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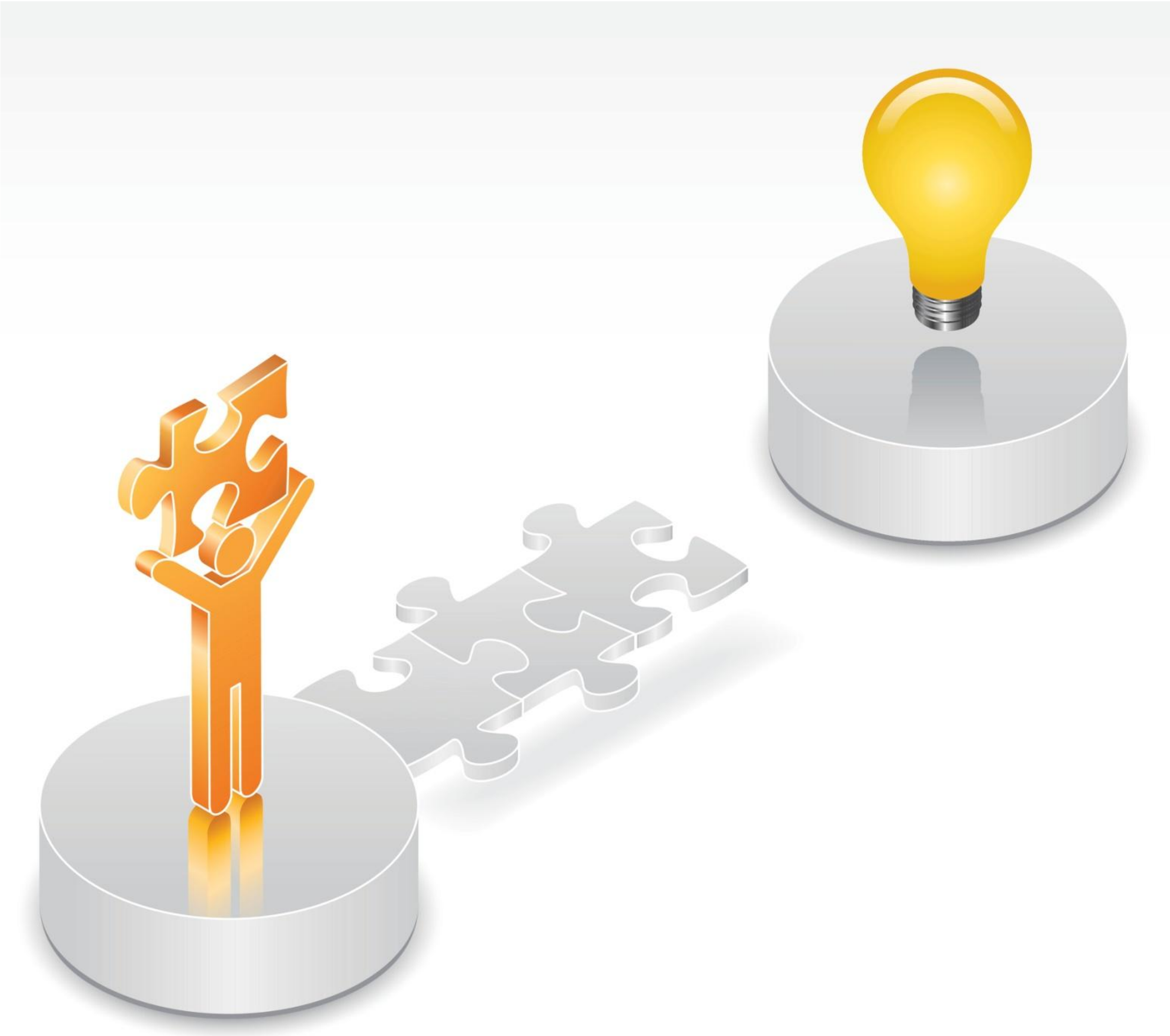
SRI Report

Corporate Governance

Bridging the data gap through shareholder engagement



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Contents

With special thanks to Naheeda Rashid for her assistance in preparing this report.

Executive summary

Coupling quantitative and qualitative data for a better assessment of companies' top management

Corporate governance has a wide scope but broadly it refers to the mechanisms, processes and relations by which companies are directed and controlled. Adopting both effective and efficient governance practices at the corporate level has become a priority.

The relevance of corporate governance principles for an organisation may be impacted by the size of the business and the industry or country in which it operates, with however "minimum" requirements. Governance principles are primarily influenced by the regulatory framework that applies to the company and by stakeholder scrutiny.

Over the last decade, there has been a significant improvement in corporate governance disclosure, transparency and communication, which has given rise to new concerns from an investor standpoint:

– What are the most relevant metrics?

– Are there any biases in such analyses?

– How should corporate governance metrics be weighted?

– Are there any red-flag indicators?

– Could companies possibly influence the results?

A careful review and assessment of a firm's corporate governance set-up is essential as any unidentified weakness or flaw could result in a failure to comply with regulatory requirements or alignment with shareholder interests. This could negatively affect the way business is done and, ultimately, the share price performance.

In addition, for a growing number of investors, Engagement, the dialogue between investors and companies, is the pivotal tool to better understand companies' management and mitigation of corporate governance risks.

While "Environmental" and "Social" risks are equally important risks that investors should examine, the purpose of this report is to:

– Single out "relevant" corporate governance metrics,

– Create a quantitative screening tool helping us to flag "most at risk" companies (within the Stoxx600 index),

– Emphasise the need for qualitative assessment through shareholder engagement,

– Provide a sample of corporate governance questions to initiate a dialogue between investors and investee companies,

– Name sector-specific other engagement topics.

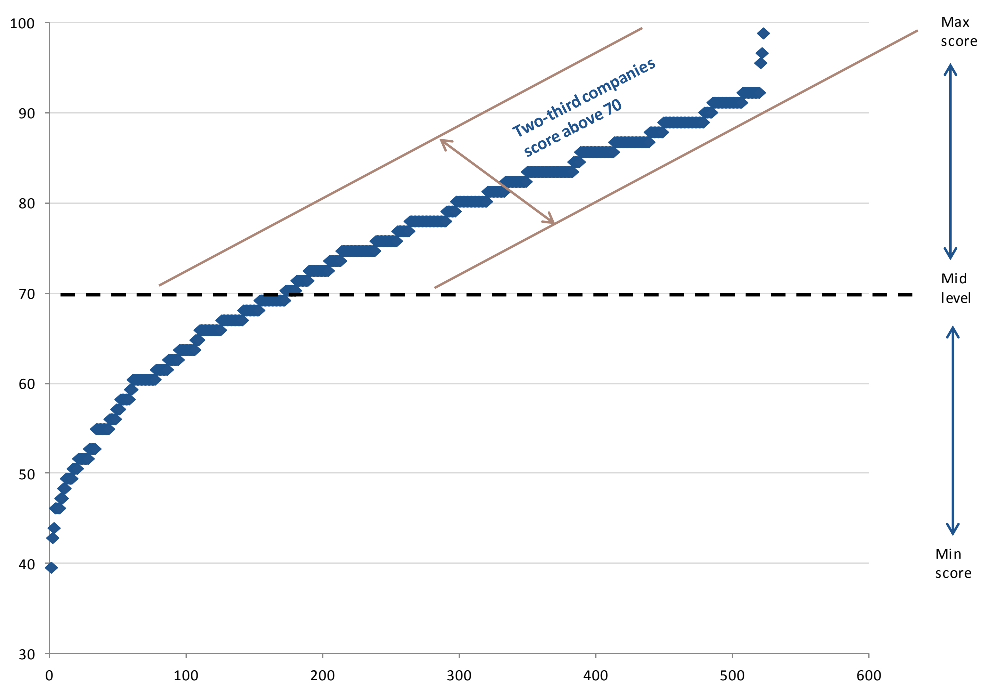
In conclusion, as the access to corporate governance data improves, we are witnessing a new trend towards the harmonisation of reported data. The challenge of discriminating between companies in this new environment can only be addressed through effective stakeholder engagement.

Key takeaways

In this report we have developed a quantitative tool that seeks to provide a first impression as to whether a company is doing well or whether it still has room to implement sound governance practice. We perform a quantitative assessment of the corporate governance profile of the Stoxx600 based on four themes, ten indicators and 29 metrics, each highlighting a degree of "confidence" or "risk". Our analysis indicates that two-thirds of companies are decently placed on their corporate governance performance. As depicted in chart below, most of the companies score higher than the mid-level '70' score in our analysis. We also observe that results are skewed based on the country of domicile for the companies, as local regulations and practices impact the governance set-up, which suggests that the quantitative signal is not sufficient enough. When making a company assessment from a governance stand-point, there are many areas that can only be covered through interaction and engagement with the management of the respective organisations.

The second section of this report builds upon the quantitative data. It describes how engagement allows a better understanding of how companies manage corporate governance risks by employing some of the best engagement techniques. We outline the key techniques to conduct successful structured shareholder engagement to create the best environment to bring about ESG change.

Dispersion of Corporate governance score for STOXX 600 companies



Source: SG Cross Asset Research/SRI, Sustainalytics

From availability to relevance: quantitative corporate governance metrics selection

Identifying key corporate governance themes & indicators

In our previous publications: "*SRI: Beyond Integration – Can quantitative ESG ratings lead to alpha generation*" (Sept. '16), "*CEO Value – A strong 10-year track record confirms Corporate Governance is a catalyst for outperformance*" (June '16), and "*Beyond the Hype – Turning succession into success in the Luxury sector*" (Feb. '15), we identified several themes and indicators that have proven their relevance from a corporate governance and materiality standpoint:

Themes

– Board and shareholding structure
– The board's independence of judgement regarding the CEO's vision
– Compensation schemes linked to shareholder returns
– Succession planning and CEO tenure

Indicators

– Independence of the board
– Share ownership and control
– Board member tenure
– Gender diversity
– Separation of Chairman and CEO functions
– International diversity
– Presence of a reference shareholder
– Presence of a golden share
– Succession planning
– Size of the board

From theory to practice

To make a quantitative evaluation of the corporate governance profile of the Stoxx600 companies, we first developed a screening tool based on our four themes, ten indicators and 29 metrics, each of which attempt to quantify a certain degree of "confidence" or "risk"[1]. This step offers an initial analysis of whether a company is doing well or still has room to implement sound governance practice.

[1] Using « Sustainalytics » for the corporate governance raw data collection

Quantitative analysis: we use 10 indicators to score companies

1) Independence of the board

■ **Rationale**: We positively view a high proportion of independent non-executive directors on the board, as executive directors may be overly dependent on the CEO.

■ **Metric**:

– The Chairman is not independent

– Despite the non-independent Chairman role, there is no Senior or Lead Independent Director defined

– The board lacks any independent representation *[i.e. 0% independent]*

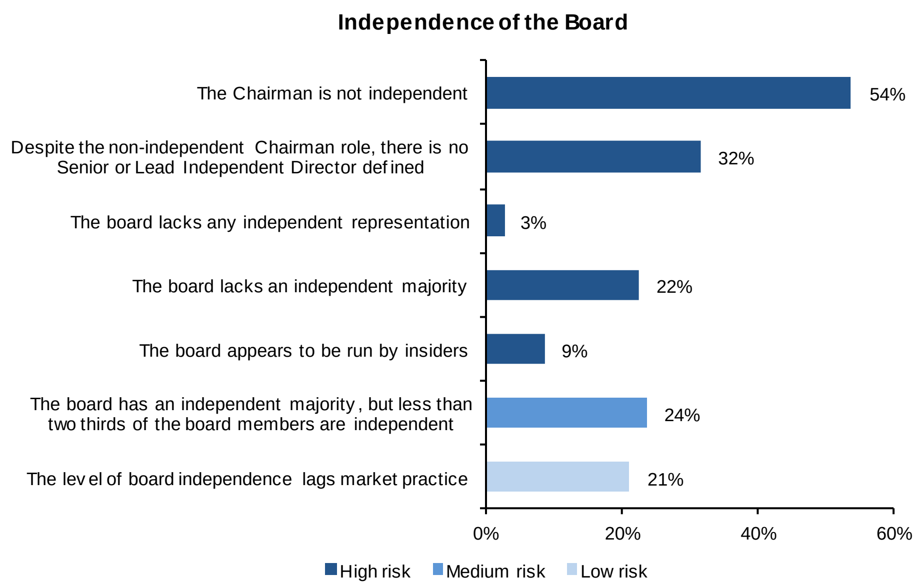
– The board lacks an independent majority *[i.e. <50% independent]*

– The board has an independent majority, but less than two thirds of the board members are independent *[i.e. 50-67% independent]*

– The board appears to be run by insiders

– The level of board independence lags behind market practice.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

2) Share capital ownership and control

▪ **Rationale**: We are in favour of the "one share-one vote-one dividend" principle. Multiple-class shares confer voting rights that are disproportionate to ownership levels, thus potentially penalizing minority shareholders.

