QUILTER CHEVIOT

Our expectations for investment trust Boards

Phase Two – Investment trusts: Alternatives

May 2024

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QUILTER CHEVIOT

Contents

3 **Executive summary**
4 **Overview**
5 Introduction and scope
5 The three factors
6 Initial assessment and escalation
6 The asset classes included in this report
7 **Board composition**
8 Skills and independence
8 Succession planning
9 Diversity
10 Diversity and Channel Islands domiciled trusts
10 Recruitment
11 Over-Boarding
12 Summary: Board composition
13 **Board effectiveness**
14 Communication
14 Board responsiveness
15 Skin in the game
15 Board evaluations
16 Case study: Princess Private Equity
17 Summary: Board effectiveness
18 **Responsible investment disclosures**
19 Different expectations
19 Private equity
19 Private equity and infrastructure: disclosure through the lifecycle of investments
20 "Others"
20 PRI signatory status
20 To committee or not to committee
20 Where to disclose
20 Investing in renewables is not equal to responsible investment
21 Summary: responsible investment disclosures
22 **Other considerations**
23 Capital allocation
24 Discount management
24 Gearing
24 Performance fees
25 **RAG rating**
27 Does size matter?
27 Isle domicile?
28 Equities versus alternatives?
29 **Our expectations**
31 Outcomes to date
31 What's next?

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Executive summary

This report covers the second phase of the investment trust thematic engagement. Last September, we reported on the first phase of this thematic engagement focused on equity investment trusts. We have used the same framework to focus on the alternatives sector where we hold 25 investment trusts within our centrally monitored universe and two investment manager led ideas[1] where we hold a significant position[2]. Within alternatives we have defined three categories:

- Private equity
- Infrastructure
- Others: this includes trusts that do not fit into the other two categories, which for Quilter Cheviot includes strategies such as multi-asset, macro and music royalties.

The aim of this engagement is to evaluate and set future expectations with each Board against three factors:

- Board composition
- Board effectiveness
- Responsible investment disclosures

An investment trust[3] is an investment fund which is listed as a public limited company and its shares can be bought and sold on the stock exchange. One of the key differences of investment trusts versus open-ended funds is that they have an independent Board of directors whose job is to work in the best interest of the shareholders. Investment trusts are typically permanent, therefore they can be well suited to investing in more illiquid assets.

As of 31/12/2023 there were 365 listed investment trusts representing £268 billion, of which £172 billion are invested in alternatives[4]. For the purpose of this report, alternatives are defined as any asset class other than equity, fixed income or real estate.

As of 31/12/2023 Quilter Cheviot[5] owned 27 investment trusts that we have classified as alternatives with a combined value of £0.9 billion.

[1] Investment manager led ideas are investments that are researched and monitored by investment managers.

[2] For the purpose of this report, we will refer to these 27 investment trusts as our engagement universe.

[3] Investment trusts are a type of investment company which has a UK tax base (unlike non-UK investment companies or Venture Capital Trusts), but for this report, we are using the term interchangeably.

[4] Association of Investment Companies (AIC).

[5] This includes 25 investment trusts within our centrally monitored universe and two investment manager led ideas.

Overview

Introduction and scope

In May 2022, Quilter Cheviot initiated an engagement focused on investment trusts. On behalf of our clients, we have significant exposure to the investment trust market. There are fundamental differences between an investment trust and an open-ended fund. When we invest in an investment trust, we become shareholders of the company, and, as such, our expectations for the governance of that company are much higher than they would be for an open-ended fund. An investment trust is a listed company, and like other listed companies, it has a Board of non-executive directors (NEDs) whose job is to ensure that the investment adviser (manager) is acting in the best interest of the shareholders. The Board appoints the manager to run the day-to-day operations of the investment trust.

Within this second phase, we have focused on the alternatives sector; for this engagement, we have focused on 27 investment trusts.

Most of the meetings were in person at our offices. On most occasions, we met the chair, or the chair and the Senior Independent Director (SID) and, sometimes, the chair of the Environmental, Social & Governance (ESG) Committee. The meetings were performed independently of the investment adviser. However, some Board members were escorted by someone on the sales team, the broker or a relationship manager.

Typically, we are happy to outline the broad agenda for the meeting, but we also received requests for a comprehensive list of questions. We understand this may be due to an investment adviser's overprotectiveness rather than at the Board's request. However, we did not provide a set of questions in advance as we prefer to have a conversation rather than a highly scripted response.

Since we published the report on the first phase of our engagement, we have attended a number of external events in person and virtually to discuss our findings.

The three factors

The objective of this engagement was to improve corporate governance practices and responsible investment disclosure in the investment trust sectors, primarily focusing on three factors:

Factor	Detail
Board composition	We expect a Board to be independent, diverse and have the right skillset. In regard to independence there are two areas of primary focus: first, we do not believe it is acceptable for an investment trust to have a Board member who has been appointed or is employed by the investment adviser. Second, we believe that tenure does impede independence and expect Boards to adhere to the nine-year rule unless there are mitigating circumstances. We expect Boards to be diverse and to meet the FTSE Women Leaders and Parker Review targets. The Board's skillset should be appropriate to challenge and support the investment adviser as well as representing shareholders.
Board effectiveness	The Board's function is to represent the shareholders and act in their best interest. Therefore, we expect Boards to have the ability and willingness to challenge the investment adviser when necessary. Additionally, Boards should be accessible and prepared to meet with shareholders and open to considering their feedback.
RI disclosures	We want to see responsible investment disclosures pertinent to the investment trust and its holdings. This will vary depending on the asset class that the trust invests in. For equities at a minimum, we want the trust to disclose how it has voted on its holdings (when applicable) and the rationale behind some of the most significant votes. Examples of how the manager has engaged with the holdings, as well as clear examples of ESG factor integration are encouraged for all asset classes. It is also good practice to report on the Board's role in managing these ESG risks.

The first phase of the overall engagement is to evaluate each investment trust against these three factors and to set expectations with each Board for the future.

Initial assessment and escalation

We have RAG (red, amber and green) rated the three factors for each of the meetings, and for all the trusts, we have set expectations for the future. These will vary depending on the RAG rating. This will be an ongoing engagement programme, and we have established our specific escalation plans which may include escalatory actions, including:

- voting against the chair or other NEDs
- voting against adviser representatives.

Quilter Cheviot will always advise Boards of its voting intentions. We have decided to largely anonymise investment trusts within this engagement framework. Our intention is to work with investment trusts to engender better governance and disclosure, and we feel that, in the majority of instances, disclosing names would not necessarily help with this. The exception would be to highlight examples of our stewardship process.

The asset classes included in this report

Private equity, commonly referred to as PE, is an alternative asset class that invests in private companies that are not listed on a stock exchange. Private equity investment trusts are particularly attractive to wealth managers as they provide a way to access an asset class that otherwise is highly illiquid, has a long investment horizon and often has a very high initial investment requirement. This is reflected in the ownership statistics: institutional investors (including wealth managers) hold the majority of alternatives investment trusts, including those focused on private equity, while retail investors dominate the registers of equity trusts.

We began this thematic engagement in 2022 and have already escalated our engagement with two of the eight trusts over concerns regarding Board composition. This has included voting against one or more directors.

The engagement focused on eight private equity trusts with an aggregated position of £394 million[6] as of 31 December 2023.

Infrastructure is a type of investment that focuses on physical assets such as roads, bridges, police stations and prisons. In the case of renewable infrastructure, the focus is on renewable energy assets such as solar fields, wind farms and hydropower stations. These investments are typically long-term and illiquid, meaning they cannot be easily sold or converted into cash. Similar to private equity, investment trusts allow wealth managers access to an asset class which they would potentially struggle to invest in without the liquidity offered by this structure.

The engagement focused on 15 investment trusts with an aggregated position of £365 million[7] as of 31 December 2023.

Others: these include strategies such as multi-asset, macro and music royalties. For this report, we will simply refer to these trusts as “others”.

The engagement focused on four trusts investing in other alternatives with an aggregated position of £129 million[8] as of 31 December 2023.

[6] This includes Quilter Cheviot centrally monitored universe only.

[7] This includes Quilter Cheviot centrally monitored trust, plus two trusts where we hold a significant position which are part of our voting and engagement universe.

[8] This includes Quilter Cheviot centrally monitored universe only.

Board composition

Investment trusts typically have smaller Boards compared to operational companies. The average Board size of an operational company in the FTSE 100 is 12[9], but investment trusts may have as few as three directors. However, it is more common to find Boards composed of four to five directors.

