STEWARDSHIP

MARTIN CURRIE
A Legg Mason Company

ANNUAL REPORT 2018

www.martincurrie.com

REPORT SUMMARY

HIGHLIGHTS IN 2017

- Highest possible (A+) rating awarded by the PRI* across all three categories
- David Sheasby, our Head of Stewardship and ESG, appointed to the PRI's ESG Engagement Advisory Committee
- Continued work with external consultants to develop our in-house ESG expertise
- Successful completion of first-round collaborative engagement on water risk in the agricultural supply chain
- Extensive engagement and voting activity on behalf of our clients

ENGAGEMENT ACTIVITY	250 # companies engaged with (private)	19 # companies engaged with (collaborative)
VOTING ACTIVITY	685 shareholder meetings	7571 resolutions

PRI RATINGS HISTORY

	Module			
Year	Strategy	Integration	Active Ownership	Reporting period
2017	A+	A+	A+	1 Jan 16 – 31 Dec 16
2016	A+	A+	A	1 Jan 15 – 31 Dec 15
2015	A+	A	A	1 Jan 14 – 31 Dec 14
2014	A	A	A	1 Jan 13 – 31 Dec 13

ACTIVE PARTICIPANTS IN COLLABORATIVE ENGAGEMENT INITIATIVES

TAX RESPONSIBILITY

ANTIBIOTIC USE

CYBERSECURITY

*PRI – Principles for Responsible Investment. Engagement and voting activity is for the period 1 January 2017 to 31 December 2017.

ABOUT US

We are international equity specialists, crafting high-conviction portfolios for client-focused solutions. We are driven by a shared sense of energy and purpose that has been a defining trait of our company's 136-year history.

Effective stewardship of capital is at the heart of our client proposition. We believe in an investment approach that makes environmental, social and governance (ESG) factors real, with analysis and active ownership fully embedded in the investment process and implemented directly by our portfolio managers. We seek to positively influence corporate behaviour and governance, living these values through the management of our own business.

WHAT WE DO

Our investment rationale is considered and focused. As bottom-up stockpickers, our objective is to identify mispriced opportunities, and combine these to deliver attractive and consistent risk-adjusted returns for our clients. As a signatory to the Principles for Responsible Investment (PRI) since 2009, we have integrated ESG analysis into our investment research process. Stewardship is a critical part of our philosophy. It is evident at every stage of our investment process, particularly in our approach to engagement and voting activity.

Throughout our long history, we have adapted and evolved, always keen to find the best solutions for our clients. Today, we offer a focused range of active strategies, underpinned by rigorous research and strong risk-management capabilities. As an independent investment affiliate of Legg Mason, we are self-directed, innovative in our approach, and able to take a long-term view.

WORKING IN PARTNERSHIP

When you become our client, you become a part of our business. We want to build a partnership, working together to meet and exceed your objectives. This means we support you with seasoned professionals, give you access to our expertise and resources, and share our investment insights.

CONTENTS

STEWARDSHIP IS A CRITICAL PART OF OUR PHILOSOPHY. IT IS EVIDENT AT EVERY STAGE OF OUR INVESTMENT PROCESS, PARTICULARLY IN OUR APPROACH TO ENGAGEMENT AND VOTING ACTIVITY.

FOREWORD

David Sheasby
Head of Stewardship and ESG

John Pickard
Head of Investment

Observers of ESG and sustainability issues may have found 2017 somewhat nerve wracking, in no small measure due to the potential fallout from political disruption. But if anyone thought the tide could be turned here, they are likely to have been positively surprised.

This has perhaps been most palpable around climate change, following the US withdrawal from the landmark Paris Agreement, which has galvanised the rest of the world – not to mention states, cities and companies in the US – to reaffirm their commitments to decarbonisation. We have certainly not let this issue slip in our minds, and continue to build on our research, including efforts to understand, measure and disclose carbon risks in the portfolios we manage. As for our engagement agenda, it has been another busy year both on the private and collective fronts. We saw the commencement of an initiative on cybersecurity in the financial, healthcare and retail sectors and signed up to a new joint project on corporate tax responsibility. Finally, we are of course very pleased to have been awarded the top 'A+' rating in all three categories judged by the PRI.

We find it somewhat curious that there are still sceptics when it comes to the merits of integrating ESG in the investment process. This isn't just because the research supporting this approach from a 'hard' risk/return perspective is growing by the day, but also because there are broader implications of agnosticism.

