The Warwickshire Pension Fund Stewardship & Voting – Executive Summary

Table of Contents

1 ABOUT THIS DOCUMENT

This document is an executive summary of Warwickshire County Council pension funds approach to investor stewardship and in particular its views on key governance and corporate sustainability issues. These issues include: capital and board structure; board evaluation and refreshment; director remuneration, audit and accountability, and narrative reporting matters.

These high-level principles are underpinned by detailed market-by-market guidelines, which are used as a basis for voting the fund's shares at general meetings.

The fund has appointed a proxy voting agency to assist the fund in the implementation of its policies. Final vote decisions are determined by Fund officers using independent research to support their decision-making. The exception to this is case-by-case investment resolutions, for example take-overs, where the investment manager is consulted before a final decision is made.

Unless otherwise specified, the Fund seeks to adopt a highest common denominator standard to its global voting. Although we recognise that local market standards may vary, our objective is to hold management accountable to the highest possible standards on a consistent basis. The only exception will be where local laws contradict Smaller companies should seek to emulate best practice.

2 SHAREHOLDER RIGHTS & RESPONSIBILITIES

2.1 One Share- One Vote

The Fund fully supports the concept of "One share- One Vote" and is not supportive of the creation of share capital with differential voting rights. Companies should therefore disclose the share structure, voting rights and any other rights or limitations attached to each class of shares.

2.2 Shareholder Engagement & Wider Stewardship Activities

The Fund is a signatory to the Stewardship Code and is also a member of the Local Authority Pension fund Forum.

While the fund undertakes its own voting, we seek to involve our fund managers in our stewardship activities and expect them to include stewardship considerations as part of their investment strategy.

As a Code signatory we believe that proper disclosure of our voting records will help companies and other stakeholders including Fund members understand our approach. These records are updated on a monthly basis and can be found at https://i.warwickshire.gov.uk/content/warwickshire-pension-fund/warwickshire-pension-fund

Companies should engage with their shareholders on a regular basis throughout the year, not just in the period leading up to the AGM. The results of any shareholder meeting should be promptly disclosed and should include a statement detailing how the Company intends to engage with shareholders in order to understand the reasons for dissent. The steps taken to resolve any concerns should be detailed in the following year's annual report.

3 THE BOARD OF DIRECTORS

3.1 Board Composition, Diversity & Succession

When assessing the quality of investee company boards, WPF takes a balanced approach to understanding board composition which takes account of overall board size; directors' skills, background and experience.

Diversity brings substantial benefits to companies in terms of skills and competencies. We therefore expect to see a structured and well-articulated approach to board refreshment and succession planning. The Corporate Governance Report should include details of the Company's diversity policies, including professional, international and gender diversity, as well as measurable objectives set for policy implementation and the progress against such objectives. Diversity is more than simply gender; while not supporting specific gender quotas, we encourage boards to voluntarily achieve a target of at least 33% women on the board and in senior positions and to provide clear explanations of how they are achieving diversity goals.

All companies should have a succession plan and explain their approach towards to the use of executive search firms or "Head-hunters" versus internal talent or "Pipeline" development. Explanations for the re-election of long serving non-executive directors should be made in the context of the succession plan and particular attention should be paid to the Chair and CEO.

Insufficient detail in disclosure or lack of improvement in practice may result in a vote against the Chairman or the Chairman of the nomination committee.

3.2 Director Independence & Commitment

Director independence is generally assessed against the standards set by the UK Corporate Governance Code ('the Code'), however there are times when a case-by-case approach is required.

Independence on its own is not a sufficient characteristic for a successful appointee, directors should be able to devote the necessary time to the company's affairs. We there expect to see full disclosure of directors other outside appointments together with a record of attendance together with explanations of non-attendance, which will be considered on a case-by-case basis.

Length of tenure will be considered on a case-by-case basis taking into account the Board's succession plans, the length of service of other Board members, evidence of the director's independent conduct and whether the director has served for more than nine years concurrently with an executive director.

The boards of large companies (excluding the chair) should consist of a majority of non-executive directors.

3.3 Board Evaluation

Boards should undertake a formal evaluation of its performance every two to three years under the guidance of an external, independent facilitator. A statement about the results of the evaluation should be included as a separate item in the annual report and should name the firm or individual undertaking the evaluation.

3.4 Chair/CEO

We support the separation of the roles of Chairman and Chief Executive.