▪ **Metric**:

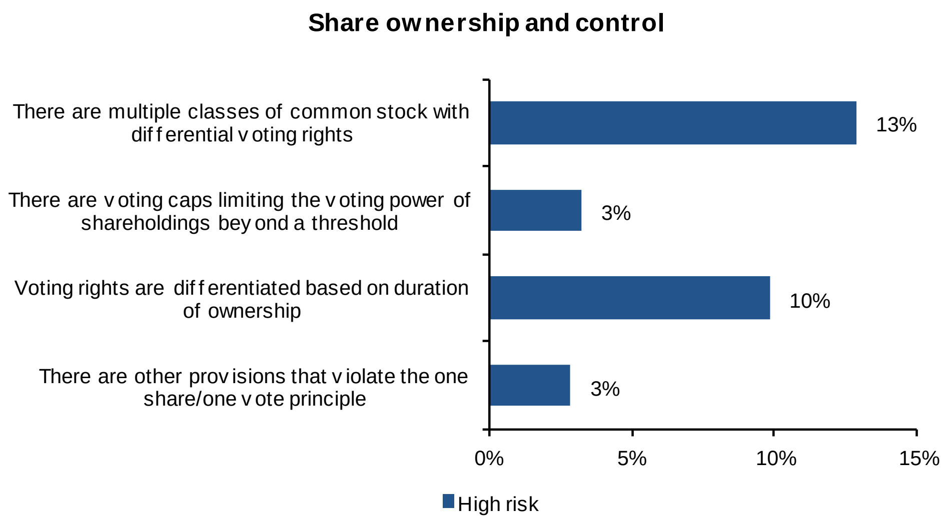
– There are multiple classes of common stock with differential voting rights

– There are voting caps limiting the voting power of shareholdings beyond a threshold

– Voting rights are differentiated based on duration of ownership

– There are other provisions that violate the one share/one vote principle.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

3) Board member tenure

■ **Rationale**: The longer the tenure of the board members in a company the better from an oversight or management viewpoint. However, tenure of more than 10 years is commonly considered inconsistent with genuine independence. A long tenure also emphasises the need for proper succession planning and board renewal. A departing board member takes a lot of management expertise away from the company, so it is important to create a pool of candidates with the ability to drive business momentum in the same direction as in the past. In addition to the various links that directors can have with a company, which raises questions over the directors' actual independence, the ability to provide a fresh perspective can be diminished by a longer tenure.

■ **Metric**:

– 50% or more of the board has 10 years or more of tenure

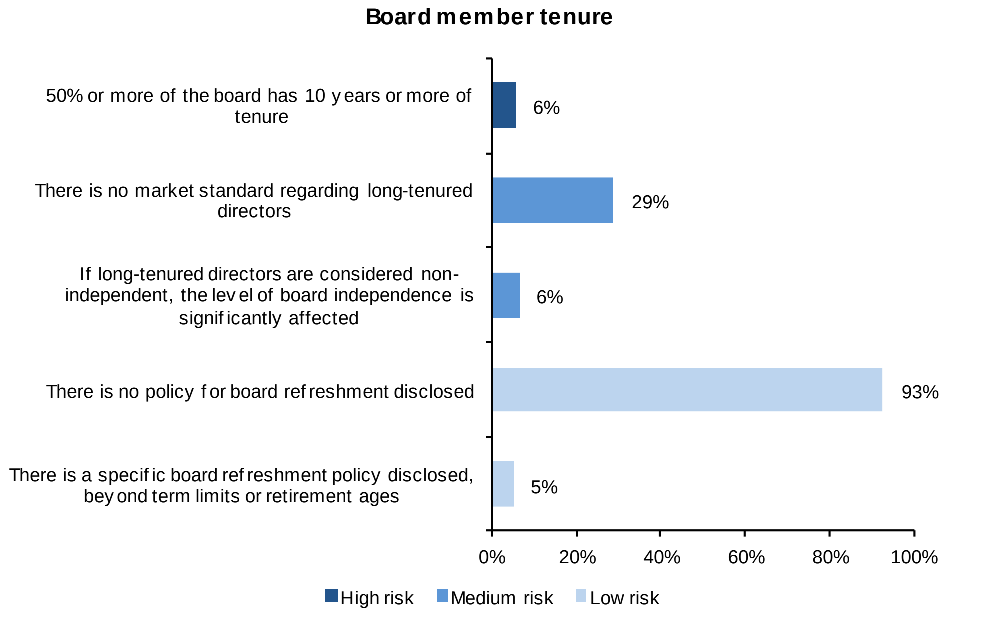
– There is no market standard regarding long-tenured directors

– If long-tenured directors are considered non-independent, the level of board independence is significantly affected

– There is no policy for board refreshment disclosed

– There is a specific board refreshment policy disclosed, beyond term limits or retirement ages.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

4) Gender diversity:

■ **Rationale**: The proportion of women on the board of listed companies in the European Union is below 25% (as per European Commission findings[2]). Positively, women are found to have different leadership styles, attend more board meetings and have a positive impact on the collective intelligence of a group, all of which would suggest a positive correlation between the percentage of women on the board and corporate performance.

■ **Metric**:

– Two or more women serve on the board, but less than one-third of the board is female

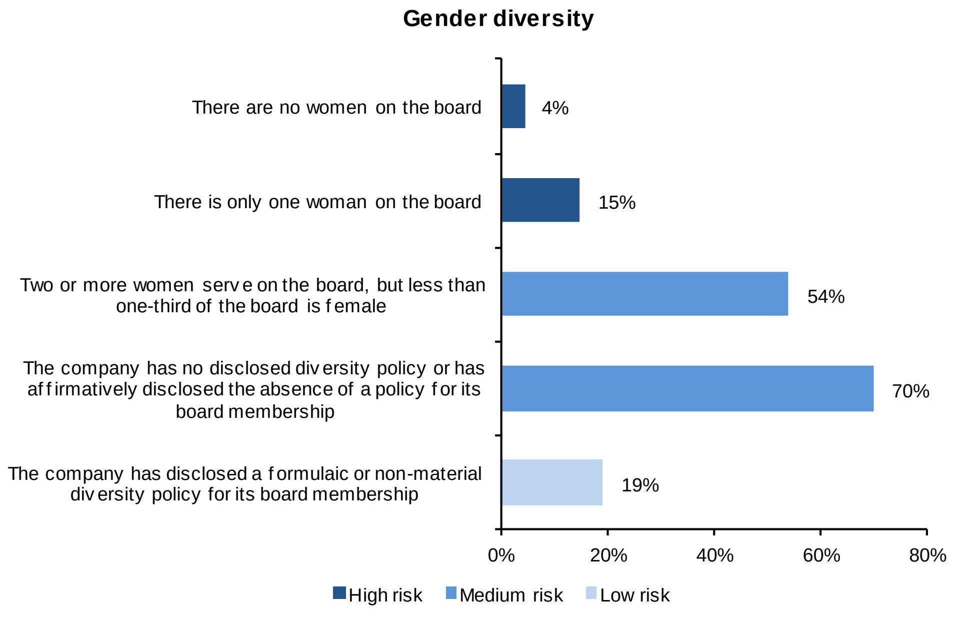
– There is only one woman on the board.

– There are no women on the board

– The company has disclosed a formulaic or non-material diversity policy for its board membership

– The company has no disclosed diversity policy or has affirmatively disclosed the absence of a policy for its board membership.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

[2] http://ec.europa.eu/justice/gender-equality/gender-decision-making/index_en.htm

5) Separation of chairman and CEO functions:

▪ **Rationale**: This not only makes it easier to question the CEO's strategy but also limits concern over the balance of power and lowers the risk linked to the departure of a single person who holds both positions.

▪ **Metric**:

– The Chairman and CEO roles are combined

– The company recently combined its CEO/Chairman positions

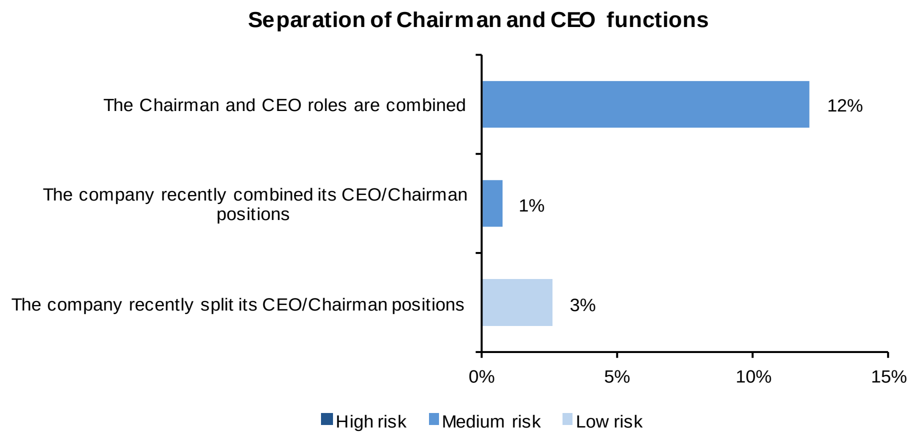
– The company recently split its CEO/Chairman positions

▪ Other metrics that can have a positive or negative impact:

– The Chairman is the former CEO

– The Chairman is the founder.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

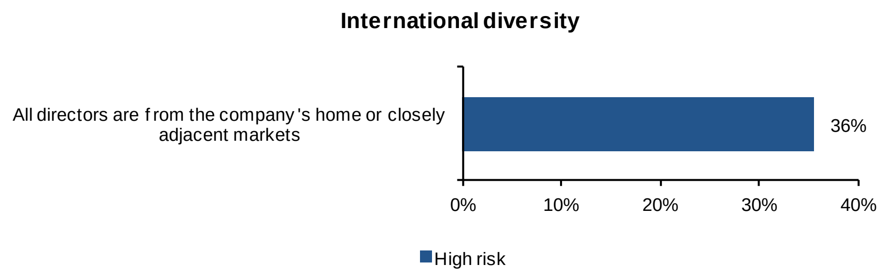
6) International diversity:

▪ **Rationale**: For a company with exposure to international markets, as is the case with most large companies, having non-nationals on the board makes business sense, as it adds knowledge and experience from diverse origins and backgrounds.

▪ **Metric**:

– All directors are from the company's home market, or closely adjacent markets.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

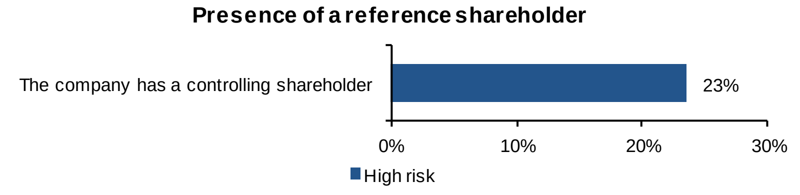
7) Presence of a reference shareholder:

▪ **Rationale**: Firms tend to be sensitive to investor preoccupations when a portion of their shares are held by active shareholders.

▪ **Metric**:

– The company has a controlling shareholder.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

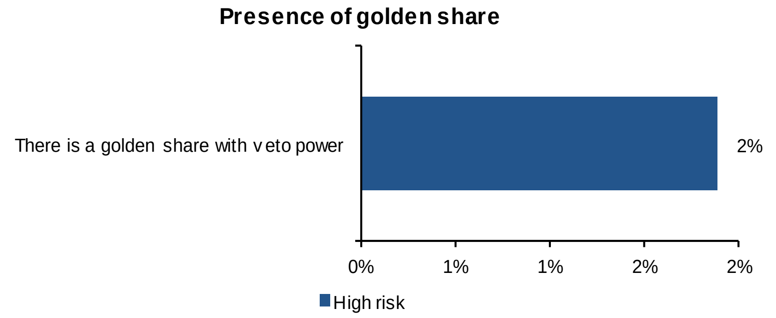
8) Presence of golden share:

▪ **Rationale**: The holder of a golden share is entitled to veto powers assigning control over important business matters which can go against the interests of ordinary shareholders.

