What is Allan Gray's approach to engagement?

Engagement is an integral part of our investment process.

Engaging directors

Our aim in engaging with a company's directors is to further the best interests of our clients by encouraging the directors to act in a way that enhances or preserves shareholder value. We always aim to engage in a constructive manner, as we believe that constructive engagement is more likely to succeed than hostile engagement.

The chairperson or non-executive directors of a company may request meetings with us from time to time. These meetings are usually arranged by the non-executive directors to elicit feedback from shareholders on matters such as the company's broad strategy, executive remuneration and the performance of executives. When offered these opportunities, we aim to speak candidly and make our views clear.

Unless it would be contrary to the best interests of our clients to do so, we aim to inform a company's representatives prior to a shareholders' meeting if our clients, in aggregate, hold a material shareholding in the company, and we intend to recommend voting against any of the resolutions. Often, this creates an opportunity to explain to the company's directors why we believe a resolution is not in the shareholders' best interests.

Engaging executives

Company executives regularly ask to meet with us. These meetings typically follow the announcement of the company's financial results. We use these meetings primarily to improve our understanding of the business of the company.

We believe that the responsibility for the day-to-day operations of the company rests with the executives, and that we probably have limited value to add in this regard. From time to time, we may believe that we can contribute to a company's deliberations over its broad strategy, particularly with regard to capital allocation. When offering our views, we try to do so with humility.

Should we identify strategic, sustainability or governance concerns, and we do not expect to have an opportunity to communicate these concerns to the company, we may contact either the company's executive or non-executive directors to discuss these concerns. We may communicate verbally or in writing if we wish for our concerns to be placed on the record.

ESG engagement

From an ESG point of view, we typically engage with multiple stakeholders, including company boards and management teams, industry regulators, other industry participants, clients and civil society or activists. The way we engage has evolved over time. In the past, we mainly engaged with executives. Direct engagements with board representatives were few and far between. Nowadays, our engagements involve a wider range of stakeholders.

An important driver of more frequent engagement was the development of the JSE Listing Requirements, which made it mandatory for companies to table their executive remuneration policy and implementation report at annual general meetings from 2017. While these resolutions are advisory, it has prompted a "standing" governance engagement between shareholders and company representatives. Over recent years, ESG measures have become more prominent in executive remuneration packages. This has meant that key E and S matters are often addressed as well.

Such engagements typically exclude executive directors and may include the board chairperson, remuneration committee chair or a company's E, S and G specialists – depending on which issues are discussed. While "standing" platforms are useful and an improvement from the past, they are not our only point of contact.

Owing to the complexity and nuanced nature of E and S issues, many of which are interrelated, more focused engagements may be warranted. We prefer not to follow a formulaic approach to these engagements. They are mostly ad hoc, as the underlying drivers and objectives vary widely. Examples of engagement triggers include 1) thematic or company-specific research that has highlighted an ESG risk or opportunity for further discussion or 2) adverse news prompting us to seek insight into whether the issue is being addressed appropriately.

While we engage proactively on E and S matters, G engagements remain more frequent and are often undertaken with the intention of influencing outcomes. Studies have shown that companies with stronger governance practices typically perform better on environmental and social metrics as well. We firmly believe in pushing for the alignment of the incentives of executives to the interests of long-term shareholders, which means that we focus on long-term sustainability.

Engagement escalation

On rare occasions, our efforts at constructive engagement and persuasion fail. If so, and we continue to harbour material concerns about the strategy, sustainability or governance of a company, we may begin to engage with the company's directors in a more forceful manner, including:

- Recommending that our clients vote against certain resolutions at shareholder meetings (including those involving the election of directors);
- Attending a shareholder meeting on our clients' behalf and voicing our concerns;
- Requesting the company's directors to add a new independent director to the board (who may or may not be nominated by us);
- Calling for a general meeting of the shareholders of the company in terms of section 61 of the Companies Act of 2008, if permitted;
- Reporting our concerns to the relevant authorities, if appropriate; and/or
- Taking legal action to enforce shareholder rights.

