



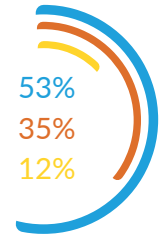
You expect remuneration committees to enter in investor engagement regarding their remuneration policies in their drafting stage



In cases where large amounts vest to executives from LTIPS as a result of sharp share price appreciation and not as result of directors' influence, you expect committees to exercise discretion to reduce vesting



You will consider voting against the re-election of members of the remuneration committee when you oppose a company's remuneration policy



It would be beneficial for a company to include an employee representative on the remuneration committee

Our findings demonstrate that 71% of respondents will consider voting against the re-election of the Remuneration Committee when they have already voted against the Remuneration Policy. Shareholders expect the Remuneration Committee to have greater discretionary powers. For instance, in cases where large amounts vest to executives from LTIPs, because of share price appreciation, but not as a result of Directors' influence, 76% of respondents expect committees to exercise discretion to reduce vesting. Any discretionary amendments, either upwards or downwards, need to be clearly justified.

94%

of respondents expect the Remuneration Committee to be in communication with shareholders...

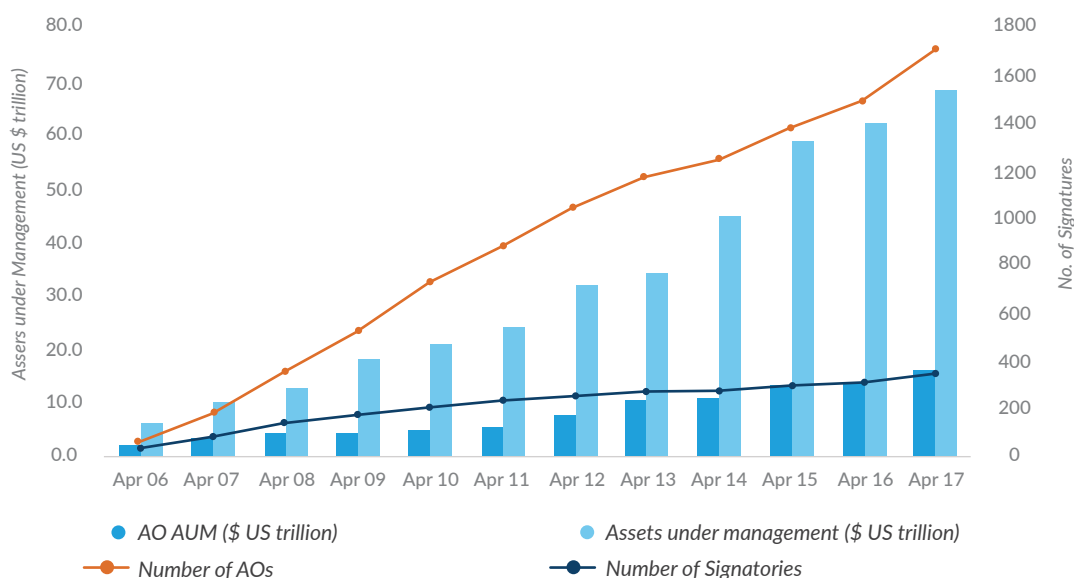
94% of respondents expect the Remuneration Committee to be in communication with shareholders, most of all at the Remuneration Policy drafting stage. The Investment Association Principles of Remuneration, which sets out members' views on the role of shareholders and directors in relation to remuneration and the manner in which remuneration should be determined and structured, states that Remuneration Committees should respond to a significant vote against their remuneration report or policy (more than 20% of the votes against).

Finally, a company should make efforts to understand and acknowledge any shareholder dissent on the Remuneration Policy and Report. The Investment Association maintains a Public Register to highlight companies who have received high votes against or that have withdrawn a resolution, and to understand the process used by those companies to identify and address the concerns of their shareholders. An effective year-round consultation process provides a platform for this as it mitigates the risk of concerns not being heard.