ESG would not be material to a company's performance unless stakeholders differentiated between good and bad practice. We don't operate in a vacuum and recognise that the signals we send through our investment decisions and engagement can contribute to a more sustainable economic and financial system. We believe stewardship is about thinking very broadly about what drives company performance, and using the tools at our disposal for that purpose. Some may place this outside of 'orthodox' definitions of fiduciary duty, but to us it is simply the wisest path to protecting and growing our clients' capital.

KEY FACTS

- Stewardship at the core of our approach
- ESG analysis integrated into the investment process
- Integration carried out by the analysts and portfolio managers – who know the companies best
- Implementation overseen by David Sheasby, Head of Stewardship and ESG
- Highest possible (A+) rating from the PRI across all three categories
- Tier-1 ranking by the FRC for our statement of compliance with the UK Stewardship Code
- Signatory to Principles for Responsible Investment (PRI) since 2009
- Signatory to UK and Japanese Stewardship Codes
- Member of International Corporate Governance Network (ICGN)

ESG – AN INTEGRAL ELEMENT OF STEWARDSHIP

WHAT IS IT?

ESG refers to a set of factors that may impact the ability of companies to generate sustainable returns over the long term. It involves understanding the governance structures and culture of a company (and its broader social and environmental impacts), employing a broad view of changes taking place in the world and assessing the effect these can have on a company's cash flows, balance sheet, reputation and, ultimately, corporate value.

WHY DO WE DO IT?

As stewards of our clients' capital we take a holistic view of investee companies, looking at all material information, whether quantitative or qualitative. There is compelling evidence that ESG factors influence returns over the long term, and therefore have to be incorporated by fiduciaries when assessing risks and opportunities.

HOW DO WE DO IT?

As bottom-up investors, our process starts at the company level. Once an idea has been identified, we subject it to rigorous fundamental analysis and peer review to decide whether it merits inclusion in our high-conviction portfolios. ESG analysis is embedded in this assessment, influencing key assumptions such as the cost of capital, revenues or costs and thus our estimate of a company's intrinsic value. Our particular emphasis on governance stems from the belief that this is a fundamental determinant of long-term performance. Problems here are more often than not reflected in a company's environmental and social track record, making it a reliable proxy for wider sustainability. In broad terms, we divide our process into three categories: identification, integration and active ownership.

> **OUR PARTICULAR EMPHASIS ON GOVERNANCE STEMS FROM THE BELIEF THAT THIS IS A FUNDAMENTAL DETERMINANT OF LONG-TERM PERFORMANCE.**

OUR PROCESS

IDENTIFICATION

- Identify material ESG factors
- In-house industry frameworks used as a guide
- Understand the potential impact on returns

INTEGRATION

- Incorporation of key ESG factors into the investment case
- Consideration of business aspects likely to be impacted
- Financial modelling and portfolio construction

ACTIVE OWNERSHIP

- Monitoring and engagement of investee companies
- Private and collaborative engagement
- Proxy voting
- Disclosures and reporting

IDENTIFICATION

WHAT WE LOOK AT:

Below is a non-exhaustive list of some of the factors we may consider as part of our fundamental analysis. The level of research and engagement varies depending on region, sector and, critically, the materiality of the issues in question. The overarching aim is to assess the extent to which ESG factors will contribute to/detract from the long-term value of a firm.

Governance

We value transparency and clear accountable governance structures, paying considerable attention to the extent to which a company demonstrates alignment with the interests of long-term investors.

- Board leadership, diversity and independence
- Management remuneration
- Shareholder rights
- Succession planning
- Accounting and audit standards

Environmental

Knowing how a company identifies and manages potential environmental issues helps us to understand how it is preparing for changes to regulation and disclosure requirements.

- Pollution
- Water usage
- Climate change (emissions)
- Energy efficiency
- Resource management

Social

How a company treats its people, customers and other stakeholders, can give valuable insight into its culture – a good proxy for long-term business success.

- Data protection and privacy
- Equality and diversity
- Community relations
- Human capital management
- Product safety and liability
- Supply-chain management

MATERIAL MATTERS

Materiality is a concept used frequently in this report. In simple terms this refers to the strength of the relationship between an ESG factor and corporate performance. Some of this is common sense. For example, carbon risk is clearly more material to an oil & gas firm than it is to an IT-services business. Similarly, cybersecurity and data protection is likely to be more material to the latter than the former. In other instances, it may be less intuitive. To make the best use of our research time we have created hierarchies of the most material issues industry by industry. This way we can gauge whether managements are focusing on the right areas – an approach that is backed up by research showing a clear link between a firm's integration of material sustainability issues and enhanced shareholder value (versus a less discriminating approach). Once the most material issues have been isolated and analysed, the challenge is to translate this information into numbers in our modelling of key financial variables such as the cost of capital, cash flow, turnover and capital expenditure.

