

Voting & Engagement Report: Q4 2012

Introduction

The fourth quarter is typically a quiet period in terms of voting at company meetings and 2012 was no exception. We had just three annual meetings for companies held in the fund during the three months. Nonetheless, there were some controversial votes, including notably on a CEO remuneration package that we voted against. We describe our approach to this vote as well as executive remuneration more generally which is an issue that has been a particular focus of media debate in recent months.

We've also expanded our reporting of our voting activity to include all votes cast on the back of input from a survey of the industry which indicated that this is considered to be best practice.

Finally, we have also been gearing up our broader company engagement including a focus on business ethics risks and some work that we have started to do in the solar panel manufacturing sector. These initiatives are described here as well.

Executive compensation – How much is too much?

Executive compensation has featured prominently in the UK media during the past 12 months. The issue is even more prominent in the US where average CEO pay is 231 times that of an average worker¹. While the sums involved are often astonishing, it is not easy to establish precisely how much is too much. This is a question we face every time we vote on remuneration reports for senior executives – something that is now happening annually in many jurisdictions.

Our approach is to consider a range of parameters when trying to determine whether executive pay is excessive. This includes ensuring that:

- there are clear and comprehensive disclosures around compensation as well as an independent and effective compensation committee;
- compensation is designed to focus executive attention on the creation of long-term shareholder value and avoids arrangements that risk 'pay for failure'; and,
- 'claw-back' provisions are utilised to ensure that key elements of compensation can be 'clawed back' where long-term performance is below expectations.

Beyond these general parameters, we also believe that the absolute amount of any individual compensation package should also be considered. In determining whether any particular package is excessive, we consider a variety of metrics including comparisons with peers² and the proportion of the company's net income and enterprise value that is represented by the compensation package.

¹ <http://www.epi.org/publication/ceo-pay-231-times-greater-average-worker/>

² We recognise that peer comparisons on their own, are flawed, but nonetheless can provide a useful additional insight as to whether any individual pay package is excessive.

The Pall Corporation vote is a case in point. Pall recruited their CEO Lawrence Kingsley in 2011 and at the 2012 AGM held an advisory vote on the CEO's compensation. We are enthusiastic holders of Pall shares and are also supportive of the recruitment of Lawrence Kingsley who we have met several times including while at his previous company. While, in our view, disclosure and wider corporate governance is good at Pall, the scale of Mr Kingsley's compensation is we believe excessive. At approximately \$36.1m it includes deferred compensation and pension that is nearly 100% greater than the peer average, an award of restricted stock that is seven times greater and option grants four times greater. While there are some extenuating circumstances (for example in compensating for foregone compensation at his previous employer) the package represents over 10% of the company's net income and more than 0.5% of the company's whole enterprise value. On this basis, we decided to vote against Mr Kingsley's compensation package.

We have written to the company to set out these reasons for voting against the compensation package but have yet to hear back from the company.

Avoiding bear-traps – managing business ethics risks

Clearly, as a responsible long-term investor, we want to avoid investing in companies with poor business ethics practices, but avoiding companies that implode or suffer significant share price devaluations as a consequence of unethical business practices is also an important contribution to the fund's performance. We also believe that these risks have increased recently, partly because of moves by regulators (such as in the UK) to increase penalties and partly through efforts to encourage whistle-blowers to come forward through increased rewards (such as in the US). We also believe that the lukewarm economic backdrop is also likely to be a contributing factor.

Prompted by our independent investment advisory committee, we undertook a review of our portfolio companies looking to highlight business practices that carry with them heightened risks of unethical business practices. These so-called 'red flags' cover specific industry sectors (e.g. oligopolies or industries with high proportion of public sector clients), regions of operation, company structure or business model (e.g. levels of recent acquisitions, use of intermediaries to win business) and management integrity and supervision (e.g. quality of corporate governance). These red flags do not in themselves indicate unethical practices, but merely indicate heightened risks.

Following the review of the fund, we identified and have written to nine companies that we consider to be exposed to significant numbers of red flags. We plan to engage with each of these companies to understand better their policies and processes for managing these heightened areas of business ethics risks and, where appropriate, to encourage more progressive approaches to these issues. Ultimately, we will also of course feed any insights from this engagement into our overall view of a given company and its position in the fund.

Here comes the sun - Raising standards in the solar industry

While we currently have no direct holdings in the solar photovoltaic industry, we nonetheless remain very optimistic about the long-term opportunities in the sector and believe that at some point we will restart a position in the industry. These long-term opportunities, however, are in part dependent on the responsible behaviour of the industry. Poor environmental practices in the manufacturing process, for example, would we believe seriously undermine demand for a product that is ostensibly intended to provide environmental benefit.