SUSTAINABILITY

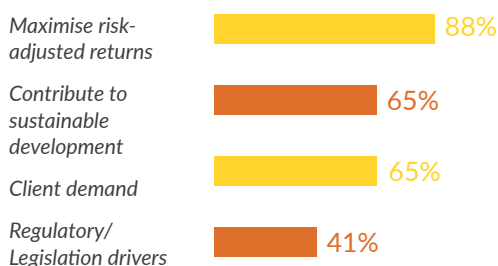
OUTLOOK FOR 2018

This section covers trends in how shareholders are integrating ESG factors into their investment strategy and discusses how lack of transparency acts as a barrier for shareholders to assess their ESG risk and opportunity. It also includes the key environmental and social areas that shareholders will be analysing in 2018.



In addition to ESG becoming an integral part of the overall investment decision-making process, it is also considered to be a fiduciary duty of shareholders to take these into account. This has been reflected by the increased number of signatories to the Principles of Responsible Investment, where in 2017, those signatories represented \$68.4 trillion USD in AUM¹.

ESG Integration Drivers

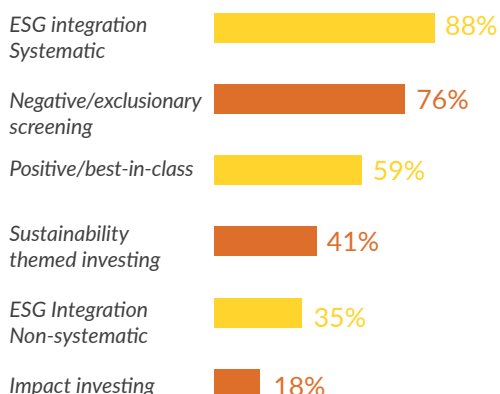


Our research highlights several drivers behind ESG integration. Over and above the usual financial metrics, Asset Managers are facing increasing pressure from their clients to demonstrate that they have assessed ESG risk and opportunity within their investment strategies. Additionally, respondents are interested in how their portfolio companies make positive contributions to sustainable development.

¹ <https://www.unpri.org/>

SUSTAINABILITY CONTINUED

How do respondents integrate ESG factors into their investment strategy?



The chart above indicates that shareholders integrate ESG factors into their investment decision-making process in several ways and these have evolved over time. Early ESG integration mainly consisted of specialist funds screening companies that operated within certain contentious industries, for example weapons and tobacco manufacture.

Even though the consideration of ESG factors into the investment strategy has progressed into the mainstream, there are still certain barriers to shareholders accessing relevant information. The Survey highlights that companies are still not providing adequate disclosure on environmental

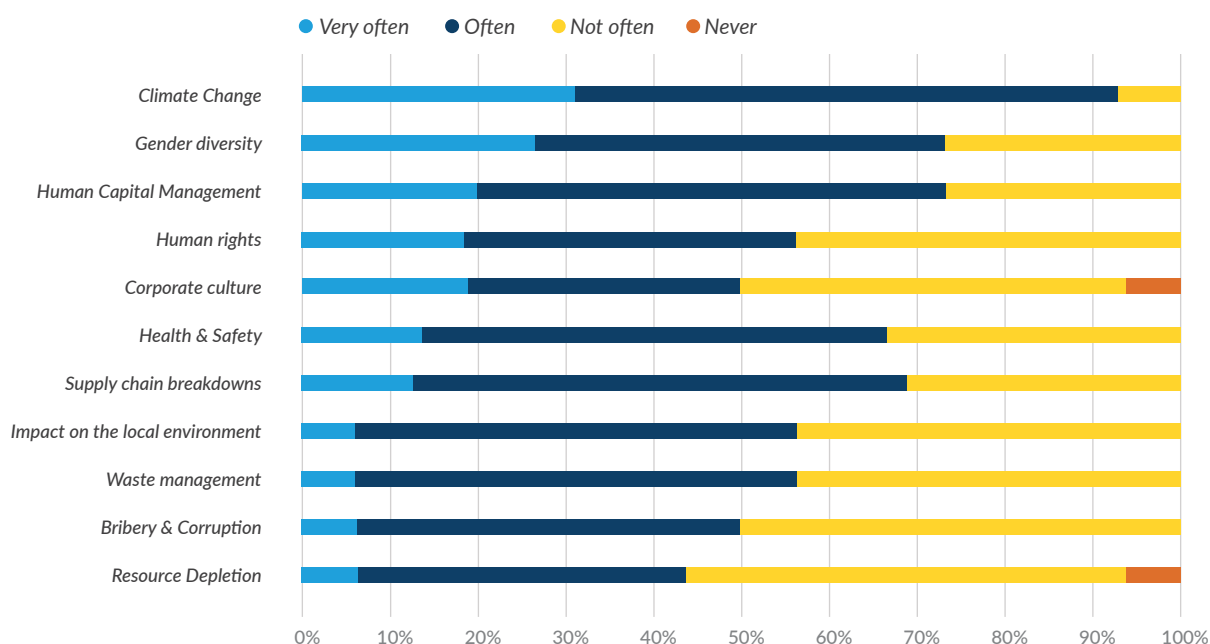
and social impact. For example, 94% of respondents “Very Often” or “Often” request