The Board size is influenced by the size of the trust as well as the complexity of the underlying investment strategy. For long-only equity trusts, which are considered more straightforward, Boards of four directors are common, and the meeting schedule tends to be lighter. In contrast, trusts investing in alternatives assets often have larger Boards of five or more members and tend to meet more frequently.

As an example, it is not uncommon for the Board of an infrastructure trust to have the final say regarding investment decisions. This is a far more hands-on role than one would see in equity investment trusts and has two notable consequences:

- Having the right set of skills on the Board is crucial.
- The Board is likely to meet more frequently, and the fees paid to NEDs will be proportionately higher than for an equity investment trust.

Additionally, we expect Boards to nominate independent SIDs; SIDs play a key role in chair evaluations as well as serving as a point of contact for investors if normal channels have failed.

Skills and independence

'The investment adviser would not be comfortable with that' [10]

In our view, limiting tenure to nine years creates the best outcome for shareholders. We have seen examples of long tenures leading to stagnation within the Board and a far from optimal composition. It is essential for Boards to plan years into the future to ensure a succession plan that will avoid gaps in corporate knowledge without overextending the tenure of NEDs.

We believe an entirely independent Board will produce the most favourable results for shareholders. Within private equity trusts there are more instances of manager representatives being NEDs. We cannot find any valid reason to support this, as it would always be expected for the manager to attend Board meetings when invited to do so by the chair and offer expertise to support the Board. We cannot identify an additional benefit in having a manager representative on the Board.

Succession planning

Succession planning is a vital aspect of Board governance. Nomination committees should keep in mind the nine-year limit, so that there is ample time to plan for departures without extending terms unnecessarily. Board size may vary as part of succession planning; as the incoming directors join the Board, it is common for them to have six to 12 months of overlap with the NED they are going to replace. We find this "shadowing" period to be beneficial in getting NEDs up to speed. We also think that having a Board of four is sometimes too small for optimal succession planning and would generally encourage Boards to increase to five members as we believe the advantages of having a more robust and diverse Board outweigh the extra cost.

When considering its composition, we would expect Boards to undertake a skills matrix. This involves an objective evaluation of the skills that the Board requires and how it delivers these as a group and as individuals. This should be part of the standard process of any Board evaluation. Having the right experience on the Board is of paramount importance, and it should be easy for shareholders to check the Board's credentials. The biographies of NEDs should mention, at a minimum, all their additional active appointments. In a few cases, we have seen incomplete information.

[9] Internal corporate governance mechanisms and financial performance: evidence from the UK's top FTSE 100 listed companies (coventry.ac.uk).

[10] A NED and manager representative's first response to our statement for preference of a fully independent Board during a meeting with other Board members. Ironically, his reaction highlighted our point.

Diversity

> *'It's only ever rooms full of white men that ask for more diversity'* [11]

When assessing diversity on Boards we follow the FCA guidance[12] which takes into consideration the FTSE Women Leaders Review and the Parker Review:

1. At least 40% of the Board are women.
2. At least one of the senior Board positions (Chair, Chief Executive Officer (CEO), Senior Independent Director (SID) or Chief Financial Officer (CFO)) is a woman.
3. At least one member of the Board is from a minority ethnic background (which is defined by reference to categories recommended by the Office for National Statistics (ONS)) excluding those listed, by the ONS, as coming from a white ethnic background.

We appreciate that given the smaller Board size and the different governance structure of an investment trust, it may be more difficult for trusts to fulfil the second requirement. Therefore, our current expectation is that the Board should have 40% female representation as well as meeting the Parker Review[13] ethnic minority target as appropriate. Additionally, we encourage Boards to scrutinise their recruitment processes and whether they are accessing a wide pool of candidates.

According to the AIC, as of August 2023, women hold 40% of all Board positions in the investment company sector, slightly lower than the 41% in the FTSE 350. However, both are slightly below the average of 44% of Board positions held of the alternatives investment trusts included in this report.

Within the engagement universe three trusts had fallen below the 40% target set by the FCA. All are working towards addressing the imbalance, and notably the issue is most prevalent in smaller Boards which are managing succession. However, in all cases, we expect companies that fall below the 40% level to explain why and what they are doing to address it going forward.

We have encountered various approaches to diversity during our interactions with different Boards. Some chairs have explained how they choose executive search firms based on their ability to provide a more diverse list of candidates. These firms search for directors outside the traditional talent pools, looking for experts in their field who may not necessarily have investment trust experience. Other Boards opt to expand the size of the Board to include a diverse candidate. While we do not oppose this strategy, it is not our preferred approach.

As part of our monitoring process, we have identified that ten of the 27 alternatives trusts did not meet the ethnic diversity target of at least one member of the Board being from a minority ethnic background as per the Parker Review. We have engaged with these Boards and shared our concerns, encouraging them to consider diversity in their organic succession planning. Although this has not been an issue so far, we may consider opposing the re-election of directors if we do not see sufficient progress in this area.

Compliance with the Parker Review

Trust	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Other	Other	Other	Other	Private equity	Private equity	Private equity	Private equity	Private equity	Private equity	Private equity
Parker Review	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓		✓		✓			✓	✓		✓	✓		✓	✓		

[11] Chair of a Board that is not compliant with the FCA diversity targets, explained that it was only rooms full of white men that pointed out the lack of diversity in his Board. Clearly a disappointing response.

[12] PS22/3: Diversity and inclusion on company Boards and executive management (fca.org.uk).

[13] The Parker Review - Encouraging greater diversity of UK Boards.

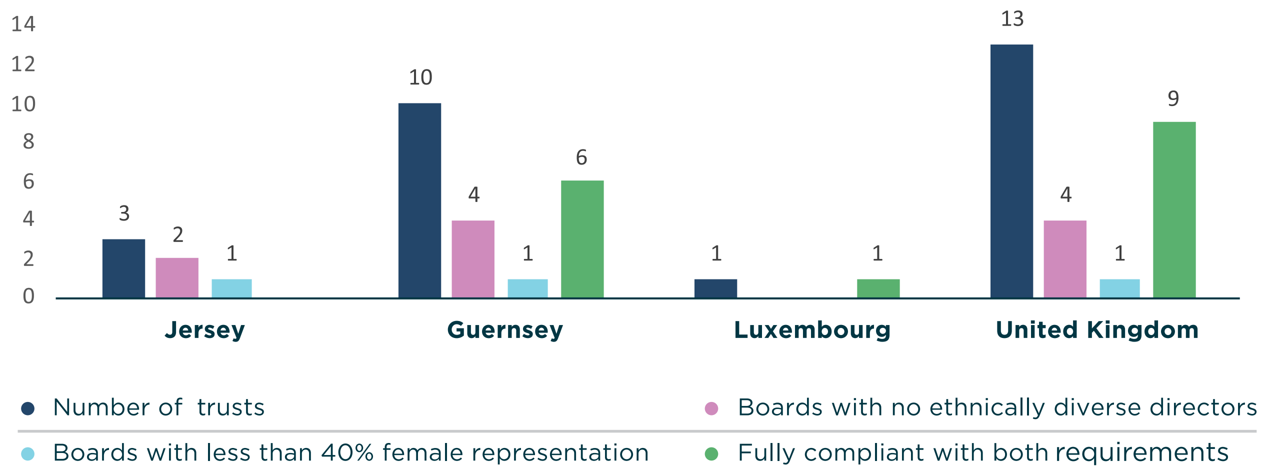
Diversity and Channel Islands domiciled trusts

The Channel Islands have always been a favoured destination for investors who want to establish investment companies. Of the 27 trusts we targeted, 13 are based in the Channel Islands, mostly in Guernsey. While there are some fiscal advantages[14] for trusts located in the Channel Islands, we have concerns about the talent pool as it is much smaller than in the United Kingdom, if we look solely at numbers of potential directors.

During our engagements, we have observed that many Boards in the Channel Islands face challenges in hiring skilled NEDs. It is comparatively easier to recruit talented individuals for equity trusts; however, alternatives funds require specialist expertise that is not so easy to find. We have found that some chairs become defensive when we discuss the availability of talent in the Channel Islands. We are not trying to undermine the quality of NEDs in the Channel Islands, we are merely pointing out that a small population of 174,000 people[15] (according to the latest census) cannot provide the same choice of directors as the 67 million people in the United Kingdom[16].

We assessed the 27 trusts' compliance with FCA diversity targets for gender and ethnicity based on their domicile. As per the chart, 60% of Guernsey trusts and 69% of UK companies comply with all the requirements. However, none of the three trusts in Jersey meet the diversity targets. It is important to note that some trusts fail to comply with either the ethnicity or diversity targets.

