WHEB

# Responsible Investing: Engagement Report Q2 2014

## Introduction

The second quarter of the year is always largely occupied with voting at company annual meetings. This year we voted at nearly 50 company meetings which we analyse and report on below. We have though also continued to engage bilaterally with many of the companies in our portfolio outside, or at least alongside, the more governance oriented activity at AGMs. We describe two initiatives below involving our on-going work on hazardous chemicals and on biodiversity.

A full list of our engagement is also included in tables on pages 3-5 with summary details of our voting record during the quarter on page 6.

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## Toxic chemicals at Johnson Matthey

Over the past eighteen months, WHEB has been leading a collaborative engagement initiative involving several UK institutional investors and focusing on toxic chemicals.

Our objective has been to understand the degree to which speciality chemical companies are involved in the manufacturing, processing or sale of chemicals that are considered to be Substances of Very High Concern (SVHC) by the European Commission. These substances are being increasingly tightly regulated in the EU and elsewhere and in some cases are being banned.

WHEB has no exposure to commodity chemical companies as they do not fit our social or environmental investment themes, but we do invest in some speciality chemical companies including the UK company Johnson Matthey (JM).

JM is a speciality chemical business that offers a range of important environmental and health benefits including manufacturing catalysts to reduce hazardous air emissions from automobiles and fine chemicals for use in the pharmaceutical industry.

In total, JM has businesses that handle four substances that are considered to be 'candidates' for authorisation as SVHCs by the European Commission. A further four are considered to be controversial by environmental groups. It was clear from our meeting, and subsequent correspondence, that the company has a robust approach to the management of these substances, but did not have a systematic approach for assessing and managing the risks of phase-out for these chemicals and the opportunity for developing less hazardous substitutes. In some cases, the company had successfully introduced alternatives, but in others their efforts had not succeeded.

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We followed up our meeting with a suggestion that the company make the issue of hazardous chemicals a higher priority, particularly in developing a more systematic approach across the company as a whole to assessing which substances are likely to be regulated, what the commercial implications of this might be, and what the company should do about it.

We were very pleased therefore to read in the company's 2014 Annual report a case-study on the work that they have been doing to manage hazardous chemicals and their decision to boost the resources they have within the business to manage these issues and to promote the use of green chemistry across the group.

*The fund does not hold any mining companies nor any fossil fuel exploration and production companies.*

## Protecting biodiversity: Smurfit Kappa

The FP WHEB Sustainability Fund is invested exclusively in companies providing solutions to sustainability challenges, and therefore we do not tend to hold high impact companies in the extractive industries. So for example, the fund does not hold any mining companies nor any fossil fuel exploration and production companies.

However, we do still have some businesses that have exposure to sensitive issues including potentially negative impacts on biodiversity. One such company is the Irish cardboard manufacturing company Smurfit Kappa. Approximately 75% of the company's raw material comes from recycling, but the company does own its own virgin manufacturing operations including timberlands in Latin America, principally in Colombia. We engaged with the company to understand both the extent to which biodiversity impacts are taken into account and the scope for improving the management of these issues.


The issue is clearly already on Smurfit Kappa's agenda and in many areas is a regulatory requirement. Approximately one third of all forest land that they own in Latin America is protected as natural forest. The company's plantations are typically contiguous to this protected forest and serve as a buffer, protecting it from development pressures. Importantly the company does not use fertilisers or pesticides that might leach or drift into the protected areas and instead use biological controls. All timberlands in Latin America are Forest Stewardship Certified (FSC).

The company has also conducted a series of research programmes together with local universities to catalogue the range of species on the company's estate. Their policy is to ensure that forestry practices on their estates support the important role that the protected forest plays for the indigenous species within it. We have encouraged the company to produce additional data on the success of their management practices in achieving this objective and to disclose this data in their annual report.