▪ **Metric**:

– There is a golden share with veto powers.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

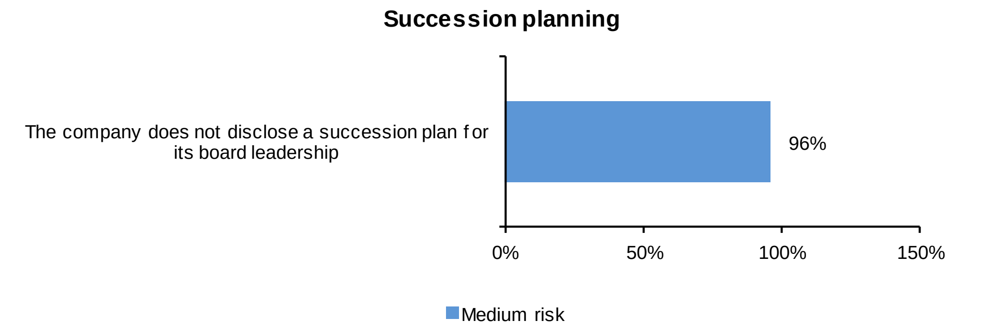
9) Succession planning:

▪ **Rationale**: Careful planning and preparation of management succession is an essential element underpinning the sustainability of the company and, incidentally, is part of the board of directors' duties.

▪ **Metrics**:

– The company does not disclose a succession plan for its board leadership.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

10) Size of the board:

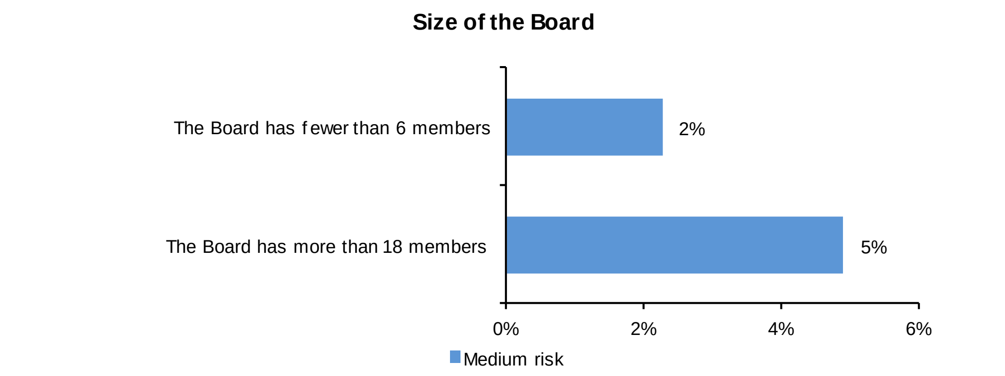
▪ **Rationale**: Large boards are considered less effective than small boards as agency problems tend to increase in oversized boards. The stewardship role of the board therefore becomes more symbolic and the board can be more prone to display weaker monitoring and control of managerial decisions.

▪ **Metric**:

– The board has more than 18 members

– The board has fewer than 6 members.

Percentage of STOXX 600 companies that meet the underlying criteria



Source: SG Cross Asset Research/SRI

Company (quantitative) evaluation

Scoring methodology

Category	Criteria	Points	Component	Rationale
Board independence	- Proportion of Board members considered independent (5pts) - Chairman independence (5pts) - Presence of senior/lead independent directors when Chairman is non-independent(5pts) - Capture of Board by insiders (5pts) -Board independence vs. market practice (1pt)	21 pts	Board independence	A high proportion of non-executive directors on the Board is viewed positively, as executive directors may be overly dependent on the CEO
Share ownership and control	- Presence of multiple classes of shares with differential voting rights (5pts) - Presence of voting caps (5pts) - Presence of differential voting rights based on duration of ownership (5pts) - Presence of any other provision that violates the one share-one vote principle (5pts)	20pts	Share ownership and control	Multiple-class shares confer disproportionate voting rights, we thus favour 'one share-one vote-one dividend'
Board member tenure	- Majority of board members have tenure of more than 10 years (5pts) - Presence of market standard regarding long-tenured directors (3pts) - If long-tenured directors are considered non-independent, the level of board independence is significantly affected (3pts) - Presence of board refreshment policy (1pt) - The board refreshment policy is beyond term limits or retirement ages (1pt)	13pts	Board member tenure	Long tenure of board members is commonly considered inconsistent with genuine independence
Gender diversity	- Proportion of women in the board(5pts) - Presence of diversity policy (3pts) - The diversity policy is non-material in true form(1pt)	9pts	Gender diversity	Women are found to have different leadership styles, attend more board meetings and have a positive impact on the collective intelligence of a group
Chairman/ CEO function	- Separation of Chairman and CEO roles (3pts) - The company recently combined its CEO/Chairman positions (3pts) - The company recently split its CEO/Chairman positions (1pt)	7pts	Separation of Chairman/CEO functions	Limits concern over balance of power
Other indicators	- Number of directors from international markets(5pts) - Presence of a controlling shareholder(5pts) - Presence of a golden share with veto power (5pts) - Disclosure of succession plan for board leadership (3pt) - Number of directors on the Board (3pt)	21pts	International diversity Presence of reference shareholder Presence of golden share Succession planning Size of the board	

Final score (rebased to max score of 100)

Source: SG Cross Asset Research/SRI

Scoring rationale

Some of the ten indicators we use to evaluate the corporate governance profiles of the companies within the Stoxx600 are "easily" quantifiable (i.e. "the proportion of independent board members"), while others are assessed on a "yes" or "no" format answer (i.e. does the company have an independent Chairman?). We further divide each of the indicators into a number of metrics that we classify as "high", "medium" and "low" risk and accordingly assign them a risk weight of 5 (high), 3 (medium) and 1 (low). We ascribe each company an overall corporate governance score in a range of 0-100 (lowest to highest score).

Note we have excluded 77 companies from the Stoxx600 universe because of the inability to gather quantitative data for them.

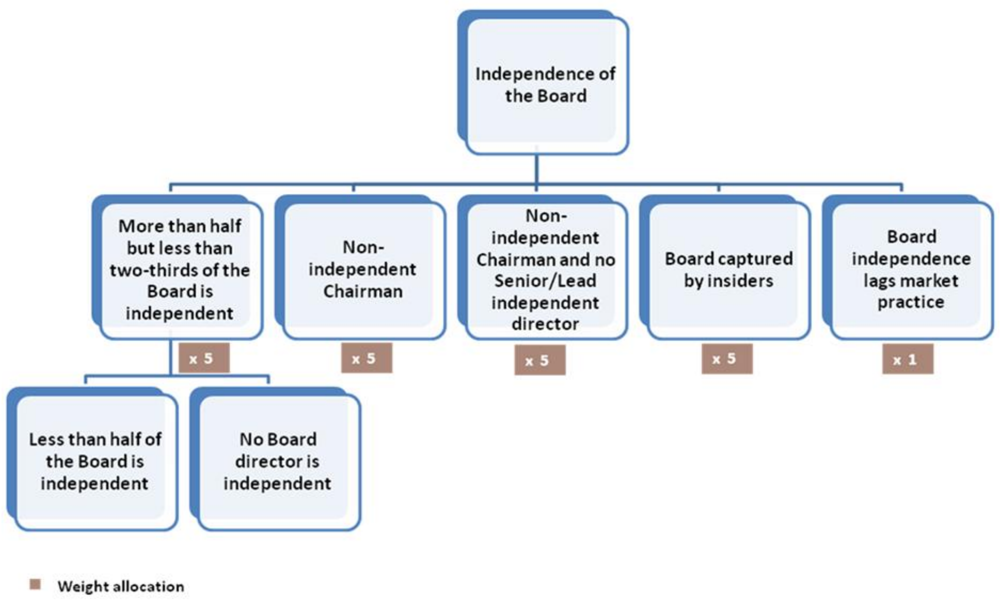
Board independence

We assess the Independence of the board on five major metrics:

– Ratio of non-independent directors
– Independence status of the Chairman
– Absence of a Senior or Lead independent director when the Chairman is non-independent
– Capture of the board by insiders, and
– Level of board independence compared to market practice.

We assign high weights to the first four metrics, as all are important in creating an environment that leads boards to make independent decisions. The ratio of non-independent directors, if less than a majority, is classified as high risk; above a majority but less than two-thirds, it is considered medium risk.

Board independence assessment



Source: SG Cross Asset Research/SRI

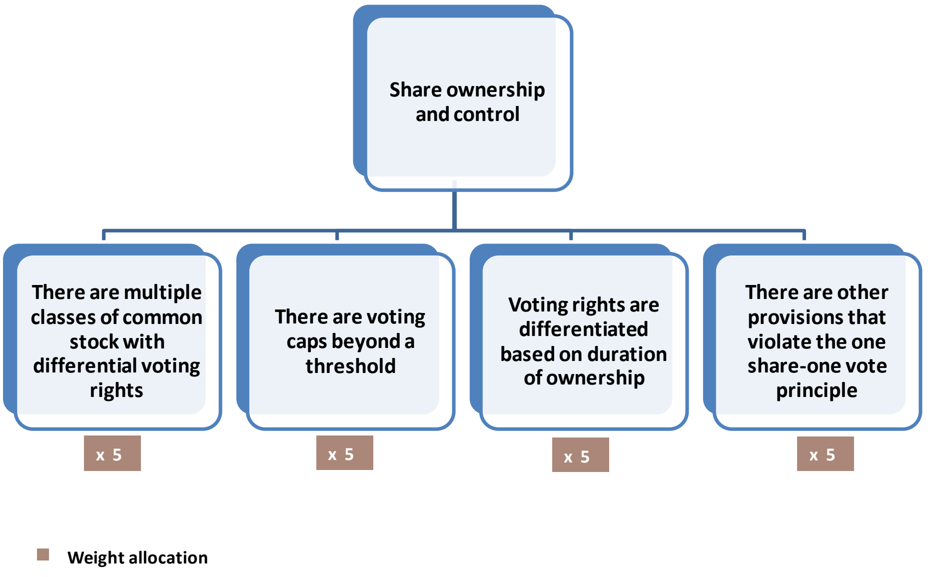
Share ownership and control

We assess share ownership and control on four major metrics:

– Multiple classes of common stock with differential voting rights
– Voting rights cap
– Voting rights differentiated on duration of ownership, and
– Other provisions.

We assign high weights to all of the above elements, as each has a significant impact on the "one share-one vote-one dividend" principle.

Share ownership and control assessment



Source: SG Cross Asset Research/SRI

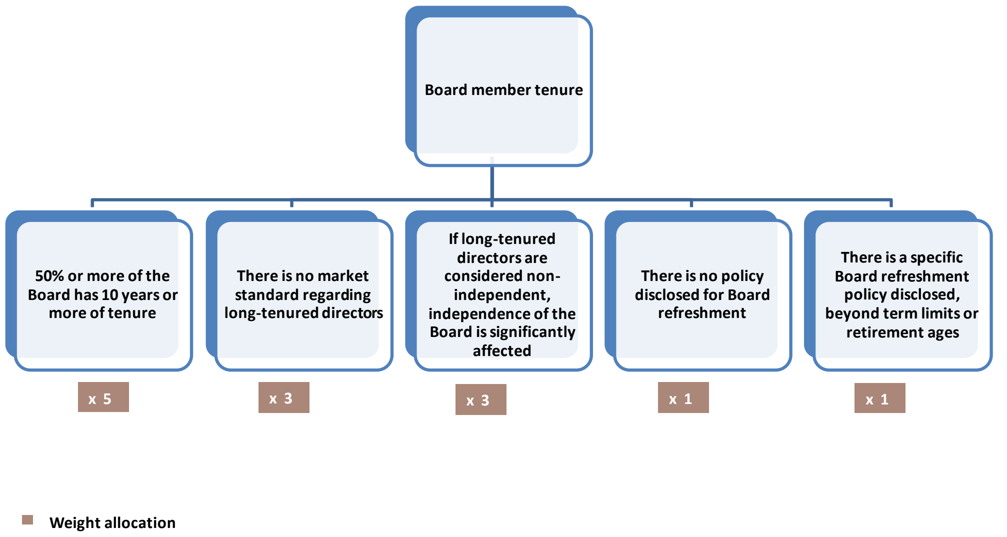
Board member tenure

To evaluate the impact of board members' tenure on independence, we consider five metrics:

– Tenure of ten years or more for a majority of the board
– Absence of market standards
– If long-tenured directors are considered as non-independent, it would significantly impact the overall board independence
– Absence of policy for board refreshment, and
– Board refreshment policy is lenient on term limits and retirement ages.

The first metric, a board with a majority of long-tenured directors, is assigned a high weight. The next two are classified as medium weight: in the absence of market standards the board would be able to re-appoint long-tenured directors; if long-tenured directors are considered as non-independent, there would be a significant impact on board independence. A low weight to capture a certain degree of risk is assigned if there is no policy on these matters or if the policy allows long-tenured directors.