Board compliance with UK diversity targets by region of domicile



Recruitment

The AIC Corporate Governance Code states an *'external search consultancy should generally be used for the appointment of the chair and non-executive directors. If an external search consultancy is engaged, it should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors'.* We still find a few cases where these external providers are not properly disclosed in the annual report. We have advised the Boards of trusts where this information is not available the need to disclose this information. We will check future reports to make sure that this information is included.

It is recommended that Boards hire an external search firm to avoid potential conflicts of interest that may emerge if the investment adviser manages the hiring process. The investment adviser may meet with candidates but should not have the final say on the appointment of a NED. The Board should validate the independence of any candidates proposed by the manager.

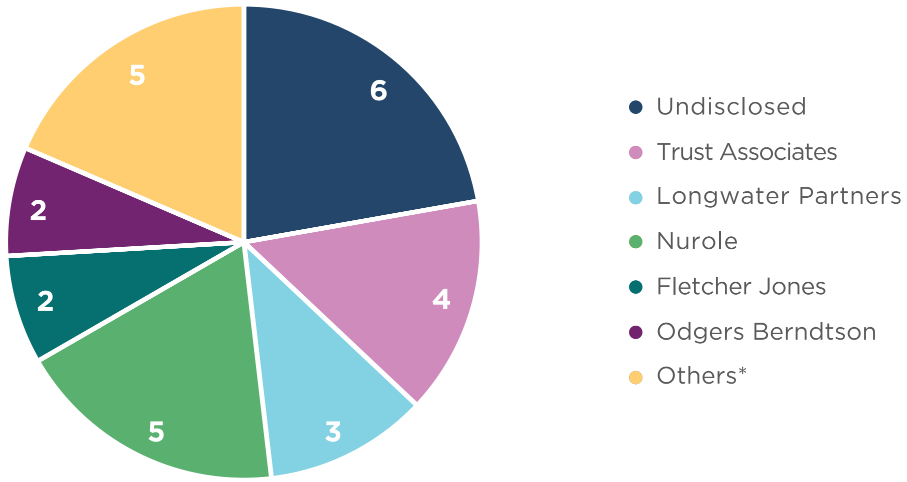
[14] Fiscal benefits include the lack of income tax, stamp duty and VAT Taxation of Guernsey investment funds | Ogier.

[15] Population, total - Channel Islands | Data (worldbank.org).

[16] Population, total - United Kingdom | Data (worldbank.org).

The chart below shows the most recently used executive search firms for the engagement universe as disclosed in annual reports:

Mandates by executive firm for the most recent NED recruitment



***Others:** Cornforth Consulting, Green Recruitment Company, Heidrick & Struggles, Korn Ferry, OSA Recruitment.

The annual report should disclose the name of the executive search firm. However, six trusts in our targeted universe failed to do so.

Over-Boarding

We have a pragmatic view on NEDs' over-Boarding. We do not follow a formulaic approach used by proxy advisers but evaluate each case on its merits. The AIC Corporate Governance Code states that:

'When making new appointments, the Board should take into account other demands on directors' time. Prior to appointment, significant commitments should be disclosed with an indication of the time involved. Additional external appointments should not be undertaken without prior approval of the Board, with the reasons for permitting significant appointments explained in the annual report.'

We agree, and we rely on the chair to assess the availability and suitability of other NEDs on the Board. Proxy advisers use a point system that assigns points per Board position and gives more weight to chairs and executive roles. This system is flawed as it does not account for private positions and "day jobs" that may be more demanding. Therefore, we usually defer to the chair's opinion as they are in the best position to judge this. However, we also apply common sense, and we do not expect the audit chair of a major bank to have a portfolio of directorships.

We expect NEDs to attend to 100% of their designated Board meetings unless there are mitigating circumstances.

Summary: Board composition

During the engagement, it was observed that one of the major issues with the Board composition was the presence of non-independent NEDs. Our position on this issue is clear: a Board is most effective when composed solely of independent directors. Tenure was also identified as an issue, as some NEDs have served over nine years. We believe that unless there are exceptional circumstances, NEDs should adhere to the nine-year rule, as recommended by the AIC Corporate Governance Code. This is particularly concerning when there is a Board with manager representatives as well as over-tenured NEDs.

We have escalated our engagement with six trusts, for reasons that included issues with Board composition.

We voted against one or more NEDs of two private equity trusts. The reason behind this was management representation on the Board, which raised independence issues. Under normal conditions, we typically wait for more than a year before we vote against the company, to allow the Board enough time to make changes in the Board composition.

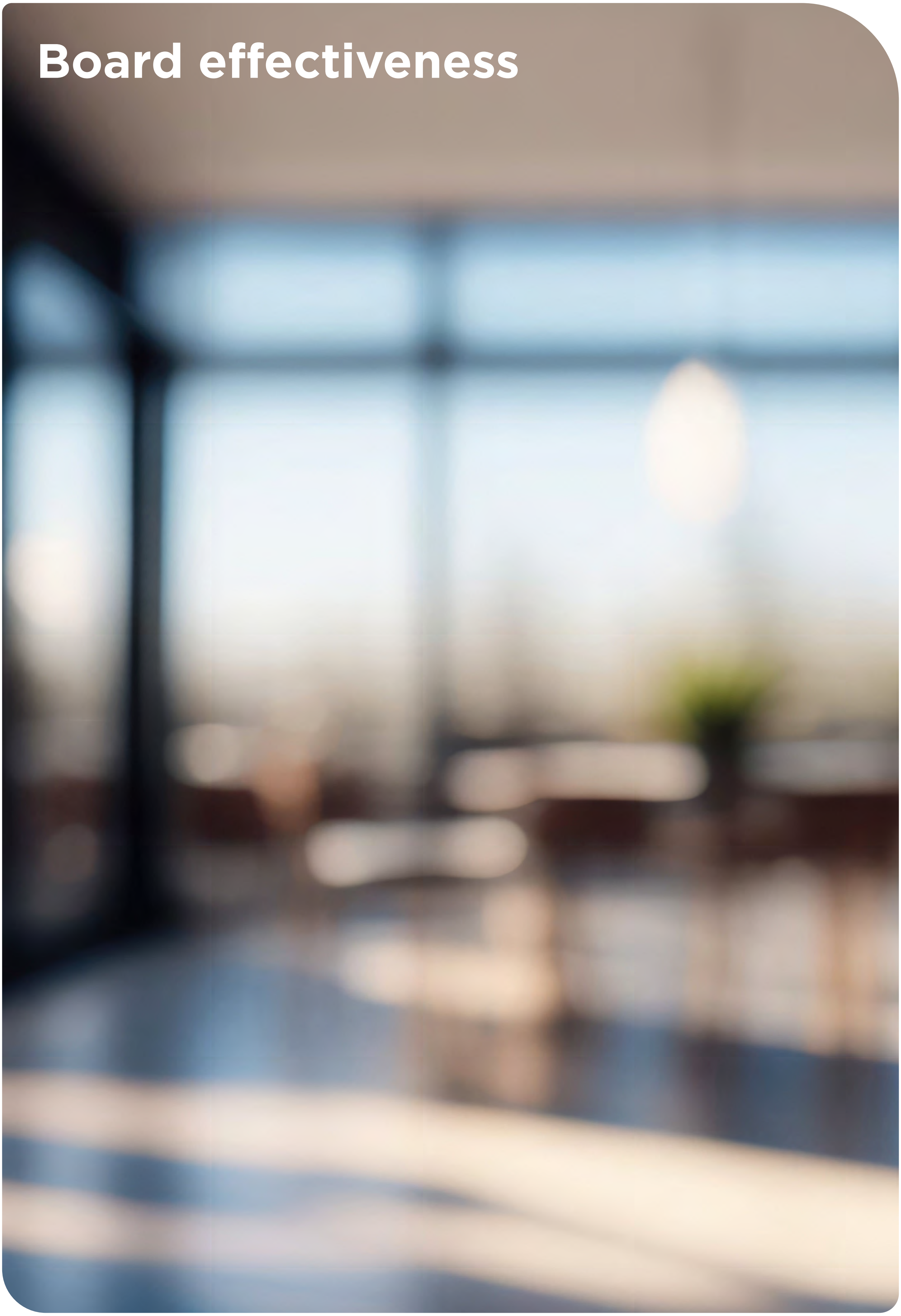
We have also written to two Boards of infrastructure trusts; one has a shareholder representative and the other has a manager representative. We have communicated our preference for fully independent Boards to them and informed them that we will support their re-election this year. However, if they are up for re-election in 2025 and still have non-independent NEDs, we will vote against them.

