Shropshire County Council

Q2 2016

The purpose of the ***reo®*** (responsible engagement overlay)* service is to engage with companies held in portfolios with a view to promoting the adoption of better environmental, social and governance (ESG) practices. The ***reo®*** approach focuses on enhancing long-term investment performance by making companies more commercially successful through safer, cleaner, and more accountable operations that are better positioned to deal with ESG risks and opportunities. Through a combination of constructive dialogue and active share voting, ***reo®*** works to drive behavioural change with companies, and records successful outcomes as 'milestones' – changes in corporate policies or behaviour following intervention.

Companies engaged this quarter

Companies engaged	20
Milestones achieved	9
Countries covered	3

Milestones achieved by issue

Environmental Standards
Business Ethics
Human Rights
Labour Standards
Public Health
Corporate Governance
Social and Environmental Governance
0
5

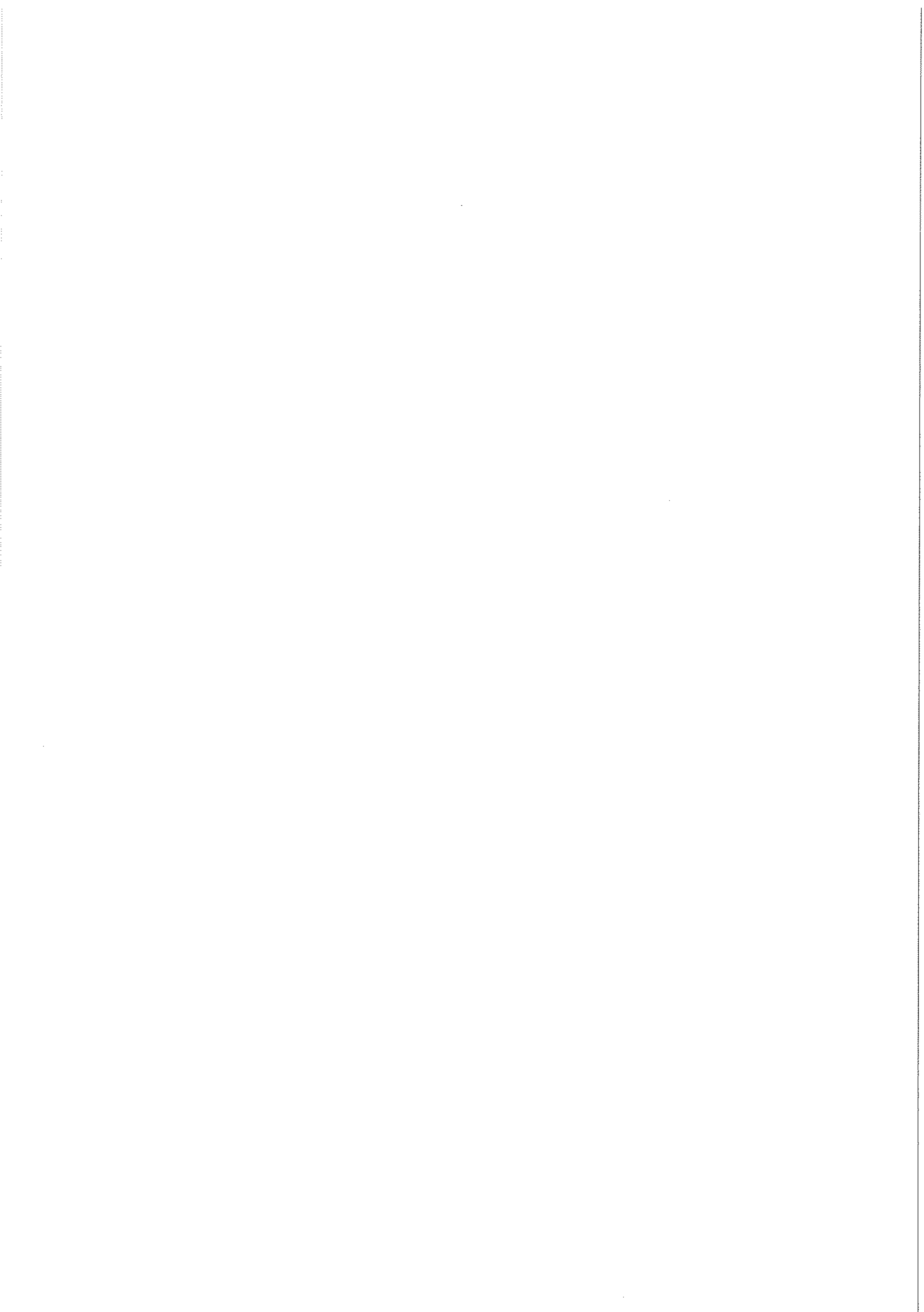
Companies engaged by country

United Kingdom	18
Continental Europe	2

Companies engaged by issue **

Environmental Standards	16
Business Ethics	13
Human Rights	4
Labour Standards	8
Public Health	4
Corporate Governance	14
Social and Environmental Governance	10

* ***reo®*** is currently applied to £87.5bn ($125.6billion / €110.4billion) of assets as at 31st March 2016. ** Companies may have been engaged on more than one issue. *** This report has been compiled using data supplied by a third-party electronic voting platform provider. The statistics exclude ballots with zero shares and re-registration meetings. Meetings/ballots/proposals are not considered voted if: ballots have been rejected by voting intermediaries (e.g. where necessary documentation (such as Powers of Attorney, beneficial owner confirmation, etc.) was not in place); instructed as "Do not vote" (e.g. in share-blocking markets); or left uninstructed. This document is for professional advisors only and should not be circulated to other investors. Past performance should not be seen as an indication of future performance. Stock market and currency movements mean the value of, and income from, investments in the Fund are not guaranteed. They can go down as well as up and you may not get back the amount you invest. © 2015 BMO Global Asset Management. All rights reserved. BMO Global Asset Management is a trading name of F&C Management Limited, which is authorised and regulated by the Financial Conduct Authority.