Board member tenure assessment



Source: SG Cross Asset Research/SRI

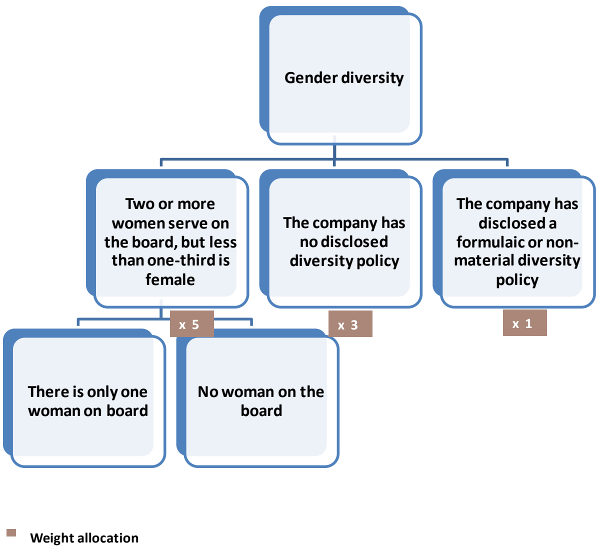
Gender diversity

Gender diversity is assessed on three metrics:

- Number of women on the board
- Absence of a policy, and
- Policy exists but is quite mechanical in structure.

The first metric carries a high weight if there are no women or only one woman on the board. A medium weight is assigned if less than one-third of the board is comprised of female members. If the company does not disclose its diversity policy, we allocate a medium weight and lastly, if a diversity policy exists but only in form, we allocate a low weight.

Gender diversity assessment



Source: SG Cross Asset Research/SRI

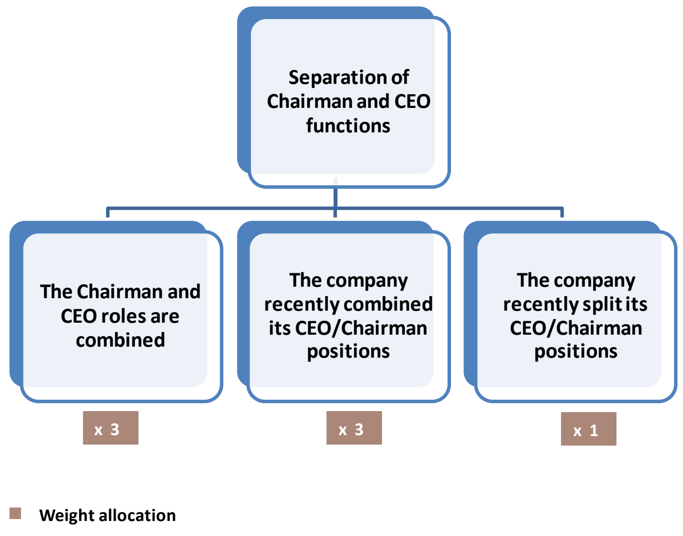
Separation of Chairman/CEO functions

Separation of Chairman/CEO functions is evaluated on three indicators:

- Overlap between Chairman and CEO roles
- Recent combination of these positions, and
- Recent split of these positions.

We assign medium weights to the first two elements as an action to combine the Chairman and CEO roles can have an impact on the balance of power with the same person influencing the strategy of management as well as decisions of the board. The third element from a corporate governance view point is a positive move per se but implementation of the roles in a clearly-defined setting is expected to take time and is thus weighted low in our analysis.

Separation of Chairman and CEO functions assessment



Source: SG Cross Asset Research/SRI

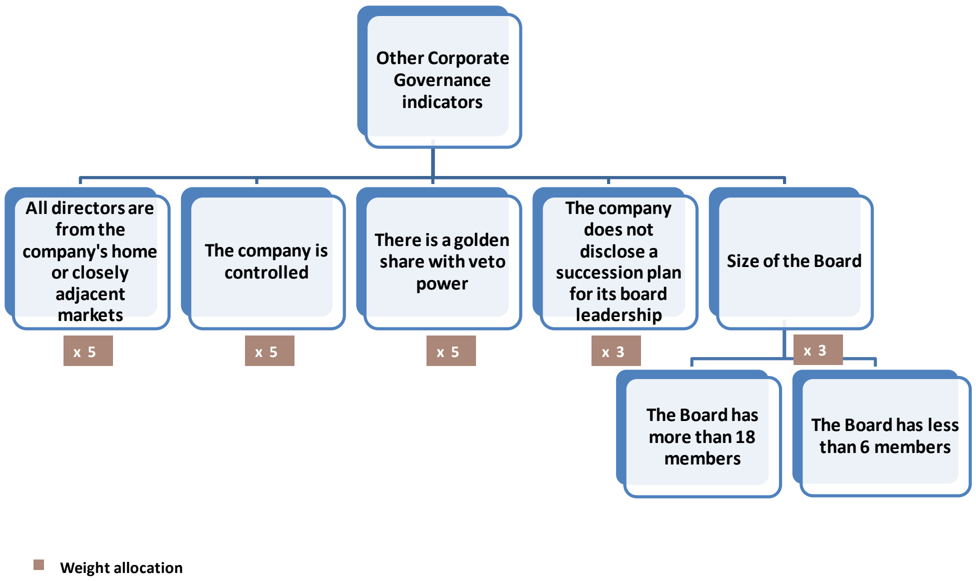
Other indicators

A few other indicators are assessed:

- International diversity of the board
- Reference shareholder
- Golden share
- Succession planning, and
- Size of the board

We assign high weights to the first three elements – diverse experience from various nationalities brings new ideas, thoughts and suggestions as most businesses have a global horizon; a shareholder that has control rights can decide on matters which could disadvantage minority shareholders; Golden share allows the use of special rights which gives the holder power to decide on important business matters. The next two elements are weighted as medium – succession planning and having the right board size are both important for smooth functioning of the board.

Other indicators: International diversity, Presence of a reference shareholder, Presence of golden share, Succession planning and Size of the board

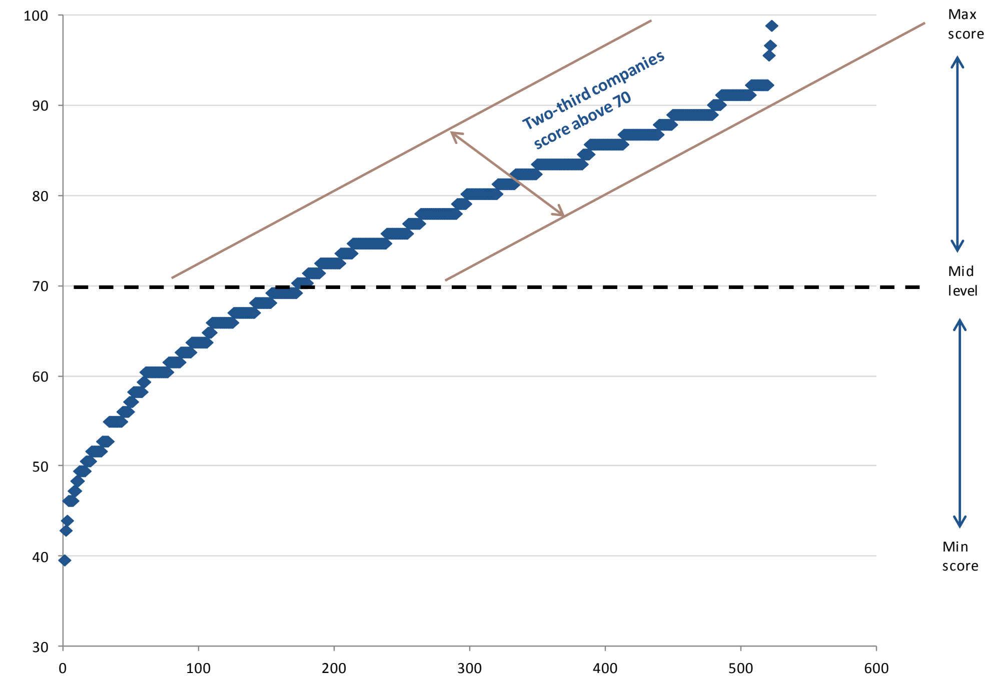


Source: SG Cross Asset Research/SRI

Quantitative output

As per the overall results we find a high concentration of companies decently placed on corporate governance standing. Two-thirds of companies lie in the top half (area divided between the maximum and minimum obtained scores) scoring above the mid-level number 70.

Dispersion of Corporate governance score for STOXX 600 companies

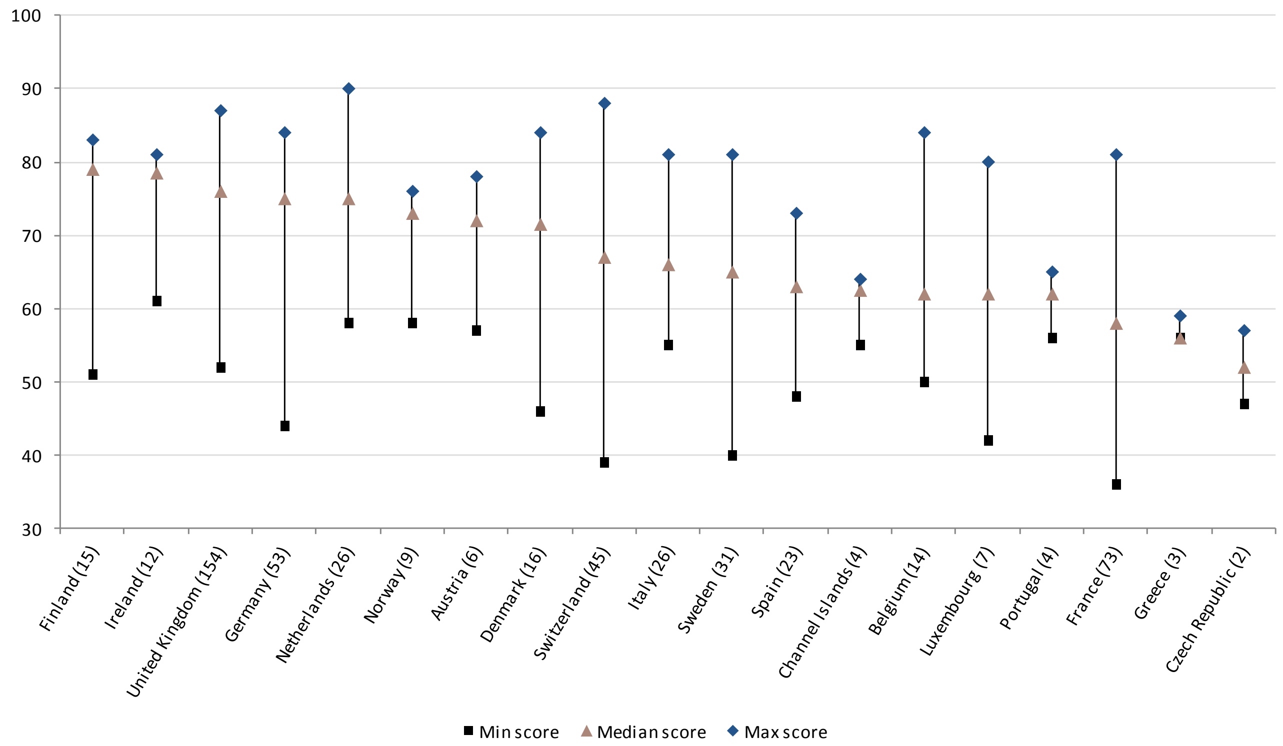


Source: SG Cross Asset Research/SRI, Sustainalytics

Quantitative output at country level

The results flag France, Spain, Sweden, Italy and Switzerland as countries with scope to improve on corporate governance scores versus their global peers. On the other hand, the United Kingdom, Germany and the Netherlands performed better.

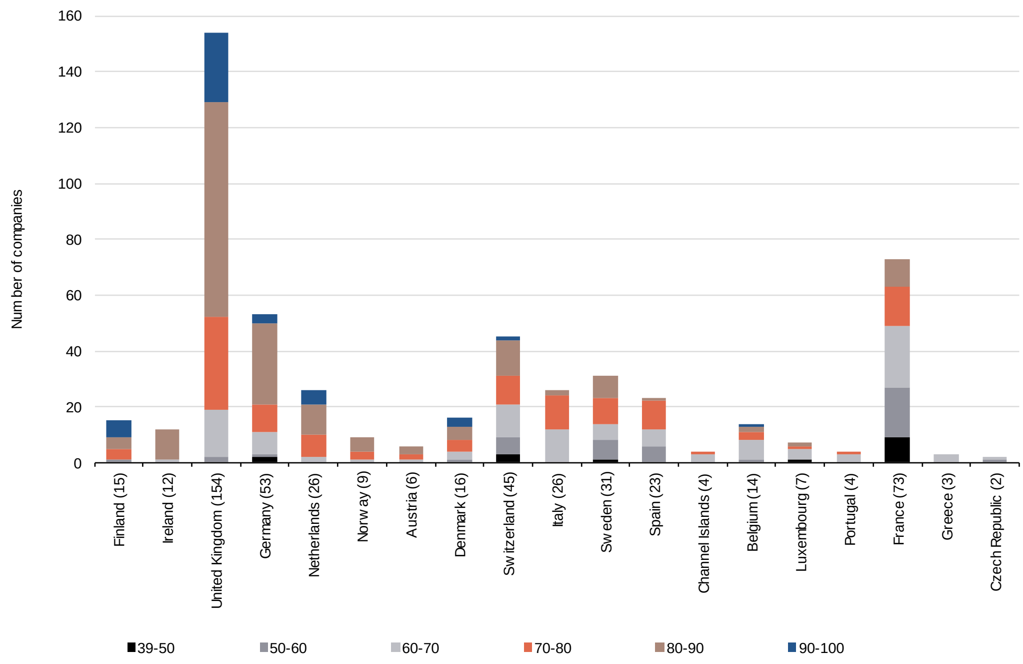
Overall corporate governance scores by country



Source: SG Cross Asset Research/SRI, Sustainalytics; Note: number of companies shown in brackets on horizontal axis

The chart overleaf further illustrates the way companies stack up by score range. As we can see France, Sweden and Switzerland have companies distributed almost evenly across the score range confirming the observation made in the previous chart that they have scope to improve. Additionally, we can see that the brown bar depicting scores of between 80 and 90 is longer, for example, for Germany, Netherlands, the UK and Ireland, supporting the better overall scores for these countries compared to the global peers.

