Governance and Sustainability

2021 Principles and Guidelines
Risk Factors

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This article contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act (‘FinSA’) and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

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## Contents

<table>
<thead>
<tr>
<th>Introduction</th>
<th>Our Stewardship Principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>02</td>
<td>03</td>
</tr>
<tr>
<td>Our Governance and Sustainability Approach</td>
<td>Voting and Engagement Guidelines</td>
</tr>
<tr>
<td>04</td>
<td>09</td>
</tr>
</tbody>
</table>
Introduction

This document sets out Baillie Gifford’s stewardship approach and how we consider governance and sustainability matters as part of our investment process. As a private partnership, we know from our own experience how critical ownership structures and corporate cultures can be to the success and longevity of a business. Too often in asset management active ownership, or ‘stewardship’, takes second place to stock selection, and governance and sustainability matters are an afterthought. As a truly long-term investor these issues are central to how Baillie Gifford invests, how we manage our own affairs and how we interact with our clients.

Our clients trust us to oversee and manage their investments for the long term. Stewardship of their holdings is a core part of this commitment. Our genuinely long-term perspective is evidenced by our low portfolio turnover relative to our industry. If you analyse a company’s business prospects over the next decade, not the next quarter, you have to think deeply about the way it interacts with a variety of stakeholders. We think that there needs to be a much more open and honest conversation among all stakeholders about how the financial sector relates to society and about the rules and behaviours that underpin those interactions.

All our investment staff are involved in our stewardship work and, as long-term investors, we believe that our approach to monitoring holdings, engaging with management and voting thoughtfully supports investment performance. We are wary of prescriptive policies and rules, believing that these are often counterproductive to thoughtful and beneficial corporate stewardship. Over the following pages, we explore how we consider and integrate governance and sustainability matters into our investment process through research, engagement and voting. Our approach is framed around our five core stewardship principles.
Our Stewardship Principles

Prioritisation of long-term value creation
We encourage company management and their boards to be ambitious and focus their investments on long-term value creation. We understand that it is easy for businesses to be influenced by short-sighted demands for profit maximisation but believe these often lead to sub-optimal long-term outcomes. We regard it as our responsibility to steer businesses away from destructive financial engineering towards activities that create genuine economic value over the long run. We are happy that our value will often be in supporting management when others don’t.

A constructive and purposeful board
We believe that boards play a key role in supporting corporate success and representing the interests of minority shareholders. There is no fixed formula, but it is our expectation that boards have the resources, cognitive diversity and information they need to fulfil these responsibilities. We believe that a board works best when there is strong independent representation able to assist, advise and constructively test the thinking of management.

Long-term focused remuneration with stretching targets
We look for remuneration policies that are simple, transparent and reward superior strategic and operational endeavour. We believe incentive schemes can be important in driving behaviour, and we encourage policies which create alignment with genuine long-term shareholders. We are accepting of significant pay-outs to executives if these are commensurate with outstanding long-run value creation, but plans should not reward mediocre outcomes. We think that performance hurdles should be skewed towards long-term results and that remuneration plans should be subject to shareholder approval.

Fair treatment of stakeholders
We believe it is in the long-term interests of companies to maintain strong relationships with all stakeholders, treating employees, customers, suppliers, governments and regulators in a fair and transparent manner. We do not believe in one-size-fits-all governance and we recognise that different shareholder structures are appropriate for different businesses. However, regardless of structure, companies must always respect the rights of all equity owners.

Sustainable business practices
We look for companies to act as responsible corporate citizens, working within the spirit and not just the letter of the laws and regulations that govern them. We believe that corporate success will only be sustained if a business’s long-run impact on society and the environment is taken into account. Management and boards should therefore understand and regularly review this aspect of their activities, disclosing such information publicly alongside plans for ongoing improvement.
What do we mean by ‘corporate governance’?

Corporate governance relates to the control, oversight and management of a company. Despite the extensive regulation and national-level corporate governance codes in place, companies still have broad discretion over how they choose to be incorporated, governed and operated. As long-term investors we pay close attention to these variables, taking particular interest in the following areas of a company’s business:

1. The capital structure, articles of incorporation, and the country or countries of incorporation and listing

2. The way in which minority shareholders are treated and protected

3. How interests are aligned across management, strategic shareholders and other investors

4. The composition and effectiveness of the board of directors, the quality and performance of management, and the remuneration of key employees

5. The corporate culture and approach to sustainable business, and how relationships with customers, employees, suppliers, regulators and the wider community are managed

We focus on corporate governance not because of an interest in shareholder rights per se, but because we believe that governance really matters with respect to long-term investment performance. Our ongoing assessment of corporate governance issues may change our view on buying, selling or resizing our clients’ holdings. It also determines how we choose to vote at company meetings and how we engage with management, the two principal levers we have for influencing change.

For us, stewardship is this combination of ongoing company monitoring and ‘active ownership’ through voting and engagement.
What do we consider to be ‘best practice’ in corporate governance?

