Catherine Horton
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Rathbone Brothers PLC - Comments on Proposed Revisions to the UK Corporate Governance Code

About Rathbone Brothers

Rathbone Brothers Plc, through its subsidiaries, is a leading provider of high-quality, personalised investment and wealth management services for private clients, charities and trustees. Our services include discretionary investment management, unit trusts, banking and loan services, financial planning, unitised portfolio services and UK trust, legal, estate and tax advice.

Total funds under management at 31 December 2017 were £39.1 billion, of which £33.8 billion were managed by our discretionary Investment Management segment. Funds managed by our institutional Unit Trusts division reached £5.3 billion at 31 December 2017. Rathbone Unit Trust Management is a Tier 2 signatory to the Stewardship Code

Background

The concept of Stewardship means taking a client-first, active approach to the ownership of securities. Implementing effective stewardship is integral to our investment process as a means of protecting and enhancing value for clients.

We believe it is in the best interests of our clients for the companies in which we invest to adopt best practice in corporate governance. This provides a framework in which each company can be managed for the long-term interests of its shareholders.

Mindful of our responsibilities to our clients, we seek to be good, long-term stewards of the investments which we manage on their behalf. Our major responsibility in this regard is to ensure that company boards are functioning well in their role as independent scrutinisers of management.

We welcome the opportunity to engage with the FRC on the proposed revisions to the Corporate Governance Code and have added our comments to the questions we consider most relevant below.

Matt Crossman

Stewardship Director
February 2018

UK Corporate Governance Code and Guidance on Board Effectiveness Questions

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

The need to align better the interests of senior management and the workforce is clear. However, the effectiveness of the suggested methods will depend mostly on the culture of employment risk management at a given company and the tone from senior leadership. Without this directive, any efforts to push further engagement will be difficult. Of all the suggestions, we consider the notion of designating a NED to be the most promising.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

As investors we were involved in the development of the SDGs, and fully support their adoption as a useful framework for ensuring that businesses act both sustainably and in the long-term best interest of society. It is clear that in an era of reduced trust in public institutions, business should do more to communicate the ways in which they are considering the views of all stakeholders.

The SDGs are a useful compendium of social and environmental objectives, at a headline level. However, their specific implementation through the agreed indicators can be problematic. We would encourage some mention of the SDGs as a context for discussions of wider stakeholder engagement and matters of sustainability in the Guidance, in order to give credence to those companies which have already considered and adopted the relevant SDGs as part of their business models.

Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

We would suggest that 20% is indeed 'significant' and should require a formal response from the company management.

We also suggest that the FRC should track votes against management deemed 'significant' and their responses, in order to create pressure to comply.

We would suggest that a further provision be included in the guidance to the effect that consistent investor disquiet on a specific resolution should trigger a deeper response from the company. For example, if a company were to receive more than 15% votes against its remuneration report in two consecutive years, the Code should require the REMCO to address the issue in the subsequent Annual Report.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

There is no perfect answer to this question. A director may be independent even with 15 years long service, or lacking independence after three. The 9 year rule is a useful 'rule of thumb', a trigger for further discussion,
We would recommend that should any director reach 9 years tenure, the Board should be required to formally explain what arrangements they have in place to ensure their independence.

Further, we would recommend that the FRC consider treating the boards of investment trusts with a degree more leniency than traditional companies. Oversight of a long-term investment strategy may benefit from long tenure, for example.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?
Yes, we agree with this statement.

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

We agree with this statement. In particular, we note the FRC's statement that board recruitment and succession planning ensuring the identification and consideration of a diverse pool of candidates is key.

However, we are concerned that steady progress with regard to female representation on boards is not yet resulting in change at all levels even in the more progressive companies. We therefore welcome the wording of Provision 17 which specifically charges the nomination committee to oversee the development of a diverse pipeline.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

The occurrence of high levels of executive pay divorced from the experience of shareholders and other stakeholders is a major issue which needs to be addressed. We welcome the adoption of the language of 'incentives' in the revised guidance.