Company score range by country



Source: SG Cross Asset Research/SRI, Sustainalytics

In general most countries need to improve their scores on "Independence of the Board", "Gender diversity" and "Succession planning". In France the categories where there is room for improvement are "Share ownership and control" and "Separation of the chairman and CEO functions". Among the other countries well represented within the Stoxx 600 Spain, Sweden and Italy need additional improvement on "International diversity". Sweden also needs to improve its "Share ownership and control" and "Presence of a reference shareholder" scores.

Country corporate governance score by category

				By category median score									
Country (No. of companies)	Min score	Median score	Max score	Independence of the Board (max score 21)	Share ownership and control (max score 20)	Board member tenure (max score 13)	Gender diversity (max score 9)	Separation of Chairman and CEO functions (max score 7)	International diversity (max score 5)	Presence of a reference shareholder (max score 5)	Presence of golden share (max score 5)	Succession planning (max score 3)	Size of the Board (max score 3)
Finland (15)	51	79	83	21	20	12	5	7	5	5	5	0	3
Ireland (12)	61	79	81	17	20	12	3	7	5	5	5	0	3
United Kingdom (154)	52	76	87	18	20	12	3	7	5	5	5	0	3
Germany (53)	44	75	84	21	20	9	3	7	5	5	5	0	3
Netherlands (26)	58	75	90	21	20	12	3	7	5	5	5	0	3
Norway (9)	58	73	76	18	20	9	6	7	5	0	5	0	3
Austria (6)	57	72	78	21	20	9	3	7	5	5	5	0	3
Denmark (16)	46	72	84	20	20	12	5	7	5	5	5	0	3
Switzerland (45)	39	67	88	13	20	9	3	7	5	5	5	0	3
Italy (26)	55	66	81	10	20	12	3	7	0	5	5	0	3
Sweden (31)	40	65	81	13	15	9	6	7	0	0	5	0	3
Spain (23)	48	63	73	8	20	12	3	7	0	5	5	0	3
Channel Islands (4)	55	63	64	5	20	9	4	7	5	5	5	0	3
Belgium (14)	50	62	84	11	20	12	4	7	5	0	5	0	3
Luxembourg (7)	42	62	80	10	20	9	1	7	5	0	5	0	3
Portugal (4)	56	62	65	6	20	12	3	7	5	3	5	0	2
France (73)	36	58	81	8	15	12	6	4	5	5	5	0	3
Greece (3)	56	56	59	6	20	12	1	7	0	0	5	0	3
Czech Republic (2)	47	52	57	6	20	9	3	4	3	0	5	0	3

Legend:
Room for most improvement
Room for some improvement
Max score

Source: SG Cross Asset Research/SRI, Sustainalytics; Note: number of companies shown in brackets

Quantitative output at company level

Even when we dive down to the top and bottom ranked companies on the corporate governance scores, we notice a country-based representation. The top 20 companies are made up of nine British, five Dutch, two Danish and two German firms, and one Belgian and one Swiss firm. The bottom 20 feature ten French, four Swiss, two Swedish and two German firms, and one Danish and one Luxembourg firm. Many of the companies ranked in the bottom come as no surprise, as there is a presence of a dominant shareholder, while most of the companies in the top 20 ranking have a dispersed shareholding structure – potentially leading to more collaborative decision making.

Top ranking 20 companies

Companies	Country	Rankir
ING Groep NV	Netherlands	Tier 1
Zurich Insurance Group AG	Switzerland	Tier 1
The Weir Group PLC	United Kingdom	Tier 1
ProSiebenSat.1 Media AG	Germany	Tier 1
Koninklijke KPN N.V.	Netherlands	Tier 1
Jupiter Fund Management Plc	United Kingdom	Tier 1
ISS A/S	Denmark	Tier 1
Hugo Boss AG	Germany	Tier 1
easyJet plc	United Kingdom	Tier 1
Koninklijke Philips N.V	Netherlands	Tier 1
ASML Holding NV	Netherlands	Tier 1
Delhaize Group	Belgium	Tier 1
SBM Offshore N.V.	Netherlands	Tier 1
Chr Hansen Holding A/S	Denmark	Tier 1
WH Smith plc	United Kingdom	Tier 1
Thomas Cook Group plc	United Kingdom	Tier 1
Travis Perkins plc	United Kingdom	Tier 1
Royal Mail plc	United Kingdom	Tier 1
RELX PLC	United Kingdom	Tier 1
IMI PLC	United Kingdom	Tier 1

Bottom ranking 20 companies

Companies	Country	Rankir
Safran SA	France	Tier 3
Pargesa Holding SA	Switzerland	Tier 3
Securitas AB	Sweden	Tier 3
Bollore	France	Tier 3
Kering SA	France	Tier 3
Tenaris SA	Luxembourg	Tier 3
LVMH Moet Hennessy Louis Vuitton	France	Tier 3
Dassault Systemes SE	France	Tier 3
Ipsen S.A.	France	Tier 3
ENGIE SA	France	Tier 3
Volkswagen AG	Germany	Tier 3
Societe BIC, S.A.	France	Tier 3
DKSH Holding Ltd.	Switzerland	Tier 3
Imerys SA	France	Tier 3
Swatch Group AG	Switzerland	Tier 3
Porsche Automobil Holding SE	Germany	Tier 3
Compagnie Financiere Richemont SA	Switzerland	Tier 3
Christian Dior SA	France	Tier 3
William Demant Holding A/S	Denmark	Tier 3
Hexagon AB	Sweden	Tier 3

Source: SG Cross Asset Research/SRI, Sustainalytics. *Methodology: Tier 1 score range = 85-100, Tier 2 score range = 70-85 and Tier 3 score range = <70

The application of our quantitative model to the Stoxx 600 data produced a short list of leaders and laggards. Focusing on shareholder engagement provides greater insights into the company's corporate governance practices. The next chapter builds on the quantitative data. We show how shareholder engagement allows for a better understanding of how companies manage corporate governance risks by employing some of the best engagement techniques.

How five Tier 3 companies perform on our 10 indicators

	Indicators	Room for improvement (--), well positioned (++)				
		Safran SA	Pargesa Holding SA	Securitas AB	Kering SA	Bollore
Independence of the Board	The Chairman is not independent	--	--	--	--	--
	Despite the non-independent Chairman role, there is no Senior or Lead Independent Director defined	--	--	--	--	--
	The board lacks any independent representation	++	++	++	--	++
	The board lacks an independent majority	--	--	--	++	--
	The board has an independent majority, but less than two thirds of the board members are independent	++	++	++	++	++
	The board appears to be captured by insiders	--	--	--	++	--
	The level of board independence lags market practice	--	--	--	--	--
Share ownership and control	There are multiple classes of common stock with differential voting rights	--	--	--	--	--
	There are voting caps limiting the voting power of shareholdings beyond a threshold	++	++	++	++	++
	Voting rights are differentiated based on duration of ownership	--	++	++	--	--
	There are other provisions that violate the one share/one vote principle	--	++	++	++	++
Separation of Chairman and CEO functions	The Chairman and CEO roles are combined	++	--	++	--	--
	The company recently combined its CEO/Chairman positions	++	++	++	++	++
	The company recently split its CEO/Chairman positions	--	++	++	++	++
Board member tenure	50% or more of the board has 10 years or more of tenure	++	--	--	++	++
	There is no market standard regarding long-tenured directors	--	--	--	++	++
	If long-tenured directors are considered non-independent, the level of board independence is significantly affected	++	++	++	++	++
	There is no policy for board refreshment disclosed	++	--	++	--	++
	There is a specific board refreshment policy disclosed, beyond term limits or retirement ages	--	++	--	++	--
Gender diversity	There are no women on the board	++	++	++	++	++
	There is only one woman on the board	++	++	++	++	++
	Two or more women serve on the board, but less than one-third of the board is female	--	--	++	--	--
	The company has no disclosed diversity policy or has affirmatively disclosed the absence of a policy for its board membership	--	--	--	--	--
	The company has disclosed a formulaic or non-material diversity policy for its board membership	++	++	++	++	++
Interna-tional diversity	All directors are from the company's home or closely adjacent markets	++	++	--	--	++
Presence of a reference shareholder	The company is controlled	++	--	--	--	--
	There is a golden share with veto power	--	++	++	++	++
Succession planning	The company does not disclose a succession plan for its board leadership	--	--	--	--	--
Size of the Board	The Board has more than 18 members	++	++	++	++	++
	The Board has fewer than 6 members	++	++	++	++	++

Source: SG Cross Asset Research/SRI, Sustainalytics

How five Tier 1 companies perform on our 10 indicators

		Room for improvement (--), well positioned (++)				
	Indicators	**ING Groep NV**	**Zurich Insurance Group AG**	**The Weir Group Plc**	**ProSiebenSat.1 Media AG**	**Koninklijke KPN N.V.**
Independence of the Board	The Chairman is not independent	++	++	++	++	++
	Despite the non-independent Chairman role, there is no Senior or Lead Independent Director defined	++	++	++	++	++
	The board lacks any independent representation	++	++	++	++	++
	The board lacks an independent majority	++	++	++	++	++
	The board has an independent majority, but less than two thirds of the board members are independent	++	++	++	++	++
	The board appears to be captured by insiders	++	++	++	++	++
	The level of board independence lags market practice	++	++	++	++	++
Share ownership and control	There are multiple classes of common stock with differential voting rights	++	++	++	++	++
	There are voting caps limiting the voting power of shareholdings beyond a threshold	++	++	++	++	++
	Voting rights are differentiated based on duration of ownership	++	++	++	++	++
	There are other provisions that violate the one share/one vote principle	++	++	++	++	++
Separation of Chairman and CEO functions	The Chairman and CEO roles are combined	++	++	++	++	++
	The company recently combined its CEO/Chairman positions	++	++	++	++	++
	The company recently split its CEO/Chairman positions	++	--	++	++	++
Board member tenure	50% or more of the board has 10 years or more of tenure	++	++	++	++	++
	There is no market standard regarding long-tenured directors	++	++	++	++	++
	If long-tenured directors are considered non-independent, the level of board independence is significantly affected	++	++	++	++	++
	There is no policy for board refreshment disclosed	--	--	--	--	--
	There is a specific board refreshment policy disclosed, beyond term limits or retirement ages	++	++	++	++	++
Gender diversity	There are no women on the board	++	++	++	++	++
	There is only one woman on the board	++	++	++	++	++
	Two or more women serve on the board, but less than one-third of the board is female	++	++	--	++	--
	The company has no disclosed diversity policy or has affirmatively disclosed the absence of a policy for its board membership	++	++	++	--	++
	The company has disclosed a formulaic or non-material diversity policy for its board membership	++	--	++	++	++
Interna-tional diversity	All directors are from the company's home or closely adjacent markets	++	++	++	++	++
Presence of a reference shareholder	The company is controlled	++	++	++	++	++
	There is a golden share with veto power	++	++	++	++	++
Succession planning	The company does not disclose a succession plan for its board leadership	++	++	++	--	--
Size of the Board	The Board has more than 18 members	++	++	++	++	++
	The Board has fewer than 6 members	++	++	++	++	++

Source: SG Cross Asset Research/SRI, Sustainalytics

Below, we highlight some examples, positive and negative, of the ten criteria assessed in our analysis.

