

Inspired thinking



The 2007 proxy voting season

On behalf of our clients, we routinely vote on all resolutions at both annual general meetings (AGMs) and extraordinary general meetings (EGMs) of the UK companies in which we invest. As the financial year-end of the majority of companies is in December, their AGMs take place during the second quarter, making it a busy time of year. Between 1 April and 30 June 2007, Insight voted on 4,489 resolutions, at 413 events, for 380 companies. This was significantly more than in 2006 due to Insight holding a larger number of tracker positions in FTSE All Share companies and our holding more companies listed on AIM (LSE's international market for small growing companies).

In this article we provide an overview of the 2007 proxy voting season, as well as highlighting four controversial AGMs.

Remuneration and Rule 9 Waivers

The UK voting season was relatively uncontroversial with the most contentious issue continuing to be remuneration (see Box 1).

The relatively low number of recommended abstentions and votes against reflects the fact that more companies are now consulting investors ahead of meetings, either directly or indirectly through their advisors, on the introduction of new schemes or the changes to existing schemes. In addition, a number of companies, for example, 3i, Vodafone, and HSBC, continue to hold annual meetings with major shareholders to discuss corporate governance and remuneration.

In this year's voting season, one third of the controversial votes related to FTSE 250 companies and approximately one half related to FTSE Small Cap companies. This suggests that the remuneration policies of larger companies are broadly in line with corporate governance best-practice, but that more work is required with smaller companies.

Apart from remuneration, the other contentious issue in this year's AGM season was Rule 9 Waivers. The UK Takeover Code disbars a shareholder of between 30% and 50% of a company's equity from increasing its stake without making a full bid for the company, unless

Box 1: Recommended abstentions and votes against remuneration reports

Insight recommended voting against the following remuneration reports: 888 Holdings, BBA Aviation, Benfield, Corporate Services Group, Emerald Energy, Entertainment Rights, Huntsworth, Mapeley, Nestor Healthcare, NSB Retail Systems, Partygaming, Puricore, Randgold Resources, Shore Capital Group, and Vislink.

We also recommended abstaining from voting on the remuneration reports at Alliance Trust, Anglo-Eastern Plantations, Dignity, IP Group, Management Consulting Group.

Further details on these specific vote recommendations can be found in the Q2 2007 Voting Reports on our website (www.insightinvestment.com/responsibility/publications/publications_and_reporting.asp)

a majority of the other shareholders have, in a General Meeting, waived the requirement to make a bid. This is known as Rule 9. Insight's policy is to take a strong stance and recommend voting against Rule 9 Waivers to prevent one shareholder from gaining 'creeping control' of the company (see our Bulletin of Winter 2004, where we provide a more detailed discussion of Rule 9 Waivers and why it is such an important issue for investors). Rule 9 Waivers were put forward at Hikma Pharmaceuticals, Jardine Lloyd Thompson Group, Shore Capital Group and Ted Baker, and we recommended voting against them in line with our policy.

Case Study 1: Remuneration policy and a requisitioned resolution at Tesco plc

There were two controversial issues at the Tesco AGM this year: amendments to the remuneration policy and a requisitioned shareholder resolution relating to labour standards.

The Chairman and Deputy Chairman of Tesco first met with Insight in March 2006 to confidentially discuss the proposed changes to the company's remuneration policy, specifically increases to bonuses. Insight had a second meeting with the Deputy Chairman and Head of Remuneration Committee in March 2007, and, in April 2007, Tesco consulted with shareholders including Insight, more widely, through a meeting at the ABI. Tesco's proposals included increasing the bonus potential for the Chief Executive and the Commercial/UK Marketing Director and introducing two new incentive schemes (New Business Incentive Plan 2007 and Executive Incentive Plan and International Bonus Plan for US Participants). The company's rationale for making these changes was to reflect the perceived importance of new business opportunities in the US. While some shareholders held the view that remuneration and incentivisation in respect of US and other international businesses should not require additional specifically targeted arrangements, and executives should be rewarded through the current structure, we supported the changes. In our view, the amended remuneration policy will reward success in a part of the business, specifically the US, whose success is more important than is currently reflected in group metrics. A potential danger of not introducing this plan would have been to under-resource a key business area. We believe the changes to the incentive framework for executive directors has aligned the company's long-term business strategy with significant incentive value that is conditional on creating shareholder value. We therefore recommended

supporting the Tesco Remuneration Report at the AGM on 29 June 2007. Nine percent of shareholders voted against approving the Remuneration Report.