Except in rare circumstances, former Chief Executives should not be appointed to the position of Chair. We would expect to see a clear explanation of the reasons and what time horizon the company is looking to for a replacement. The position may be temporary, due to unexpected circumstances such as illness, for example. Where possible, evidence that external search consultants have been engaged should be provided.

We support the principle that the chair should be independent on appointment.

3.5 Lead Independent Director

A Lead Independent Director should be identified, especially where the Chairman of the Company is not independent. The Lead Independent Director should be a key contact for shareholders where the normal communication avenues through the Chairman or CEO have failed or are inappropriate.

3.6 Director Re-election

Directors are expected to submit themselves for re-election on a regular basis and that boards should not insulate individual candidates. We are supportive of annual relection.

3.7 Directors' Service Contracts

Companies should fully disclose directors' service contracts or terms of appointment; all contracts should include a notice period of no longer than one year and any exit payments should be clearly disclosed. In particular:

- Severance payments relating to poor corporate performance should not extend beyond basic salary. There should be no entitlement to discretionary payments in these circumstances.
- Contracts should not provide additional compensation for severance as a result of change of control;
- The duty to mitigate should be a made a specific contract provision and remuneration committees should consider phased payments in order to fulfil compensation commitments on early termination.

4 SHAREHOLDERS' CAPITAL

Pre-emption rights are a basic shareholder right which can be easily eroded without careful monitoring. We support the principles of the UK's Pre-Emption Group guidelines on dilution which permit up to 10% of share capital to be offered for cash rather than on a rights basis (5% additional authority to be used only in connection with an acquisition or specified capital investment). Existing shareholders should be offered the right of first refusal when a company issues shares exceeding 5% of the existing shares in issue or exceeding a 7.5% threshold in any three-year rolling period (excluding issues in connection with a specific acquisition or capital investment), as set out in the Pre-Emption Group's document "*Disapplying Pre-Emption Rights: A Statement of Principles*", issued in 2015.

Companies should provide explicit assurance that share buybacks will only be exercised in the best interests of all shareholders. This is particularly important where incentive pay may be linked to Earnings per Share performance – a statement that EPS will be normalised would be welcome

A clear dividend policy should be disclosed and separate approval should be sought for the payment of the final dividend. Where a scrip dividend or equivalent is offered, there should always be a cash alternative in place.

5 AUDIT & ACCOUNTABILITY

5.1 Audit & Accountability

Sound audit and reporting standards are an essential investor protection. Clear presentation of material risks to the business and how they are mitigated is a core requirement. Explanations in relation to changes to accounting practices, restatements or matters of emphasis must be prominent and transparent.

5.2 Audit Committee

Boards should ensure that the relationship with the auditor is appropriately focussed on the protection of the company and not of management. The audit committee, which should be composed of suitably qualified individuals, with a least one designated "Financial Expert", is responsible for ensuring that the auditors offer independent and effective services. The committee should be comprised of entirely independent directors.

5.3 Non-audit Services

Non-audit related work should be minimised to avoid unnecessary conflicts of interest. The fees paid for non-audit work should not exceed 70% of the average audit fee over the previous 3 years unless exceptional circumstances apply and are explained. A clearly defined policy on the provision non-audit services should form part of the Audit Committee's report to shareholders.

5.4 Internal Controls

Oversight and management of risk can be enhanced by the use of an internal audit function. Financial institutions should operate a separate risk committee.

5.5 Risk Management

Reporting of risk should be dynamic and subject to continual refinement and refreshment. Companies should communicate how risks are managed and details of the changes that have occurred in relation to risks identified during the year. The Company should also report on its response to actualised risks.

5.6 Audit Partner, Audit Firm Rotation

We encourage competitive tendering for audit every 10 years and mandatory rotation after no more than 15 years. Retendering alone is unlikely to safeguard auditor independence. We do not support "Big 4 only" restrictions in tenders or any such requirements by lenders.

6 DIRECTOR REMUNERATION

6.1 Remuneration Committee

The UK Corporate Governance Code provisions on the role and composition of remuneration committees, serves as a benchmark for our approach to committee composition for our UK and global holdings. Remuneration committees should have access to their own independent advice which is not connected with any other services provided to management e.g. audit, HR, board evaluation etc. Non-executive fees and any associated policies, including share ownership policies should also be disclosed.

In their reporting to shareholders, committees are encouraged to explain their approach to the discretionary powers they exercise over the various components of executive pay. Blanket discretion is not supported.