Before deciding to embark on any one or more of the more forceful actions listed above, we consider whether:

- Our clients have a reasonable prospect for success;
- The proposed action may impede our ability to effectively manage our clients' investment in the company concerned;
- The time and effort required to pursue the forceful action is commensurate with the potential benefit for our clients if we succeed; and
- The nature of the planned action is appropriate in the circumstances.

We will not act in a forceful manner merely to assert ourselves or to generate publicity. If our concerns regarding a company's strategy, sustainability or governance cause us to lower our estimate of the company's intrinsic value, we may sell the company's shares.

Price-sensitive information

From time to time, companies may request to share information, which they regard as material and price sensitive because it is not yet in the public domain. Provided that this information will either be made public or lose its relevance within a period of a few weeks, we believe that it may be in our clients' best interests, depending on the specific circumstances at the time, to agree to become party to this information.

If we do so, we follow the procedures outlined in our policies covering insider trading and applicable legal requirements, including placing an immediate ban on trading in the relevant shares and ensuring immediate isolation of the information. In deciding on whether to become party to this information, we weigh up the benefit of engaging with the company, and potentially influencing a significant event in the life of the company, against the opportunity cost of not being able to trade in the share for the duration of the trade ban.

Our policy covering the treatment of material, price-sensitive information is different to practice recommendation 2.3 of the Second Code for Responsible Investing in South Africa (CRISA 2), which recommends that service providers implement controls to avoid exposure to or acting upon such information. In certain circumstances, becoming party to material, price-sensitive information in a strictly controlled manner and for a limited period affords us the opportunity to engage with company directors and influence their thinking on potential events of significant importance for the company for the benefit of our clients. Indeed, companies are sometimes unwilling to publicly announce potential transactions without first hearing the opinions of representatives of their major shareholders. Thus, we believe that it is in our clients' best interests to deviate from this recommendation.

We expect all company executives and representatives to be aware that we never wish to be made party to material, price-sensitive information without them formally inviting us to become party to such information and offering us the opportunity to either accept or decline their invitation. On rare occasions, a company representative may inadvertently say something to us, which could be regarded as material, price-sensitive information. In such circumstances, there is nothing we can do to prevent the receipt of such information, and we will follow the procedures outlined in our policies covering the receipt of insider information.

Fixed income engagement

Bondholders and shareholders broadly share the same ESG concerns, but bondholders do not benefit from the same powers of ownership conferred on shareholders; for example, they cannot vote to remove directors. Therefore, our engagement approach when it comes to fixed income differs to that of our equity holdings.

We typically engage with debt issuers' management during debt investor roadshows, which frequently occur after financial results are published or before an issuer intends to come to market with a new instrument.

In South Africa, we aim to play a constructive role by engaging with government on key matters through various channels, for example, through the Association for Savings and Investment South Africa (ASISA), or through direct engagement with policymakers on matters such as the fiscus, corporate governance and the environment.

In the case of corporates and parastatals, where we may be a more significant lender, we may request meetings with key management or write to boards when specific issues arise. Most of the corporates in our fixed income investment universe are listed entities, which allows us to draw on our equity research process in assessing the creditworthiness of issuers.

Engagement objectives

We categorise engagements into four buckets according to their objective:

Fact finding

The lowest level of engagement is a "fact-finding" exercise, where we enquire about a particular E, S or G issue to gain more insight.

Sometimes management and members of the board also proactively offer further information or opportunities to engage on ESG matters, as discussed above. Alternatively, we approach or are approached by third parties. Not everyone considers a fact-finding exercise to be eligible to meet the definition of an engagement. The Principles for Responsible Investing (PRI) defines an engagement as "interactions between the investor and current or potential investees (which may be companies, governments, municipalities, etc.) on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosure".

Our fact-finding engagements are mostly held to obtain more detail on a company's material ESG risks, which may lead to further engagement if we have concerns around mitigation. Often, the outcome is that we obtain comfort with the management thereof and do not take it further. However, given that fact-finding communications still require preparation (detailed review of ESG reporting and tracking of trends and metrics over time) and because they may help us to identify areas warranting more intensive probing, we believe they still meet the definition of an engagement.