We consider shareholder representatives to be non-independent even if he or she is not related to the investment adviser. Shareholder representatives may prioritise the interest of their specific shareholder, which may not align with other shareholders. Therefore, we require fully independent Boards, which does not include shareholder representatives. Additionally, we do not expect shareholder or manager representatives to receive a director fee paid by the trust.

Finally, for the "other" alternatives trust we have escalated our engagement with two trusts. For the first one, we discussed the extended tenure of one of the NEDs. We have written to the Board explaining that we will be supportive this year but will be voting against the director in question at the 2025 AGM if he is up for re-election.

On the second trust, we faced severe problems with the independence of the Board and communication with shareholders. These issues resulted in governance and headline risk. Despite engaging with the Board multiple times, we ultimately voted against the entire Board and against continuing the trust. Taking these examples aside, generally the composition of alternatives investment trust Boards meet our current expectations. Most Boards have relevant experience in the assets they invest in or are able to access appropriate advice. However, some Boards have room for improvement in terms of diversity, particularly ethnic diversity. Nonetheless, most have plans in place to address any imbalances as soon as possible.

Board effectiveness



For a Board to be effective, it needs two key elements: independence and relevant experience. Directors should be able to act independently without any personal circumstances that can affect their ability to defend shareholder interests. However, they can only do this if they have the necessary time capacity, knowledge and expertise to provide rigorous oversight of the manager's application of the investment mandate and can challenge decisions when necessary.

Investment trusts are a specialised investment vehicle that not everyone, even in the finance industry, understands. It is important for Boards to have a deep collective understanding of how investment trusts work, especially when considering the position of the chair. Previous experience with investment trusts is advantageous, however, having a Board entirely comprised of investment trust veterans is not a diverse or effective Board in our opinion.

With respect to alternative asset classes in particular, we believe that it is vitally important that an effective Board not only has a sound knowledge of the investment trust structure but also, amongst the constituent members of the Board, there should be practical and specialist knowledge of the relevant asset class in which the trust invests.

Communication

Our research team provides recommendations on investments based on their confidence in the investment strategy. Any significant changes in the investment strategy of the trust can alter our recommendations. Therefore, shareholders should be consulted and informed of any such changes. Moreover, the Board should explain how the trust has an advantage in the new area of investment and where the expertise of the Board and that of the investment adviser lie in this regard. This applies to changes in the investable universe, such as introducing new technologies to the investment strategy, for example, adding hydrogen to a previously solar-only fund or investing in new regions, such as a UK-only fund investing in the US.

In addition to disclosing NEDs' appointments, publishing a Board skills matrix is helpful. This matrix details the overall skills of the Board, categorised by areas of specialisation, asset class and regional experience. This is a good way for investors to see how the Board thinks about what each director brings to the Board. A notable example of this is included in the 2022 annual report of The Renewables Infrastructure Group (TRIG) (p.105).

Board responsiveness

When we assess the Board's responsiveness, we look into two key questions: how easy is it for shareholders to contact the Board, and how open is the Board to receiving shareholder feedback?

We have considered how easy it is for us to arrange a meeting with the Board, i.e. the chair. The best performers are those that proactively and regularly offer meetings to shareholders. Then, there are other Boards that are less proactive but are still quick to respond. Finally, there is a small minority of Boards, with overprotective investment advisers, that make it a longer process to contact the Board. We hypothesise that these Boards engage with shareholders less frequently and usually only when something has gone wrong. Then, when a request for a routine meeting is made, the Board and the manager have their guard up.

Our objective as long-term shareholders is to build a relationship with the Board through regular engagements. This will allow us to communicate more effectively with the Board in the event of any future issues.

However, with some Boards that have acted swiftly to our suggestions, we have seen good outcomes without the need to escalate engagements.

Assessing Board responsiveness to our views can be a little harder. However, some Boards have taken action swiftly, reacting to our suggestions. There have been several cases where we have seen good outcomes without the need to escalate engagements.

Conversely, some Boards appear to be both less receptive and responsive to shareholder feedback.

Hopefully this will improve over time.

Skin in the game

'Everyone owns shares' 'I don't...' [17]

In 2021, along with most of the shareholders of Scottish Mortgage Investment Trust, Quilter Cheviot supported the amendments to the Articles of Association. The changes included the removal of the obligation for directors to buy 5,000 shares in the company as a condition for joining the Board, which amounted to £57,000 at the end of 2020. The Board explained that this obligation was imposed when the share price was much lower. Moreover, the Board did not think that this obligation was helpful for attracting diverse talent. This matches with the wider direction of the industry and our position. We do not want to see "entry fees" for joining Boards, but rather the opportunity for NEDs to build up their positions over time if they do not have the funds available immediately. Our preference is for NEDs to own shares, but this must not be an impediment to diversity and encouraging new entrants into the NED market. We also believe that ongoing purchases by NEDs (and management) signal to the market the alignment of the trust with long-term holders.

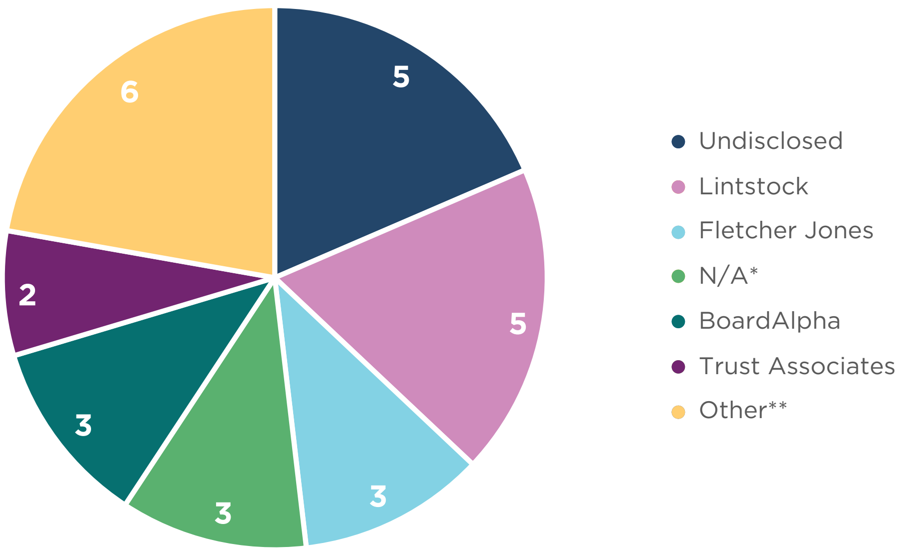
Board evaluations

The AIC Corporate Governance Code recommends that investment trusts in the FTSE 350 should:

- undergo an externally procured Board evaluation every three years
- state the name of the provider in the annual report and
- additionally, provide a statement declaring any connections it has with the company or individual directors.

Of the 27 investment trusts' disclosures in annual reports regarding the most recent Board evaluation, five have not provided any information.

External Board evaluation (most recent)



***N/A:** Indicates companies that have not had an external evaluation as the trust has been operating for less than three years.

****Other:** Includes Condign Board Consulting, Satori Board Review, Stephenson Executive Search Limited, Aspida, Board Level Partners, Trusted Advisers

We believe that external evaluations are a positive input into an effective Board. Although they may not always uncover significant issues, they can provide another view. We prefer interview-based evaluations to paper-based ones as they are more likely to start a dialogue and identify and explore different topics.

Moreover, we think the descriptions of the outcomes in the annual report can be improved. Too often, it is a short descriptor that only reflects the positive.

[17] We were surprised that on more than one occasion a chair had to be corrected by another Board member, or later through email, of the claim that all Board members own shares, which was in fact incorrect.

Case study: Princess Private Equity

This showcases our engagement and escalation approach in the case of an adverse event. In this case we had concerns regarding the Board effectiveness and composition.

NOVEMBER 2022

Event: Princess PE announces discontinuation of dividend and new investments.

DECEMBER 2022

Engagement 1: We meet the chair to discuss the situation. The engagement raised several issues: lack of communication between the manager and the Board (despite the manager having Board representation), length of tenure issues for the chair and one NED, manager representative as a NED and a lack of PE experience amongst independent directors.

Letter 1: Following the engagement we wrote to the Board explaining that given our concerns and recent events we would vote against all directors unless sufficient remedial action was taken before the next AGM.

MARCH 2023

Engagement 2: The chair announced that he would be retiring at the AGM (having served 13 years), and the chair of the Audit and Risk Committee would succeed him. However, we still had concerns regarding the tenure of another NED and the manager representative on the Board, as well as the number and type of NED positions the incoming chair held.