There is no simple answer. Just as there is no universally ‘right’ way to invest in the stock market, or to manage a pension fund, there is no ‘one-size-fits-all’ step-by-step approach to corporate governance. We are open minded about what is the most appropriate way to govern and manage a company, and we are pragmatic about the significant differences in what is expected and the options available to companies across the world. For example, we don’t have a fixed view as to how a company’s board of directors should look. Effective boards can and do take many forms, and some of the least effective boards conform to the full range of widely-accepted corporate governance ‘norms’.

For this reason, we are sceptical of overly prescriptive policies and checklists when analysing, engaging and voting on corporate governance issues. In the same way as our investment research is bottom up, we prefer to take a case-by-case view on governance, focusing on what works in practice:

- Are we consulted by management?
- Are we respected as minority holders?
- Is executive compensation consistent with performance?

Ultimately, we want to be in a position where we can step back and trust management to take a long-term view and to look after our clients’ interests as minority shareholders.

What do we mean by sustainability?

We believe that a company cannot be financially sustainable in the long run if its approach to business is fundamentally out of line with what society expects of it. Our definition of ‘sustainability’ is deliberately broad to encapsulate a company’s purpose, values, business model, culture and operating practices.

With ever-increasing scrutiny and disclosure requirements, businesses are having to pay even greater attention to their relationship with stakeholders and wider society. In response to mounting evidence of environmental challenges, the United Nations’ Brundtland Report of 1987 defined sustainable development as “the kind of development that meets the needs of the present without undermining the ability of future generations to meet their own needs”. For business, this can be reinterpreted as ‘making profits in a way today that does not undermine the ability of the firm to generate profits in the future’.

As expectations and regulations continue to raise the bar, we closely monitor and analyse how things are developing at our holdings in this increasingly important area of business. In common with many organisations, we have found the United Nations’ Sustainable Development Goals (SDGs) to be particularly instructive as a widely-endorsed benchmark for assessing progress.

We also believe that we have a wider ‘stewardship’ role to play in encouraging responsible, long-term capitalism. How companies approach governance issues can have a very material impact on society, and we should continue to use our influence to encourage sustainable practices. More broadly, our business is based on our ability to invest in stable and functional public markets. It is therefore in our own interests in the long run to ensure that the business sector enjoys ongoing stakeholder support and political, legal and regulatory backing around the world. This will only happen if companies are seen to be operating with integrity and in a way that respects the interests of wider society.

Is ESG the same as governance and sustainability?

ESG is the acronym for ‘environmental, social and governance’ issues. It has emerged as an industry shorthand for a very broad range of matters relating to how a company is governed and its impact on society. While it is now a widely-accepted term, we prefer to focus on governance and sustainability as broader interlinked concepts which also factor in a company’s performance on environmental and social issues – a business with an unacceptable environmental record, for example, is a poorly governed one that should be a priority for engagement and, if necessary, voting action.
Controversial weapons policy

Baillie Gifford prohibits investment in controversial weapons such as landmines, cluster munitions, nuclear weapons, chemical weapons, white phosphorus and depleted uranium (‘controversial weapons’). Baillie Gifford is not permitted to invest in companies that produce controversial weapons or in companies providing products or services that are integral to, and tailor-made for, the dissemination or use of controversial weapons. Baillie Gifford uses screens across all products and investments to ensure compliance with this policy, using data from Sustainalytics, MSCI and Pax Christi to identify and exclude companies involved in controversial weapons.

How do we embed governance and sustainability into our investment process?

Our long only, active approach to investment is based on identifying and holding high-quality growth businesses that enjoy sustainable competitive advantages in their marketplace. To do this, we look beyond current financial performance, undertaking proprietary research to build up our in-depth knowledge of an individual company and form a view on its long-term prospects. This focus on ‘bottom-up’ research also applies to our work on governance and sustainability. We believe financially-material governance and sustainability issues can positively or negatively influence investment returns and therefore such issues are routinely considered throughout the investment process. However, for the majority of our funds, there are no limitations to the sectors in which we can invest beyond the controversial weapons restrictions outlined in this document.

Likewise, while the principles outlined in this document are valid across all our investment strategies, each investment strategy may take a different approach to reach the same goal of properly assessing and weighing up governance and sustainability matters within its investment process. In this regard, a subset of our investment products take governance and sustainability integration further through negative screening, positive selection or having an impact focus.

The EU Sustainable Finance Disclosure Regulation (‘SFDR’) requires asset managers to disclose how they integrate and measure governance and sustainability risks into the investment process. Under the regulation on sustainability-related disclosures in the SFDR, investment products need to be classified as article 6 (mainstream products which do or do not integrate ESG criteria), article 8 (products that promote environmental or social characteristics) or article 9 (sustainable products). We have a number of investment products classified as Article 6, 8 and 9. The current product classifications are indicative, and it is possible certain product classifications may change hereafter.
Research and engagement

Governance and sustainability are not separate from, but central to, our investment process. All our investment staff share the responsibility for identifying, analysing and monitoring issues and opportunities for both existing and potential holdings. They spend significant time assessing the quality, integrity, motivation and culture of management teams, and then acting upon their convictions. The work of our dedicated Governance and Sustainability Team supports this.