Engagements and Your Fund: Red rated

The table below highlights the companies with which we have engaged on your behalf in the past quarter and which you currently hold within your portfolio. The table is split by ESG risk rating. For full details of our engagements with companies please refer to the online ***reo***® client portal.

					Themes engaged						
Name	Country	Sector	Priority company	ESG Rating	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
BP PLC	United Kingdom	Energy	✔	RED	●		●	●		●	
HSBC Holdings PLC	United Kingdom	Financials	✔	RED						●	●

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile: GREEN Second quartile: YELLOW Third quartile: ORANGE Bottom quartile: RED

Engagements and Your Fund: Orange rated

The table below highlights the companies with which we have engaged on your behalf in the past quarter and which you currently hold within your portfolio. The table is split by ESG risk rating. For full details of our engagements with companies please refer to the online ***reo***® client portal.

					Themes engaged						
Name	Country	Sector	Priority company	ESG Rating	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
Glencore PLC	Switzerland	Materials	✔	ORANGE	●		●	●			
Lloyds Banking Group PLC	United Kingdom	Financials		ORANGE		●				●	●
Royal Bank of Scotland Group PLC	United Kingdom	Financials		ORANGE	●	●				●	●
Smith & Nephew PLC	United Kingdom	Health Care		ORANGE						●	

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile: GREEN Second quartile: YELLOW Third quartile: ORANGE Bottom quartile: RED

Engagements and Your Fund: Yellow rated

The table below highlights the companies with which we have engaged on your behalf in the past quarter and which you currently hold within your portfolio. The table is split by ESG risk rating. For full details of our engagements with companies please refer to the online ***reo***® client portal.

					Themes engaged						
Name	**Country**	**Sector**	**Priority company**	**ESG Rating**	**Environmental Standards**	**Business Ethics**	**Human Rights**	**Labour Standards**	**Public Health**	**Corporate Governance**	**Social and Environmental Governance**
Anglo American PLC	United Kingdom	Materials	✔	YELLOW						●	
British American Tobacco PLC	United Kingdom	Consumer Staples		YELLOW	●	●			●		●
GlaxoSmithKline PLC	United Kingdom	Health Care	✔	YELLOW		●			●	●	●
Next PLC	United Kingdom	Consumer Discretionary		YELLOW	●						
Royal Dutch Shell PLC	Netherlands	Energy	✔	YELLOW	●		●	●		●	
Tesco PLC	United Kingdom	Consumer Staples	✔	YELLOW	●			●		●	
Tullow Oil PLC	United Kingdom	Energy		YELLOW	●						

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile: GREEN Second quartile: YELLOW Third quartile: ORANGE Bottom quartile: RED

Engagements and Your Fund: Green rated

The table below highlights the companies with which we have engaged on your behalf in the past quarter and which you currently hold within your portfolio. The table is split by ESG risk rating. For full details of our engagements with companies please refer to the online ***reo***® client portal.

					Themes engaged						
Name	Country	Sector	Priority company	ESG Rating	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
AstraZeneca PLC	United Kingdom	Health Care		GREEN		●			●	●	●
Aviva PLC	United Kingdom	Financials		GREEN						●	
BT Group PLC	United Kingdom	Telecommunication Services		GREEN		●					
J Sainsbury PLC	United Kingdom	Consumer Staples		GREEN				●			
Pearson PLC	United Kingdom	Consumer Discretionary		GREEN						●	
Unilever PLC	United Kingdom	Consumer Staples		GREEN		●					●
Vodafone Group PLC	United Kingdom	Telecommunication Services		GREEN		●					●

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile: GREEN Second quartile: YELLOW Third quartile: ORANGE Bottom quartile: RED