Letter 2: We acknowledged that the Board has acted on the issue regarding the chair's tenure but highlighted our additional concerns. We also communicated our revised voting intentions: to vote against the over-tenured NED and the manager representative, rather than the entire Board.

JUNE 2023

Announcement: The incoming chair and the non-independent management representative withdrew their re-elections a couple of days before the annual general meeting. However, the over-tenured NED would remain on the Board.

AGM results: The trust received significant dissenting votes, notably the over-tenured NED received over 30% votes against.

JULY 2023

Engagement 3: The Board is now reduced to three NEDs, one of whom is the over-tenured director, therefore the focus is on rebuilding the Board. We met with the interim chair and chair of the Audit and Risk Committee to outline our expectations for the new directors. In our view the Board must hire directors with previous experience in PE and, in the case of the chair, someone that also has investment trust experience, preferably as a chair. The Board indicated that it is considering whether there should be a manager representative on the new Board.

Letter 3: We outlined to the Board that having a manager representative as a NED will result in us voting against the entire Board.

2023/2024

Next steps

November 2023: The new chair was elected to the Board.

March 2024: We engaged with the new chair and were impressed with his candidness in regards the challenges the trust has faced and the changes already implemented.

Summary: Board effectiveness

One of the primary methods that Boards can use to communicate with shareholders is through annual report disclosures. High-quality disclosures about Board matters demonstrate transparency to investors. Moreover, and this is also very important for us, communication should be a two-way street. We want to know what the Board is doing to gauge shareholder sentiment and how open it is to shareholder feedback.

Another factor we look at when assessing effectiveness for alternatives is the Board's willingness to defend shareholder interests; this can be done by challenging the manager when needed, for example, by being active in cost reduction discussions. Additionally, we want Boards to be proactive when it comes to engaging with shareholders and understanding their views.

We consider discount control to be a Board's responsibility, and therefore, any poor management of this reflects adversely on the Board. Shareholder relations is another key area: there is a huge difference between interacting with a chair who is open to suggestions and dialogue, and one who is a closed book.

Most Boards have significant shareholding positions. However, we have noticed that in some cases, NEDs do not hold any shares. In such instances, we have inquired with the chair to understand the reasons behind it. In most cases, there is a straightforward explanation. For example, the NED's spouse may work for an audit firm that restricts them from buying shares. Alternatively, there could be other regulatory impediments preventing them from acquiring shares. On the other hand, it could be because it's the NED's first directorship, and they do not have the capital to invest. As with the rest of our views we are pragmatic in our approach.

As previously mentioned, some trusts still need to disclose their external service providers, executive search and Board evaluations per the AIC Corporate Governance Code recommendations. We expect all companies to comply with the AIC Corporate Governance Code recommendations or clearly explain where and why they have deviated from it. We will monitor further disclosures to ensure alignment.

Responsible investment disclosures

Responsible investment disclosure is a term used to refer to the information that a company discloses related to its ESG risks and opportunities. This includes the identification of which of these risks are material for the investment trust, as well as the actions taken by the Board and the investment adviser to mitigate them. It also includes stewardship activities such as engagement strategy and voting, when applicable.

It is important to note that we are not talking about whether the trust has sustainable or responsible investment objectives or outcomes; that is irrelevant. ESG-related risks can be material to any investment trust irrespective of its objectives. Therefore, as a minimum we expect ESG integration as a method of risk mitigation.

Different expectations

It is important to note that not all asset classes have widely adopted standardised frameworks for responsible investment disclosures. Equities have the most developed and standardised disclosure; therefore, our expectations for that asset class are more clearly delineated. Regarding PE and infrastructure, there is a higher degree of variability as it will depend on the structure of ownership and the type of assets in the portfolio. However, we still have a number of defined disclosures that we are looking for, such as responsible investment due diligence before purchasing the asset, the environmental impact of assets and engagement with stakeholders, to name a few. However, there is no standard disclosure model when we talk about "other" alternatives, such as multi-asset, macro, music royalties. Of course, we do not simply disregard responsible investment factors; however, in this case, it is up to the Board to identify what material ESG factors could potentially affect shareholder returns and disclose what the trust is doing to mitigate the risk. In this case, what this disclosure looks like is up to the Board. Although most of our feedback focused on responsible investment disclosures, on some occasions, we have also spoken about financial disclosure, such as requesting more timely updates regarding the composition of the portfolio and financial performance.

Private equity

When assessing responsible investment disclosures, one of the questions we ask is: how does the trust influence the underlying holdings in line with its responsible investment policy? The influence it can have on the underlying holdings depends on the ownership structure.

For private equity the two most common structures are:

Direct control: when an investment trust wholly owns or owns the majority of the underlying asset it has control over who the directors are and the overall strategy. Providing case studies detailing the engagement with the underlying holdings is a good way of illustrating stewardship in action.

Indirect control: where a trust is a minority co-investor, commonly known as a Limited Partner (LP) and the General Partner (GP) invests on their behalf. Within an investment trust, holdings may be managed by different GPs, therefore, we expect the trust to disclose how it is engaging with these GPs and ensure that they are managing the assets in line with the trust's own responsible investment principles. The same ethos applies to fund of funds – we expect the investment adviser to be engaging with the underlying managers.

Private equity and infrastructure: disclosure through the lifecycle of investments

When we evaluate responsible investment disclosures, we are interested in understanding how responsible investment-related risks are considered at all stages of the investment, i.e. acquisition, holding and exit. As an example, how is it factored into due diligence. This usually is when the investor has the strongest leverage, especially in the case of minority investments. However, managers should also monitor and influence post-investment; Due Diligence Questionnaires (DDQs) are a key resource to obtain this information and then use this as a basis for evaluation and engagement. A further useful disclosure is to describe the role of the Board during the acquisition process.

Once the investment has been made, consideration should be given to disclosing the metrics and data the trust is monitoring, as well as any net zero alignment. It is also important to include how the metrics are being used. It is best practice to have metrics linked to responsible investment-related targets, and evidence of how the investment adviser is influencing underlying holdings to achieve this aim.

Finally, the exit strategy. Best practice would be to include commentary and metrics, if possible, to indicate how the asset's responsible investment credentials have improved over the holding period. Additionally, if the asset is being sold, details on the due diligence around the responsible or sustainable attributes of the buyer would be useful. The best responsible investment-related targets are those that are quantitative, material and have specific timeframes. Frequently changing the targets can be a red flag as this makes it difficult for investors to keep track of the performance of the portfolio.

Some alternatives trusts also have a portion of the portfolio allocated to equity investments. We expect stewardship disclosures for this part of the portfolio, as with other investment trusts. This would include describing the stewardship activities undertaken during the year, a voting record and rationale for significant votes, and engagement with the underlying holdings.

"Others"

As we previously stated, we do not have a clear expectation of the type or format of the disclosures for more specialised sub-sectors. These Boards can set an example and innovate in the field of responsible investment disclosures for their sub-sectors. However, simply brushing responsible investment factors as non-material with our providing adequate rationale is not sufficient.

PRI signatory status

As an additional measure, from 1 June 2021 onwards, we implemented a requirement that any new funds are expected to have UN PRI signatory status through their investment manager/adviser. If this is a fund that is managed by a recently established firm, we would agree a timeline for the firm to sign up to the UN PRI. In exceptional circumstances new funds may be added to our investment universe which are not, and do not, have an intention to become a signatory. However, this would be extremely rare and the rationale for not being a signatory would have to be linked explicitly to the specific strategy that the fund was invested in. Any fund being added to coverage in this instance requires senior approval. We have not added any funds that do not have PRI signatory status to the Quilter Cheviot centrally monitored universe since we implemented this measure.

All the investment advisers of the investment trusts included in this report were PRI signatories.

To committee or not to committee

Boards will set different levels of oversight in regards responsible investment. Typically, the level of supervision is related to the NEDs' experience with the subject. Many Boards have told us that they have responsible investment-related matters as a fixed agenda item at their meetings.

Some Boards have created an ESG Committee to ensure that sufficient time is spent on the subject. However, there are differing views on this approach: supporters claim that it guarantees enough time for the subject, while those opposed argue that the topic is already discussed at length and should not be spun off into a separate discussion. We do not have a preference when it comes to ESG committees, especially for smaller Boards.

Other Boards have a dedicated "ESG champion" – this is a NED that takes the lead with dealing with investment-related related issues. This NED has frequent calls with the head of ESG at the manager, which can help maintain contact between Board meetings.