As active managers we have regular meetings with management and board members to identify and understand issues and to monitor performance. Analysts from the Governance and Sustainability Team regularly join our investors for these meetings, in addition to holding meetings directly with company representatives to discuss specific issues.

We set clear objectives when engaging with companies on governance issues. Where we do have reservations about a company’s approach we prefer to encourage change through active ownership rather than divestment in the first instance. This may mean approaching the company directly to express our concern, holding face-to-face meetings with management and, where appropriate, voting against management. If, after a protracted period, we have been unable to exert any influence over a company on a material issue, our investment managers will consider reducing or selling our holdings.

Voting

Thoughtful voting of our clients’ holdings is an integral part of our commitment to stewardship. We believe that voting should be investment led, because how we vote is an important part of the long-term investment process, which is why our strong preference is to be given this responsibility by our clients. The ability to vote our clients’ shares also strengthens our position when engaging with investee companies. Our Governance and Sustainability Team oversees our voting analysis and execution in conjunction with our investment managers. Unlike many of our peers, we do not outsource any part of the responsibility for voting to third-party suppliers. We utilise research from proxy advisers for information only. Baillie Gifford analyses all meetings in-house and we endeavour to vote every one of our clients’ holdings in all markets. However, on occasion this may not be possible due to a practice known as share blocking, whereby voting these shares would prevent us from trading for a certain period. Additionally, we are not able to vote clients shares if their stock is on loan, a common industry practice which we discourage because of the potential impact on our voting rights. If we deem a meeting to be significant or contentious, we may consider requesting that clients recall any stock on loan so we can vote.

We review the merits of proposals on a case-by-case basis rather than following restrictive checklists. Checklists often by necessity revert to focusing on inputs rather than outcomes. For example, it is easier to draw up a rule dictating how many other company boards a director can be on than to try to determine whether their performance as an independent director is effective. A formulaic approach to governance can often lead to recommendations that just don’t make sense to us in an investment context – attempting to vote a successful founder CEO off the board because they are also the board chair, for example.

We recognise that some votes can be more significant than others and that not every vote against is necessarily significant. Whether a vote is deemed significant is determined by market opinion, media scrutiny or an internal view.

The list below is not exhaustive, but exemplifies potentially significant voting situations:

- Baillie Gifford’s holding had a material impact on the outcome of the meeting
- The resolution received 20 per cent or more opposition and Baillie Gifford opposed
- Egregious remuneration
- Controversial equity issuance
- Shareholder resolutions that Baillie Gifford supported and received 20 per cent or more support from shareholders
- Where there has been a significant audit failing
- Where we have opposed mergers and acquisitions
- Where we have opposed the financial statements/annual report
- Where we have opposed the election of directors and executives.

Stewardship reporting

We recognise the importance of transparency with regards to our stewardship activities. Each quarter, our clients receive detailed voting and engagement information in their quarterly reports. We also regularly fulfil client specific requests for more detailed information on our stewardship activities and will accommodate these wherever possible.

Additionally, we publicly disclose on our website all our voting decisions and which companies we have engaged with on a quarterly basis. Each year, we publish an Investment Stewardship Activities report detailing our compliance with the five stewardship codes we are signatory to globally. The report features case studies of our most substantive engagement and voting activity allowing further insight into our approach.

For more information on how we implement our voting and engagement guidelines, including detail on the most significant votes, please see our Investment Stewardship Activities report available on the Governance and Sustainability section of our website.
Investments in other asset classes – multi asset and fixed income

Our Multi Asset and Fixed Income Teams invest in a range of other assets. We believe governance and sustainability factors are applicable and important across all asset classes and therefore take these issues into account as part of the investment process.

Multi-Asset – real assets

Within our real asset class allocations (commodities, infrastructure and property), longer-term governance and sustainability trends and factors can often be clearly identified. For example, environmental considerations may play an important role in the long-term attractiveness of a property investment or infrastructure project. As with other asset classes, our focus is on engaging with companies rather than excluding them. All relevant factors are considered as part of our investment analysis, and the integration of governance and sustainability factors allows a better assessment of the risks involved. Investing in these asset classes can often offer the opportunity to support sustainable projects or benefit from relevant technological developments.

Multi-Asset – external managers

Where we invest in externally-managed vehicles as a means of accessing desired asset classes, we employ a thorough due diligence process to select and monitor investments, including seeking managerial alignment with our own governance and sustainability beliefs and practices. We engage regularly and pro-actively with the management and boards of these vehicles to monitor and progress relevant governance and performance issues.

Fixed Income – corporate bonds

Alongside a company’s long-term competitive position and capital structure, governance and sustainability factors are considered as a key component in assessing a bond issuer’s fundamental financial resilience. As well as providing warning signs of upcoming issues, governance and sustainability factors may also signal that a company is becoming a more attractive investment opportunity. As such, we believe additional governance and sustainability analysis adds value in both controlling risk and identifying opportunities for outperformance. The materiality of these factors will vary depending on the company’s sector, region and the strength of its financial position. Strong governance and sustainability factors may increase our enthusiasm for an investment. Conversely, negative performance may weigh against a potential investment, causing us to hold a smaller position than we otherwise might, demand a higher risk premium, or choose not to invest.