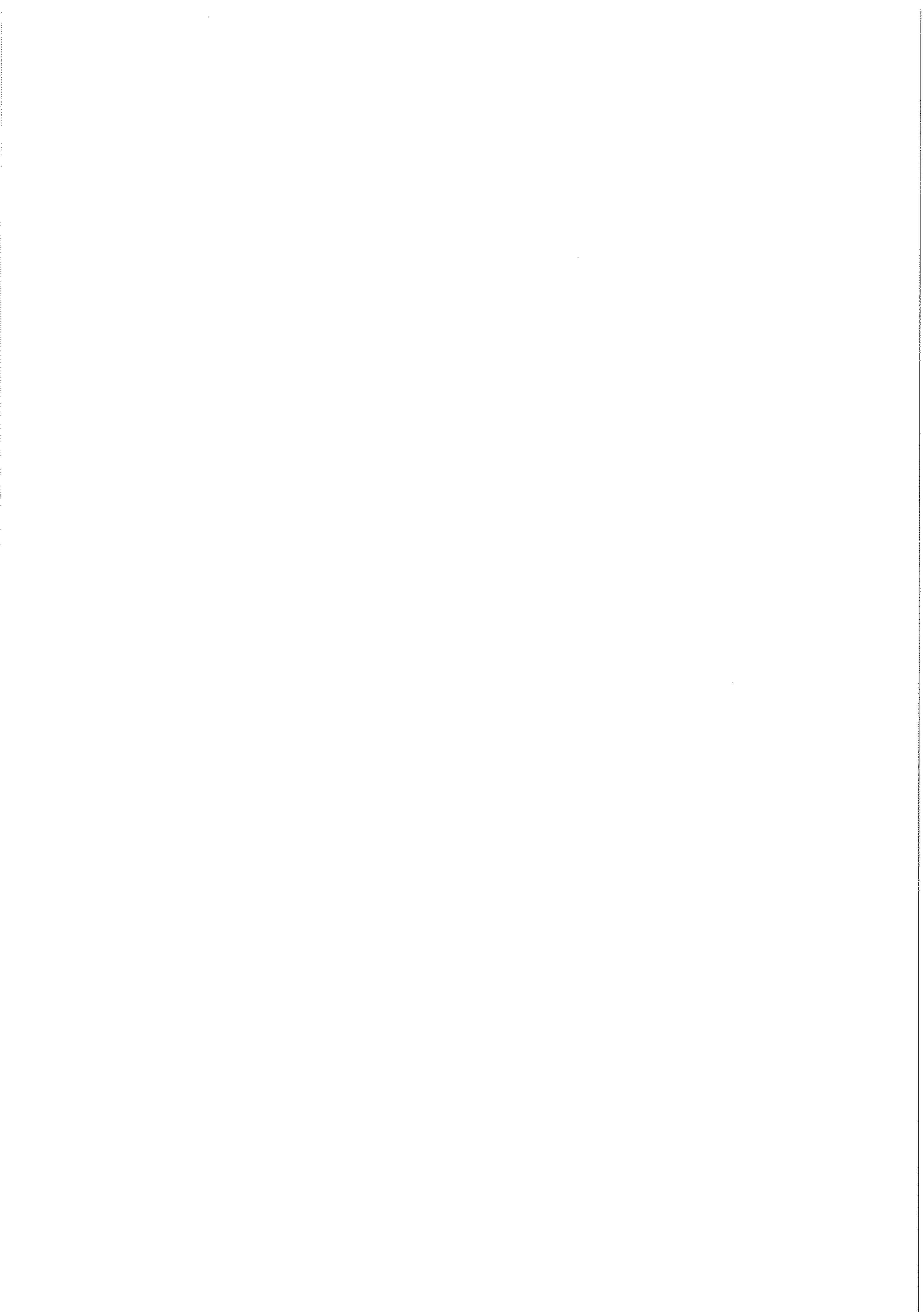
Milestones and Your Fund

The table below highlights the companies with which we have recorded milestones on your behalf in the past quarter and which you currently hold within your portfolio. Milestones are engagement outcomes which we have identified and is rated on the extent to which it protects investor value. For full details of our engagements which led to these milestones please refer to the online ***reo***® client portal.

					Themes engaged						
Name	Country	Sector	Priority company	ESG Rating	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
★★★											
Royal Dutch Shell PLC	Netherlands	Energy	✔	YELLOW	●						
★★											
BP PLC	United Kingdom	Energy	✔	RED						●	
Glencore PLC	Switzerland	Materials	✔	ORANGE	●						
HSBC Holdings PLC	United Kingdom	Financials	✔	RED						●	
Smith & Nephew PLC	United Kingdom	Health Care		ORANGE						●	
Standard Life PLC	United Kingdom	Financials		GREEN						●	
★											
HSBC Holdings PLC	United Kingdom	Financials	✔	RED						●	
Royal Dutch Shell PLC	Netherlands	Energy	✔	YELLOW		●					
Tullow Oil PLC	United Kingdom	Energy		YELLOW		●					

ESG Risk Rating: Rating of a company's ESG risk exposure and risk management compared to industry peers. Source: MSCI ESG Research Inc.

Top quartile: GREEN Second quartile: YELLOW Third quartile: ORANGE Bottom quartile: RED



ESG Viewpoint

April 2016

Matthias Beer, Associate Director, Governance and Sustainable Investment

Living wages in the garment supply chain

- **Goal:** Address wage concerns to mitigate supply chain labour standards risks
- **Engagement since:** 2015
- **Sectors involved:** Textiles, Apparel and Luxury Goods

Key summary

- Most apparel companies have been able to review and improve labour standards in their supply chains in recent years, yet workers' wages in many markets persistently remain below the cost of living.
- Despite some targeted corporate initiatives to address the question of living wages among supply chain workers, there is no evidence of any significant progress to date.
- Only two out of 40 companies we engaged have committed to a time-bound strategy to improve supply chain wages.

Background

Supply chain workers in many low-cost garment-producing countries remain trapped in poverty with income levels too low to afford basic necessities, such as sufficient food and adequate housing. This is leading to serious concerns about the welfare of more than 60 million people – and their direct dependents – employed in the textile, clothing and footwear sectors globally.

For more than a decade, we have been engaging with apparel companies on a range of supply chain labour issues, including health and safety practices, child labour policies and concerns over migrant labour standards. While we noted many improvements during this period, the Rana Plaza building collapse in Bangladesh in 2013 was a stark reminder of the persistent shortcomings and risks in many countries which supply the global apparel industry. There have been some important breakthroughs, including the introduction of a minimum wage and enhanced monitoring of social and safety standards. However, underlying structural issues – such as poor levels of governance and weak institutions – which could lead to similar catastrophes repeating, remain largely in place.

The issue of supply chain wages is intricately linked to such broader market failings that have eroded labour standards in many low-cost garment-producing countries.