further disclosure on climate change policies, which could explain the recent increase in the number of climate change-related shareholder proposals. All respondents have at some point supported social or environmental shareholder proposals at shareholder meetings.

Interestingly, “Gender Diversity” has increased from ninth position in 2017 to second in 2018. Health & Safety has fallen from second in 2017 to sixth in 2018.

Which Environmental and Social areas do respondents request additional disclosure on?

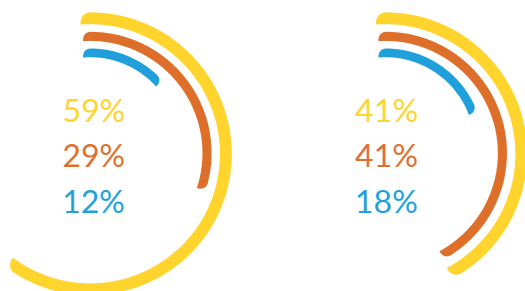
It is largely acknowledged that there still is a lack of adequate ESG reporting and disclosure and there have been a number of reporting framework developments and initiatives designed to make this information more accessible. For example, the EU Non-Financial Directive requires further disclosure by companies on how they manage social and environmental challenges. This directive allows companies to choose the framework they use to disclose information. Some frameworks are global, such as the Global Reporting Initiative



(which was introduced to harmonise standards) whereas others may choose frameworks which are relevant to certain countries or markets. For example, France has introduced mandatory climate change-related reporting for institutional shareholders through Article 173. This presents a challenge for Asset Managers and Owners when seeking standardised and comparable company information on the financial and non-financial aspects of a business. The Financial Stability Board Task Force on Climate-related Financial Disclosures works towards providing consistent climate-related financial risk disclosures for use by companies in providing information to shareholders.

The impact of ESG Reporting on respondents voting behavior

● Agree ● Neither agree or disagree ● Disagree



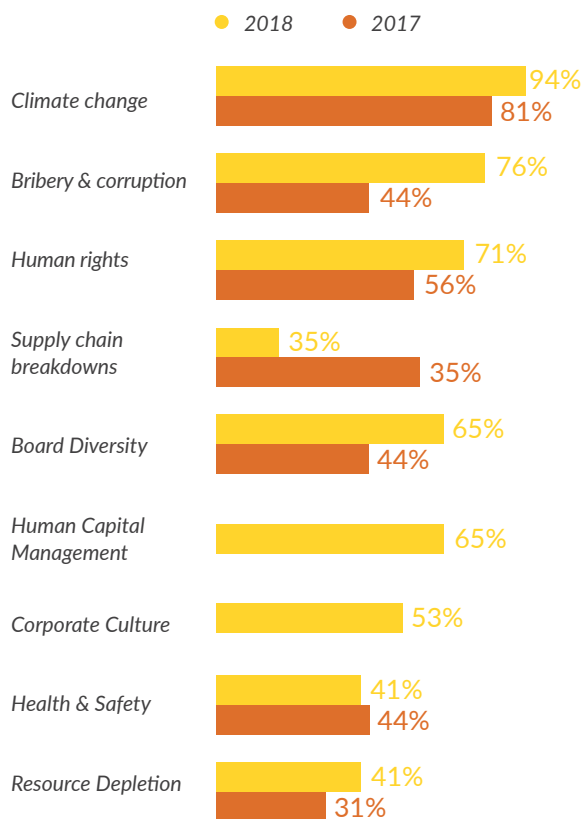
Inadequate ESG reporting would impact your voting around director re-elections

