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Portfolio Manager

A TALE OF TWO BANKS

COMPANY DESCRIPTION AND INVESTMENT CASE

As a long-term investor, we believe that incorporating relevant environmental, social and governance (ESG) factors into our investment and ownership decisions ultimately leads to improved risk-adjusted returns for our clients. Identifying issues that currently or at some point in the future may materially impact the long-term value of a company, gives us insight into a business's ability to grow sustainably. As shareholders on behalf of our clients, we regularly engage with companies' executive teams as well as actively exercising our voting rights.

With me being a financial services sector analyst, Robert Lewenson (Head of ESG Engagement) and I engage with companies across this sector, specifically on governance issues. Given that a significant portion of financial services companies' expenses is remuneration, it is our responsibility to ensure that the remuneration policies of companies in which we invest are aligned to shareholders by being appropriate, transparent and set against clearly defined and sufficiently challenging targets.

By way of example, two financial services companies with which we have had numerous engagements are Standard Bank and ABSA. While these discussions have been constructive, we have not always voted in favour of their remuneration polices.

STANDARD BANK is the largest South African banking group ranked by assets and earnings. It has a strong market position in corporate and investment banking, and in retail banking and operations in 20 African countries. It has a controlling stake in Liberty Holdings. Given the diverse nature of the business, we need to clearly understand remuneration, compliance and policy decisions taken by its remuneration committee.

ABSA GROUP is one of Africa's largest diversified financial services groups. It has a presence in 12 African countries. The group offers a range of retail, business, corporate and investment, and wealth management solutions. Apart from the share's current extremely low valuation and its solid dividend yield, the investment case also lies in the benefit of Barclays plc no longer being a controlling shareholder. We believed this move would give management greater scope to drive growth without the constraint of the parent company.

STANDARD BANK ENGAGEMENTS

Over the years, we have met with Standard Bank to better understand a number of key remuneration issues, including special incentives, performance-related pay targets and adjustments to targets relative to profits. The outcome of these engagements influenced how we voted at the AGMs as follows:

2015

QUALIFIED VOTE IN FAVOUR
The performance measurements for the long-term incentive plan seemed easily attainable over the near term, but we concede that over the longer term this may not be the case.
Action: To monitor the stretch of the metrics over the next year.

2016

QUALIFIED VOTE IN FAVOUR
Our concerns listed in 2015 remain.
Action: Continue to actively engage with the company on these issues.

2017

VOTED IN FAVOUR
Appropriate changes were made to the stretch of performance targets.

2018

VOTED IN FAVOUR
Our concerns were satisfactorily addressed in the remuneration policy.

We appreciate the frankness with which Standard Bank responded to our queries and the consequent amendments it has made to it remuneration policy and reports. We continue to view Standard Bank as a valuable holding in our client portfolios and are comfortable that its remuneration structures are sufficiently aligned with shareholders’ interests.

ABSA ENGAGEMENTS

We have engaged with the bank both under the Barclays plc brand and, subsequently, as an Africa-only organisation. Our engagements have largely concerned executives' long-term incentive plans and revisions to its remuneration structure after decoupling from Barclays plc (ABSA was previously constrained by the UK regulatory framework, which calls for role-based pay). Specific issues addressed with ABSA include clarity on performance targets, the appropriateness of the stretch criteria used and the calculations used for short-term incentives. The outcome of these discussions influenced how we voted at the AGMs as follows:

2015

VOTED AGAINST
We were concerned by the lack of disclosure on key performance criteria for the long-term incentive plans.
Action: Continue to engage with the company to improve disclosure and better understand how incentives link to company strategy.

2016

QUALIFIED VOTE IN FAVOUR
While the long-term incentive targets were disclosed, they were unclear in some respects. The company explained that the remuneration policy would change after its separation from Barclays plc.
Action: Monitor changes to the remuneration policy post the separation.

2017

QUALIFIED VOTE IN FAVOUR
Our concerns listed in 2016 remained.
Action: Actively engage with the company for greater clarity on targets post the separation from Barclays plc.

2018

VOTED AGAINST
Previous remuneration concerns were not addressed.
Action: Review the performance criteria that were disclosed to ensure remuneration targets align to performance.

We understood that when Barclays plc was the majority shareholder, UK legislation bound its remuneration policy. However, we expected amendments to be made thereafter. We viewed the separation from Barclays as a significant change that provides opportunity to unlock value over the longer term, as it is now in control of its own destiny. It gives ABSA management full control of the company's risk appetite and frees the bank up to lend more appropriately to drive growth. As such, we are keen to see remuneration that is better aligned to management achieving these growth targets.

In conclusion, I must stress that our engagements as shareholders are not an attempt to run the companies, but I do believe that we have a role to play in working with management to ensure remuneration polices are realistic and aligned to a company strategy where value is created for shareholders (you, our clients).