Sourcing efficiency vs. risk

Clothing retailers operate in a fragmented and highly competitive market. Improving supply chain efficiency, gained through order volume and sourcing location, is crucial for retailers to achieve savings. In the past, many companies have increasingly shifted their sourcing into low-cost, low wage inflation countries like Bangladesh, Cambodia and more recently Myanmar.

The benefits of low costs in many of these producing countries need to be balanced against the disadvantage of longer lead times in shipping orders back to Europe and

North America. In addition, the increased risk associated with these countries, including business continuity issues and political risk, can result in even longer lead times for bringing products to market. This is crucial for many retailers where the success of the business model is reliant on being able to offer the latest fashion trends quickly and at an affordable price. As such, the Western apparel companies should have an incentive to develop innovative business models which seek to establish more sustainable sourcing markets where supply chain efficiency and risk factors are balanced.

However, the lack of progress in tackling labour standards continues to represent real business risks for suppliers from low-income countries and Western buying companies alike. In the context of in-work poverty, low wages can be linked at a factory level to high turnover of labour, restricted skills development as well as strikes and social unrest[1]. As a result, suppliers are more likely to experience operational disruptions and reduced productivity[2]. In addition to reputational risks, these factors can negatively affect the security of supply for global brands and retailers.

Definition: Living wage

Living wage is defined as the ability to earn enough in a standard week to cover all basic needs and some discretionary income for the worker and their immediate dependents. The concept of a living wage is established in several International Labour Organization (ILO) declarations and is acknowledged in the United Nations (UN) Universal Declaration of Human Rights and in the UN International Covenant on Economic, Social and Cultural Rights.

Engagement action

In 2015, we started an engagement project on this issue. We reached out to more than 40 textiles and apparel companies to discuss their approach for addressing wage concerns in their global supply chain. We asked for details on companies' risk exposure and mitigation measures as well as on specific activities focused on living wage questions. We also probed how companies monitor suppliers' general payment practices and how they assess procurement strategies in terms of their potential impact on wage levels.

To get a better understanding of leading practices in the garment industry, we initially spoke with five companies well-known to be working on the issue of supply chain wage levels. These were **Adidas, Hennes & Mauritz (H&M), Inditex, Marks & Spencer Group,** and **Associated British Foods** (parent company of UK fashion retailer Primark). Following these discussions, we developed a more detailed list of questions and reached out to a further 35 companies to review their approaches. All companies were assessed on three key-factors that can positively influence wage-setting processes: *sustainable purchasing practices, supporting workers' rights and collaborative action.*

Findings of engagement

Following our engagement with 40 companies, we divided them into three groups with distinct standard of practices around living wage.

- **Leaders**: 16 provided evidence of initiatives focused on wage levels in the supply chain. All five of the companies we spoke to at the start of this project Adidas, H&M, Inditex, Marks & Spencer Group, and Primark were in this group.
- **Middle-of-the-pack**: 14 companies had considerable supplier management and audit programs in place but did not carry out any specific actions to increase wages above the legal minimum wage. Although some executives expressed awareness of the risk of inadequate supply chain wages, their corporate response revolved primarily around monitoring actions linked to payroll systems, such as double bookkeeping, withholding social benefits payments and faulty overtime records.
- **Laggards**: 10 companies either did not review the risk of low supply chain wages or declined to discuss with us this topic altogether.

Barriers for changing wage levels

The following list shows key challenges companies highlighted to us as well as the main arguments we provided in response:

1. **Suppliers are independent companies**: Brands and retailers cannot pay supply chain workers higher wages as they are not their direct employers. ***Our view:*** *Meeting living wage levels can be incorporated in supplier contract requirements.*
2. **Changing wage practices requires regulatory action**: Some corporates point at the role of governments to ensure that legal minimum wage levels are adequate without outlining a strategy in low-cost markets with persistent wage concerns. ***Our***

[1] Ethical Trading Initiative (ETI): Living wages in global supply chains, 2015.
[2] Societe Generale: Social risk in the clothing retails supply chain, 2014.

view: Where regulation and market mechanisms are failing, companies individually and collectively are responsible to encourage governments to rectify the situation of low wages.

3. **Ineffective payment systems**: Standard supplier codes of conduct require compliance with countries' legal minimum wage or the industry average. Many companies pointed out that the industry must first ensure pay arrangements are in accordance with contract agreements which are implemented consistently. ***Our view**: Commitments to achieve living wage standards should be complementary to efforts targeting more fundamental shortcomings in pay systems.*
4. **Competitive barriers**: Companies hesitate to pay higher prices to suppliers for fear of putting themselves at a competitive disadvantage. ***Our view**: Competitors sourcing from the same suppliers and factories also presents opportunities for cooperating on developing supplier standards in partnership and to achieve living wage levels over time.*
5. **Calculating a living wage**: The actual measurement and setting of living wage levels remains subject to ongoing debate and many companies argue better methodologies need to be developed before wage benchmarks can be adopted more widely. ***Our view**: There are opportunities for brands and retailers to become part of the solution by contributing to the development of living wage estimates and benchmarks.*

Purchasing practices and living wage commitments

Standard supplier codes used by most companies in our sample include requirements for wage levels to comply with the country's legal minimum wage or the industry average. However, legal minimum wages in many low-cost sourcing countries fall short of meeting the cost of living. Companies that formerly recognise this difference between a minimum and a living wage in their supplier codes were more likely to have developed practices to improve supply chain wages.

All companies with specific living wage initiatives had reviewed their purchasing practices and considered steps to mitigate their impact on wage. The steps implemented included working with suppliers to improve productivity, developing more robust payment structures, and training programs for workers and suppliers on building social dialogue and industry relations.