*Auditor tenure was as much as 44 years at one company.*

## AGM voting 2014: Key themes audit and disclosure

The vast majority of company annual general meetings (AGMs) happens during the second quarter of the year. Over the past three months we have voted 639 times at 49 company meetings. While the vast majority of these votes are uncontroversial, we have nonetheless elected to vote against company management at 62% of the companies that we invest in. The areas where we disagree with management tend to fall into a relatively small number of areas. This quarter the key issues were:

- **Lack of independence of the auditor**: Auditor tenure was as much as 44 years at one company. Recent policy recommendations from the European Commission suggest that the audit contract should be retendered at least every ten years. We voted against or abstained at 20 company meetings on this issue.
- **Executive remuneration**: We voted against or abstained on 13 votes involving executive or board-level compensation. In seven cases this was explicitly a vote against the absolute amount of the package. Our policy is to be inclined to vote against executive compensation packages that exceed US$10m in any year.
- **Independent directors**: Another common issue is a lack of independent directors and/or independent chairman at Board level. We do not have a hard and fast policy on this, but are inclined to vote against or abstain on votes where there is insufficient independence at Board level. This year we voted against five companies on this basis.
- **Sustainability reporting**: A perennial challenge remains the lack of quality disclosure from companies on environmental, social and governance (ESG) issues. Most sizeable European businesses now provide reasonable levels of disclosure of these issues, but this type of disclosure is still quite rare among mid-sized US businesses. While not something that regularly comes up for a vote at AGMs, we have nonetheless written to nine companies explicitly asking them to improve their reporting of critical ESG issues in their annual disclosures.

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Further details on the bilateral engagement work that we have done over the quarter is covered in the following tables.

## 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 |
|---|---|---|---|---|
| Geberit | Independent audit | Non-audit represent 62% of total fees | No response received as of 30/6 | 3/4 |
| Cooper Companies | Auditor independence | Auditor tenure is 34 years which we believe is excessive | Brief response acknowledging receipt of letter | 7/4 |
| Agilent | CEO remuneration | Long-term incentive is weak and should include more ESG parameters | Co. emphasised long-term performance structure but admitted that CEO has no ESG performance criteria | 7/4 |
| Nibe | Environmental management | Management of refrigerants with high global warming impact | Robust approach to managing issue, but encouraged higher priority and better disclosure | 9/4 |
| Dialight | Independent audit | Auditor has been in place for 12 years | No response received as of 30/6 | 16/4 |
| Praxair | CEO remuneration | CEO's pay of US$15m and poor disclosure | Co. believe that compensation level is appropriate | 22/4 |
| Hera | Corporate governance | Poor levels of disclosure around remuneration & voting | Co. clarified policy on director remuneration incl. 25% on ESG. Agreed to consider longer term criteria | 23/4 |
| Comfortdelgro Ltd. | Independent audit / Director independence | Auditor has been in place for 11 years / Board director commitment | Clarification on Directors external commitments and audit policy | 23/4 |
| Regal Beloit Corporation | Independent audit | Auditor has been in place for 12 years | No response received as of 30/6 | 28/4 |
| Umicore | CEO remuneration / Director independence | Lack of ESG criteria in CEO remuneration / Lack of independent directors | Brief response acknowledging receipt of letter | 29/4 |
| ABB Ltd. | Incentive plans | Lack of disclosure on detail of performance criteria in incentive plan | Brief response acknowledging receipt of letter | 30/4 |
| Kansas City Southern | Independent audit / ESG disclosure | Auditor tenure is 13 year / Poor disclosure on ESG performance | No response received as of 30/6 | 1/5 |
| Canadian Solar | Environmental, Health and Safety Management | Company has performed poorly in third party surveys of industry | Conference call planned | 6/5 |