Fixed Income – sovereign bonds

When we consider investing in a country’s bonds we examine key governance and sustainability factors to help consider associated risks, the country’s broad direction of travel and if our provision of capital is likely to aid its progression. We believe that if a country is governed effectively, its people are respected, and its natural assets are managed responsibly, there is a greater chance it will enjoy sustainable growth and development, as well as be in a better position to repay bond debt.

These factors are integrated into our analytical framework, which rests on three key areas: macroeconomic sustainability, economic management and growth potential. This framework allows us to identify and focus on the risks specific to the potential investment being analysed, from political stability in one country to environmental pressure in another, and to monitor these risks on an ongoing basis.
Voting and Engagement Guidelines

Introduction

We believe that ‘active ownership’ of our clients’ holdings is as important as selecting the right investments in the first instance. These guidelines are aligned with our Stewardship Principles and describe our approach to proxy voting and company engagement, the key levers of active ownership, often described as ‘stewardship’.

While the guidelines are intended to provide an insight into how we approach voting and engagement on our clients’ behalf, it is important to note that we assess every company individually. In voting, we will always evaluate proposals on a case-by-case basis, based on what we believe to be in the best long-term interests of our clients, rather than rigidly applying a policy.

Furthermore, just as our approach to investment is based around empowered and independent teams, our voting and engagement is investment-team led, and all members of our investment staff are involved in our ongoing work on stewardship. In keeping with our decentralised and autonomous culture, our investment teams will, on occasion, elect to vote differently on the same general meeting resolutions. Where this happens, we report accordingly in the proxy voting disclosure on our website. We also have clear processes in place to identify, prevent and manage potential proxy voting related conflicts of interest. Baillie Gifford’s firm-wide conflict of interest disclosure is available on our website. While these guidelines primarily relate to listed equities, we also carefully consider relevant governance and sustainability issues in voting, research and engagement for other asset classes, such as fixed income and unlisted equity investments.

Core to the way in which we invest is that our investment staff meet with company leadership teams to understand their business strategy and to discuss and monitor progress, both before and after taking a holding. We believe that ongoing dialogue between investors and companies on strategic issues can protect and enhance our clients’ long-term returns. However, we are equally mindful of not attempting to ‘micromanage’ our holdings in areas where we have no special expertise or insight, or distracting managements from their core role of running the business for the long term.

Prior to taking any voting action, we usually address specific governance and sustainability concerns by engaging directly with the company. What we engage on is informed by our own research. It will vary between geographic regions, industry sectors and between individual companies, but will typically cover areas set out within these guidelines. When appropriate, we engage collaboratively with other shareholders through a range of industry organisations and associations. Full details of the industry organisations that we support are available on our website.
Prioritisation of long-term value creation

Equity issuance

We consider companies’ requests to raise additional capital with or without pre-emptive rights on a case-by-case basis, taking account of their specific circumstances and local market practice. We view excessive equity issuances as potentially destructive to creating long-term value. We believe that pre-emptive rights are important to protect shareholders from being detrimentally diluted, although we recognise that in some instances it is appropriate for companies to have the flexibility to issue shares without first offering them to existing shareholders on a pre-emptive basis. We also typically prefer that shareholders are given the opportunity to vote on large amounts of capital issuance. In both instances, the onus is on the board to clearly demonstrate that the request is necessary and proportionate.

Although individual investment teams’ preferences vary, we typically approve requests to issue up to 5 per cent of authorised capital without pre-emption rights and up to 20 per cent of authorised capital with pre-emption rights, unless we have concerns about a company’s leadership, capital allocation track record or proposed use of funds. Beyond these limits, we evaluate requests individually based on the views of our investment teams.

Share repurchase

Share repurchases, when executed in a thoughtful and appropriate manner, can play an important role in creating long-term value. Boards should be clear about how the share repurchase authority will be used. We typically approve share repurchases up to 15 per cent of authorised capital, dependent upon the share price at which shares will be repurchased. Above this limit, we evaluate requests on a case-by-case basis considering the views of our investment teams.

Allocation of income and dividends

We support the efficient and effective use of shareholder capital and normally expect to vote in favour of the allocation of any dividend. However, many profitable companies (especially in Japan) continue to propose unusually low dividend payments without an adequate explanation, deciding to retain cash on their balance sheets. In such instances, we typically oppose the proposed dividend.

Additionally, if we have significant and ongoing concerns over a company’s capital allocation policy, we endeavour to engage with management to encourage them to improve their practices and, if this proves ineffective, will take appropriate voting action.

Mergers, acquisitions and disposals

Corporate restructuring such as mergers, acquisitions and disposals can clearly have a very significant impact on shareholder value. When done well, successful mergers or acquisitions can accelerate a company’s growth and increase its market share. However, when used inappropriately, they can be destructive to long-term value creation. It can be difficult to successfully integrate acquired companies, particularly when they each have distinctive company cultures. Therefore, we carefully consider all such proposals on a case-by-case basis.