Marks & Spencer and H&M were the only companies in our sample that had publicly committed to a timeline for improving supply chain wages. Other companies did not link their living wage programs to specific goals or timelines but focused instead on pilot projects that were being tested for their impact on improving supply chain wages. In addition, some companies like Adidas joined up with external organisations, such as the Fair Labor Association (FLA), which launched an ambitious fair compensation program that will benchmark data on supplier wages over the next years and measure progress among its members to increase wages[3].

Wage benchmarks and transparency

Companies' approaches to address living wage concerns have been met with some criticism, in particular the absence of any references to public guideline figures such as a living wage benchmarks. This omission has raised questions about ambitions and targets; at what salary figure will the company consider suppliers to have sufficiently increased wages[4]?

Moreover, a lack of commitment to specific targets and timelines to improve wages can create uncertainty about the overall accountability of corporate efforts. Companies and suppliers may have implemented business strategies aimed at enabling the achievement of living wages, but ultimately the results count: did workers in the end receive sufficiently higher wages? The findings of some pilots released so far suggest wage increases of just above the legal minimum wage, and still below widely used living wage estimates.

Corporate transparency on supply chains has improved generally, with companies like Adidas, H&M, **Levi Strauss & Co, Puma** and **Nike** having publicly disclosed their list of garment suppliers. This is an important development in as far as it enables civil society to monitor wage improvements at factory level. However, beyond this transparency, companies have generally been reluctant to commit to set living wage benchmarks. Some have developed internal benchmarks, yet these have not been publicly disclosed.

Collaborative approaches and collective bargaining

Instead of committing to public wage benchmarks, many companies prefer instead to support the establishment of appropriate mechanisms for determining wage levels, such as through collective bargaining agreements.

Most companies with explicit strategies on living wages work in close partnership with trade unions. Inditex, for example, was the first company in 2007 to sign a global framework agreement with IndustriALL which helped to reinstate

[3] See http://www.fairlabor.org/
[4] Labour behind the brand, 2016: http://labourbehindthelabel.net/wp-content/uploads/2016/02/DoWeBuyIt-spreadssml-1.pdf

workers expelled for being union activists, raise salaries and promote freedom of association in countries where unionisations has been weak. H&M also works with IndustriALL and other local trade unions to provide trainings for suppliers and workers.

Inditex, H&M and Primark initiated a top-down approach to improve supply chain wages: they joined efforts with a few other brands to work in collaboration with the global union IndustriALL on a program ACT (Action, Collaboration, Transformation) to kick-off industry level collective bargaining with national governments to improve minimum wage levels[5] .

Collective agreements, freely negotiated between employers, employees and elected trade union representatives, undoubtedly represent a crucial mechanism to address some of the structural power imbalances that can lead to an eroding of labour standards and wage levels. However, they are not mutually exclusive with using living wages benchmarks. In fact, most wage benchmarks include the input from multiple stakeholders, including employees.

When promoting collective bargaining, it is also important to consider the possibility of workers negotiating for wages below the cost of living, especially in situations with strong downward price pressures and unions operating in hostile environments. Therefore, the outcomes of collective agreements need to be carefully assessed within the context in which they were negotiated. In and of themselves they are not a guarantee for achieve living wage levels.

Conclusion and next steps

Achieving changes to supplier wage practices requires corporates to develop initiatives on a number of levels – ranging from scaling up pilot projects at factory level to working collaboratively on an industry level to influence market-wide standards. While a significant number of companies we engaged have recently launched new schemes aimed at addressing supply chain living wage issues, there are still few signs of any substantial progress. In most cases it is still too early to identify which programs are most successful in their implementation and outcomes. We are planning to review the progress of these initiatives as their results will be disclosed over the coming years.

In the meantime, we will be building on our engagement on the living wage theme by focusing on collective bargaining processes. The recognition of workers' right to freedom of association and collective bargaining provide an important precondition for addressing many supply chain labour standards issues (such as reasonable working hours, health and safety, discrimination, wage levels). In 2016, we have begun asking brands and retailers to detail how collective worker rights are acknowledged in their code of conduct, and what steps are taken to enable effective collective engagement with workers in the supply chain.

[5] ACT Factsheet: http://www.industriall-union.org/sites/default/files/uploads/documents/2015/Cambodia/act_factsheet2.pdf

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ESG Viewpoint

July 2016

Daniel Jarman, Associate Director, Governance and Sustainable Investment

Shareholder spring 2016: A contentious voting season

- Executive pay awards have attracted significant investor discontent this year in Europe.
- Shareholders have been emboldened to use their voting rights to strike down inappropriate pay plans for executives and vote against board directors in a number of high profile revolts.
- The high levels of votes 'against' represent a defining moment for shareholders and UK boards. It remains to be seen whether this is the new normal or a "flash in the pan".

Background

The 2016 voting season proved to be one of the most contentious ever. The term "Shareholder Spring" reappeared in media coverage as investors voted against executive pay resolutions at a succession of companies in Europe – particularly in the UK. Despite many years of engagement between investors and companies, significant concerns remain over corporate governance practices at major companies.

Back in the spring of 2012 we witnessed overall investor dissent at shareholder meetings rise to a level not seen in more than a decade with the main focus on executive pay. CEOs were toppled and high profile business figures such as Sir Martin Sorrell of **WPP plc** had to justify the level of pay they received. As companies were experiencing this increased level of shareholder dissent, the Department for Business Innovation and Skills (BIS) sought to enhance shareholder rights by requiring companies to seek binding shareholder approval for their remuneration policy (at least once every three years starting in 2013/14) before they could grant awards.