You would consider voting against the annual report and accounts if portfolio companies were not providing adequate reporting on ESG risks

It is important to understand how ESG reporting may impact investor voting behaviour. 59% of respondents claim it would impact how they vote around director re-elections. The same number of respondents would prefer to see the responsibility of sustainability oversight shared across the entire Board rather than just by a standalone committee. ESG reporting can also impact the approval of the annual report and accounts, as stated by 41% of respondents. In their evaluation,

respondents stated they will consider each ESG issue on a case-by-case basis, because they will take into account industry and other company-specific circumstances.

Which Environmental and Social areas will respondents pay particular attention to

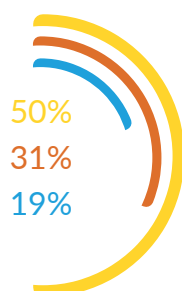


Respondents focus on a range of Social and Environmental areas, including less traditional topics such as "Corporate Culture". As discussed previously 2017 saw many cases of Climate Change related shareholder proposals, notably at ExxonMobil, where shareholders approved proposals requesting greater disclosure on the company's climate change policies. Climate Change has been recognised as a systemic issue which can also explain the increased focus on this area. These efforts signify shareholders' intent to take action when companies do not respond adequately. "Supply Chain Breakdowns" has decreased from 81% to 65%.

SUSTAINABILITY CONTINUED

How effectively do issuers make the link between sustainability and financial performance?

● Moderately ● Slightly ● Very



Shareholders seeking companies with a sustainable equity story will expect clear communication from companies about any ESG risks. They will look to determine how effectively a company has made the link between sustainability and financial performance. However, the survey reveals that only 19% of respondents believe that “companies can **‘Very’** effectively” make the link between sustainability and financial performance. Some respondents argued that this differed from industry to industry, for example one investor stated that companies in the ‘extractives’ industry are very knowledgeable of the impact of safety on financial performance.

If companies fail to demonstrate that they understand the link, respondents did state that they are likely to offer assistance to their portfolio companies. 88% of respondents will actively engage with their portfolio companies to help them understand how their ESG risks could impact their business.

One way that shareholders may judge how well a company demonstrates their understanding of this link, is by their implementation of non-financial measures in variable pay. 82% of respondents agree that variable pay should contain a mixture of financial and non-financial metrics.

82%

... of respondents agree that variable pay should contain a mixture of financial and non-financial metrics.

BOARD COMPOSITION

BOARD EFFECTIVENESS

This section provides insight into investor sentiment on the quality of Board effectiveness and performance. Topics discussed include Board Evaluation Reports, differing definitions of Board Diversity, and the importance of “Proxy Access” laws to promote Board accountability.