Detailed examples of company practices for each of our 10 criteria

Pillar	*Best practice examples*	*Practices below market standards*
Independence of the board	Zurich Insurance Group has an independent chairman, Tom de Swaan, and all members of the board of directors are independent non-executives.	Pargesa Holding's board has 15 directors of which only 19% are considered independent. Although the chairman 'Paul Desmarais Jr' is non-independent, there is an absence of a senior or lead independent director.
	ING Groep has an independent chairman, Jeroen van der Veer, as part of the Supervisory Board. All members of the board but one (Eric Boyer de la Giroday) are independent, in accordance with the Dutch Corporate Governance Code.	
	Engie's chairman, Gérard Mestrallet recently split the job into a single role from his earlier joint chairman-CEO position. The board has 18 members of which 1 member is an employee shareholder representative, 3 employee representatives, 4 government representatives. Other than the chairman and CEO, the remaining 8 members are independent.	
Share ownership and control	Each holder of Weir Group ordinary shares is entitled to one vote.	Lagardère has granted double voting rights to shares registered for at least four years.
		In Volvo, one A share carries one vote and one B share carries one-tenth of a vote. Dividends are same for both classes of shares.
		Airbus' Articles prohibit any shareholder from acquiring more than 15% of the share capital or voting rights either alone or in concert.
Board member tenure	KPN NV has 7 directors on the supervisory board with none having a tenure of more than 10 years.	ArcelorMittal has 6 of 12 directors with a tenure of at least 10 years on the board. Four of the latter are among of the 8 independent directors. If the long-tenured directors are classified as non-independent then the overall board independence is reduced to 33%.
Gender diversity	Jupiter Asset Management has 10 directors of which 40% are women. It believes gender diversity to be of great value and its policy is to aim for at least 30% female representation on the board.	There is no female representation on the board of Tenaris SA. Besides, there is no disclosed policy on gender diversity as part of the board membership.
Separation of Chairman and CEO functions	Rexel adopted a new structure and asked the chairman and CEO 'Rudy Provoost' to relinquish his position in June 2016. The board has had an independent chairman, Ian Meakins, since October 2016 and the new CEO, Patrick Berard assumed his role in July 2016. The board is today 100% comprised of independent members.	In AA plc, following the departure of the CEO, the then chairman 'Bob Mackenzie' also took up the CEO role.
International diversity	ABB has 11 board members representing 10 nationalities: 2 Swiss, 1 Swedish, 1 Finnish, 1 Canadian, 1 Brazilian, 1 Australian, 1 American, 1 Indian, 1 French, 1 Chinese.	Alfa Laval has 8 board members excluding 3 employee representatives. 7 are Swedish and 1 is Norwegian, i.e. all members are from the same region or adjacent markets
Presence of a reference shareholder	ProSiebenSat.1 Media has no shares with special rights that confer controlling powers.	Hennes & Mauritz voting rights are 70.1% controlled by the Stefan Persson family and related companies through a 38.5% shareholding.
Presence of golden share	Hugo Boss has no shares with special rights granting control powers. No shareholder controls more than 10% voting rights.	Richemont has golden a shareholder, Compagnie Financière Rupert, which controls majority voting rights in the company with only 9.1% of the share capital held through B class shares.
Succession planning	Astrazeneca's Nomination and Governance Committee conducts succession planning for board positions and executive roles.	Safran does not disclose a succession plan for its board leadership.
Size of the board	Easyjet plc has a one-tier board with 10 members.	HSBC plc has a one-tier board with 20 members.

Source: SG Cross Asset Research/ESG, Company reporting-website- feedback, Sustainalytics

Questionable limitations of quantitative analysis

Other important parameters not included in the above assessment are:

– **Independence of outside directors**: The independence of the outside directors should take into account their current or past relationship with the CEO or chairman, or with one another.

– **Independence of the Nomination Committee**: The nomination committee controls the appointment of the board members, as well as of senior executives. Its own independence is important to create a board with an independent interest.

– **Related-party transactions**: Transactions between parties that are related to one another can result in benefits to those parties as opposed to the shareholders. Thus disclosure of transactions with related parties such as executives, associates and their family members are essential.

– **Business ethics-related controversies:** Such controversies may arise when management or employees commit unethical actions like the participation in bribery or accounting fraud. Those unethical business actions not only impact the company financially, raising questions about its internal controls, but also create reputational risk. Therefore, analysing these issues is a good complement to the other analysis criteria.

– **Shareholding structure**: A higher free float makes for a diverse shareholding structure and (potentially) a meaningful engagement of shareholders at the AGMs. Family ownership can have both positive and negative outcomes, positive through direct oversight and negative by exerting excessive influence.

– **Composition of the board**: In a two-tier board structure, a supervisory board, essentially composed of non-executives, oversees the functioning of the executive management board. The composition of a board depends on the business profile and needs of the company. The selection process for non-executive board members involves filters like merit, professional qualifications, experience, personal traits and independence with a particular emphasis on diversity.

– **Professional diversity**: Diversity of professional backgrounds and experience should result in superior decision-making through a better understanding of the various impacts of a decision on a company's markets, its financial performance or its stakeholders, whether employees, customers, suppliers or regulators.

– **CEO's role in the Nomination Committee**: We like company policies where the CEO does not sit on the nomination committee and has no role in appointing non-executive or supervisory directors. Board members appointed by the CEO who enjoy substantial pay and prestige because of their position may be less likely to challenge management actions and decisions, particularly in trying times.

– **CEO tenure**: The longer the tenure of the CEO in a company the better from an oversight or management viewpoint. However, a long tenure also emphasises the need for proper succession planning. A departing CEO takes a lot of management expertise away from the company, so it is important to create a pool of candidates with the ability to drive business momentum in the same direction as in the past.

– **AGM agenda & results**: The AGM is the platform for shareholders to agree or oppose the agenda proposed by the board. It is also a forum for shareholders to understand the company's management strategy and direction of business and ask questions. An AGM with a high proportion of shareholder votes against the items on the agenda may highlight views that diverge from the board's proposals/strategy. In recent proxy seasons, one of the agenda items that have attracted the most debate is "executive remuneration".

– **Director remuneration policy**: Directors' remuneration can be seen as a way to align the interests of shareholders with those of the executive directors. Poor remuneration policy disclosure may give rise to questions on the transfer of value from the company to executives. Also a short-term focus on performance may have an impact on long-term objectives. It is important for the variable remuneration of executive directors to be intrinsically linked to their performance and responsibilities. Various action points in this respect include adequate disclosure of remuneration policy of executive and non-executive directors, disclosure of their remuneration, and a shareholder resolution on remuneration policy. Finally, the remuneration committee should be fully independent, with greater autonomy given to non-executive directors in setting up the remuneration policy.

– **Remuneration structure**: We are in favour of a good balance between short-, medium- and long-term incentives. The variable component should incentivise long-term performance but also have a claw-back clause for accountability for past actions (i.e. corporate fraud). The policy should have a transparent structure, be backed with quantitative indicators and be available for shareholder perusal.

– **Succession planning structures and schemes**: Being proactive allows companies to build a pool of candidates for key functions within the organisation.

Engagement: the business case

Engagement: what is it all about?

It has become best practice for shareholders to exercise their rights as owners of companies through engagement and for companies to prioritise meaningful engagement with investors. In this chapter we outline the key techniques to conducting successful structured shareholder engagement to create the best environment to bring about ESG change. Successful engagement by investors is not only about having a deep understanding of the company and asking the right questions at the right time, but also having the right skills to gently cajole the company to meet sensible and agreed engagement goals.

Made more pertinent by the financial crisis of 2008, questions have been asked over the past decade particularly to those in the investment industry about whether corporate governance considerations add value to the performance of investee companies. In response, it has become both accepted and expected practice for investors to maintain a dialogue with portfolio companies which touches on a range of social, environmental and governance factors which may be relevant to longer-term corporate performance.

Engagement, the dialogue between investors and companies, is often cited as key evidence of how investors can positively influence the corporate governance behaviours of companies, leading to long-term sustainable returns. When engagement is successfully undertaken it allows investors to understand their investee companies in greater depth, positioning the investment manager to make better informed investment decisions about the quality of company management and their ability to manage and mitigate key ESG risks, and in return reduce share price volatility. Equipped with such information some investors have begun to document case studies on how their intervention through engagement has lead to positive corporate governance change at their investee companies.

For passive investors engagement can be of increased importance, as such investment strategies restrict their ability to sell their shares or exclude the company from their portfolio. Instead engagement is applied to both good and bad performing companies by reducing the value destruction of poorly performing companies and ensuring that well performing companies are effectively governed to manage future risks.

The level of engagement and receptiveness by companies to a dialogue with their investors varies across the world. The response to engagement can be dependent on a number of factors, including the level of interest among local and majority investors and the company's shareholding structure. In more recent years a number of jurisdictions have introduced stewardship codes with the aim of promoting a deeper dialogue between investors and companies relevant to sustainable long-term value. Stewardship codes continue to evolve on a global level, along with a trend towards "Say on Pay" by investors.

Testing times for engagement

Over the past few years engagement and those undertaking it have received scrutiny on both its success and relevance. Following the financial crisis and major controversies such as the BP Deepwater Horizon disaster, probing and testing questions were asked of responsible investors on the effectiveness of engagement in being able to prevent or predict catastrophic and financially damaging events. Stakeholders questioned the behaviour of investors in exercising their voting rights intelligently and thoughtfully, and in providing the right level of challenge to management and effectively holding the board of directors to account.

There is a powerful understanding that in the absence of engagement and interest by investors, the number of ESG catastrophes and controversies could be far greater and wider and the investment world would be even more detached from the business world.

The benefit of engagement for investors is to have influence, impact and the potential to add value by managing ESG risks – including reputational risks – at portfolio companies. Without engagement and support from investors, non-executive directors whose role it is to provide constructive challenge within company boards may otherwise find it difficult to bring such challenge to the boardroom. Lessons from the financial crisis indicate a greater need for deeper shareholder engagement to probe companies' corporate governance practices and, in particular, their corporate culture so as to ensure the delivery of sustainable economic returns and minimise the risk of such crises occurring in the future.

Industry trend towards responsible investment

At the time of writing, the **UN Principles for Responsible Investment**[3] has 1,556 signatories globally, comprising many of the world's largest asset owners, investment managers and other financial market participants. The large and growing number of signatories indicates a greater appreciation among asset owners and managers of the importance of responsible investment. However, this expanding number does not represent a direct correlation between the number of signatories and those which possess internal expertise in engagement activities with its investee companies or have been trained on how to conduct engagement on governance, environmental or social issues. However, it does indicate that traditional or 'mainstream' fund managers are taking more of an interest in responsible investment and in working towards addressing concerns about a tendency towards short-termism in the investment industry.

In addition to the emergence of stewardship codes, over the next few years there is likely to be a greater emphasis on, and monitoring of, the impact and implementation of investor engagement activities and a drive to satisfactorily quantify the impact of such engagement.

The rationale for going beyond publicly disclosed information

The data that companies provide on environmental, social and governance factors is helpful, as it provides investors with a basis on which to compare and contrast the performance of companies within a sector. Some of the largest companies in Europe make a significant amount of ESG data available in the public domain and this is a significant step. However, for investors this information alone may not be sufficient to be able to factor it into investment decisions. Information on ESG risks is often provided as part of the annual report and sustainability report, but is generally backward looking and historical in nature. Investors require a deeper understanding of how risks have been mitigated by the company and how some of the difficult decisions were reached by the board.

Engagement is necessary to address the gap between the information provided by companies and a real understanding of the issues facing them.

[3] https://www.unpri.org/

Setting the scene for effective shareholder engagement

Options for engagement

Engagement is generally described as a dialogue between investors and companies in order to influence and bring about positive changes in corporate governance and impact how companies operate, with the aim of protecting and enhancing shareholder returns. Engagement may incorporate one or more of the following techniques:

Face to face meetings

Investors may meet with an individual or a group of representatives from a company either in anticipation of addressing a future problem that could damage the long-term profitability of a company or to express concerns as to how key risks are being managed. This type of forum allows investors to exchange ideas directly with the company, which may spark or instigate a debate and further internal discussion at the company. Most engagement professionals prefer to hold face to face meetings, as this leads to a more authentic and impactful dialogue.

Voting of shares at annual and special meetings

Responsible investors usually engage in active discussions with companies' pre and post meetings to either escalate or initiate an outline of their concerns. Some investors have begun sharing their views well ahead of the proxy season. For instance, investor concerns or views on board composition and the influence the board has on the company's nomination process will be expressed earlier to the board rather than just a few weeks before the meeting. The AGM is an important period in the investor engagement calendar, and many investors believe this is when companies are most receptive to listening to shareholder concerns.

Filling shareholder resolutions

In the US in particular, shareholder resolutions are common form of engagement. In other jurisdictions, however, shareholder resolutions may be used as a "method of last resort" when investors or engagement professionals consider all other channels of effective dialogue with the company have been exhausted.