In larger companies, executive pay must also be considered within the context of remuneration as a whole. We have seen companies in the housing sector outperform their rivals owing in part to the extension of incentive arrangements beyond the executive team, covering the top 100 managers also. We have also seen companies in the energy sector adopting balanced scorecards for all staff which add an additional degree of balance and fairness. A fair system of reward for all staff would appear to be a basic element of corporate responsibility.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

It has become expected practice for remuneration policies to give wide discretion to remuneration committees to adjust outcomes from remuneration policies. However, there is little transparency regarding how and when the powers of discretion are expected to be used. We recommend that remuneration committees be directed to flesh out how and when they plan to use powers granted to them. Malus and clawback provisions are now almost universal. However, they are rarely used. We would welcome more transparency from remuneration committees regarding how and when they would use the powers they have been granted.

UK Stewardship Code Questions

General comments
We have welcomed the engagement of the FRC with Stewardship Code signatories, and generally align behind the values and principles expressed in the Code. However, we do not yet feel that companies in the wealth management space are adequately provided for. Our Unit Trust division is a signatory, but not our private client business, as the requirements would be too onerous for our level of resource.

Asset managers come in many varieties. Our particular area of the market is in bespoke private client investment management. Our teams of independent fund managers manage direct relationships with high net worth individuals and organisations on a fully bespoke basis, following our non-prescriptive investment process. We do not run 'funds' for clients to invest in – typically each client will have a portfolio of direct equities suitable for their financial needs and risk appetite.

This has two major implications for our stewardship and engagement activities.

- Firstly, our reasons for holding a stock are not homogenous. We may hold a 3% of a company, but for 1,000 different clients. There is therefore a limit to the way in which we can act for the entire shareholding. Occasionally, we may have a divergence of opinion on corporate governance matters which would see shares within our nominee voted both for and against management. This is especially true regarding our larger charity clients who are fully entitled to issue specific voting instructions. We do not feel the language of the Code as it stands makes appropriate reference to these situations, and the role of the private client asset manager in seeking to act in the best interests of different categories of clients holding the same stock for different reasons.
- Second, the nature of private wealth business is that our exposure is constantly changing. We are bringing in new clients' portfolios on a daily basis, and whilst the majority of our assets are in blue chip FTSE listed names, we have a long tail of holdings in smaller companies. In the private client side of the business, we have holdings in between 6,000 to 7,000 lines of stock. In the unit trust side, , an institutional manager, the number is far lower at 450-500. Committing, as recommended by the code, to voting actively on all stocks is therefore highly problematic for the private client business. We have instead taken the decision to focus efforts on the most widely held stocks in the business and engage on a defined range of issues. However appropriate this approach may be, it is not considered so by the current arrangements.

We would therefore welcome an evolution of the Code which allowed private client managers' stewardship and voting efforts to be recognised externally.

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?

Some further elucidation of expected best practice would be welcome. There is a wealth of literature available about the effectiveness of engagement which could be a source for the FRC, not least the work conducted of late by the UN PRI in its guide to effective listed equity engagement.

Collaborative engagement is beset by structural problems applicable to any group endeavour (free riding, tragedy of the commons etc.) and some guidance on how to avoid these pitfalls is vital in avoiding weak stewardship.

Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

Whilst factual information such as voting data and numbers of engagement meetings can be helpful, effective engagement cannot be boiled down to single factors worthy of reporting, and hence are not necessarily enhanced by assurance. Where data is used it should be assured, however the quality of dialogue with a company cannot be as readily assessed, especially in a manner which enables comparison across companies ad sectors.,

A signatory's status as a responsible investor is better covered by other benchmarking exercises, for example the UN PRI's annual assessment.

Q27. Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds.

In short, yes, but the issue lies more with the providers of financial products than those investing in them. Fiduciary duty is best discharged by applying close attention to the underlying needs and views of the ultimate beneficiary. In our private client we have taken steps to enable our clients to exercise their ownership rights in companies as they see sit. It is natural that the providers of pooled funds should see their underlying beneficiaries in the same light and commit time and resource to enabling directed voting.

That said, investors in those products who wish to direct voting on important, non-routine matters, should be actively communicating their demand for this service, even if it is not yet practical for the provider in question to deliver. Requiring managers to at least disclose their approach to voting in pooled funds would be an important first step.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

Whilst highly supportive of investor engagement on climate issues through our specialist ethical and sustainable investment arm, Rathbone Greenbank Investments, we are not persuaded that this is the right approach.