| Company | Topic | Comment | Outcome | Date |
|---|---|---|---|---|
| Danaher | Independent audit / CEO compensation / ESG disclosure | Auditor tenure of 12 years / CEO remuneration of US$20m / Poor ESG disclosure | No response received as of 30/6 | 6/5 |
| Schneider Electric | CEO and CFO severance packages | Excessive severance packages equivalent to 24 months pay | No response received as of 30/6 | 6/5 |
| Xylem | Independent audit | Auditor tenure of 13 years | No response received as of 30/6 | 6/5 |
| Assa Abloy | Executive incentive plan | Time period for incentive plan only one year. Argued for longer time period. | No response received as of 30/6 | 7/5 |
| Ecolab | Independent audit / CEO remuneration | Auditor tenure of 44 years / CEO pay of US$11.5m | No response received as of 30/6 | 8/5 |
| Mednax | Independent audit / CEO remuneration | Auditor tenure of 15 years / Performance criteria for CEO bonus too generous | No response received as of 30/6 | 8/5 |
| Mettler-Toledo International | Independent audit | Auditor tenure of 15 years | No response received as of 30/6 | 8/5 |
| Trimble Navigation | Corporate governance | Board director attending <75% of Board meetings | No response received as of 30/6 | 8/5 |
| WABTEC | Independent audit | Auditor tenure of 12 years | No response received as of 30/6 | 14/5 |
| NIBE Industrier | Corporate governance | Insufficient number of independent board directors | No response received as of 30/6 | 15/5 |
| Stantec | Independent audit | Auditor tenure of 21 years | No response received as of 30/6 | 15/5 |
| Arcadis | Corporate governance | Take-over defence that is not in the interests of shareholders | No response received as of 30/6 | 16/5 |
| Intertek Group | Independent audit | Auditor tenure of 18 years | No response received as of 30/6 | 16/5 |
| Pentair | Corporate governance / CEO remuneration / Independent audit / ESG disclosure | Separation of CEO and Chairman / Audit tenure of 37 years / CEO remuneration of US$12m / Poor ESG disclosure | No response received as of 30/6 | 20/5 |
| Thermo Fisher Scientific | Independent audit / CEO remuneration | Auditor tenure of 12 years / CEO remuneration of US$16m | No response received as of 30/6 | 20/5 |

| Company | Topic | Comment | Outcome | Date |
|---|---|---|---|---|
| Roper Industries | Independent audit / CEO remuneration / ESG disclosure | Auditor tenure of 12 years / CEO remuneration of US$21m / Poor ESG disclosure | No response received as of 30/6 | 21/5 |
| Stericycle | Independent audit / ESG disclosure | Auditor tenure of 25 years / Poor ESG disclosure | No response received as of 30/6 | 21/5 |
| China Longyuan Power Group | Corporate governance / ESG Disclosure | Equity issuance too dilutive and inadequate ESG disclosure | No response received as of 30/6 | 22/5 |
| Quanta Services | Independent audit / ESG disclosure | Auditor tenure of 12 years / Poor ESG disclosure | No response received as of 30/6 | 22/5 |
| Smurfit Kappa | Management of forest assets | Company performed well in third party research – keen to understand more about their approach | Strong approach to managing biodiversity impacts – encouraged more disclosure (see above) | 28/5 |
| CT Environmental | Corporate governance | Equity issuance too dilutive and inadequate disclosure | No response received as of 30/6 | 29/5 |
| Boer Power | Corporate governance | Equity issuance too dilutive and inadequate disclosure | No response received as of 30/6 | 30/5 |
| IPG Photonics | Independent audit | Auditor tenure of 14 years | No response received as of 30/6 | 3/6 |
| Pall Corporation | Executive Remuneration | Wrote expressing concern over what we consider to be excessive CEO pay | Co. has agreed to review their process of benchmarking CEO pay | 6/6 |
| Keyence Corporation | Corporate governance | Inadequate pay-out ratio | No response received as of 30/6 | 12/6 |
| DaVita Healthcare Partners | Auditor tenure / ESG Disclosure / CEO remuneration | Auditor tenure of 14 years / Poor ESG disclosure / CEO remuneration of US$16.6m | No response received as of 30/6 | 17/6 |
| HMS Holdings | Independent audit | Auditor tenure of 33 years | No response received as of 30/6 | 19/6 |
| East Japan Railway | Corporate governance | Insufficient number of independent directors | No response received as of 30/6 | 24/6 |
| Littelfuse | ESG Disclosure | Relatively poor disclosure of ESG performance | Co. plans to disclose operational and sustainability metrics | 24/6 |
| Ebara | ESG Disclosure | Relatively poor disclosure of ESG performance | No response received as of 30/6 | 24/6 |

## Voting record: Q2 2014

The table below summarises the voting record for the FP WHEB Sustainability Fund from 1 April – 30 June 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 | 52 | - |
| # meetings at which votes were cast | 49 | 94%[1] |
| # meetings at which we voted against mgmt. or abstained | 32 | 62% |

| Resolutions | # of resolutions | % |
|---|---|---|
| # votes cast with management | 584 | 92% |
| # resolutions where votes cast were against mgmt. or abstained (see list in appendix) | 53 | 8% |
| # resolutions where votes were withheld | 2 | <1% |

[1] The meetings where our votes were not cast include meetings where we had already sold the holding in the company and at companies which required their investors (or their proxies) to be physically present .