As a consequence, we set up an initiative with the University of Berkeley in California, the environmental organisation the Silicon Valley Toxics Coalition (SVTC) and a group of other investors to encourage solar panel manufacturers to develop and implement comprehensive environmental, health and safety (EHS) policies governing their operations. This initiative, known as the ‘Solar Scorecard³’ is now entering its fourth year, has investors representing approximately US\$1 trillion of fund under management and receives responses from over half of the solar panel manufacturing industry. We have joined again as supporters of the 2013 Solar Scorecard and will be working, alongside our sister company WHEB Infrastructure to encourage a larger proportion of the industry to respond to the initiative and implement progressive EHS policies.

Voting record: Q4 2012

The table below summarises the voting record for the IM WHEB Sustainability Fund from 1 October – 31 December 2012. In this quarter’s report we have included full details of our voting following feed-back from stakeholders suggesting that full disclosure of voting records represents best practice in the industry.⁴

Meetings	
Number of votable meetings	4
Number of meetings at which votes were cast	3 ⁵ (75%)
Number of meetings at which we voted against management or abstained	2 (50%)
Resolutions	
Number of votes cast with management	24 (89%)
Number of resolutions where votes were cast against management or abstained – see list overleaf	3 (11%)
Number of resolutions where votes were withheld	0 (0%)

³ <http://solarscorecard.com/2012/>

⁴ See FairPensions’ latest survey at http://fairpensions.org.uk/sites/default/files/uploaded_files/researchpublications/EthicalFundReportII.pdf

⁵ The one meeting we did not vote it was at WoongJin Coway – a company that we had previously sold our stake in before the AGM.

Company	Meeting date	Ballot #	Resolution	Vote	Rationale (where vote considered controversial)
Hera SpA	15/10/12	1	Approve merger by absorption of Acegas-Aps Holding Srl	For	A good strategic acquisition which in our view warranted support.
		2	Amend articles Re: 16 and 26	For	
		3	Amend Articles Re: 7 and 17	For	
		4	Approve Creation of €84.8m Pool of Capital without Pre-emptive Rights Related to Acquisition of Acegas Aps SpA	For	
		5	Approve Creation of €80m Pool of Capital with Pre-emptive Rights	For	
		5	Elect Three Directors	Against	The names of the directors were not disclosed at the time of the vote.
		6	Integrate Internal Statutory Auditor Board	Against	The name and details of the nominee were not disclosed at the time of the vote.
CSL Ltd.	17/10/12	2a	Elect Maurice Renshaw as a Director	For	
		2b	Elect David Anstice as a Director	For	
		3	Approve the Adoption of Remuneration Report	For	
		4	Approve the Adoption of a New Constitution	For	
		5a	Amend the Company's Constitution to Insert Proportional Takeover Provisions in the New Constitution	For	
		5b	Amend the Company's Constitution to Re Insert Proportional Takeover Provisions in the Existing Constitution	For	

Pall Corporation	12/12/12	1.1	Elect Director Amy E. Alving	For	
		1.2	Elect Director Robert B. Coutts	For	
		1.3	Elect Director Mark E. Goldstein	For	
		1.4	Elect Director Cheryl W. Grise	For	
		1.5	Elect Director Ronald L. Hoffman	For	
		1.6	Elect Director Lawrence D. Kingsley	For	
		1.7	Elect Director Dennis N. Longstreet	For	
		1.8	Elect Director B. Craig Owens	For	
		1.9	Elect Director Katharine L. Plourde	For	
		1.10	Elect Director Edward Travaglianti	For	
		1.11	Elect Director Bret W. Wise	For	
		2	Ratify Auditors	For	
		3	Amend Bylaws	For	
		4	Advisory Vote to Ratify Named Executive Officers' Compensation	Against	We considered the remuneration package to be excessively generous (see discussion above).

Engagement activity: Q4 2012

In addition to voting our shareholdings at annual general and other shareholder meetings, we also actively engage with company management over a range of environmental, social and governance issues which we consider to be material in the context of the company's activities. In addition, we also engage with a range of other stakeholders including governments, regulators, non-governmental organisations, academia and trade unions on critical ESG issues of relevance to our investments. The key areas of engagement over the past quarter are listed below.