Climate change is an issue which affects different companies in different sectors at different rates with different degrees of severity. It creates winners and losers. Engagement should be driven by risk analysis and should be prioritised on the highest risk, highest impact sectors. Requiring asset managers to ask every company about climate risk may risk diluting important existing engagement with the highest exposed companies.

Further, disclosure on strategic sustainability issues by companies is less an issue for investors as it is for regulators. Reporting of carbon emissions is covered by regulation, as is supply chains transparency. Investors should instead be directed towards prioritising engagement towards the greatest sustainability risks facing the companies it has exposure to.

Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?

More transparency is welcome, however the consequence may well be decreased impetus behind internal efforts to mainstream stewardship and responsible investment. RI and ESG funds may well be important drivers for organisational change within an asset manager, but we question whether a requirement on these funds to disclose more than others run by the same provider may actually be counterproductive.

Important information

This document and the information within it does not constitute investment research or a research recommendation. Forecasts of future performance are not a reliable indicator of future performance. Nothing in this document should be construed as a recommendation to purchase any product or service from any provider, shares or funds in any particular asset class or weighting, and you should always take appropriate independent advice from a professional, who has made an evaluation, at the point of investing.

The value of investments and the income generated by them can go down as well as up, as can the relative value and yields of different asset classes. Emerging or less mature markets or regimes may be volatile and subject to significant political and economic change. Hedge funds and other investment classes may not be subject to regulation or the protections afforded by the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA) regulatory regimes.

The asset allocation strategies included are provided as an indication of the benefits of strategic asset allocation and diversification in constructing a portfolio of investments, without provision of any views in terms of stock selection or fund selection.
Changes to the basis of taxation or currency exchange rates, and the effects they may have on investments are not taken into account. The process of strategic asset allocation should underpin a subsequent stock selection process.

Rathbones produces these strategies as guidance to its investment managers in the construction of client portfolios, which the investment managers combine with the specific circumstances, needs and objectives of their client, and will vary the asset allocation accordingly to provide a bespoke asset allocation for that client. The asset allocation strategies included should not be regarded as a benchmark or measure of performance for any client portfolio. Rathbones will not, by virtue of distribution of this document, be responsible to any person for providing the protections afforded to clients for advising on any investment, strategy or scheme of investments.

Neither Rathbones nor any associated company, director, representative or employee accepts any liability whatsoever for errors of fact, errors or differences of opinion or for forecasts or estimates or for any direct or consequential loss arising from the use of or reliance on information contained in this document, provided that nothing in this document shall exclude or restrict any duty or liability which Rathbones may have to its clients under the rules of the FCA or the PRA.
We are covered by the Financial Services Compensation Scheme (FSCS). The FSCS can pay compensation to investors if a bank is unable to meet its financial obligations. For further information (including the amounts covered and the eligibility to claim) please refer to the FSCS website fscs.org.uk or call 020 7892 7300 or 0800 678 1100.

Rathbone Investment Management International is the Registered Business Name of Rathbone Investment Management International Limited which is regulated by the Jersey Financial Services Commission. Registered office: 26 Esplanade, St. Helier, Jersey JE1 2RB. Company Registration No. 50503. Rathbone Investment Management International Limited is not authorised or regulated by the PRA or the FCA in the UK. Rathbone Investment Management International Limited is not subject to the provisions of the UK Financial Services and Markets Act 2000 and the Financial Services Act 2012; and, investors entering into investment agreements with Rathbone Investment Management International Limited will not have the protections afforded by those Acts or the rules and regulations made under them, including the UK FSCS. This document is not intended as an offer or solicitation for the purchase or sale of any financial instrument by Rathbone Investment Management International Limited. Not for distribution in the United States. *Rathbones and Rathbone Greenbank Investments are trading names of Rathbone Investment Management Limited, which is authorised by the PRA and regulated by the FCA and the PRA.*

Registered Office:
Port of Liverpool Building, Pier Head, Liverpool L3 1NW. Registered in England No. 01448919. Rathbone Investment Management Limited is a wholly owned subsidiary of Rathbone Brothers Plc.
Our logo and logo symbol are registered trademarks of Rathbone Brothers Plc.