Political donations

We generally oppose all resolutions that seek approval for intentional political contributions, and we will usually support shareholder resolutions which oblige companies to report to shareholders on their political contributions.
A constructive and purposeful board

Board effectiveness

Effective company boards should perform a number of key functions. First and foremost, they should provide oversight to executive management teams, regularly reviewing performance against a defined strategy, recognising and supporting success but taking firm action if changes of direction or leadership are required. Specifically, we expect boards to perform the following important functions:

— To undertake effective succession planning for key roles with consideration given to the diversity of current and future board members
— To put in place an appropriate and effective remuneration plan to attract, retain, motivate and direct key executives
— To establish the necessary risk management framework and controls on corporate activity
— To review and, where necessary, challenge key capital allocation decisions, ensuring that management teams are taking a long-term approach to business planning
— To appoint, monitor and set the remuneration for a suitably qualified and independent financial auditor
— To undertake a formal and transparent process for nominations and appointments to the board, the details of which should be fully disclosed in the annual report
— To regularly evaluate the effectiveness of their own work, taking appropriate measures to address any priority issues
— To ensure that management are working within the legal and regulatory norms of their countries of operation and that stakeholders of the business are treated fairly
— To ensure the material social and environmental impacts of the business are considered and to make necessary improvements to support the sustainable growth of the business

If a board of directors is persistently failing to exercise one or more of these key responsibilities, we aim to engage with the company in the first instance and then consider taking additional voting action if appropriate. Such voting action may include voting against the election of the chair or members of relevant board committees. This may be escalated to the board chair if we feel the overall effectiveness of the board is in question, or if our previous action has not materialised in any progress.

We also believe that independent directors should be periodically available to engage with shareholders.

Board composition

When considering board composition, we generally prefer to see the following features:

— A majority of independent non-executive directors on the main board, and fully independent audit and remuneration committees of three members or more
— The appointment of a senior or lead independent director
— An effective mix of qualifications, experience and diversity
— Directors with sufficient time to focus on their responsibilities, given their other commitments and directorships

Companies should be able to demonstrate an appropriate level of commitment and independence on the board. With regards to diversity, we expect boards to have made reasonable progress towards both gender and ethnic diversity or having at least set out a clear roadmap as to how to achieve this. If the board composition or that of its subcommittees very different from these expectations, we aim to engage with the company in the first instance, and may also consider taking additional voting action against appropriate directors, such as the Chair of the Nomination Committee, if we do not believe sufficient progress has been made.
The roles of board chair, chief executive and senior (or lead) independent director

We generally support separating the roles of board chair and chief executive, although we recognise that these roles have been very successfully combined in a number of our holdings. If the roles are combined, there should ideally be a majority of independent directors on the board. The board should also appoint a senior or lead independent director with clearly defined responsibilities separate from that of the board chair to mitigate the risks associated with combining the positions. This should include the senior independent director having the right to periodically convene a meeting of the independent directors with the full support of the company. Additional actions to strengthen corporate governance should be considered where appropriate, such as enhanced authorisation, audit and disclosure requirements.

We also typically prefer that companies do not appoint a retiring CEO as board chair, however we recognise that in exceptional cases this may be in shareholders’ best interests. In these circumstances, the board should explain why it is appropriate and we will consider the justification on a case-by-case basis.

Director tenure

We believe that companies should be mindful of the value of periodically refreshing the membership of the board of directors. While we recognise the value that long-serving directors can bring in terms of continuity and experience, when a director’s tenure exceeds nine years of service we will no longer consider the director to be independent. This is in keeping with the UK Corporate Governance Code. Where a director is deemed not to be independent, we will consider the impact this has on the wider composition of the board and associated committees, taking voting action against said director should we deem overall independence is insufficient. The board should have in place an effective succession plan to mitigate any impact long-tenured directors may have on board composition.
Effective remuneration policies help to recruit, retain and motivate the best available talent, while also incentivising management to focus on the right long-term priorities for the business. We encourage our investee companies to develop robust and transparent pay practices. These should demonstrate clear alignment with long-term shareholders, reward outstanding performance and mitigate against excessive risk taking or unintended consequences arising from a narrow focus on inappropriate targets. In addition to this, companies should take due account of increasing public scrutiny of executive pay practices and should be cognisant of the reputational and regulatory risks of excessive or inequitable pay practices. We believe that substantive changes to executive remuneration policies should be submitted to a shareholder vote. We also welcome the opportunity to engage with our investee companies on material remuneration matters.

To achieve the right overall balance, we expect the Remuneration Committee to take full responsibility for this process, taking independent advice as necessary. They should retain discretion to make upward or downward revisions in exceptional circumstances, particularly where such action is clearly aligned with long-term shareholder interests. For us to effectively assess a company’s executive remuneration, it is essential that we receive timely disclosure. Therefore, early in their deliberations, we look to receive clear and concise information about the design of the scheme, the underlying targets that are used to assess performance awards, and the total quantum of reward that is possible. We review each policy on a case-by-case basis and are prepared to support innovative structures which do not necessarily fit within conventional practices, but which are appropriate for a company’s individual circumstances. When reviewing remuneration proposals, we generally favour the following:

— We prefer that a substantial proportion of total reward potential for senior executives is made up of variable performance-based pay that is subject to deferral and clawback provisions. Performance for long-term incentives should be measured over a minimum three-year period. However, we acknowledge that for some businesses restricted stock plans may be more suitable. We expect the board to clearly justify why this structure is suitable and assess the appropriateness of such proposals on an individual basis.