6.2 Remuneration Policy & Disclosure

Remuneration policies should be clear and straightforward so as to facilitate understanding of how management is incentivised to achieve long term shareholder value and support the success of the company. Remuneration policies should be put to the vote on a triennial basis and should be sufficient designed to encompass any changes in executive management in that time.

- Remuneration Packages

The size of the overall remuneration package should be considered in relation to average employee remuneration as well as the performance and growth of the Company. Pay increases should not be in excess of inflation or those awarded to the rest of the workforce without sufficient explanation.

- Pay for Performance

We expect to see a significant proportion of executive pay linked to corporate performance which is clearly and meaningfully aligned with strategy and positive shareholder value. Financial metrics and ratios such as EPS or TSR on their own are unlikely to be sufficient measures of strategy. We therefore we wish to understand the relationship between pay and Key Performance Indicators; business and market risk; and how these support long-term, sustainable returns. Sustainability or "extra-financial" criteria which have a material business impact are encouraged as part of the KPIs. We are supportive of long term incentive plans that have a time horizon of at least 3 years.

- Variable or Performance-Related Pay

Companies should clearly disclose the performance targets used in any variable pay plans (Annual Bonus, Short-Term Incentives or Long-term Incentives). Where commercial sensitivity prevents forward disclosures, we expect to see retrospective disclosure. The technical analysis of variable pay schemes is provided by our research provider and takes account of global and market best practices.

- Share Ownership Policy

Executives should make a material long-term investment in shares. Companies should consider requiring executives to continue to hold such material holdings post-retirement or resignation.

- Recruitment Payments

We recognise that companies may need flexibility in order to be able to recruit new directors. We expect to see clear disclosure relating to the maximum variable pay which an be paid to incoming directors. Such payments should exclude compensation for variable pay forgone at the previous employer. Transaction-related payments such be subject to demanding performance conditions.

- Change of Control

There should be no automatic waiving of performance conditions for either change of control or capital reorganisations. Any consequential early vesting should be time pro-rated.

- Dilution

Share-based remuneration plans have the potential to dilute shareholders. For this reason share plans should not exceed 10% of the ordinary issued share capital in any rolling 10 year period.

- Claw-backs

Clawback provisions should be in place for all incentive plans and should be described clearly within the remuneration policy. The remuneration committee should have sufficient flexibility to operate the policy rather than simply tying clawback to specific events such as financial restatements, for example.

7 SUSTAINABILITY REPORTING

7.1 Responsibility & Disclosure

There is strong evidence that demonstrates that companies with a long-term sustainable approach to their management outperform their peers. We therefore encourage our companies to describe their approach to sustainability in the widest possible sense and explain how their policies align with long- term corporate strategy. The board of directors should be directly responsible for sustainability considerations.

7.2 Sustainability Risk Reporting

We strongly support transparent and understandable sustainability risk reporting in the context of how relevant and material risk impact their business strategy.

7.3 Employment, Health and Safety

Poor employment practices present significant operational and investment risks for companies. We expect management to develop good employment practices across their organisation that are linked to sustainable corporate prosperity and thus investment value.

Companies should disclose more details of their corporate culture and working practices, including stability, training & skills, engagement levels of the workforce and explanations of how this relates to the underlying business strategy.

7.4 Political Donations

Political donations are considered on a case-by-case basis according to jurisdiction, however as a general rule we do not support shareholders' funds being used for party political donations.

8 DETAILED VOTING PROCEDURES

In addition to these high level principles, the Fund maintains detailed voting procedures on a market by market and issue by issue basis. These are maintained by our service provider on behalf of the fund and are reviewed on a regular basis, at least annually to ensure that our procedures are consistent with local laws and best practices.

The fund aims to cast its votes on an informed and pragmatic basis having given due consideration to the specific circumstances of the company and the disclosures given to shareholders. Companies are encouraged to provide transparent explanations which explain and justify their reasons for non-compliance with standards.

Limited or boilerplate disclosure regarding corporate governance, risk management or sustainability arrangements and reporting, including disclosures lacking clarity, may result in a vote against the adoption of the report and accounts. If practice does not improve and engagement is ineffective, we may consider a vote against the Chairman.

In cases where there is insufficient information or unduly harsh voting deadlines, the fund reserves the right to withhold votes on all resolutions.

9 INVESTMENT TRUSTS

We apply to investment trusts the same expectations around board composition, audit, and director independence as to other companies. We believe there should be independence between the board of an investment trust its investment managers.

For further information, please contact

Chris Norton
Strategic Finance Manager, Corporate Financial Services
Warwickshire County Council
chrisnorton@warwickshire.gov.uk