Where to disclose

We are flexible about where the disclosures should go. We definitely understand the worry that annual reports are getting longer and harder to manage. There should be some mention of responsible investment in the annual report, and if the Board wants to reduce the length, then a separate report or a section on the website is also fine. The ESG Committee's chair's report, if used well, can be a good way to provide information, especially to show the Board's oversight of responsible investment.

Investing in renewables is not equal to responsible investment

During our engagement, we had discussions with several renewable energy infrastructure trusts. One misconception we want to address is the assumption that renewables are automatically a responsible investment and tick lots of environmental boxes.

Recent scandals have reminded us that this is not the case. For instance, there have been reports of forced labour camps in Xinjiang, a region in China where a significant portion of the world's solar panels' polysilicon material is produced[18]. This incident highlighted the importance of proper supplier due diligence as well as supply chain auditing.

One of our concerns is related to the recyclability of our renewable infrastructure assets. In 2023, our Sustainable Investment team conducted an engagement titled "The Lifecycle of Renewable Infrastructure Assets[19]", focused on the sourcing of infrastructure assets and raw materials, as well as the end-of-life plan for these assets. For example, many wind turbines from the industry's early days are reaching their end of life, and currently around 90% of a turbine is recyclable in a scalable and economical way. This is becoming an increasingly pressing issue, as it is estimated that there will be 52,000 tonnes of blade waste in Europe and more than two million tonnes in the USA by 2050. Similarly, the International Renewable Energy Agency predicts that global solar panel waste will reach 78 million tonnes by 2050. While many components can be easily recycled, some parts, such as the silicon solar cell (about 10%), cannot be recycled. This engagement also delved into the trust supply chain policies and how they mitigate risk in their supply chain – including ensuring solar panels are not built in regions associated with human rights abuses and wind turbines are built using conflict minerals.

The "lifecycle" engagement was carried out with the investment advisers of the trusts. As part of this infrastructure engagement, we followed up with the Boards to understand their perspective on this issue and whether it was discussed at the Board level.

During our discussion with the Boards, we observed that different approaches are being considered for the decommissioning of assets. Some Boards are planning to sell the assets to other parties before they reach the decommissioning stage, while others focus on repowering the assets. Both approaches have their challenges. If the trusts decide to sell their assets to another party, it is crucial to conduct due diligence to ensure that the buyer is a responsible investor. If the trust chooses to repower or decommission the assets themselves, in that case, proper care should be taken to recycle as much of the materials as possible and dispose of any toxic waste appropriately, as repowering assets does involve the need to change some parts.

Many renewable infrastructure trusts own portfolios that are relatively new, with assets that have a useful life of more than 25 years. As a result, many of these trusts do not have a solid plan in place, but they do acknowledge that considering future decommission is important.

Summary: responsible investment disclosures

For responsible investment disclosures, we have seen that private equity trusts are less developed than equity trusts when showcasing the responsible investment activities within the portfolio. Many of the investment trusts we have spoken with have a responsible investment process in place; however, there is a disconnect when it comes to the disclosure of such activities. Notably, all the trusts covered in this report are signatories to the UN-backed PRI, through their investment manager.

Almost all the Boards that we have talked to recognise the importance of responsible investment issues for the portfolio. However, some chairs and Boards are more cognisant of these issues than others. The rigour of oversight that the Board provides is going to depend on its knowledge of the issue. We have seen some Boards create ESG committees or assign an "ESG champion" who is a specific NED taking the lead on ESG-related issues.

Overall, the disclosure was good but with room to improve. Most trusts were scored "amber", indicating good baseline of disclosure and good direction of travel. There were a few trusts leading the pack and a couple of laggards. Perhaps unsurprisingly, the disclosure of "other" alternatives were less developed.

In some cases, the pathways of disclosure can also improve, especially regarding some websites, which are the first place shareholders visit for information.

[18] Revealed: UK solar projects using panels from firms linked to Xinjiang forced labour | Solar power | The Guardian.

[19] Lifecycle-of-renewable-energy.pdf (quiltercheviot.com).

Other considerations

Capital allocation
by Matt Ennion

Matt Ennion
Fund Research Analyst

Capital allocation has come to the fore of investors' minds this year, particularly in the alternatives income sectors of the investment company universe, with long-standing premium ratings on many of the vehicles in this space sinking to wide discounts. The inability to access capital markets to fund new investments and future growth alongside sharply rising interest rates making the use of debt facilities expensive has focused the minds of investment company Boards in how best to generate value for shareholders over the short and long term, and to continue to meet stated investment objectives.

Our engagements with Boards have focused on this issue, which dovetailed neatly with our discussions on relevant Board experience in terms of both asset class knowledge and specific investment company experience, and how Boards interact with the investment adviser in terms of the decision-making process around buying and selling assets.

Our discussions saw many Boards having capital allocation at the top of their priority list at present, with several stating a clear, often newly introduced, capital allocation policy which we support. It was of particular interest to discuss these issues with what we would consider sub-scale companies where clear considerations for future growth are critical to long-term success. It was notable that mergers and acquisition activity (M&A) was mentioned in several discussions, as a clear acknowledgement of the need for scale and liquidity.

With wide discounts to net asset value (NAV) present across the alternatives sectors, share buybacks were usually central to our discussions around capital allocation. Buybacks are broadly seen as the main tool to address a stubbornly wide discount, and as we found there are a wide range of opinions regarding why buybacks should be used and how successful they are at achieving their intended goal. As we would expect, the majority of Boards regularly consider the need for a buyback programme, but several Boards stated a reluctance to utilise them, highlighting limited evidence in their ability to reduce discounts. This is a valid opinion. Our broad message has been that there are a few tools available that should be considered not only to manage the discount but to also make accretive capital allocation for shareholders. More specifically on buybacks, we see their use as a clear demonstration of confidence in the NAV and potentially an accretive way to utilise a company's capital by investing in the adviser's high conviction portfolio and reducing the share count. In turn, this demonstrates the high hurdle for new investments.

With interest rates high, potentially for longer, it was pleasing to see most Boards looking to address drawn credit facilities with several companies having begun or looking to recycle capital from the invested portfolio. Short-term credit facilities have been the mechanism to fund new purchases in the alternatives income space for many years, paid down by tapping the equity market. This has needed a rethink, and many Boards are making progress in this respect.

Two important points of feedback we offered Boards were to make improved disclosures around capital allocation decisions, especially regarding the impact on short-term and long-term returns. There are no perfect solutions to capital allocation. However, we would encourage enhanced disclosure around capital allocation decisions taken accompanied by reasoned explanations as to why these decisions were taken at the expense of others. It can be easy to be drawn into short-term considerations when discounts are wide and shareholders unhappy. However, it is equally as important to consider long-term returns even if on occasion that is at the expense of short-term accretion. Again, disclosure is key. We are long-term investors and maintaining a strong portfolio of assets, guided by robust governance and a well-defined capital allocation policy is vital for our client portfolios.

Discount management

Following the 2008 Global Financial Crisis (GFC), it has not been usual to see private equity investment trusts trading at a persistent discount to NAV, which has widened over the last few years. Although we acknowledge no one solution to addressing discounts, we expect Boards to be proactive in reviewing and addressing a share price discount as one of its main responsibilities.

A recent example of a Board directly addressing its discount with some success is Pantheon International, which, after shareholder engagement, announced a significant buyback of £200 million, which included a £150 million tender offer[20]. However, when announcing buybacks, Boards need to consider various factors, as buybacks can reduce the size of the trust and its liquidity, and there may be other competing interests for the cash, such as new investments or dividends.

Additionally, buybacks can also serve to reassure the market that the Board believes in the valuations as well as be an accretive use of capital for shareholders. Buybacks are not the only way to address a discount, and successful asset disposals above NAV can also help investors reassure them of the validity of the valuations.

Gearing

We do not like to see structural gearing in private equity investment trusts, given the lack of visibility on cash flow timing and the fact there is already a significant amount of leverage in the underlying assets. However, private equity trusts may require credit facilities to help bridge short-term cash flow mismatches.

