April 2014

Governance & Engagement Report Q1 2014

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Introduction

We are sometimes asked whether we ever sell shares in a company because of poor environmental, social or governance (ESG) practices. Fortunately this is rare, because we invest exclusively in companies providing solutions to sustainability challenges so companies with poor ESG practices tend not to qualify for the fund. However, there are inevitably companies that do not adopt the high ESG standards that we typically like. We engage actively with these businesses but, where engagement is unsuccessful, we are willing – and do – use the ultimate sanction of divestment. We describe an example of this which happened this quarter as well as reporting on more positive impacts that we have had over the period!

When enough is enough – when to divest?

The ultimate sanction that active investors have in efforts to engage with companies is their ability to sell company shares. This step is usually only taken after all other efforts have been exhausted in trying to convince a management team to address the issue of concern.

One company which we chose to sell during the quarter, in part because of a failure to get a satisfactory response to our engagement, was a US industrial business called Emerson Electric. The team had held Emerson shares for approximately six years, first when running SRI funds at Henderson, and for the past two years while at WHEB. The stock price over this time has broadly tracked the S&P 500 index of shares.

Emerson is a business …[which] in our view, has been unresponsive to investor engagement

In recent years, however, sales growth has slowed at Emerson. According to analysts William Blair, the company's compound annual growth rate in sales was 13% for the period from 2003-2008 and only 6% from 2010-2013[1]. Management recently confirmed its outlook for underlying sales growth of 3 to 5 percent for 2014[2]. This slowdown may be temporary, and in other businesses displaying what we consider to be better governance, we might have been tempted to hold onto our position in anticipation of a recovery. However, we had reached the conclusion that Emerson is a business where we have concerns over corporate governance and, in our view, has been unresponsive to investor engagement seeking changes in the way the company is governed and how it reports to investors and other stakeholders.

The list of issues is long. ISS (Institutional Shareholder Services, the independent governance and proxy advisory service), ranks Emerson in the bottom decile of US companies for the quality of its governance[3], board composition and practices. Even in audit, an area of corporate governance at Emerson that ISS rates more highly, the company has not changed its auditors for 71 years. Current legislative proposals in the EU suggest that good practice is to rotate auditors every ten years[4].

At the most recent Annual General Meeting, fully 49% of shareholders abstained or voted in favour of a resolution calling for the company to start reporting on its performance on sustainability.

We have attempted to engage the company on a range of issues including co-filing shareholder resolutions encouraging the company to report on critical social and environmental issues facing the business. The company though has been unresponsive to these concerns. At the most recent Annual General Meeting in early February 2014, fully 49% of shareholders either abstained or voted in favour of a resolution calling for the company to start reporting on its performance on sustainability issues[5].

A similar resolution has been tabled for four years running, attracting support (not including abstentions) of more than a third of those shares voted in each year. Emerson's current reporting of environmental issues is, we consider, wholly inadequate. The company scored just nine out of 100 in the 2012 analysis of responses to the Carbon Disclosure Project[6]. In 2013, Emerson's response was not included because it was submitted after the deadline for responses had expired. The average score in 2013 for the industrials sector as a whole was 65.

[1] William Blair, Emerson Electric Co., 13 February 2014
[2] http://www.emerson.com/en-US/newsroom/news-releases/emerson-financial-news/Pages/Emerson-Reports-First-Quarter-2014-Results.aspx.
[3] ISS Proxy Advisory Services, Emerson Electric Co., 4th February 2014
[4] Financial Times, EU deal marks big step in auditor rotation reforms, 17 December 2013

Earlier this year we reached the decision to divest our shares in the company and have written to the CEO to explain why.

We've written repeatedly to the company about these issues as well as co-filing shareholder resolutions. We've also worked with other investors to try and emphasise why, in our view, these issues represent commercial risks and opportunities for the business. However, after an initial meeting and exchange of views after the first resolution was filed in 2010, we have had no further opportunities to discuss these issues with the company in spite of repeated requests for ongoing dialogue.

There are other issues at the business. In our view the CEO's remuneration remains very high in spite of lacklustre growth in recent years[7]. In 2013 the total package equated to over US$25m. In 2012, although the overall package was lower at US$10.4m this equated to a package that was, according to Bloomberg, 177 times the salary of an average Emerson employee[8]. In our view this degree of pay stratification is harmful to long-term company performance.

Earlier this year we reached the decision to divest our shares in the company and have written to the CEO to explain why. Ultimately this means that our engagement has been a failure. We have not managed to convince the management team to engage seriously with our concerns. This represents a relatively unusual outcome for our engagement which more typically leads to at least modest positive change. We greatly regret this. Emerson remains an interesting company in an attractive sector, albeit one that seems determined to ignore the views of a substantial proportion of its own shareholders in relation to environmental, social and governance concerns. We believe that this represents a significant flaw in the governance of the company, and for this reason we have decided to exit from our interest in the business.

Orpéa: how healthy dialogue de-risks investment

In contrast to our experience at Emerson Electric as described above, we are able to report on a much more productive engagement with Orpéa a €2.3bn business in the fund that fits our 'Well-being' theme and operates retirement homes and rehabilitation clinics listed on the Paris stock exchange.

Our intervention had been used by the Chairman to highlight the importance of business ethics to the company's broader management team.

Our initial engagement with the company focused on their management of business ethics risks at the company. Orpéa had screened poorly against a series of criteria that indicated high levels of business ethics risks in the business[9]. We sought a conversation with the Chairman, both to understand whether they recognised the risk factors that we had identified, and to assess how they mitigated these risks.