Companies and investors alike hoped at the time that with increased shareholder powers, engagement and guidance on executive remuneration, another 2012-style 'Shareholder Spring' would be avoided in future. However, four years on, we have witnessed levels of dissent exceeding those of 2012 with, what some commentators are referring to as, "Shareholder Spring II".

Deteriorating corporate earnings, the shift in energy prices and continued sluggish economic outlook around the globe have all played a part in setting the tone for this year's events. Nevertheless, the high levels of dissent seen at some companies has surprised observers.

Pay is not the only issue which attracted shareholder discontent this year. We have seen high dissent levels with respect to director elections and high levels of support for shareholder proposals at underperforming companies.

These trends are likely to continue in the UK market during the second wave of shareholder meetings in July, principally covering companies with financial years ending in March. It is not yet clear whether uncertainty following the UK EU referendum outcome will influence investor voting patterns. Sustained levels of votes against management in July would herald a defining shift in investor attitudes towards executive pay. We plan to review these developments later this year.

Continued

UK pay - jargon buster

In the UK there are two types of pay related resolutions on which investors can vote.

Remuneration policy: This defines the framework adopted by a company to decide on executives' pay. This includes the balance between salary, annual bonus, long-term equity plan and pensions. It also details the key performance indicators and targets. This is a binding vote – so companies have to follow investors' wishes. It is voted on generally every three years.

Remuneration report: This is an annual vote on how the remuneration policy was implemented. This would involve what performance was achieved and what payouts were made. This is an advisory vote – so companies retain discretion on whether the investors' wishes are followed.

Remuneration in focus

Following the 2015 voting season, in which only one remuneration report was voted down at **Intertek**, few in the market were anticipating the forthcoming events. Many assumed that this would be a year when management maintained a steady course before the next round of binding remuneration policy votes in 2017.

However, as meeting information was released, significant press coverage around the 2016 voting season began to hone in on remuneration at large UK companies. An increased attention from wider society on the level of pay awarded to executives was supported by large international investors gaining an appetite for voting against egregious pay packages following years of largely watching from the side-lines. The scene was set for an eventful season.

As at the time of writing (28 June 2016), we had seen five remuneration related proposals at FTSE All-Share companies voted down, two of which were binding. Many others had received high levels of dissent with **Shire** dodging a bullet with an extremely narrow 50.55% approval rate in response to a 25% salary increase for the specialty pharmaceutical company's CEO.

This year we saw the first binding remuneration policy voted down at the engineering company **Weir Group**. Contradicting the long-held view that investors typically shy away from voting against binding remuneration resolutions, over 72% of investors voted against the policy resolution. In addition, at the same meeting, a similar percentage of investors did not support the proposed long-term incentive plan.

Weir Group proposed to grant share awards to participants that were restricted to vest over several years although the company did not include performance conditions. This was in response to the challenging operating environment and a desire to retain and motivate staff. Given the binding nature of the proposals, the company will have to go back to the drawing board and present something more palatable to shareholders in future.

In mid-April, **BP** lost its remuneration report vote with approximately 59% of shareholders choosing not to support management. In a year when the energy company had announced its largest ever loss of $6.5 billion, the remuneration committee approved maximum awards under the annual bonus scheme and vesting of the long-term incentive awards to board level executives. The CEO Bob Dudley's pay totalled £14m for 2016. This award, in light of company performance and judgements made by the remuneration committee, was deemed to be excessive.

We engaged with the company prior to the AGM and are currently continuing this conversation ahead of the 2017 remuneration policy vote. The majority of shareholders recognised that the problems arose due to a pay-for-performance disconnect at the company. Investors and the company are now required to draw upon this experience to ensure safeguards are built into the remuneration policy to avoid such perverse outcomes in future.

Elsewhere at **Smith & Nephew,** 53% of shareholders voted against the annual remuneration report of the medical devices company. The point of contention was the use of discretion by the remuneration committee, which adjusted the performance result for the long-term incentive award to allow 25% of the potential maximum award to vest under the total shareholder return (TSR) element. Over the period the company had achieved approximately 80% absolute return and outperformed the upper quartile of the FTSE100 on a relative basis. However, against its chosen comparator peer group, the company finished slightly below median; yet the remuneration committee decided that an adjustment to this result was warranted.

Whilst the above two companies set the voting season off to a momentous start, they were by no means the only companies to receive high levels of dissent. Some further interesting cases are highlighted below.

- **Paysafe Group**: Remuneration report voted down. Significant increase in salary awarded to the CEO along with increases to bonus limits. The company also chose not to disclose sufficient information relating to the annual bonus performance conditions and also made a significant non-performance related award to the CFO on recruitment.

Continued

- **Anglo American**: Performance issues following collapse in commodity prices resulting in a 75% fall in share price over the year under review. The remuneration committee chose to continue awarding long-term incentive grants at their normal level, without reducing them on account of poor underlying performance. Due to the share price fall, this resulted in a much higher number of shares being awarded which would provide a large payout should share price recover.

In continental Europe, we also saw high profile cases of shareholders revolting against pay. A majority of investors voted against pay plans at French carmaker Renault and German lender Deutsche Bank. Of Renault's investors, 54% including the French government, voted against CEO Carlos Ghosn's 2015 remuneration package (€7.2 million). This was the first time that shareholders have rejected a say-on-pay proposal in France in the two years since it was introduced. Renault's board chose not to reduce the CEO's pay and this caused a swift response by the government. It retaliated by toughening market rules and introducing a binding vote on pay in France. The rejection of the remuneration system at Deutsche Bank stemmed from concerns about the poor link between pay and performance. In addition, in a year when the company did not award bonuses or long-term incentives, investors nevertheless questioned the discretion that the Supervisory Board could exercise over awards in future.