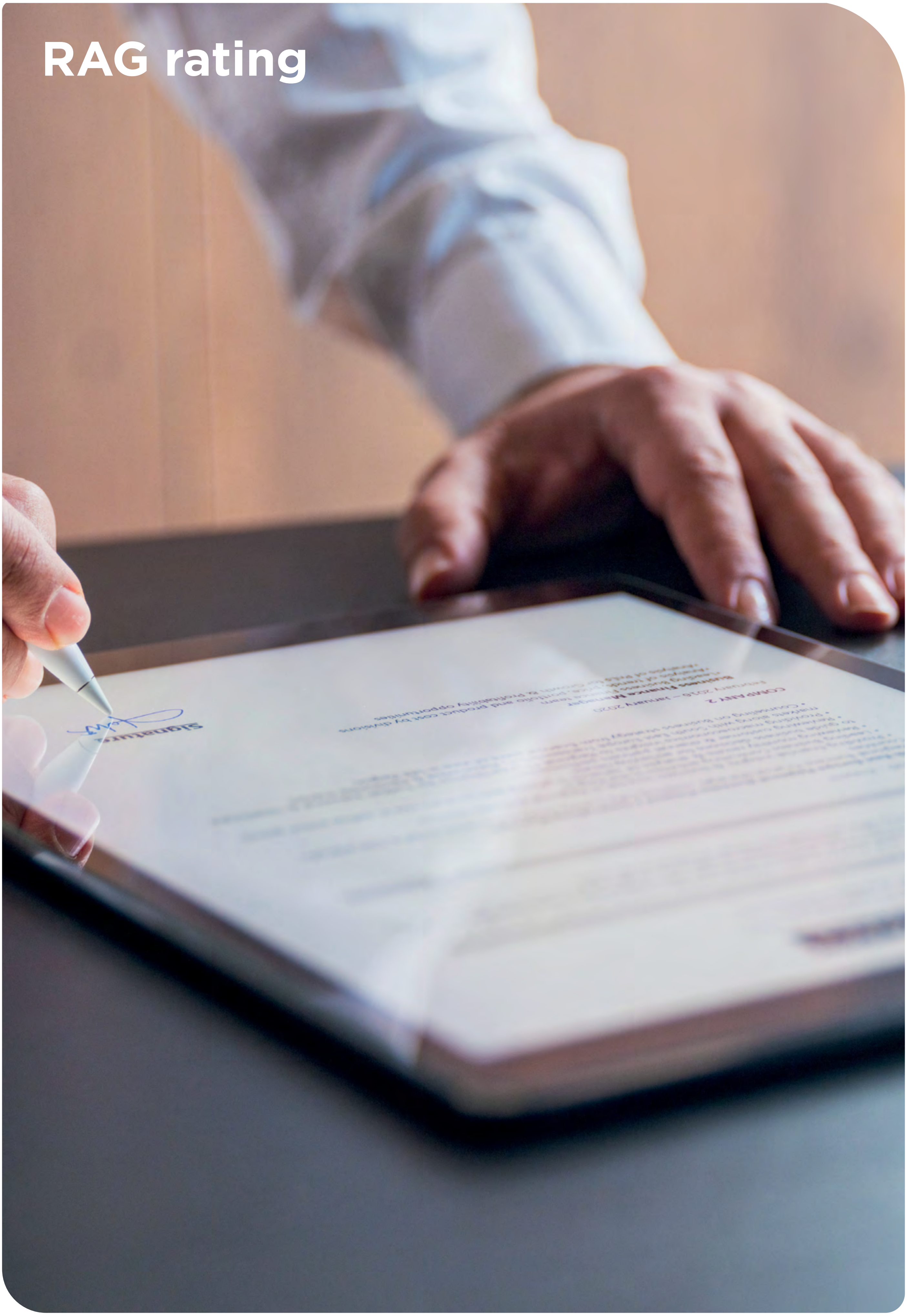
Performance fees

Performance fees are common within PE; however, structuring performance fees can be a complex task to, on the one hand, incentivise the investment adviser, but at the same time be reasonable for shareholders. Quilter Cheviot is not averse to performance fees but requires that they are carefully constructed and that there is a balance made between annual charges and performance fees. Certain underlying principles need to be applied to make the structure effective. For instance, performance fees should not be calculated solely based on the NAV, as this can lead to short-term outcomes and not match the experience of the shareholders. The performance period should also be long-term, ideally three to five years. Furthermore, the fees should ideally focus on selling or realising assets in a way that benefits the underlying holders, meaning that managers should not be rewarded for unrealised gains. Caps, high water marks and hurdle rates are also important considerations when structuring the fee. By adhering to these principles, the performance fee structure will hopefully avoid some of the most common misalignments. Not all trusts have performance fees in place. However, in an industry (PE) where these are common, this is not the norm and PE firms may be unwilling to put different structures in place.

Other areas of fee structures Boards need to give consideration (not just PE trusts) are firstly, how they will lower fees as the trust assets grow, given many underlying trust costs are fixed. And secondly, consideration should be given to how fees can be structured to incentivise the investment adviser to help deal with discounts. Ultimately, however, as investors, performance net of costs should be the critical metric.

[20] Pantheon £150m tender offer to buy back shares at 'material discount' | Market News | The AIC

RAG rating



RAG rating

This RAG rating covers 27 alternatives trusts, categorised into 15 infrastructure, eight private equity and four that we have classified as others.

Each investment trust was RAG rated for three categories: Board composition, Board effectiveness and responsible investment disclosures. We have looked at this in several ways, first by asset class, market cap and domicile. We seek to set higher standards, therefore, achieving a green rating is the exception, not the norm. Within the amber rating, there is a range – some trusts need to do a little bit more, while others have quite a bit more work. We have anonymised the trusts as this is a long-term engagement, and we do not see any advantage in publicising the names at this stage.

Asset class	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Infrastructure	Other	Other	Other	Other	Private equity	Private equity	Private equity	Private equity	Private equity	Private equity	Private equity	Private equity
Board composition	Green	Red	Red	Green	Green	Green	Green	Green	Amber	Green	Green	Green	Green	Green	Green	Red	Green	Green	Red	Amber	Red	Green	Green	Green	Green	Red	Amber
Board effectiveness	Amber	Green	Green	Green	Green	Green	Green	Green	Amber	Amber	Green	Green	Green	Green	Amber	Amber	Green	Red	Red	Amber	Green	Green	Amber	Green	Green	Red	Amber
RI disclosure	Amber	Green	Amber	Green	Amber	Amber	Amber	Amber	Amber	Amber	Green	Green	Amber	Amber	Amber	Amber	Green	Amber	Amber	Amber	Amber	Amber	Red	Amber	Amber	Red	Amber

Green rating:

- Only four companies have a green rating for all three factors (15% of the targeted universe).
- The factor that received the highest green rating was Board composition, at 67%. However, this was also the factor that received the greatest number of red ratings (22%).
- 48% of the Boards achieved a green rating for composition and effectiveness.

Amber rating:

- The most frequent amber rating was for responsible investment disclosure, with 74% of trusts receiving this rating.
- 30% of trusts received an amber for Board effectiveness. This was for a variety of reasons, including perceived lack of independence, poor communication and lack of general awareness of shareholder sentiment.
- 11% of Boards have an amber for Board composition; this was largely as a result of Boards not meeting FCA diversity targets but plans to address the issue imminently (before the next shareholder meeting).

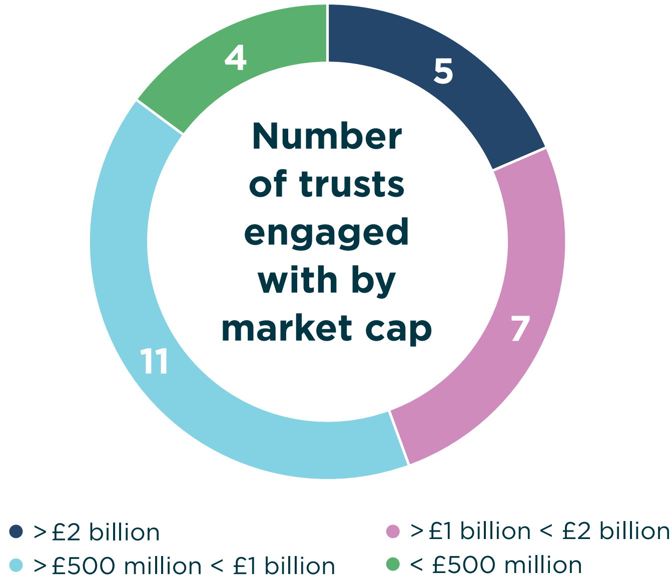
Red rating:

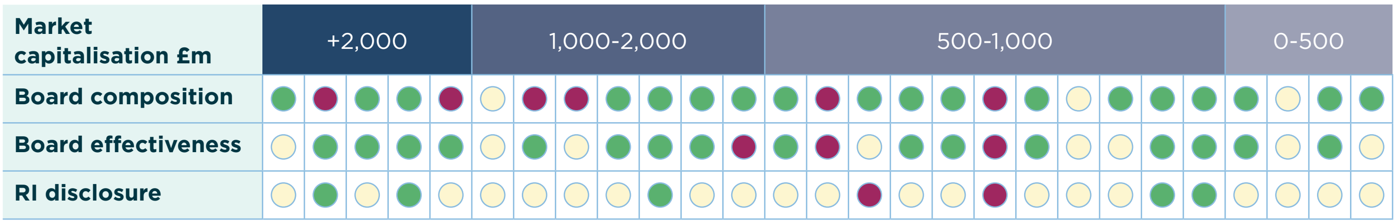
- One trust received red for all three factors. This was caused by an evident lack of Board independence, manager representation and poor communication with shareholders.
- Board composition had the greatest number of red ratings: 22% of the universe as a result of:
  - lack of independence: manager representatives on the Board serving more than nine years.
  - poor oversight of the investment adviser and communication with shareholders.
  - failure to meet FCA diversity targets with no indication of corrective action.