Disclosure enhancing

We aim to encourage useful sustainability disclosure. One example here is where we query changes in investee company ESG disclosures; for example, why GHG emissions have been restated, or why a particular safety metric is no longer being disclosed. We believe that asking these questions enhances disclosures by highlighting to companies that investors are following the detail closely and therefore that consistency and transparency is important. We also engage to request additional disclosures or more clarity regarding certain disclosures, most notably on executive remuneration.

We do not believe in making broad-based requests in this category; for example, emailing all companies in our portfolio to request that they comply with a particular disclosure framework. Detailed reporting is onerous and resource intensive. Therefore, we should not expect a company with a small market capitalisation operating in one country to publish the same level of disclosures as a large multinational company. It also may not be in shareholders' best interest from a cost and complexity perspective. Instead, we look to what is most material for each and engage on a case-by-case basis.

Influencing
We appreciate that, when holding listed equities as shareholders on behalf of our clients, we can vote towards the election of board members who are thereafter accountable for a company's governance, such as its strategy, compliance and ethics. Executive management also directs strategy as well as operational execution. In the latter case, shareholders vote on how executives are remunerated. What does this mean? For the most part, we believe that the responsibility for the day-to-day operations of the company rests with the executives, and that we likely have limited value to add in this regard. Our best levers for positively influencing management are to vote in a competent and accountable board of directors that can provide crucial oversight, and to vote against management incentive schemes that poorly align with long-term shareholder value creation. In practice, however, this lever does not always work out. We may have small position sizes in companies, a lower level of voting rights (depending on share classes) or, given the range of shareholders with varying opinions and interests, exercising our proxy vote does not always effect the change we consider necessary. Influencing engagements are therefore an important part of active ownership. Our ongoing governance engagements on executive remuneration are a good example. When necessary, we push for positive changes to the executive remuneration policy and implementation. This may be requesting better disclosures on criteria (to enhance transparency and accountability) or attempting to improve the link between performance and pay. Often, the changes are incremental year-on-year but add up over time. We are generally reluctant to take full credit for an "ESG outcome" and have concerns about the proliferation of this type of reporting. We recognise that companies engage with many stakeholders and undertake their own benchmarking exercises. Sometimes, we may be one of many voices that have influenced change.
Strategic intervention
The final step is when we engage to push for a "strategic intervention". Of course, this is the exception rather than the norm. We have a long history – spanning decades – of demonstrating that we are willing to step in more decisively to protect our clients' interests when required.

Engagement strategy

Over our history, we have learnt that the manner in which we approach our engagements is critical to achieving constructive outcomes.

The following considerations, while not exhaustive, inform our approach.

- **Materiality.** We prioritise engagements with companies that are material in our clients' portfolios, or where our clients own a material percentage of the business. This contrasts with engaging on every company held in the portfolio. Instead, we dedicate more time to researching and engaging on issues that have the largest potential impact on our clients' portfolios or where we are most able to influence change.
- **Quality, not quantity.** We are comfortable holding fewer, more meaningful, engagements per year. We do not believe in contacting companies to discuss ESG issues on which they already report. We respect the time taken to prepare disclosures and always use them as a first port of call. We would like to develop a reputation with companies for high-quality ESG engagements that are mutually beneficial. This reputation should, in turn, allow us to have more influence.
- **Humility.** We recognise that we are one of many stakeholders, and companies undertake improvements of their own volition. Therefore, we avoid taking full credit for engagement outcomes. We also respect that boards may hear our views on strategy or executive performance and disagree with them. We prefer to engage with companies in private, recognising that these are typically more constructive than public engagement, which may be perceived as hostile, resulting in defensive behaviour.
- **Purpose.** We engage only with the aim to achieve better outcomes for our clients (and society, although this is complex and often subjective) and not for other reasons such as publicity.
- **Proactivity.** We aim to identify any potential ESG issues through thematic, sector- or stock-level research before they impact the business. We prefer to engage on these upfront, rather than when adverse news emerges, i.e. we aim to be proactive rather than reactive. Given the breadth of ESG factors, this is not always possible, but we have examples of detecting concerns and engaging before they become news headlines.

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