Company	Topic	Comment	Outcome	Date
Kansas City Southern	Environmental	Wrote to Chairman over relatively poor disclosure of environmental policies and performance c/f railroad peers.	Co. supplied additional environmental data demonstrating good performance and committed to publish more data in 2013.	04/10/12
Sodastream International	Human rights	We wrote to the co. about operations at their main facility in the Palestinian territory of the West Bank as part of our initial investment research.	We predicated investment on high levels of corporate responsibility in operations and support for democratic rights in the region. We concluded their activities were insufficient and advised boosting their activities in and around their facility.	15/10/12

Mettler-Toledo	Sustainability	Spoke to sustainability director about their strategy and how this supports overall business objectives.	Encouraged the co. to ensure congruence between sustainability and business strategies and particular focus on energy use, product quality and total cost of ownership for clients.	28/10/12
Stericycle	Environmental	Fined by US EPA for improper disposal of human waste. CEO indicated that clients had breached agreements causing fine. Co. has discontinued work with these clients.	We accepted explanation of the fine but encouraged co. to publish more details on its environmental policies and performance.	29/10/12
Pennon Group	Governance	Wrote to Chairman explaining that we voted against board authorisation to fix auditor remuneration because the auditor had received non-audit fees greater than the audit fee thus compromising audit independence.	We received a letter from the Chairman indicating that the company agreed with our concerns and that they would be tendering the audit work in 2013 for the 2013/14 audit.	30/10/12
Intertek	Business ethics	Alleged bribery of staff in return for clean social audits in Chinese factories.	Head of Compliance is implementing measures to combat bribery incl. external audits of auditors, a strict compliance code, on-line training, independent hot-line, and an industry-wide 'white list' of 'clean' auditors. We encourage co. to publish these details on website.	20/11/12
EMC	Human rights	Wrote to CEO asking them to provide details on policies and processes for managing human rights risks associated with the use of their equipment.	Co. appears very engaged with human rights agenda with sophisticated processes for ensuring legal compliance incl. use of internal data-mining tools for due diligence on human rights records of biz partners.	26/11/12
Intertek	Sustainability	We met with VP/Treasury/IR and discussed their governance and internal control systems and how it can be improved.	The co. has recently appointed a new sustainability officer who we plan to meet in due course to discuss their approach further.	29/11/12
Keyence	Governance	Wrote to Chairman explaining our vote against management on basis that the company's pay-out ratio has been consistently low with no satisfactory explanation.	No response has yet been received from the company.	02/12/12
Becton Dickinson	Sustainability	While not a current holding, the co. fits in the health theme. We were invited to a roundtable to review their sustainability report.	Encouraged the co. to think how its good sustainability performance supported its core business strategy and make links explicit in sustainability and annual reports.	06/12/12
Covanta	Business ethics	Wrote to CEO with results from business ethics screen (as above) asking for call to discuss.	Call scheduled for early January.	05/12/12

DaVita	Business ethics	Wrote to CEO with results from business ethics screen (as above) asking for call to discuss.	No response has yet been received from the company.	05/12/12
Hera	Business ethics	Wrote to CEO with results from business ethics screen (as above) asking for call to discuss.	Co. has submitted a detailed response to our questions which indicate that broadly the co. has strong systems in place to manage business ethics risks.	05/12/12
Faiveley Transport	Business ethics	Wrote to CEO with results from business ethics screen (as above) asking for call to discuss.	Call to be scheduled in January.	06/12/12
HMS Holdings	Business ethics	Wrote to CEO with results from business ethics screen (as above) asking for call to discuss.	No response has yet been received from the company.	07/12/12
Orpea	Business ethics	Wrote to CEO with results from business ethics screen (as above) asking for call to discuss.	No response has yet been received from the company.	07/12/12
Pall Corporation	Governance	Wrote to Chairman explaining reasons for voting against management on AGM ballots (see above).	No response has yet been received from the company.	07/12/12
Ameresco	Business ethics	Wrote to CEO with results from business ethics screen (as above) asking for call to discuss.	Call with CFO demonstrated clear internal processes to manage corruption risk. Co. did dispute aspects of the red flag analysis.	20/12/12

Other Policy and Industry Engagement

- **FairPensions survey:** During the quarter we participated in a survey conducted by the non-governmental organisation FairPensions. The survey⁶ ranked a variety of sustainable and responsible investment fund providers on their transparency, screening processes and the stewardship and engagement that they undertake with companies, policy makers and the wider industry. We were pleased to be ranked joint second in the survey of twenty providers.

⁶ The survey is available at <http://fairpensions.org.uk/ethicalfunds>.