THE OVERARCHING AIM IS TO ASSESS THE EXTENT TO WHICH ESG FACTORS WILL CONTRIBUTE TO/ DETRACT FROM THE LONG-TERM VALUE OF A FIRM.

INTEGRATION

ESG factors are integrated into our fundamental analysis and decision-making process. We make both qualitative and quantitative assessments of issues deemed material to long-term performance, using industry frameworks to ensure that we focus on the most relevant issues/indicators in each industry.

EXAMPLES OF ESG INTEGRATION FOR THE REPORTING PERIOD:

TITAN INDUSTRIES

Indian jewellery retailer

Issue: Titan has faced large informal competition from a market that has principally been made up of small individual businesses, many of whom have avoided paying tax and therefore have been able to offer more attractive prices. However, the direction of policy and regulation, including: the introduction of the Goods and Services Tax (GST); government efforts to build transparency around jewellery buying through 'know your customer' and the elimination of large cash transactions; and a broader push to reduce the role of jewellery as an investment asset in the economy, has created opportunities for consumer-focused and design-led businesses that operate with high standards.

Impact on manager's decision: We used this information to build a 360-degree picture of the company, and to assess the full scale of the opportunity, including the calculation of its sustainable growth rate. The result was heightened conviction in the investment case.

ULTRATECH CEMENT

Indian cement company

Issue: The price of petroleum coke (PetCoke) – which is significantly more pollutive than thermal coal – has dropped significantly since 2015. As a consequence, cement companies have been using it as a cheaper alternative to thermal coal. It is currently legal to use PetCoke, but given India's increasing focus on environmental policy, the sustainability of this fuel source is doubtful in the long term.

Impact on manager's decision: We increased the power cost assumptions in our modelling – from 16% to 19% of sales – to reflect a likely reduction of, and eventual end to, the use of PetCoke. Even with higher costs factored in, we concluded that UltraTech was an attractive investment opportunity with strong long-term prospects.

INTEGRATION

ADELAIDE BRIGHTON CEMENT

Australian cement company

Issue: Climate-change risk is considered by our investment team in assessing both the potential impact on future earnings of companies as well as in our quality/risk assessment. As a construction material company, Adelaide Brighton has high exposure to risks stemming from new or more stringent carbon regulations and overall environmental management.

Impact on manager's decision: With an understanding of the potential risks the group faces, we made an assessment of the management and mitigation of these risks. We were concerned that, while the company was making some improvements in its approach to environmental issues, overall practices were weak relative to competitors (and best practice) with a notable lack of emission reduction targets and currently no reporting to the CDP (formerly the 'Carbon Disclosure Project'). As such, it was rated relatively poorly in this area. We reflected this in our assessment of the quality of the company, which impacted our financial modelling.

AGL

Australian energy company

Issue: As a utility with fossil fuel generation assets, AGL is exposed to the transition of the Australian energy market towards a lower-carbon economy, which entails significant changes to the overall energy mix over time.

Impact on manager's decision: Environmental factors are considered in our AGL risk assessment, which feed into our quality rating and valuation. With some exposure to coal-fired generation, threats include risks from tighter environmental regulation around fossil fuels. These are partially offset by opportunities from its existing renewable energy portfolio and the additional development opportunities in this area.

In the transition away from coal-fired power stations towards a lower-carbon economy, there are clear impacts on AGL's energy mix and capex plans, which have informed our quality assessment, valuation, and determination of a sustainable dividend, in turn driving the size of position we will take in the stock.

ACTIVE OWNERSHIP

As an active manager of long-term concentrated portfolios, we place a significant emphasis on stewardship. Engagement is a key element of this. We are motivated by a firm belief that this both helps protect, and enhance the risk-adjusted return on, our clients' capital. We build strong relationships with investee companies and engage in a constructive manner. Our focus will always be on issues that are most material and thus could have an impact on long-term shareholder value, such as strategy, capital structure, governance and wider sustainability matters. While we typically engage in private, we will continue to join collaborative efforts, particularly when deemed likely to be more effective than acting alone. Our decision to pursue the latter will, among other things, be a function of: the specific nature of the issue; the likely efficacy against acting privately; and the degree of alignment with the other investors.

