How Engagement Can Affect Executive Compensation

Responsible investment has been core to Newton’s investment approach since our inception in 1978, when we began actively voting on our clients’ shares. Since then, our responsible investment approach has grown to include environmental, social and governance (ESG) integration and active engagement across all our strategies. This is done to identify risks and opportunities that have the potential to affect companies’ performance over the long term. This example of our active engagement work concerns our work with an infrastructure fund in Korea. While we first invested in this fund in May 2007, an opportunity for meaningful engagement arose eleven years later, and our investment team was able to play its part in improving the situation for both the company and its shareholders. This company has a mandate to invest in companies that construct, operate and manage infrastructure projects across the country, including toll roads, bridges, tunnels and ports. It then intends to generate profit from its investments and distribute these profits to shareholders.

What Was the Issue?

We consider ourselves not only shareholders, but stakeholders. After a decade of being invested in this fund, a situation arose in April 2018 where an activist investor bought a large stake in the company, and launched a campaign aiming to oust the current management by way of an extraordinary general meeting (EGM). The activist investor argued that the company’s business model had been simplified but that the fees charged by the management company did not reflect this development. With the firm’s business model having changed such that the fund was no longer actively seeking new infrastructure assets and would only be maintaining existing investments, the activist investor believed that this was akin to the fund changing from an active to a passive management approach but still charging active management fees, when it was no longer clear exactly what work those fees were funding.

How Did We Engage?

After the activist investor announced its intention to take over the fund by appointing its own director and manager, the fund’s management approached Newton as we were the biggest shareholder. We then entered into multiple engagements with both parties to review existing policies and hear the thoughts, concerns and plans for the fund from both sides. As we had had positive interactions with the company (and seen strong returns) over the eleven years we had held the fund, and because in situations like this we aim to engage with a firm if possible rather than ‘cut and run’, we made clear we would consider supporting the current management against the activist investor provided meaningful governance changes were enacted.

What Was the Outcome?
After multiple conversations back and forth, Newton voted against the hostile shareholder at the EGM and sided with the current management. We voted against the takeover motion because:

- the current manager had consistently supported and respected minority shareholders over the course of our investment with the company
- improvements were expected to the company’s fee structure and the strength of its board
- the company had significantly outperformed peers and the market.

Ultimately, the activist investor was defeated and sold its position.

In January 2019, because of our engagements, the fund announced its revised compensation structure which was passed at the 2019 AGM with strong shareholder support.

This case study shows the value of actively engaging with companies in which we are stakeholders. While we recognized that legitimate concerns had been raised about the fund’s new business plan and the fees shareholders paid to the management company, we also knew that the current management had been incredibly effective in their roles, producing returns that exceeded those of both peers and the market across the decade we had been an investor.

By leveraging our position as a major shareholder and engaging actively, we were able to address these concerns head-on while also showing our support for other aspects of the business. This resulted in a fairer compensation structure being agreed, an outcome that was received well by shareholders. It also strengthened the board by way of the appointment of a high-quality, independent non-executive director with relevant skills and experience.

We believe the company is now better poised to develop with its new, more transparent governance practices – practices that may have never come into being without our active engagement work.
IMPORTANT INFORMATION

Investors should consider the investment objectives, risks, charges, and expenses of a mutual fund carefully before investing. Contact a financial professional or visit im.bnymellon.com to obtain a prospectus, or summary prospectus, that contains this and other information about the fund, and read it carefully before investing.

All investments involve risk including loss of principal. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Asset allocation and diversification cannot ensure a profit or protect against loss.

Risks:

**Bonds** are subject to interest-rate, credit, liquidity, call and market risks, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. **Equities** are subject to market, market sector, market liquidity, issuer, and investment style risks to varying degrees.

**Currencies** are can decline in value relative to a local currency, or, in the case of hedged positions, the local currency will decline relative to the currency being hedged. These risks may increase fund volatility.

Investing in **foreign denominated and/or domiciled securities** involves special risks, including changes in currency exchange rates, political, economic, and social instability, limited company information, differing auditing and legal standards, and less market liquidity. These risks generally are greater with emerging market countries.

Impact investing and/or Environmental, Social and Governance (ESG) managers may take into consideration factors beyond traditional financial information to select securities, which could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. Further, ESG strategies may rely on certain values based criteria to eliminate exposures found in similar strategies or broad market benchmarks, which could also result in relative investment performance deviating. Recent market risks include pandemic risks related to COVID-19. The effects of COVID-19 have contributed to increased volatility in global markets and will likely affect certain countries, companies, industries and market sectors more dramatically than others. To the extent the fund may overweight its investments in certain countries, companies, industries or market sectors, such positions will increase the fund's exposure to risk of loss from adverse developments affecting those countries, companies, industries or sectors.

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