Outcome and next steps

Despite the increased disclosure, shareholder engagement, remuneration committee independence and the binding remuneration policy vote, so far this year investor support for pay overall is going down, not up. The second phase of shareholder meetings in the UK will take place in late-July and this may bring further upsets for companies. We did not support any of the resolutions covered and are planning to engage with the companies on the issues. We will be particularly critical of remuneration committees which chose to ignore investor views. We plan to release an update in the autumn on our engagement activities and future plans. With the next round of remuneration policy votes approaching in 2017, we expect a continued and intense focus on pay in the coming year.

Director elections

Remuneration was not the sole issue that led to high levels of votes against management. The re-election process for UK board directors has become more rigorous in recent years as a result of the introduction of annual director re-elections at the majority of UK companies and amendments to the Listing Rules to require companies with a controlling shareholder to grant minority shareholders a separate vote on the election of independent directors.

The force of the new Listing Rule was felt at majority controlled **Ferrexpo** where 75% of minority shareholders did not support the re-election of five non-executive directors. The iron ore company is now required to hold a shareholder meeting to seek approval of the re-election of these directors. This will take place following a consultation process to understand investor concerns.

Housebuilder **Persimmon**, also received an unusually high level of dissent (47%) the election of new Non-Executive Director Nigel Mills. Having served as a Senior Adviser at Citigroup Global Markets, and also as Chairman of Corporate Broking at Citi between 2005 and 2015, investors questioned Mr Mills's independence given that Citi is one of Persimmon's financial advisers/stockbrokers. His appointment resulted in further reduction in the proportion of independent representatives on the board which can be detrimental to the investor interests.

Whilst the board maintains Mr Mills is independent, , the company intends to meet with shareholders to discuss the issue.

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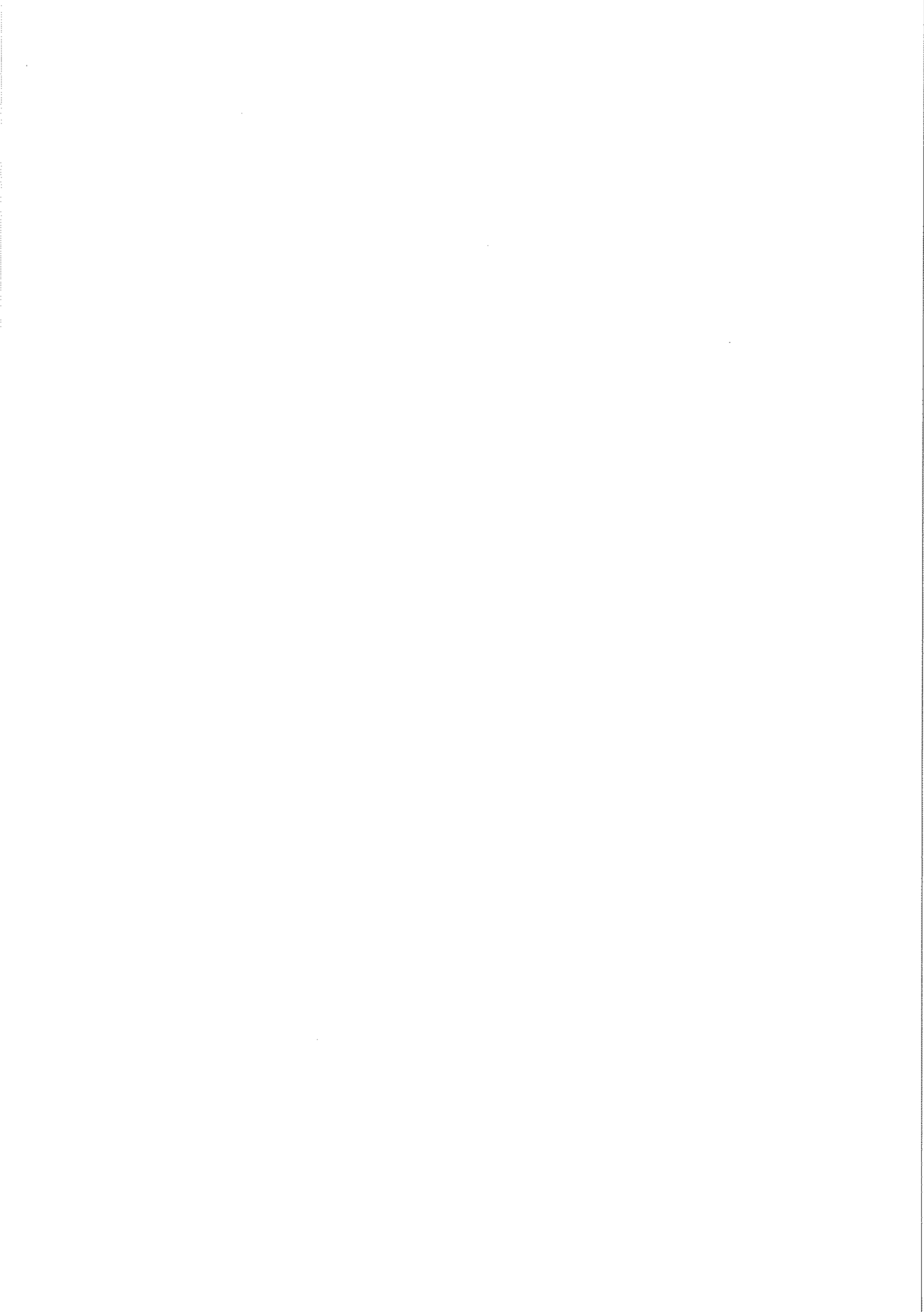

ESG Viewpoint

July 2016

Vicki Bakhshi, Head of Governance and Sustainable Investment

Perspectives on Brexit: The impact on responsible investment

Short-term impacts of the Brexit vote may create market headwinds and regulatory uncertainty.