Addressing the annual general meeting of shareholders

Addressing the board of directors at the General Meeting brings the engagement into the public domain. Such a strategy can be viewed as adversarial and may not be the preferred forum for investors attempting to pursue a positive collaboration with their investee companies. However, in some European countries such as Germany, addressing the AGM is more usual and is expected by management. Viewed more positively, addressing the AGM can be an opportunity to inform the wider stakeholders on the company's progress in respect of a specific engagement issue raised by an individual investor. Most investors would prefer to take a constructive approach by outlining the major recommendations for change at a company in order to publicly hold the company to account.

Letter writing

Investors will usually put the goals of their engagement in writing to the senior management and board of directors. This can also be done as a multi-investor campaign, addressing a number of companies that face the same risks or, more usefully, as part of a wider programme of engagement with a single company in order to summarise or further engagement discussions.

Collaborative engagements

Engagers may team up with other like-minded investors to increase their influence at the company. This is particularly effective in the presence of a major shareholder. Indeed, the UN Principles for Responsible Investment actively encourages its signatory base to participate in collaborative engagement initiatives and has established an engagement 'Clearing House' to enable investors to view and participate in engagement initiatives alongside other investors.

Site visits

It can often be both important and useful for those undertaking the engagement to view a company's operations at first hand. This is particularly true when challenging environmental and social issues are involved that could lead to reputational and/or financial risks and put a company's license to operate in a particular region in jeopardy. In addition, when there is conflicting information about a company's approach to engagement on the ground, companies may invite investors to their sites so they can make their own assessment. Such visits are also likely to increase the credibility of the investor as a long-term interested owner of the company and they will generally allow the engager to ask the company a number of refreshingly new and specific questions about the business after the visit.

Engagement discussions on corporate governance may focus on a broad range of issues. **The most frequently discussed and important issues for investors include the following**:

- **Capital structure** (incl. respect of minority shareholders' interests)
- **Board composition** (incl. independence, board renewal, succession, remuneration and committees)
- **Strategy and risk management** (incl. board and top management skills assessment).

Getting the most out of engagement with companies

Investors are more likely to focus their engagement efforts on a company where their exposure is greatest and then compare how issues are dealt with at other of their investee companies. Undertaken effectively, engagement can be an important tool for investors by helping companies to manage key risks. To be effective, engagement initiatives need to be carefully planned and strategized.

There are a number of key stages in planning engagements:

Engagement objectives

Engagement objectives often centre on mitigating key risks or preventing future events that may negatively impact a company's operating environment and performance. The objectives need to be ascribed a realistic time frame for completion. The United Nations Principles for Responsible Investment along with a small number of institutional investors have introduced a milestone approach that sets out clear objectives and a time line for implementing agreed changes.

It is useful for engagers to share the areas identified for improvement (as outlined in their engagement objectives) with the company. Such transparency is usually welcomed by all stakeholders and allows a clearer understanding of the motives for investor action. Setting out the concerns in this way also helps maintain a clear focus on the areas for change throughout the engagement process, which is beneficial for the various levels of company representatives an engager meets with.

Interaction objectives

It is important that all interactions with the company are oriented towards fulfilling the engagement objectives at the company. In some instances, however, investors may be required to give important feedback to companies that, while it may not be effective in mitigating current risks, could be useful in preventing future issues. For example, engagers may be invited to take part in a remuneration consultation or to give views and feedback on the company's public reporting.

During engagement meetings it is important for investors to be clear on the outcome of the discussion and how this is part of fulfilling the wider engagement objectives. Engagers can specify beforehand what they would like to cover with the company at the meeting.

Capturing key commitments and impressions from engagement meetings

During constructive interactions the company may agree to follow up with additional information that will allow the investor to assess whether the company has the right controls in place. It is useful to keep a record of any such agreed outcomes and commitments made by the company so that companies can be held to account to provide such information.

It is also useful that the engager's 'gut feeling' or 'impressions' of a company are captured, as this in itself can provide useful insights into the corporate culture at the company.

Be prepared on both the company and investor side

For the engager, this means constructing a well-researched agenda that takes into account all information publicly disclosed by the company and other relevant external resources. It is important to ensure the engager is confident about the reliability and integrity of any third-party research, particularly if this research is to be shared with the company.

Additionally, knowing the background and – as far as possible – the business and ESG motivations of the person you are meeting with can be useful.

Being open to a two-way dialogue

Investors may enter an engagement dialogue with preconceived ideas and answers to their questions ahead of their contact with the company. The goals of both parties – safeguarding the company's long-term value and license to operate – need to be aligned.

Mutual respect, with both sides listening carefully to each other's arguments rather than pulling in different directions, is likely to lead to a more collaborative and constructive engagement.

Listening

Experienced engagers take time to listen to the company's presentation of its approach and give management the opportunity to expand on the issues on the agenda. Some companies have noted that the style of an engagement meeting conducted by an ESG engagement specialist can differ significantly from that of mainstream investors, with engagement specialists tending to be less interested in a purely question and answer approach.

Often meetings between shareholders and companies take place over a short period of time. To manage the limitations of engagement within a short period it is important that investors take the time to listen rather than spend too much time putting across their point. This open style of discussion is more likely to lead to a considered and thoughtful response on behalf of the company's management.

Questions and questioning

It is the role of investors to ask the right question at the right time, but rarely their job to have the answers.

- Engagement specialists should ask companies questions that are open ended and facilitate the right tone and scope for dialogue.

- If the engager is not satisfied with the initial response, listening carefully to the information provided by the company and politely asking a second and often even third question may lead to a more comprehensive or satisfactory response.

Construct a road map

Compiling a timeline on suggested ESG changes – particularly if this is done in collaboration with, or after consultation with, other investors – is an essential element of successful engagement. This approach can be particularly helpful in bringing about long-term cultural and structural changes in governance.

Cultural sensitivities

Although a company may be listed on a European exchange, its operations and the origins of its board of directors may be in a different country. When engaging with companies that are international or multicultural in nature, entering into the engagement with an understanding of the local context and culture is important in building the relationships and credibility that will enable the engagement to be successful.

Timely and appropriate follow-up

After an engagement meeting, engagers should set out in writing their understanding of the next steps with the company. This may include expressing in writing their continued concerns on particular issues, any commitments or undertakings by the company, and the date of the next meeting. Often people's impressions and views of the success of the engagement can vary.

- Building a 'paper trail' that covers the issues, outcomes and the roadmap of the engagement in writing helps to remove any ambiguity and allows the engager to hold the company to account, particularly in the event that the company is slow to adopt measures to engender positive and meaningful change on the issues discussed.

- Following up the engagement meeting in writing is also an opportunity to outline or reiterate the engager's recommendations for change in the company's practices. Including recommendations and examples of industry best practice and international guidance can also be helpful benchmarks for the company.

- If the engager has not been able to secure board-level access at the company, reiterating all discussions in writing ensures that a consistent message is delivered to all personnel within the company who participate in the engagement. It may also be helpful to copy or include relevant members of the company's board in the written communication.

Access to decision makers

Engagement with relevant board members to understand how decisions have been and will be taken by the board allows a deeper understanding of the company and strengthens confidence in their decision making. In developing markets, getting past the initial investor gatekeeper at the company to gain access to a decision maker is often more difficult and time consuming than in developed markets. The need to get past the gatekeeper to reach the decision maker (ultimately a board member) is so that bigger picture issues can be tackled. In Europe, companies are often familiar with the need for shareholders to engage in dialogue with non-executive directors. However, their responsiveness to such requests and frequency of access at the required level can vary.

Privacy

Both investors and companies prefer their engagement to be confidential. This enables trust to be built up between both parties. A mutually respectful relationship where details of the engagement are kept private is key to a constructive dialogue and to achieving positive change. When it would be beneficial to the engagement for there to be an element of public disclosure around the engagement, this should be expressly agreed by both the company and the engager.

Building effective relationships with companies

Building strong relationships with senior management and board members is essential to being able to gain traction in the engagement. Honouring the private nature of the engagement discussions and not sharing them negatively with others is an important step towards embedding trust. It is also important that the requests made by investors are realistic and deliverable. Making significant ESG changes can often take several years. Giving companies a reasonable timeframe within which to implement ESG changes – whilst continuing to monitor progress towards such change – is another significant element in ensuring the engager is able to build credibility at the company. Building strong relationships within the company also enables the engagement to continue in difficult circumstances. This may be the case if there is a need for the investor to hold the company to account by withholding its support at the AGM because it failed to meet commitments without providing an explanation.

Challenging the norm

Engagers should try to avoid making judgements based on a perceived status quo. For instance, there may be a perception that a company with a controlling shareholder is less likely to be responsive to dialogue on ESG issues and that the company may therefore not be a productive target for engagement. However, the reactions of family-run companies or majority investors can be surprising.

- Sometimes relevant individuals have a more personal interest and motivation in environmental and social issues and perhaps also a desire to leave a legacy for future generations which can be a great lever for change. Engagement progress can be slow and at times frustrating.

- Adopting a resistant, persevering style will give the engager an increased chance of success.

Getting feedback from companies

Receiving genuine feedback from companies about their engagement experience can be difficult. However, such information, if provided in an informative manner, has the potential to strengthening engagement activities.

Reporting to clients and stakeholders

Many of the ultimate owners of companies including pension funds, sovereign wealth or state funds and high net worth individuals have an interest in stewardship issues and perceive them to be relevant to the value of their investments. Reporting to investors and stakeholders on the progress of stewardship activities being undertaken on their behalf empowers them to challenge its investment managers on their activities and approach to responsible investment.

Encouraging a dialogue between all stakeholders helps to promote responsible investment and in turn makes stewardship activities more effective.

Governance questions for engagement with companies

Outlined below are a series of key governance questions that investors may consider including in their dialogue with investee companies. The questions assume there is a certain degree of established governance framework at the company (such as the existence of a nomination committee).

As mentioned previously, the time allowed for engagement meetings can be short. Therefore the preparation for such meetings should include reviewing all publicly disclosed company materials and asking questions that expand on this.

- The sample questions have intentionally been designed to initiate a discussion between the company and the investor and to prevent the occurrence of a 'box-ticking' form of dialogue. Often the most effective engagement specialists will start by asking general questions and then politely probe further on the same topic to seek clarification and commitments were necessary.

- It is important that any information requested from the company is not already available within the public domain. In the absence of a clearly articulated question from an investor to the company, the representative may become frustrated for what he/she believes is information the company has already communicated in its annual or sustainability report and the engager may lose credibility.

However, in most cases, investors are seeking additional disclosures, clarification and even examples of how things work in practice. Therefore it is important for the engager to consider the ultimate objective when asking the questions so as to avoid any confusion.

The style and selection of questions should be altered depending on whether the meeting is with the investor relations or sustainability teams, other specialists or members of the board of directors.

Themes, topics & questions (alphabetical order)

Board effectiveness

- How does the board assess the performance and resilience of the business portfolio?
- How do the non-executives demonstrate that they hold the management to account in the interests of all shareholders to deliver effective governance across the business?
- What assessments/mechanisms are in place to measure the board's effectiveness of managing governance and sustainability risks, including the committees?
- How do you ensure that the non-executives inject constructive challenge and an alternative perspective (in the interests of all shareholders) in board room discussions in a collegial manner?
- Does the board operate so that all non-executive directors are free to question and listen to other members of the board to ensure that decisions are taken in the interest of all shareholders?
- How are the committees and their composition considered; for instance, do they have the relevant experience and independence?
- Are there are changes planned among the board of directors? If so when will the new directors be joining the board and what was the reason for the departure of the director/s in question?

Board independence

- How many of the non-executive directors are considered independent by the board?
- How does the company define independence?
- What is the company's rationale for appointing directors that are not considered independent? How do directors who have lost their independence due to board tenure ensure that this does not affect their contribution and allows them to bring a fresh perspective?
- How does the company manage conflicts of interest in the situation where the independence of some of the directors is questionable?

Board quality, diversity and evaluation

- How does the nomination committee ensure that the board has the right balance of skills, experience and independence to effectively contribute and develop the strategy and monitor the company's performance?

- What process does the board use to evaluate its performance and identify any skills gap and or weaknesses?

- What key parameters form part of the evaluation process, i.e. succession plans, board tenure and size, independence?

- How is this information used to address any risks?

Board renewal

- How does the nomination committee ensure that succession plans focus on ensuring the board has the appropriate size and the right blend of experience and skills to effectively oversee the company?

- How far ahead does the nomination committee identify successors and potential candidates for appointment to the board so that the management structure is sustainable beyond the tenure of the current incumbents?

- Who has responsibility for ensuring that succession planning, board renewal, training and development are co-ordinated across the business to secure the correct talent?

Business ethics

- How would you describe the ethical values of the company?

- How are these behaviours and those consistent with the company's code of business demonstrated by employees?

- Is there a clear understanding of the ethical standards expected of employees when carrying out business on behalf of the company?

- How do you ensure that the corporate ethical values are consistent across the business operations and, in particular, in less developed markets?