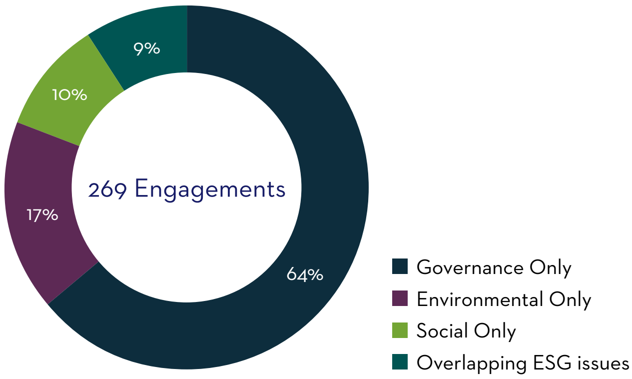
WE BUILD STRONG RELATIONSHIPS WITH INVESTEE COMPANIES AND ENGAGE IN A CONSTRUCTIVE MANNER. OUR FOCUS WILL ALWAYS BE ON ISSUES THAT ARE MOST MATERIAL AND THUS COULD HAVE AN IMPACT ON LONG-TERM SHAREHOLDER VALUE, SUCH AS STRATEGY, CAPITAL STRUCTURE, GOVERNANCE AND WIDER SUSTAINABILITY MATTERS.

NUMBER OF ENGAGEMENTS

250: NUMBER OF COMPANIES PRIVATELY ENGAGED

19: NUMBER OF COMPANIES ENGAGED VIA COLLABORATIVE INITIATIVES

ENGAGEMENTS BY THEME



Source: Martin Currie. Engagement activity is for the period 1 January 2017 – 31 December 2017.

ENGAGEMENT ACTIVITY EXAMPLES:*

Australian telecoms company

Reason for engagement: We engaged with the company, which was seeking shareholder input on a new 'Executive Variable Plan'. We had concerns about the plan to combine the current short-term incentive (STI) and long-term incentive (LTI) plans for the CEO and 11-member management team. The chair and board were looking to simplify remuneration with the aim of delivering on customer experience, improving value derived from the core business and the identification of new growth opportunities.

Objectives: We wanted to put forward our concerns that the new structure, while applying a discount to the existing LTI, removed any performance hurdle and as such made the discount inappropriately low.

Scope and process: We met the chairs of the board and the remuneration committee. They outlined their approach and the new balance of metrics to be used. We expressed our concern about the changes proposed and suggested that as well as using cash-flow measured post-capital expenditures and acquisitions, there should be continued inclusion of a performance measure (total shareholder return – TSR) for the LTI or a larger discount applied to reflect the greater certainty for a scheme with no performance hurdles. We then had a follow-up meeting with the chair of the remuneration committee to hear the additional feedback that had been received from other investors.

Engagement outcome: This engagement effort has been successful. The remuneration committee has reflected on our feedback and is removing the proposal to grant untested shares/LTI with no hurdle. This will be proposed with a view to implementing in the coming remuneration cycle.

UK financials company

Reason for engagement: We engaged with this group as we were concerned that one of the new board appointees would not be able to dedicate sufficient time to what is a large and very complex business.

Objectives: We wanted to ensure the new board appointee was going to be in a position to allocate sufficient time to discharge his duties as a director. With considerable additional responsibilities outside the group, we were looking for a commitment that may have included a reduction in these additional calls on his time.

Scope and process: We contacted the company outlining our concerns. We noted that, as set out in the UK Corporate Governance Code, all directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively – particularly with a business as complex, both geographically and operationally, as the one concerned. We noted that this director's external roles included two roles as chair and that he serves on the nomination and remuneration committees for the company concerned.

Engagement outcome: Following engagement with ourselves and other investors on this particular problem, the director in question reviewed his position and decided to resign from the board.

*We have chosen not to name companies in this section.

ENGAGEMENT ACTIVITY EXAMPLES:

Taiwan-based hardware company

Reason for engagement: A report published by China Labor Watch (CLW) highlighted poor working conditions in the company's China facilities.

Objectives: We wanted to understand how the company had responded to the report, what actions were being taken to address the concerns and what commitments were being made.

Scope and process: We had previously met management representatives from the company, which is involved in the technology hardware sector. The CLW report highlighted issues with labour conditions at the group's Chinese facilities and we took the opportunity when meeting the CFO and the Director of Finance to explore what measures had been taken in response to the report and their intentions going forward.

Engagement outcome: The company has now set out a clearer approach and has improved overall labour conditions. The company chooses to pay higher salaries than the local average and has set out a policy whereby each worker can only work to the maximum of 60 hours (and six days) per week. The company also provides education and training courses for workers to develop other skills. Moreover, it has committed to follow the standard set by a major customer. These polices have helped substantially lower the staff turnover rate across its sizeable workforce.

US and UK food service groups*

Reason for engagement: Antibiotic resistance is a key emerging public health threat and the livestock sector stands out as a central source of this risk. The majority of antibiotics produced are given to farmed animals – exposing many companies in the food chain to risks.