But at times of heightened risk, long-term investment thinking becomes even more important.

The dissatisfaction behind the vote adds to momentum for a more sustainable form of capitalism.

It is still early days following the 'Brexit' vote with the political and market fallout continuing. Wider market impacts were discussed in detail in a note by BMO Global Asset Management's EMEA investment teams*. Here we focus in on one of our core business areas: responsible investment.

Overall, our view is that the momentum behind responsible investing is global, and the Brexit decision will not put this into reverse. By their very nature, activities such as engagement with companies on the management of environmental, social and governance (ESG) issues are long term in nature, and not affected materially by market volatility. However, the wide-ranging causes and consequences of the referendum result will change the context in which we as a UK-based responsible investor operate.

Investment implications for the Responsible Funds

Our Responsible Funds are actively-managed funds which screen out companies involved in controversial activities or that fail to meet minimum sustainability standards, and positively favour investment in companies with strong management of environmental, social and governance (ESG) risks and opportunities.

In the short term, equity market volatility and the flight to 'defensive' sectors can work to the disadvantage of ethically-screened funds, which typically have below-market exposure to sectors including tobacco, defence and extractives. However, looking beyond this period of unusual market activity, the rationale for our long-term investment approach across the Responsible Funds range remains compelling and is perhaps enhanced. Across both equities and credit, we seek to invest in quality companies with sound long-term strategies and solid governance that offer superior growth. These companies should still derive better share price performance over the mid-to-long term, and should be well-placed to adjust to reflect dramatically new realities.

Company engagement – don't neglect the long term

In times of uncertainty or economic weakness, companies tend to retrench and go into short-term crisis management mode. We believe at BMO Global Asset Management (EMEA) that Brexit is likely to lead to a UK economic slowdown, though with sterling weakness providing some comfort to exporters. Faced with weaker growth and regulatory uncertainty, we anticipate that in the UK market in particular, but also potentially across the EU, getting Board time and

attention focused onto long-term issues such as climate change is likely to be more challenging.

In our company engagement we will be sensitive to the more difficult environment, but will continue to emphasise the importance of long-term thinking, which is perhaps now more, rather than less, important.

Regulatory uncertainty

The vote has no immediate regulatory implications, given that Brexit will take at least two years and potentially longer. However, the UK's voice will be less influential at the European table, and the uncertainty over exactly how our legislation will be disentangled from the EU will hang over the UK economy.

For the financial services industry as a whole, the key issue will be 'passporting' – the ability of asset managers in any EU jurisdiction to market across the region. Successfully resolving this issue will be key to retaining London as a centre of excellence for responsible investment.

More specifically, the UK had been an advocate for the inclusion of strong responsible investment principles in key European legislation, particularly the Capital Markets Union Directive and the revisions to the European Shareholder Rights Directive. Losing influence could be a negative factor in the finely-balanced negotiations underway.

Another key area will be climate and energy policy, where European legislation such as the EU emissions trading scheme has been driving towards a more common European approach. However, the EU is no longer the primary driver of the UK's energy policy. The Paris deal sets a broader global direction, and in the UK, an ambitious 2032 emissions goal has just been set – the change in the relationship with the EU is unlikely to materially impact the direction of travel. Of greater potential significance is the political fall-out from the Brexit vote, which included the abolition of the Department for Energy and Climate Change and incorporation of its functions into the Department of Business, Energy and Industrial Strategy. This was widely viewed as a step backwards, though it is yet to be seen whether this was a change in name or a change in substance.

Brexit and sustainable capitalism

Beyond these direct impacts on responsible investment activities lies a deeper question about the state of capitalism. Certainly, the vote reflected dissatisfaction with the European Union as an institution. But it also reflected a much deeper malaise, particularly amongst lower-income groups: disempowerment, a mistrust of institutions, and anger that the spoils of capitalism have not been fairly shared. EU membership and immigration became the scapegoats. This is not unique to the UK: it is also seen in the rise of populist, anti-establishment parties across Europe, and indeed elsewhere in the world.

Within this challenging context lies an opportunity for investors to be part of a move towards a more sustainable form of capitalism. Getting across the message that investors can actually be a force for good – by financing sustainable companies, through investor engagement, and active involvement in public policy – can be one part of changing the narrative about whose purpose capitalism actually serves.

Bringing this back to our engagement with companies, we see these deeper root causes behind Brexit as a warning shot to companies. Disempowerment and mistrust are as much a risk to businesses as they have proven to be to governments. Our engagement around human capital management and supply chain labour standards, already a focus for BMO Global Asset Management (EMEA) this year, takes on added impetus. Companies that genuinely invest in their staff and their careers, have a thoughtful approach to such issues as paying a fair living wage and avoid the egregious excesses of executive pay are more likely to gain loyalty and thrive in the more uncertain world ahead, and at the same time will make their own contribution to the wider global challenge of inequality.**

**Early impressions: Perspectives on Brexit,* can be found on our website at:
www.bmogam.com/uk/intermediaries/news-and-views/

***ESG Viewpoint- Living Wage-April 2016,* can be found on our website:
www.bmogam.com/uk/institutional/products/responsible-investment/

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