- How does the board measure itself, its employees' conduct and business relationships with suppliers, clients, customers, investors against its ethical values?

- What mechanisms are place for internal and external stakeholders to raise confidential concerns (without fear of retaliation) about ethical breaches?

Controversies

Does the company have a policy and an approach to facilitate shareholder engagement on governance-related controversies or incidents?

Corporate culture

- How would you describe the corporate culture at the company?

- Can you describe what symbolises a component of the corporate culture at the company?

- How do you foster a culture that values and rewards high ethical standards?

- How does the board cultivate and promote an ethical corporate culture to drive appropriate behaviours across all levels of the organisation?

- How do you measure and ensure that the corporate culture rhetoric translates to how business is done across the company?
- How do you monitor the success of the company's corporate culture?
- Based on your visits within the company, would you describe the corporate culture as to how things are done across the business?
- Are there any complaints from your stakeholders about the corporate culture?
- How are complaints on culture monitored and addressed?

Executive remuneration

- How is the executive remuneration designed to best deliver the long-term strategic goals of the business and minimise short-term behaviours which could put the long-term objectives at risk?
- How does the remuneration committee ensure executive remuneration is designed to attract, incentivise and appropriately reward executives in the interests of shareholders and management?
- Can the remuneration committee explain how individual directors pay is set to reflect the responsibility and contribution of the director (in particular for the CEO) and that this is in line with shareholder expectations and not driven unfairly by market conditions?
- Does the remuneration committee meet a sufficient number of times to achieve performance based remuneration outcomes?
- Do you believe the performance criteria attached to the incentive schemes are the appropriate measures and sufficiently challenging?
- To what extent does the sustainability committee assist the remuneration committee in determining appropriate sustainability measures to be included in management performance?
- Are shareholders receiving the necessary remuneration policy disclosures, including explanations on how the remuneration committee took its decisions?
- Does the remuneration committee have a mechanism of shareholder dialogue which allows a deeper understanding of shareholder views?
- If relevant, is the company considering introducing a shareholder vote on its remuneration report?

Joint CEO and Chairman position

- How is the rigour, and challenge to decision-making, enabled by an independent chair role achieved with a joint CEO/Chairman?
- Who monitors how the joint CEO/Chairman's operational decisions are aligned to the interests of all shareholders?
- In the presence of a joint CEO/Chairman, how does the company manage any potential conflicts of interest, for instance on the voting of the CEO's compensation?

Tax ethics/tax compliance

- How do you ensure that the company pays long-term sustainable and transparent tax charges that are in the interests of your shareholders?
- What type of questions do the non-executives ask of management to ensure that your tax liability complies with local law?
- How does your ethical policy influence your tax policy in grey areas?

Voting rights

- What are the benefits of a dual class structure for minority shareholders?
- Is the company aware of the concerns among shareholders on non-equal voting rights? Will the company consider moving towards a one share/one vote approach in the future?
- Given the presence of a dual class structure how do you ensure the views of minority shareholders are appropriately taken into account in key corporate decisions? How does the company define key corporate decisions?

What can investors realistically expect from the company's response?

If the engager has been able to secure a meeting with a board member this should allow the best insights into how the governance structures work in practice. For instance, at the most fruitful meetings, board members provide actual examples to illustrate how they witnessed challenge and rigour being brought to the boardroom discussions or how they did that themselves. This may allay investor concerns or act as a mechanism to politely probe further until the investor is assured that the relevant risk is being managed and mitigated effectively.

In the case of engagement dialogue with senior management, some individual representatives at companies may recognise and acknowledge the benefit of the questions asked and the underlying investor interest behind them. The investor engagement may in turn allow the representative to communicate more robustly internally on the types of investor concern and the need to manage the relevant governance risk more closely.

However, some companies may not be as receptive to engagement questions and be defensive on the engagement topics raised or on questions regarding the motivations of the investment manager. In the case of hostile meetings or those where text book governance responses are being provided by the company, the investor can benefit by keeping a clear log of the company's responses so that the company can be held to account in later discussions, and so that the investor has evidence of fulfilling his/her fiduciary duty. At companies where there may be a questionable corporate culture leading to a dismissive attitude to corporate governance, it is important where possible to preserve the engagement efforts. Sharing case studies of industry best practices can be helpful, as may involving or engaging with other board members, regulators and other parties in a position to influence the company's governance positively.

Key ESG engagement topics by sector

Sectors	Theme 1	Theme 2	Theme 3	Theme 4	Theme 5
Aerospace & Defence	Bribery & Corruption	Controversial Weapons	Climate Change	Human Rights	Community Relations
Automobiles & Auto Components	Quality & Safety	Climate Change	Supply Chain Management	Employment Conditions	Health & Safety
Banks & Financial Services	Bribery & Corruption	Corporate Culture	Board Effectiveness/ Remuneration	Cyber Security	Tax Evasion
Building Products & Construction Materials	Environmental Management	Health & Safety	Product Sustainability	Labour Rights	Community Relations
Capital Goods	Environmental Management	Bribery & Corruption	Labour Rights	Health & Safety	Human Rights
Chemicals	Health & Safety	Environmental Management	Climate Change	Human Rights	Labour Rights
Commercial Services & Supplies	Tax Evasion	Employee Relations	Data Privacy	Environmental Impacts	
Consumer Durables & Services	Supply Chain Management	Product sustainability	Environmental Performance	Climate Change	Business Ethics
Food, Beverages & Tobacco	Climate Change	Supply Chain	Food Safety	Water Intensity	Sustainable Agriculture
Food & Staples Retailing	Supply Chain	Food Safety	Food Waste	Customer privacy and security	
Household & Personal Products	Sustainable Products	Product Stewardship	Environmental Impacts	Customer / Animal welfare	Business Ethics
Insurance	Business Ethics	Impact Investing	Employee Relations		
Media	Data Privacy & Security	Business Ethics	Conflicts of Interest	Editorial Quality & Integrity	Employee Relations
Metals & Mining (incl. Gold & Precious Metals)	Environmental Risk Management	Health & Safety	Business Ethics	Climate Change	Employee Relations
Oil & Gas (incl. Energy Equip. & Services)	Environmental Risk Management	Health & Safety	Business Ethics	Climate Change	Security Risk
Pharma & Healthcare (incl. Biotech & Equip.)	Business Ethics	Manufacturing Safety	Access to Healthcare	Responsible Marketing	Data Privacy & Security
Real Estate	Green Building / Renovation	Energy Efficiency	Quality & Safety	Business Ethics	Supply Chain Monitoring
Retailing	Supply Chain Management	Environmental Impacts	Forced Labour	Health & Safety	Employee Relations
Semiconductors	Water Intensity	Supply Chain Management	Environmental Impact	Health & Safety	Employee Relations
Software & Services	Cyber security	Data Privacy	Energy Efficiency	Human Capital Management	
Steel	Employee Relations	Business Ethics	Climate Change	Environmental Management	Health & Safety
Technology Hardware & Equipment	Data Privacy & Security	Climate Change	Conflict Minerals	Tax Evasion	Supply Chain Management
Telecommunication Services	Business Ethics	Data Privacy & Security	Human Rights	Public Health	Employee Relations
Transportation	Climate Change	Flight Safety	Child Labour	Sustainable Products	Employee Relations
Transportation Infrastructure	Climate Change	Business Ethics	Quality & Safety	Water Intensity	Labour Relations

Source: SG Cross Asset Research/SRI

Addendum 1 – Sustainalytics / Independent ESG data provider

Methodology

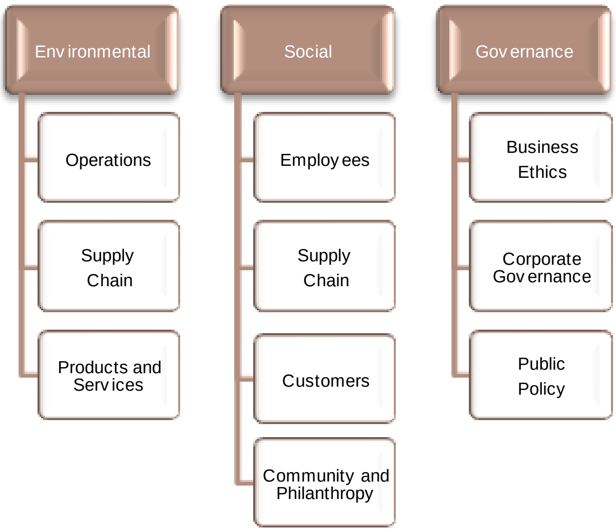
▪ SG uses data and analysis from Sustainalytics, an independent provider of ESG data, research and support services, in relation to ESG generally and specifically to collect corporate governance data for this report. SG does not guarantee the completeness or accuracy of Sustainalytics' analysis and data.

▪ Sustainalytics' analytical framework and ESG metrics are based on a wide variety of international initiatives and frameworks, ranging from international standards for ESG-related management systems, international conventions such as the ILO labour standards, certification schemes, and multi-stakeholder initiatives that have produced sector-specific or thematic standards.

▪ Sustainalytics' research framework broadly addresses three themes: environment, social and governance, which are subdivided into a range of topics as illustrated in the figure, below. The analysis in each of these areas covers policies and management systems, performance targets and outcomes, and controversies.

▪ Sustainalytics' makes use of an extensive research framework through a template of indicators, including some industry-specific indicators and some generic indicators that are applied to each company in the given industry. Each template typically includes 70-90 indicators. The scores for each indicator are aggregated using a weight matrix to produce scores at the topic and theme levels and for the company overall. The weights can be fully customised to clients' needs and preferences. The company ratings that result from these assessments reflect how a company performs, relative to industry peers, on ESG issues shown in the following table.

ESG topics



Source: Sustainalytics

The research on controversies and incidents is often used by clients to identify companies at high risk, both financial and reputational. The assessments of controversies are based on relevance and severity of incidents using a scale from 1 to 5, whereby the most significant controversies are rated as 'Category 5'. Sustainalytics applies strict internal guidelines concerning the use of the five category levels. Elements taken into consideration when deciding upon the applicable controversy level are the impact of the incident, the degree of exceptionality, the sphere of influence that the company has, the level of recurrence, the company response, and managerial responsibility for the event.

For more details, please go to www.sustainalytics.com.

APPENDIX

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The following named research analyst(s) hereby certifies or certify that (i) the views expressed in the research report accurately reflect his or her or their personal views about any and all of the subject securities or issuers and (ii) no part of his or her or their compensation was, is, or will be related, directly or indirectly, to the specific recommendations or views expressed in this report: **Yannick Ouaknine, Nimit Agarwal, Niamh Whooley**

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Total shareholder return means forecast share price appreciation plus all forecast cash dividend income, including income from special dividends, paid during the 12 month period. Ratings are determined by the ranges described above at the time of the initiation of coverage or a change in rating (subject to limited management discretion). At other times, ratings may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

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The sector weightings are assigned by the SG Equity Research Strategist and are distinct and separate from SG equity research analyst ratings. They are based on the relevant MSCI.

OVERWEIGHT: sector expected to outperform the relevant broad market benchmark over the next 12 months.

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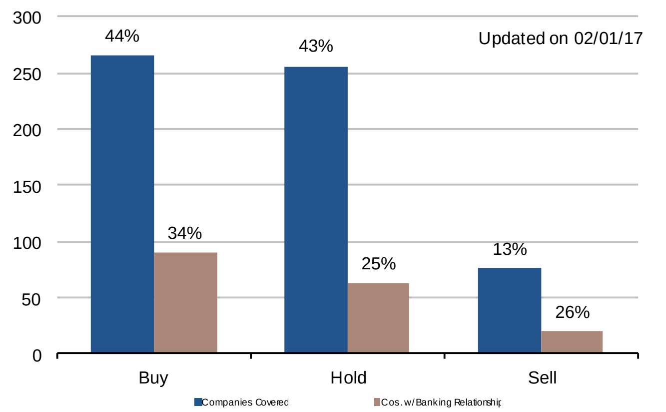
The Preferred and Least preferred stocks are selected by the covering analyst based on the individual analyst's coverage universe and not by the SG Equity Research Strategist.

Equity rating and dispersion relationship



Source: SG Cross Asset Research/Equity

SRI

For those reports containing a contribution from the SRI research team, the ESG numerical rating (with 100 being the highest score) is based on a four step rating methodology that includes: (i)identifying material ESG factors and associate weightings by sector; (ii)providing key performance indicators of company evaluation; (iii) calculating quantitative ESG rating (based on Sustainalytics data); and combining SG equity and ESG ratings to ide
ntify top picks. The ESG ratings are grouped into three equal tiers (Tiers 1,2 and 3) with Tier 1 containing the companies with the highest ESG numerical scores. The ESG numerical ratings should not be considered fundamental ratings of any kind and are completely separate from SG's equity and credit ratings.

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