Objectives: Through a collaborative engagement led by the Farm Animal Investment Risk & Return (FAIRR) initiative and supported by more than 73 institutional investors, there was an opportunity to work towards a reduction or structured process to phase out the non-therapeutic use of antibiotics in food supply chains.

Scope and process: This engagement was set up to target leading consumer companies, notably those in the restaurant and quick-service restaurant (QSR) space, as large buyers of much of the protein produced. Letters were sent out to target companies setting out the issue, noting each company's current approach and making some suggestions for improvement. There were also follow-up, face-to-face meetings in some cases and a second series of letters sent out. The engagement was expanded during the course of 2017 to include additional companies.

Engagement outcome: This ongoing engagement has so far resulted in varying degrees of success at the targeted companies. Examples include updated polices on how this issue is being approached, time-bound commitments to phase out the use of critically important antibiotics in chicken production, and for some of the leaders, proactive steps to engage with wider stakeholders to advance progress across the industry in various markets.

*Collaborative engagement.

ACTIVE OWNERSHIP

COLLABORATIVE ENGAGEMENT ACTIVITY

Although most of our engagement is private, we have participated in a number of collaborative efforts to address specific issues at companies held in our portfolios. Finding a coalition of like-minded shareholders is a good way of sharing knowledge and can generate more tangible results than acting alone. The following are a few examples of activities we are, or have been, involved in:

Signatory of: *

PRI Principles for Responsible Investment

Water risks in the agricultural supply chain	Improving disclosure and encouraging the adoption of best practice from food, beverage, apparel, retail and agricultural companies, based on their exposure to water risks. **Status: completed.**
Antibiotic use in the food sector	This is an engagement co-ordinated in the UK by ShareAction, in conjunction with Farm Animal Investment Risk and Return (FAIRR), focusing on livestock production and the prophylactic use of antibiotics. **Status: ongoing.**
Cybersecurity	An initiative aimed at companies in the financial, healthcare, and retail sectors and is based on work we did as members of the original advisory committee. The project commenced in 2017, with letters sent out to the target companies. We are leading the engagement with five of the businesses included. **Status: ongoing.**
Tax responsibility	This effort concerns corporate tax responsibility, notably in the IT and healthcare sectors. It focuses particularly on tax policy disclosures, governance and risk management, as well as broader transparency around tax strategies. We are lead managers for two of the technology companies targeted. **Status: starting in 2018.**

FINDING A COALITION OF LIKE-MINDED SHAREHOLDERS IS A GOOD WAY OF SHARING KNOWLEDGE AND CAN GENERATE MORE TANGIBLE RESULTS THAN ACTING ALONE.

CASE STUDY: WATER RISK

Water stress is one of the most serious, yet underappreciated, challenges the world faces – with direct impacts on businesses and therefore investors. A growing and increasingly wealthy global population, using ever more fresh water, at a time when climate change is playing havoc with the hydrological cycle, has created a pretty dire scenario. To give an idea, by 2025, it is estimated that two-thirds of the world's population could be living in 'stress conditions' (where water is restricted by either drought or lack of access).* Businesses that do not address this issue are courting real risks, not just from an operational point of view, but also from a regulatory and reputational perspective.

Critically, this is not just a problem of the future. Ask the residents of Cape Town, who at the start of 2018 are undergoing the worst drought in over a century, and face the very real prospect of a 'Day Zero' when the taps run dry. Or Californian farmers who have had to watch their vines wilt, not to mention battle fierce wild fires, in recent years, due to abnormally long periods without meaningful rainfall (and thus depletion of groundwater and reservoirs).

Although no business is immune to water risk, some sectors are clearly more vulnerable than others. Agriculture, which consumes an enormous 70% of the world's fresh water, is unsurprisingly the most exposed – but with knock-on effects on many other sectors dependent on its produce. Take the example of cotton, which the apparel industry relies on heavily. It is a very water intensive crop (using roughly five times more water than wheat) and therefore very sensitive to reductions in water supply. Higher cotton prices can translate into reduced profit margins for clothing retailers, if they are unable to pass on these costs to the end consumer.

Of course, water is a key input in many other sectors too, including the semiconductor or extractive industries. In our company research we have seen many cases of water risk having direct financial impacts, such as a major copper miner having to invest a significant amount in a desalination plant so as not to deplete scarce water resources used by local communities. This type of competition is only set to rise.

Water has been an important area for our engagement efforts, both privately and collaboratively, and we continue to support industry initiatives such as CDP of which we are signatories. Last year saw the successful conclusion of a two-year (first-round) PRI initiative on water risk in the agricultural supply chain which we participated in. This was a great opportunity for us to explore this material topic more in depth, providing useful frameworks for future engagement and very good ideas around how to integrate water data into company analysis and valuations.