The second controversy at the Tesco AGM was a shareholder resolution lodged by the Company Secretary for War on Want that requested Tesco: "to take appropriate measures, to be independently audited, to ensure that workers in its supplier factories are guaranteed decent working conditions, a living wage, job security, freedom of association and of collective bargaining including, where available, the right to join a trade union of their choice." Ninety-two percent of shareholders voted against the resolution and 8% supported it. Insight recommended voting against the resolution (i.e. we supported management) as we believe that the company already has in place appropriate ethical trading policies and management systems to address supply chain risks.

Insight has been engaging with Tesco on labour standards issues since 2002. At that time, the company did not have a best practice management system in place, but since then has put in place the requisite elements, i.e. a policy and a management system that includes staff training, first-tier supplier auditing and membership in Sedex (Suppliers Ethical Database Exchange). Given the vast size of Tesco's supply base, it is highly likely that violations will occasionally occur, especially with suppliers further down the supply chain. To deal with such 'non-compliance' cases, Tesco has processes to respond to such allegations. If an instance of non-compliance has not been verified as resolved by the third-party company six months after the assessment date, a Tesco technical manager assesses the suitability of the site to continue supplying the company. Where full rectification takes longer than six months, an ongoing status summary report is maintained by Tesco. When problems with compliance emerge, Tesco aims, when possible, to work with the supplier to resolve the issue, believing that this approach helps to achieve long-term improvements in ethical performance. However, if there is no commitment from the supplier to improve, Tesco will cease to trade with them.

Overall, we believe that Tesco is managing its supply chain risks effectively. It is genuinely engaged in the labour standards debate. The company is an active member of the Ethical Trading Initiative and has been gradually improving its approach to ensuring that good labour standards are upheld. Prior to the AGM and following a presentation by Tesco to several institutional investors, we asked the company to provide more clarity on how it addresses potential

risks with its second- and third-tier suppliers. We also suggested that the company's disclosure might be improved by explaining more about its process for dealing with suppliers who are found not to be in compliance with its Code and by providing some examples of how these have been addressed. We also asked for more information about how Tesco addresses its commitments to ensuring that suppliers pay employees a living wage and how the company tracks the outcomes of its labour standards policy, in terms of improving workers' lives and livelihoods. We are awaiting a response.

Case Study 2: Bonuses for executive directors at Brixton plc

In April 2007, following the publication of the Annual Report & Accounts for the year ending 31 December 2006, the Chairman of Brixton's Remuneration Committee wrote to us to highlight changes in the company's remuneration policy, in particular the Remuneration Committee's decision to provide two executive directors with a bonus in excess of the normal 100% of salary maximum. The company stated that the reason for this decision was the increase in shareholders' funds of £276 million and the portfolio rental value growth of 3.8% which far exceeded the 1.7% for the IPD UK Industrial Index Comparator for Brixton's areas of operation. Additional bonuses – which will be deferred for three years – 50% of salary for the Chief Executive and 25% of salary for the Deputy Chief Executive were also proposed.

Following our review of the company's remuneration report and the rationale provided by the company for the increased payments, we concluded that bonus payments were above the normal limit; our view is that shareholders would normally only expect maximum bonuses to be paid for exceptional performance. The company did not achieve exceptional performance during the year. For example, one of the parameters used to set bonuses, total shareholder return (TSR), underperformed the benchmark index during the year. We explained to the company's advisors and the Head of Remuneration Committee that, although we fully accepted that the company had a good year, we would normally expect additional reward to come through the company's long-term arrangements rather than through a one-off grant.