— We typically favour the use of a maximum cap on long-term incentive schemes to limit the total compensation available at an appropriate level.

— While we recognise that circumstances can change, we prefer investee companies’ pay policies to be consistent long-term structures and are therefore not usually supportive of regular changes or subsequent amends.

Typically, we would not support the following pay practices:

— Repricing of equity awards
— Retesting of performance conditions
— Vesting of incentive awards for below median performance
— Incentive-based awards for non-executive directors
— Severance agreements which (i) are excessive relative to market practice and/or (ii) allow accelerated vesting of variable pay awards without pro-rating for time and performance.

When a company’s remuneration policy or report is significantly below expectations we will consider taking voting action against any relevant pay proposals on the ballot, against the chair of the Remuneration Committee and, where appropriate, against the chair of the board and other independent directors.

Long-term focused remuneration with stretching targets
Fair treatment of stakeholders

Annual general meetings

All listed companies should aim to ensure that an annual shareholder meeting takes place where substantive matters are submitted for shareholder approval. All shareholders should be actively solicited for their voting instructions. All paperwork, particularly the annual report signed off by the appointed auditor, should be available to investors well in advance of the meeting. This enables due consideration by investors of any matters ahead of any relevant regulatory and market proxy voting deadlines. In the limited number of markets where the above features are not common practice, we engage with issuers and relevant third parties to encourage change and consider taking voting action where appropriate and possible. Such action may include voting against the board chair or the annual report and accounts.

Director elections

As a general principle, we believe that all directors should be subject to annual, individually proposed, majority voting, standard elections. Currently, there are several alternatives:

— ‘plurality voting’ enables uncontested board nominees to be elected with a single affirmative vote, even if all other votes are withheld
— ‘cumulative voting’ allows shareholders to direct all or any of their votes to single or multiple directors
— ‘bundled’ director elections are when several or all directors are proposed as a single resolution, without the ability to support or oppose individual directors
— ‘classified’ boards is the term for when only a subset of directors is put up for election each year.

We believe that each of these alternatives can potentially undermine individual director accountability, although we recognise that there may on occasions be company specific circumstances that support such voting arrangements.

We are supportive of management and shareholder resolutions calling for alternative director voting procedures to be replaced by a simple majority voting standard on an annual basis. When asked to vote in cumulative elections, we typically allocate our votes equally across independent directors on the ballot, unless we have specific concerns about their effectiveness or a desire to see a particular director on the board.

Auditors

The appointment of auditors should ideally be submitted to an annual shareholder vote. We will consider voting against the auditors’ appointment if we have concerns about their independence, level of non-audit fees, audit quality, or where a company changes its auditor without providing an adequate explanation to shareholders.

We believe that it is good practice to rotate the lead audit partner at least every five years and to limit continuous audit firm tenure to no more than twenty years, in line with current guidelines across a number of markets.

Non-audit fees paid to the audit firm should not typically exceed audit fees, except for a limited period (and not for more than two consecutive years) where there are exceptional circumstances which support that position. In this case, the company should provide additional disclosure on the nature of the non-audit work undertaken by the audit firm.

Appointment of statutory auditors (Japan)

Statutory auditors play an important role in defining audit policy in the Japanese market, supervising the external audit of a company’s financial statements and advising the board. Given their responsibilities we prefer outside nominees. We assess internal candidates on a case-by-case basis, considering the materiality of their relationship with the company and the presence of other external statutory auditors.

Proxy access

Proxy access is the ability for a shareholder or group of shareholders to nominate candidates to the board. We are supportive of proxy access in principle, believing that long-term shareholders should have the ability to place director nominees on the proxy ballot. While we are likely to support proposals based on the terms outlined above, we review each resolution individually. We also welcome the opportunity to engage with investee companies to help structure an appropriate policy which enhances board accountability and responsiveness to shareholders but also limits potential abuse by shareholders without a meaningful long-term interest in the company. Where a shareholder proposal is proposed on proxy access, we will assess the merits of this proposal against a company’s existing practice.
‘Poison pill’ anti-takeover devices

We generally oppose proposals for new anti-takeover devices, particularly when introduced post-Initial Public Offering. We also usually support shareholder proposals that request a company to submit a shareholder rights plan to a shareholder vote or to revoke a poison pill.

We evaluate proposals to modify or remove existing shareholder rights plans or poison pills on a case-by-case basis. While many anti-takeover devices have the potential to entrench management and damage shareholder value, there may be certain growth-oriented companies and sectors where an element of protection from short-term market priorities can support long-term shareholder value creation.

Articles of association

We review amendments to a company’s articles of association within the context of the company’s business strategy and shareholders’ best interests. Accordingly, we usually oppose any proposed changes that have the potential to erode shareholders’ rights.