In our interactions with companies, we seek to build confidence around three interconnected areas. Firstly, we need to understand the degree to which company managements are aware of the problem. Do they believe it is material? Secondly, and importantly, does the company disclose adequate information on its water use. From our experience, the answer to this question is typically no, but just like the improving reporting of 'carbon footprints', we want companies to be transparent about their water management. Thirdly, we want to see evidence of a mitigation strategy. Is the company investing to increase water efficiency, including in its supply chains, and does it have robust plans in place to deal with potential disruption?

Management awareness?

Adequate disclosure?

Mitigation strategy?

Some businesses are showing real leadership here, consumer staples giant Unilever being a very good case in point. As part of its 'Sustainable Living Plan' Unilever is taking a genuinely holistic approach to water disclosure, measuring both direct and indirect impacts, including at the consumer level (when its products are being used). Likewise, in the semiconductor space Intel has a very comprehensive water policy, considering the water footprint across all stages its operations – for example, building water conservation features into the design of its facilities and using sustainable water sources as a criterion when siting them.

In summary, while it may have been treated as a peripheral issue in the past, water scarcity now presents a real danger to value creation for shareholders. That said, as with the related issue of decarbonisation, we believe there is a silver lining to this story too, in that the businesses which act most prudently should be able to widen their competitive moats and improve long-term performance.

*Source: Food and Agriculture Organisation of the UN (FAO), 2015.

The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the security transactions discussed here were, or will prove to be, profitable.

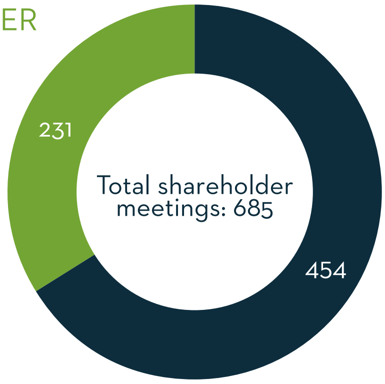
VOTING ACTIVITY

Proxy voting is a key component of stewardship. When voting on behalf of our clients, we consider the long-term economic impact of our voting decisions. 2017 saw a continuation of many of the themes we have seen in recent years, including remuneration where there is a broad push to increase transparency and bring incentive plans in greater alignment with the long-term interests of shareholders.

'Overboarding' has been another common concern, with many directors still taking on unrealistic numbers of commitments. Meanwhile, the long-standing issue of board structure has kept cropping up, particularly regarding independence and diversity. Finally, as we mentioned last year, the pressure around climate change ('carbon risk') disclosure is increasing – with an unsurprising focus on the fossil fuel sector – and we remain supportive of many initiatives on this front. As always, we review all meeting proposals on a case-by-case basis, with our clients' best interests at the heart of all our decisions.

> **PROXY VOTING IS A KEY COMPONENT OF STEWARDSHIP. WHEN VOTING ON BEHALF OF OUR CLIENTS, WE CONSIDER THE LONG-TERM ECONOMIC IMPACT OF OUR VOTING DECISIONS.**

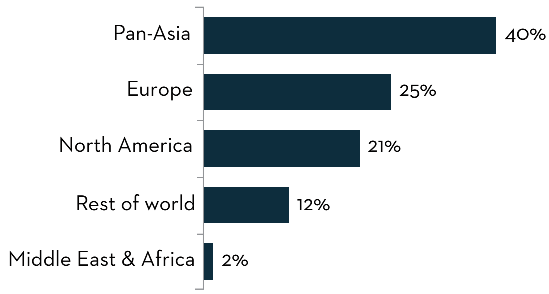
SHAREHOLDER MEETINGS



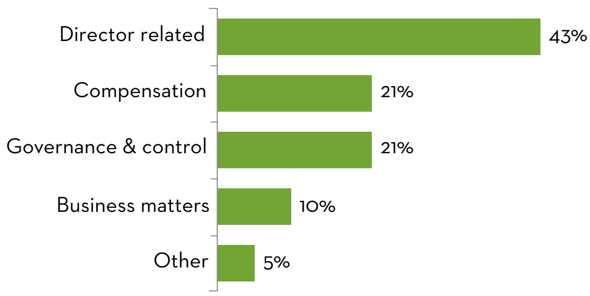
■ Number of shareholder meetings at which we voted in line with management

■ Number of shareholder meetings at which we voted against management on at least one resolution