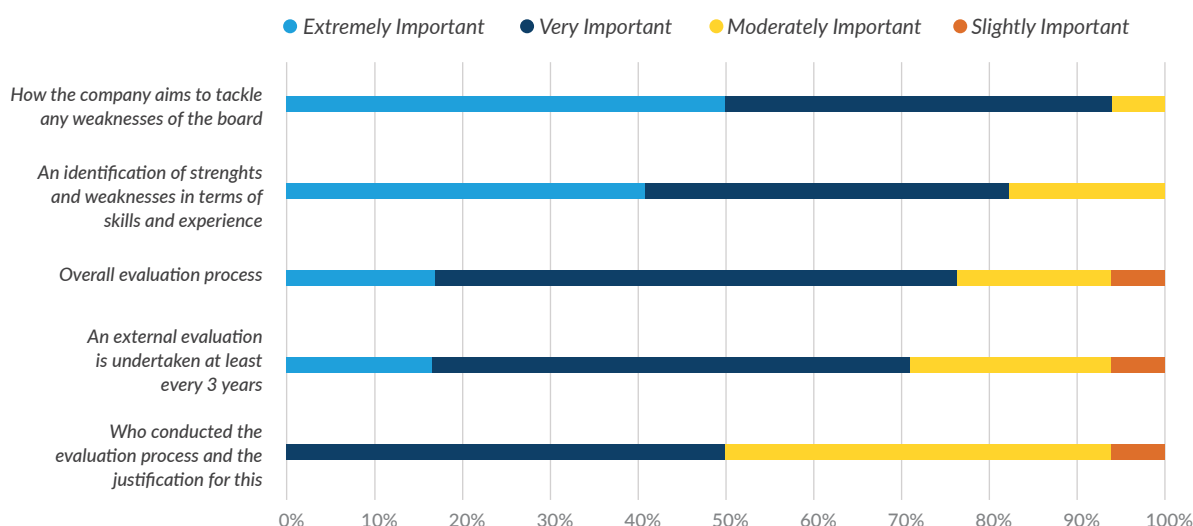
Shareholders expect the Board of a company to be comprised of members with a diverse set of attributes (as outlined below) as these are considered important to the long-term performance of the company. Board Evaluation Reports help shareholders to establish how effectively they are achieving this diversity. However, despite their importance, 88% of respondents believe that companies can still improve their disclosure within these reports.

Respondents stated that *“This area of disclosure is typically weak”* and that *“it’s rare to see substantive qualitative or quantitative information on this subject”*.

The following sections provide shareholder opinions as to how the Board Evaluation Reports should be structured. Whilst certain respondents have specific preferences, others prefer to give greater discretion to their portfolio companies - with one respondent even stating that they would be happy with whatever the company felt it was *“comfortable disclosing”*.

Almost half of respondents prefer that the exercise should be carried out on each individual Board member, rather than a report on the Board as a whole.

Within the Board Evaluation Report, which details are most important?

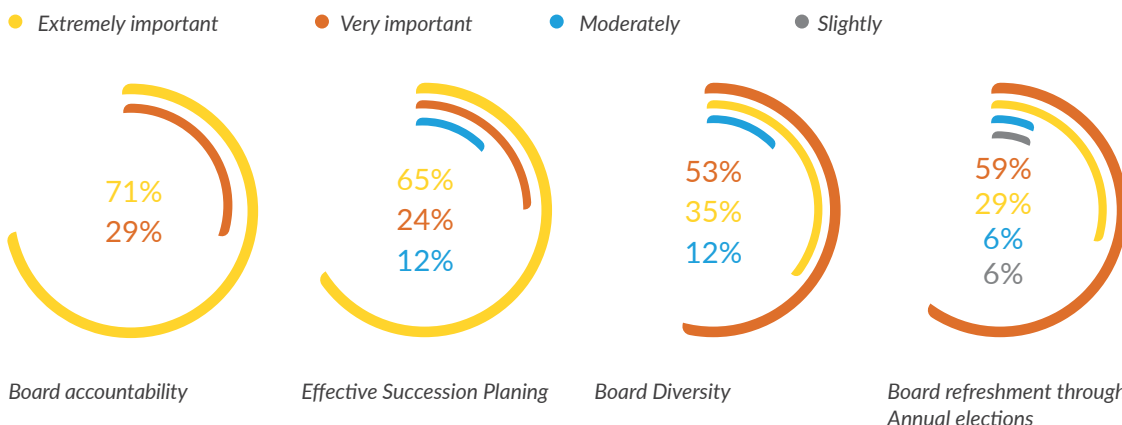


According to our survey the most important aspect of the Board Evaluation Report is how the Board intends to tackle any weaknesses identified, such as gaps in skills or experience. The Institute of Chartered Accountants in England and Wales¹ recommend that an external evaluation is conducted every three years, which 71% of respondents believed was “Extremely Important” or “Very Important”. An independent body is able to provide an external perspective with a degree of impartiality.