The Association of British Insurers (ABI) 'amber topped' the Brixton Institutional Voting Information Service (IVIS) report, highlighting that the company's remuneration report was the subject of discussion because of apparent non-compliance with the ABI guidelines. Insight and other investors discussed the additional bonuses at a meeting held at the ABI. We accepted the argument that recruitment and retention of executives within the property market was difficult in view of competition for talent from outside the quoted company arena. While we were not happy with the company's approach, we decided to support the proposal, although 9% of shareholders did vote against it.

Case Study 3: Adjusted performance targets in BPP holdings Plc 2007 Performance Share Plan

In January 2007, the company wrote to major shareholders, including Insight, outlining proposed changes to its Performance Share Plan, specifically the establishment of a new incentive programme to reward exceptional performance. Insight met with the Head of the Remuneration Committee to discuss the proposed changes and provide feedback. We were supportive of the scheme using earnings per share (EPS) as a performance metric; however, in our view, the initially proposed targets were not sufficiently stretching. In March, the Chairman of BPP's Remuneration Committee wrote to the ABI confirming the finalised proposals. The finalised proposals reflected our concerns and in our view, the final proposal of Retail Price Index + 20% for the maximum payout under the scheme is a sufficiently challenging target.

On 1 March 2007, during the consultation on incentives, BPP rejected an offer of a bid from Carter & Carter, stating "it significantly undervalued the company". We believe that management made the correct decision in not accepting the bid. At the company's AGM in May 2007, 27% of shareholders voted against the Performance Share Plan. We understand that a major BPP shareholder voted against the scheme believing that the appropriate performance metric for the scheme should be TSR, which would take account of the rise in the shareprice resulting from Carter & Carter's bid approach. Insight continued to believe that the adjusted EPS targets were an appropriate measure of management success in creating shareholder value, and we, therefore, recommended supporting the Plan.

Case Study 4: Dignity plc and discretionary bonuses

The directors at Dignity plc received additional bonuses following the completion of the issue of Secured Notes in 2006. Shareholders and the ABI took the view that the issue of Secured Notes is part of directors' general duties and, therefore, directors should not be additionally remunerated for such transactions. Insight recommended abstaining from voting on the Remuneration Report at the company's AGM on 8 June 2007. We wrote to the Company Secretary on 1 June to inform the company of our decision. The Chairman responded to our letter on 28 June stating the significant votes against the Remuneration Report (59%) prompted him to write to Dignity's shareholders directly.

In his letter, the Chairman stated that the Remuneration Committee had recommended that a discretionary bonus be paid in recognition of management's efforts to return value to shareholders through the issue of Secured Notes in 2006. He argued that, because this wasn't built into the budget for the year, it should be rewarded. The Chairman also stated that he recognised that the payment of discretionary bonuses is clearly unacceptable to many shareholders, irrespective of the circumstances, and re-iterated that this would not happen again.

Insight wrote to the Chairman to re-iterate the explanation for our abstention on the Remuneration Report. Unlike other investors, Insight believes there are occasions when it is appropriate to pay discretionary bonuses. However, after discussions with our fund managers, we were not convinced that this was one of those situations. We understand

that a core element of the company's strategy is regular refinancing and believe that the success or otherwise of this strategy in delivering shareholder value is the best measure in the medium term. We therefore believe that reward for this refinancing should be delivered through an appropriately structured plan linked to performance going forward. Indeed, if the Remuneration Committee felt that last year's refinancing deserved exceptional awards, we believe these should have been made through additional participation in the company's Long-Term Incentive Plan, rather than a cash bonus.

Conclusion

It is evident that more companies are consulting with their largest shareholders on new remuneration proposals and amendments to current schemes. We support this process and believe it is important that companies can work together with shareholders, and, on occasions, the ABI, in a two-way dialogue to find acceptable solutions to thorny subjects such as director's remuneration.

More generally, we are of the view that voting at AGMs is just one of our broader efforts to encourage companies to be run in the long-term interests of their shareholders. Our ongoing dialogue with companies and our deep understanding of their businesses mean that we have good working relationships with boards and senior management which, in turn, allows us to constructively engage with companies when a controversy does arise and to find solutions that are in the best interests of long-term shareholders.

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