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We've reported before on this engagement which involved conversations with the Chairman and then subsequently with Investor Relations, most recently in mid-February 2014. On these occasions we have been impressed with the degree of oversight that these issues receive from the management team and the rigor with which they manage them. What was particularly pleasing, however, was that Orpéa reported to us that our intervention had been used by the Chairman to highlight the importance of business ethics to the company's broader management team. Furthermore, the company had also begun to use our framework to inform the company's efforts to expand into new geographies such as China where business ethics issues are particularly pressing.

The importance of business ethics is clearly one area where we as investors are closely aligned with the attitudes of Orpéa's Chairman and wider executive. We believe that our work has helped underline the importance of this issue within the business and is helping managers to implement more robust business ethics practices. There are, however, areas where we continue to have an on-going dialogue with the company such as on the level of board independence.

We believe that such engagement can help reinforce the importance of strong governance focused on long-term performance

A 'healthy dialogue' does not mean we always agree with each other, but so long as exchanges remain respectful and open-minded, we believe that such engagement can help reinforce the importance of strong governance focused on long-term performance. This in turn can help companies achieve superior, long-term returns when compared with companies without such engagement.

[5] http://www.sec.gov/Archives/edgar/data/32604/000003260414000012/kendleelection2014annualme.htm
[6] https://www.pwc.com/us/en/corporate-sustainability-climate-change/assets/pwc-cdp-s-and-p-500-climate-change-report.pdf
[7] Op. Cit. 1 and 2
[8] http://go.bloomberg.com/multimedia/ceo-pay-ratio/
[9] Risk factors include the geography of operations, the extent of recent mergers and acquisition activity, the degree of reliance on public sector customers as well as 14 other business characteristics

Spreading the message – building support for sustainable investing

In addition to the bilateral work engaging with individual companies (as above and summarised in the table below), we also undertake a wide variety of projects with other investors, foundations and companies aimed at promoting more sustainable ways of investing. Among the initiatives that we have taken this quarter are:

- Co-organising an event with the French Responsible Investment Forum (Forum pour l'Investissement Responsable) and HSBC for 80 institutional investors in Paris to share best practices in investor engagement and encourage French investors to develop their own practices in this area;
- Hosting a similar event in London aimed at encouraging charitable foundations to work with their own asset managers to engage with companies on their behalf on critical ESG issues; and,
- Hosting the fourth in a series of events for leading corporates and their pension funds aimed at encouraging the pension fund to embrace sustainability issues in the same way that leading corporations are now integrating sustainability issues into their strategies.

During the quarter we co-organised an event with the French Responsible Investment Forum and HSBC for 80 institutional investors in Paris

Summary of other areas of work

The following section details the range of engagement work that we have done bilaterally with individual companies in our portfolio and in the wider investment themes as well as the voting that we have done at annual general meetings that were hosted during the quarter.

Company	Topic	Comment	Outcome	Date
Tianneng Power	Environmental pollution	Sold company shares because of concerns about lack of transparency and poor environmental management quality	Company stated that they have been increasing mgmt. focus on environmental issues and have set up study group to develop clearer disclosure	16/1
Orpea	Board independence Quality mgmt. & business ethics	Wrote expressing our concerns over insufficient board independence Met IR to discuss quality mgmt. issues	Company believes that Board Directors representing major investors have useful skills for Board discussions See discussion above	14/2
Johnson Controls	CEO remuneration Auditor independence	We believe that the CEO's remuneration (US$18m) and length of auditor tenure (63yrs) are excessive	No response received by 31/3	16/2
Varian Medical Systems	Auditor independence	Believe length of auditor tenure (52yrs) is excessive	No response received by 31/3	17/2
Emerson Electric	CEO remuneration Auditor independence Transparency	We believe that the CEO's remuneration (US$25m) and length of auditor tenure (71yrs) are excessive Poor sustainability reporting	No response received 31/3 See discussion above	20/2

Company	Topic	Comment	Outcome	Date
Canadian Solar	Environmental, Health and Safety Management	Company has performed poorly in third party surveys of industry	No response received 31/3	26/2
Umicore	Management of hazardous chemicals	Teleconference to understand more on their approach to this issue	Recognise investor interest in this issue and will review strategy and reporting	28/2
Kemira	Management of hazardous chemicals	Teleconference to understand more on their approach to this issue	Company is proactively addressing this issue and have already phased out some materials	4/3
Smurfit Kappa	Management of forest assets	Company performed well in third party research – keen to understand more about their approach	No response received 31/3	10/3
Nibe	Environmental management	Management of refrigerants with high global warming impact	Call scheduled for early April	24/3
Cooper Companies	Auditor independence	Auditor tenure is 34 years which we believe is excessive	No response received 31/3	31/3
Covidien	CEO remuneration and share issuance	Long-term incentive is weak and should include more ESG parameters Share issuance is overly generous	No response received 31/3	31/3
Geberit	Auditor independence	Non-audit work comprises 62% of total fees compromising independence	No response received 31/3	31/3
Agilent	CEO remuneration	Long-term incentive is weak and should include more ESG parameters	No response received 31/3	31/3

Voting record: Q1 2014

The table below summarises the voting record for the FP WHEB Sustainability Fund from 1 January – 31 March 2014. Full details of how we voted on each of the individual votes are detailed in Appendix 1 (http://www.whebgroup.com/investment-strategies/listed-equity/fund-governance/engagement-and-voting-records/) including with rationales for votes against management and abstentions and where we supported shareholder resolutions.

Meetings	# of meetings	%
# votable meetings	11	-
# meetings at which votes were cast	11	100%
# meetings at which we voted against mgmt. or abstained	7	64%

Resolutions	# of resolutions	%
# votes cast with management	103	88%
# resolutions where votes cast were against mgmt. or abstained (see list in appendix)	14	12%
# resolutions where votes were withheld	0	0%