¹ <https://www.icaew.com/technical/corporate-governance/uk-corporate-governance/board-evaluations-and-effectiveness-reviews>

BOARD COMPOSITION CONTINUED

What ensures board effectiveness?



The chart above indicates the various elements to an effective Board, such as Accountability, which has been a prevalent theme throughout this report. Succession Planning has also proved to be an important factor. In our previous Corporate Governance Annual Reports, we have highlighted concerns from respondents that Boards are inadequately prepared for unplanned succession. The majority of respondents clearly stated that they want greater involvement in the succession planning process.

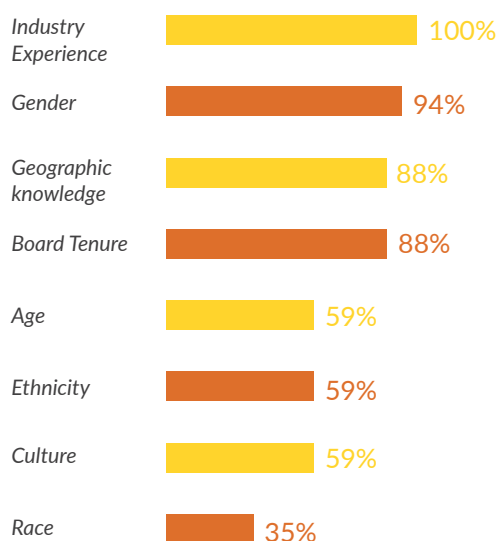
One of the benefits of a diverse Board is that it can help overcome challenges such as “group thinking” which is seen as a weakness because it can demonstrate that there is not a broad enough range of perspectives.

Board skills, experience and female representation have long been considered important characteristics of Board diversity. However, there are other Board characteristics which promote diversity as outlined below.

Sir John Parker produced an independent report on ethno-cultural diversity, named the Parker Review to set out a broader definition of “diversity” in order to avoid, for example, a mono-ethnic Board. The Review states that the “Boardrooms of Britain’s leading public companies do not reflect the ethnic diversity of either the UK, or the stakeholders that they seek

to engage and represent”. Similarly, the Hampton-Alexander Review encourages Boards to consider diversity in their management pipeline - and not just through the current composition of the Board. The Parker and Hampton-Alexander Reviews are being considered for inclusion in the Proposed Provisions of the UK Corporate Governance Code.

When assessing Board Diversity, what attributes do respondents consider?



When a Board make no progress with improving diversity standards, shareholders will mainly look to hold the nomination committee accountable.

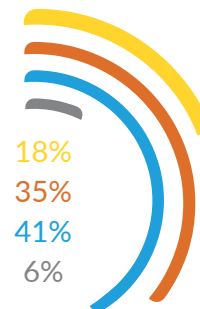
The previous chart indicates the various attributes respondents take into account when assessing Board diversity. When a Board make no progress with improving diversity standards, shareholders will mainly look to hold the nomination committee accountable. They will do this by requesting additional dialogue with the nomination committee and if they fail to get that, they may even vote against their re-election. When a company fails to meet internal and/or external diversity targets, reasons should be provided with a clear action plan to resolve the issue.

BOARD ACCOUNTABILITY

In the US market, companies are encouraged to adopt a “Proxy Access By-Law”, which allows their shareholders to nominate (Director) candidates on to the company’s AGM ballot. 56% of respondents feel it is either “Extremely Important” or “Very Important” to give shareholders Proxy Access rights to help improve Board effectiveness. Only 6% of respondents disagreed with this sentiment.

How important is giving shareholders the right to nominate their own directors (proxy access) in improving Board Effectiveness

● Extremely ● Moderately
● Very ● Not at all



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