Shareholder resolutions

Shareholder resolutions are a mechanism permitted in a number of markets which enable shareholders to table proposals at company meetings relating to any aspect of a company’s business. These proposals often request that companies improve their approach to environmental and social issues. Shareholder proposals can be a useful mechanism to hold companies accountable on their wider impact on stakeholders.

We review each resolution on a case-by-case basis and will support those resolutions that address key governance and sustainability concerns or encourage progress on material governance and sustainability issues where we feel improvement is required. We do not however expect these proposals to be repetitive, prescriptive or to seek to micromanage companies. Prior to voting, we consider the company’s current approach to the issue, its response to the resolution, and whether the resolution is workable and in the best interests of all stakeholders.

Bundled resolutions

In some markets it is still common for companies to ‘bundle’ together proposals, such as the election of directors, or amendments to articles of association. This practice reduces shareholder discretion by preventing voting on separate issues. For example, if shareholders have concerns about one specific director, the only option may be to vote in favour or against the entire board, which may be counterproductive. Nonetheless, we vote against bundled resolutions where we have serious concerns and it is in shareholders’ best interests for us to do so. We communicate our views to the company and encourage them to isolate all relevant matters as separate resolutions in the future.

Related party transactions

As a general principle, we believe that large shareholders should recuse themselves from voting if they are involved in related party transactions. Most markets have specific disclosure rules on related party transactions and require approval from minority shareholders. We consider such transactions carefully to determine if they are appropriate and in our clients’ best interests.

Multi class share structures

The use of dual and multi class share structures is common in a number of regions where listing rules allow. While the one-share, one-vote principle clearly aligns voting rights and economic rights for all holders, we appreciate that multiple share structures with different voting rights can enhance long-termism and protect the strategy and culture of some organisations. Accordingly, we assess all proposals to introduce additional share classes or amend existing voting rights on a case-by-case basis.

Disclosure

Levels of disclosure vary significantly between sectors and countries. We believe that all material issues should be set out succinctly in an annual report, and that the approach to governance and sustainability matters should be reported in the context of the whole range of risks and opportunities faced by the company.

When disclosure on key financial, governance and sustainability information is significantly below expectations and impedes us exercising our stewardship responsibilities for our clients, we endeavour to engage with the company in the first instance and consider taking appropriate voting action thereafter, where necessary. Such action may include voting against the board chair or the annual report and accounts.
Sustainable business practices

We believe that a company cannot be financially sustainable in the long run if its approach to business is fundamentally out of kilter with changing society expectations. We consider each of the following sustainability risks and opportunities in the context of our overall focus on long-term investment performance.

As a minimum, we expect all holdings to operate in accordance with the principles and standards set out in the United Nations Global Compact. When a company’s performance on any of the following issues is significantly below what is expected, making it a material risk to the long-term performance of their business, we will engage with management in the first instance, before considering taking appropriate voting action.

We expect that all our holdings to operate their businesses in a way that takes account of all relevant legal and regulatory guidelines and which is supportive of good stakeholder relations. Relevant areas of practice include responsible marketing, governance of data privacy and security, responsible taxation approaches and how the company manages product and service issues, such as product quality and integrity, complaint handling, safety recalls and compensation. Where we have concerns with a company’s practice in any of these areas, we will seek to engage with the company to seek improvements, support any relevant shareholder proposals and consider voting against members of the board to ensure accountability for continued progress. Should our concerns be material and continue to persist, we will consider selling the shareholding.
Diversity and inclusion
We believe that employee diversity is an important issue for all businesses, and we expect our holdings to take steps to understand and, where necessary, improve any aspect of employee diversity. Companies should disclose their policy on diversity and inclusion with details of initiatives to improve the diversity of the workforce where required. The diversity of employees throughout the organisation is important to ensure a diverse pipeline of talent for future senior roles and improve equality generally within society.

Reporting on the diversity of the workforce should also be provided and include details on gender, ethnicity, culture and nationality. In markets where it is required, gender pay gap reporting should be clear and unambiguous with clear actions to solve the pay gap should it exist.

We further expect businesses to carefully monitor and manage the culture within their organisation to ensure that all employees are treated equally and with respect in the workplace. There should be suitable policies and processes in place to ensure that inappropriate behaviour and/or discrimination is identified and addressed accordingly.

Combating bribery and corruption
We expect all our holdings to work against corruption in all its forms, including extortion and bribery. For companies in the extractive industries, we support active participation in the Extractive Industries Transparency Initiative. We expect to see apt conduct and compliance programmes reinforced by leadership, policies and training, and appropriate reporting procedures such as confidential ‘whistleblower’ hotlines. We would also not ordinarily expect our holdings to make political donations or contributions to ‘politically exposed’ charitable organisations.

Human rights and labour rights
We expect all our holdings to respect internationally accepted human rights and labour rights throughout their business operations and value chain in line with the United Nations Guiding Principles for Business and Human Rights. As a minimum, this should include the maintenance of health, safety and wellbeing management systems, particularly in high-risk sectors; the management of exposure to labour and human rights risks throughout their value chain, especially human/modern slavery; and encouraging positive relationships with local communities.

As signatories to the UN Global Compact, we believe that the following principles should be upheld in relation to human rights and labour:

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

Principle 2: make sure that they are not complicit in human rights abuses.