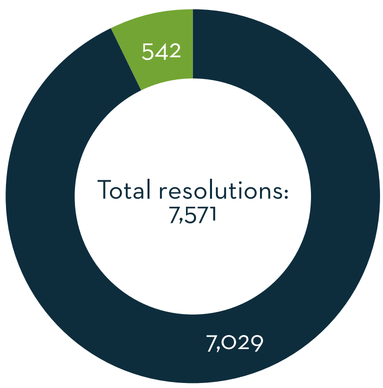
GEOGRAPHICAL BREAKDOWN OF VOTES AGAINST MANAGEMENT



CATEGORIES FOR VOTES AGAINST MANAGEMENT



RESOLUTIONS



■ Number of resolutions voted in line with management

■ Number of resolutions voted against management

Source: Martin Currie. Voting activity between 1 January 2017 and 31 December 2017.

VOTING EXAMPLES*

Indian auto company

Issue: Over-boarded director.

Objectives: We believe all directors should be able to allocate sufficient time to discharge their responsibilities effectively. We were looking for reassurance that the director concerned would be able to commit to the board responsibilities.

Scope and process: We reviewed the materials published ahead of the AGM and noted that one of the candidates, while highly respected and potentially a valuable addition to the board, was already sitting on a large number of boards at other companies. We contacted the company to express our concern and seek some assurance that the director would be able to allocate sufficient time to effectively contribute to the board.

Outcome: We were not able to satisfy ourselves of the time commitment and voted against the election of the director.

US oil & gas company

Issue: Climate-related disclosure.

Objectives: We believe companies with exposure to climate change should demonstrate awareness of the range of potential outcomes and regulatory responses and provide this information to shareholders in an appropriate manner. Following the Paris Agreement coming into force and with the release of the Task Force on Climate-related Financial Disclosures (TCFD) final recommendations, we were looking for clearer disclosure from the group on how it was considering this issue.

Scope and process: In 2017, a shareholder proposal was (once again) put to the board of this company looking for a structured report addressing climate change policies. We reviewed the proposal and contacted the company to explain our view, setting out why we felt this was important to investors and why we intended to support the proposal.

Outcome: We voted in favour of the proposal and in 2017 it received support from a majority of investors. In response to this, the company has subsequently produced an initial climate risk report.

*We have chosen not to name companies in this section.

VOTING ACTIVITY

VOTING EXAMPLES*

UK insurance group

Issue: Concerns over management remuneration.

Objectives: We believe remuneration can play a role in driving behaviours and decision making for company management and that pay should be proportionate and driven by incentives aligned with the long-term success of the business. We were looking to understand the reasons for the measures proposed in the remuneration policy and the degree of alignment with the success of the business.

Scope and process: We contacted the company to set out our questions and concerns regarding the new remuneration policy. We subsequently held a call with the chair of the remuneration committee and the company's head of HR, during which they were able to clearly articulate the reasons for the metrics chosen, demonstrate their efficacy and the alignment of these with the long-term success of the business.

Outcome: Following our discussion with the company we decided to support the new remuneration policy and remuneration report.

US consumer group

Issue: Proxy contest for board appointment.

Objectives: A proxy contest arose as a shareholder in the group sought to elect a dissident nominee to the board. We reviewed the supporting arguments for this proposal and concluded it was in the best interests of the company and shareholders to support this nomination.

Scope and process: We contacted the company to set out our view and why we felt that we should support the candidate. In particular, we could see the skills and experience that the new candidate would bring to the board and that this would be only one of a board of more than 10 so could not push for unilateral change. We subsequently held a call with company management, where they articulated their concerns about the potential push for aggressive cost cutting or changes to the business portfolio structure, but also could see the benefits of the nominee's experience.

Outcome: Following our discussion with the company we continued to support the dissident candidate. He was subsequently appointed to the board.

*We have chosen not to name companies in this section.

UK consumer group

Issue: Concerns over changes to the quantum of remuneration of management

Objectives: We were concerned that changes proposed in a new remuneration policy presented to shareholders substantially increased the potential remuneration outcomes for the CEO and other senior managers. Our objective was to understand the reasons behind this and whether we should consider supporting the change.

Scope and process: We contacted the company to set out our views and concerns regarding the new policy. We then had the opportunity to meet the CEO of the company. Although the company was proposing a slight increase to one of the performance targets, the clear intention was set out to effectively pay more for the delivery of the levels of performance seen in recent years as the view was that pay for its executive team was below average for companies of its size. We did not feel that the quantum of the change was justified and had been poorly explained to shareholders.

Outcome: Following feedback from us and other shareholders the company withdrew the proposal.

Australian bank

Issue: Concerns about the remuneration report and approval of a 'spill resolution' which requires the board to resign.