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labour;

Principle 5: the effective abolition of child labour; and

Climate change and other environmental impacts and risks

Our primary role as long-term investors is to support the new technologies, business models and societal changes that will help address the global challenge of climate change. If we do this effectively then the results for our clients will look after themselves, provided we are cognisant of the risks that derive from both the physical impacts of climate change itself and the myriad of technological, policy and market changes that accompany the transition to net zero emissions globally.

As an independent private partnership, our governance of climate risks and opportunities is to a large extent devolved to our individual investment strategies in which clients invest and with whom they have most of their interaction. Given that our core investment strategies (which number 25 in total) have quite differentiated investment objectives, the main responsibility for overseeing and managing climate-related risks and opportunities therefore sits with the investment managers running each portfolio.

Climate change could impact our firm-wide strategy via the effect it has on the companies we invest in, and the societies and ecosystems that support them. Our view at this stage is that ‘transitional’ risks and opportunities are more material to overall investment performance over the short to medium term (0–5 and 5–10 years) than physical risks, which we expect to become more severe over the medium to long term (5–10+ years). We believe that without sufficient investment in the solutions to climate change, all actors in the financial system and wider economy will be affected negatively, including ordinary savers and pension holders.

In general, we see transition-related risks and opportunities as being particularly acute for companies or assets associated with the energy, transport, agriculture and construction/property sectors. These sectors generally have some of the highest emissions (either directly or indirectly) and are the most susceptible to policy, technology and market changes associated with the drive to reduce them. Our exposure to these sectors tends to be relatively low versus the average, apart from transport.

An example of investing in the solutions to climate change: Tesla Inc.

We invest in Tesla through several of our investment strategies and were one of the largest outside shareholders in the company for several years. Our earliest investments were back in 2013 at a time when the company’s technical achievements were already world-leading but its potential to fundamentally re-engineer the shape of the global auto industry was poorly understood by many investors. We supported the company through some very difficult years when accessing capital was difficult and some market participants were betting on their failure. Their role as a visionary leader of the energy transition hung in the balance. Our long-term view of the company’s potential over those years has proven one of our core beliefs to be true: that our purpose as investors is to assist in mobilising beneficial, transformation change.
Our risk management approach is focused on stock-level research and analysis within individual investment strategies, with the assistance of dedicated sustainability, governance and risk specialists working across the firm. Key considerations include the carbon intensity of the company or asset, the climate impact of its core products and services, and its relationships with its own stakeholders, including customers, regulators and non-governmental organisations (NGOs). We have access to data from independent providers to help add further detail to our understanding of each holding, and place great value in seeking the perspectives and insights of external experts and researchers to help inform our approach.

We use this information primarily as an aid to engage with companies to ascertain how they are mitigating risks and maximising opportunities. We use this information to help inform stock discussions and investment decision-making. If we feel that companies are not making enough progress in mitigating risks then we retain the option of exercising our voting rights in shareholder resolutions and ultimately divesting our holdings.

We make use of some company-level carbon footprint and weighted-average greenhouse gas (‘GHG’) intensity metrics for Scope 1 and 2 emissions. We are also making use of Scope 3 emissions data to help us further understand risks in companies’ upstream and downstream value chains. To help us understand physical climate risks, we have access to data that can make estimations of company-level impacts under different warming scenarios. More broadly, our intention is to further develop climate scenarios to allow us to undertake more sophisticated analysis at both the company and portfolio level. We are also exploring the use of other climate metrics such as climate value-at-risk, temperature alignment and various definitions of net zero transition alignment.

When we look across the entirety of our largest holding across the firm, we see a picture of much lower than average carbon intensity on a weighted average basis. For example, our top 250 holdings, which account for around 90 per cent of all our holdings by value, have a weighted average carbon intensity of 66.5 tonnes of Scope 1 and 2 greenhouse gas emissions per million pounds of revenue (where data exists) versus a figure of 224.8 for the MSCI ACWI (against which many of our strategies are benchmarked).

Further details of our approach to climate change can be found in our Taskforce on Climate-related Financial Disclosures (TCFD) report, available on our website.
Biodiversity

Biodiversity loss (including deforestation) is considered one of the greatest risks facing society today. Related risks may include increased raw material or resource costs, regulation and taxation, resource availability and/or supply chain disruption.

The protection of biodiversity should be a priority for all businesses and companies should take steps to limit the destruction of the natural environment as far as possible. We are working towards developing a policy in relation to our material sector exposures, considering how best to assess and integrate the consideration of biodiversity risk into our investment and engagement process. Key sectors we are planning to target under our biodiversity policy include:

— Agricultural Products
— Apparel, Accessories & Luxury Goods
— Brewers
— Distribution
— Electric Utilities
— Home Furnishing
— Independent Power Producers & Energy Traders
— Mining
— Oil & Gas Exploration & Production
— Oil & Gas Storage & Transportation
— Tyre Manufacturers

Learning from industry initiatives like FAIRR, which we joined in 2020, is aiding this process. The FAIRR Initiative is a collaborative investor network that raises awareness of the ESG risks and opportunities brought about by intensive animal agriculture.
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