Objectives: In the previous year's AGM, this company saw significant negative votes recorded against its remuneration report and received its first 'strike' under the Australian 'two-strikes' system. We were one of the shareholders who voted against remuneration in the previous year due to poor disclosure and transparency.

Scope and process: We engaged with the chair of the board on the issue of remuneration prior to the AGM. The remuneration structure had been redesigned and reconfigured following the previous year's majority vote against. The short-term performance has seen revamped risk inputs; the long-term retains some non-financial measures, but also positive profit gateways and total shareholder return (TSR) vesting. We also discussed what circumstances would lead to deferment or withdrawal of performance rights given recent regulatory issues concerning the company.

Outcome: We voted in favour of the remuneration proposal and against the spill resolution as we concluded the company had acted decisively following the previous year's strike and had taken tangible action in relation to the regulatory charges brought against them.

OUTLOOK

Pressure to improve	Heightened focus on	Increasing integration of	Clearer path towards
CO_2 Carbon disclosure	Cybersecurity	Sustainable development goals	Sustainable financial system

As referenced at the start of this report, these may feel like uncertain times when looking at the world through a political lens. We are naturally aware of such concerns, but as bottom-up investors with a long-term mindset, focus our efforts on areas where we don't have to resort to unnecessary conjecture. Many ESG themes are secular in nature, and, as a result, highly unlikely to be derailed by swings in the political cycle. Again, climate change is perhaps the most obvious example here, due to the broad consensus around the need for large-scale concerted action. We expect this to remain a focus in 2018, with major debates – including around divestment and stranded assets – certain to rumble on.

Thus far, from an investment perspective, a major challenge has been the lack of consistent (and relevant) climate change reporting by companies, in turn complicated by absence of measurement standards (dealing with emissions classification, potential double counting etc.). The good news is that this is changing, thanks in no small measure to initiatives like CDP and the Task Force on Climate-related Financial Disclosures (TFCD). Indeed, last year saw the publication of the TFCD's high-profile recommendations which have informed the CDP's 2018 questionnaire. The recommendations provide a very useful framework for companies – structured around 'Governance', 'Strategy', 'Risk-management' and 'Metrics and targets' – making sure that the information reported is 'decision-critical' for investors. We are highly supportive of these efforts and continue to look at ways to better integrate climate change data into our investment process, both to assess risk and to identify opportunities.

Another ESG issue that is certain to remain at the forefront of investors' minds in 2018 is cybersecurity. Last year saw no let up in major attacks, illustrating the growing sophistication of hackers. Besides spending more on their cyber defences, we believe companies will increasingly question the risk/reward of holding certain data, not least due to more stringent regulation. The most significant development here in 2018 is the introduction of the European Union's General Data Protection Regulation (GDPR), which European companies must comply with by the end of May.

The GDPR is not without bite – failure to comply can lead to fines of up to €20 million, or 4% of annual group turnover (whichever is larger). In addition, companies will be required to report data breaches within 72 hours of discovery. Cybersecurity is an important area for our research and company engagement and a reason why we are involved in a collective initiative co-ordinated by the PRI.

We have mentioned the overarching United Nation's Sustainable Development Goals (SDGs) in the past, but it is worth reiterating just how important these are likely to become to asset owners and the fiduciaries they employ. We are increasingly seeing these incorporated into reporting frameworks, with the sizeable number of goals (17) and sub-targets (169) organised on the grounds of materiality. Indeed, while some of the goals may only have a tenuous link to business activity, many are directly investable. True, we are not 'impact' investors, in the sense of seeking explicit ESG outcomes, but believe that companies whose business models conflict with the SDGs risk eroding their licences to operate. Conversely, those businesses that take a proactive approach to sustainability are likely to strengthen their competitive positions.

At the time of writing, we have just seen the publication of the European Commission's High-Level Expert Group (HLEG)'s final recommendations on how to create a sustainable financial system. Among other things, HLEG has proposed a clearer taxonomy around sustainability, more specificity around investors' duties when it comes to creating a more sustainable financial system and better disclosure as to how sustainability features in decision making for investors and companies. This is a very significant report that will feed directly into the Commission's 'Action Plan' on sustainable finance, thus having a real impact on policy.

The above is, of course, only a subset of the many issues on our radar screens, but ones that are bound to flash with a steady light due to their materiality. As the SDG's and other international efforts illustrate, the days of treating ESG and sustainability matters as 'extra-curricular' are clearly numbered. The question for investors now is not why, but what and how. At least this is where we will continue to focus our energy.

For access to some of our insights on stewardship and ESG, visit our website www.martincurrie.com

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