Does size matter?

During our engagement, we spoke with trusts with a market cap ranging from £3 billion to £200 million. However, most investment trusts fell within the £1-2 billion range.

There appears to be no correlation between the performance of these trusts and market capitalisation, as per our RAG rating.





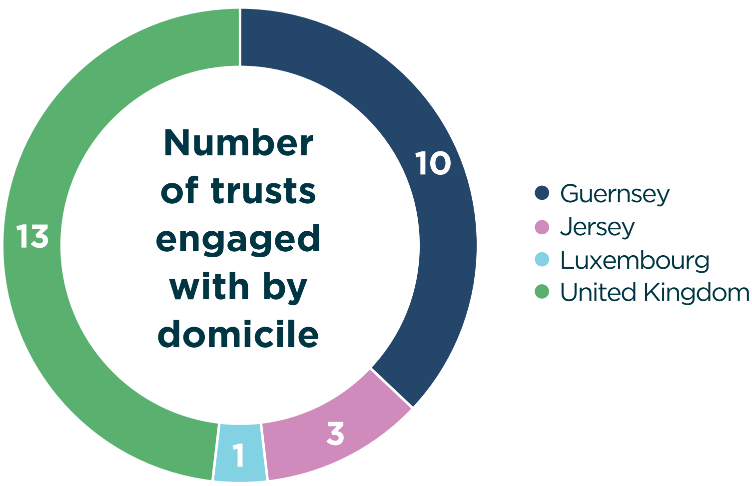
Isle domicile?

As discussed earlier in this paper, we have some concerns regarding the depth and breadth of talent available in the Channel Islands for such specialist vehicles. The effectiveness of a Board depends on the expertise of its directors, and we explored whether being domiciled in the Channel Islands impacted RAG ratings.

In the universe that we analysed, we have 13 Boards based in the Channel Islands, 13 in the United Kingdom and one in Luxembourg. Although the sample size is not large enough to be statistically significant, it gives some colour to some of the issues we have come across:

Domicile	Red rating	Amber rating
Channel Islands	8/39	15/39
United Kingdom	3/39	13/39

There are 13 trusts domiciled in the Channel Islands and United Kingdom respectively. The maximum score is 39 (3 x 13), therefore we have assessed the scores out of a possible 39.



Domicile	Guernsey	Guernsey	Guernsey	Guernsey	Guernsey	Guernsey	Guernsey	Guernsey	Guernsey	Guernsey	Jersey	Jersey	Jersey	Luxembourg	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom	United Kingdom
Board composition	Green	Red	Green	Green	Red	Green	Green	Red	Green	Amber	Red	Amber	Green	Green	Green	Green	Green	Amber	Red	Green	Green	Green	Green	Green	Red	Green	Green
Board effectiveness	Green	Green	Green	Green	Red	Amber	Green	Red	Green	Amber	Green	Amber	Amber	Green	Amber	Green	Green	Amber	Amber	Green	Red	Green	Green	Green	Green	Green	Amber
RI disclosure	Amber	Amber	Green	Amber	Amber	Red	Amber	Red	Amber	Amber	Green	Amber	Amber	Amber	Amber	Green	Amber	Amber	Amber	Amber	Amber	Amber	Green	Green	Amber	Amber	Amber

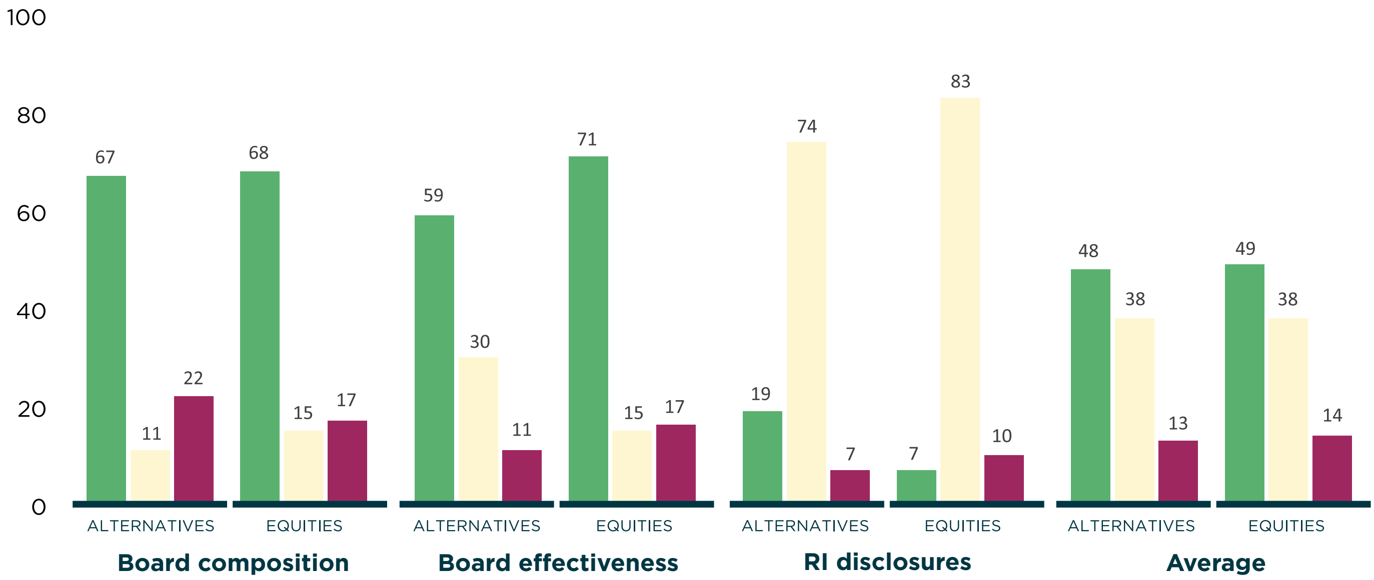
Equities versus alternatives?

Last September, we released the report of the initial phase of our thematic engagement, which involved evaluating the equity trusts in our engagement universe and assigning each an RAG rating. To compare the results, we aggregated the RAG scores of the 41 Boards in the equity engagement and the 27 in the alternatives. It's important to note that this was not a direct comparison due to the varying number of Boards in each engagement.

If we take a look at the table provided, we can notice some discrepancies in the summarised factors. For instance, the alternatives have a higher number of Boards that scored green for responsible investment disclosures. However, a lower percentage of Boards received a green for Board effectiveness.

Despite these differences in specific factors, the averages show that both perform similarly. In fact, they are within rounding errors of each other.

Alternatives vs equities[21]



[21] Table might not add up to 100% due to rounding.

Our expectations

Investor expectations evolve over time and what was good practice a couple of years ago becomes the norm. As it stands, this is what we expect.

Board composition: We expect Boards to be optimised to defend the interest of shareholders and to avoid Board compositions that hinder this.

Independence: this is perhaps the most critical feature of a Board. The Board's role is to act in the interest of shareholders, having management representatives on the Board is in our opinion far from optimal. Additionally, we also consider shareholder representatives to be not independent. We believe that a 100% independent Board is in the best interest of shareholders. We understand that manager-appointed NEDs can add valuable experience and knowledge to Board's discussions, however, we argue that this experience can also be shared without being a NED. Additionally, we want Boards to show independence of action; for example, we do not expect the investment adviser to be involved in the selection of NEDs bar a simple sense check.

Tenure: we agree that best practice is a maximum of nine years' tenure. We understand that a director will not automatically become non-independent after nine years, and in some cases a limited extension of the tenure might be a requirement to ensure appropriate succession. We expect Boards to have solid succession plans in place to avoid director cliffs and excessively long tenures.

Over- Boarding: NEDs should dedicate sufficient time to the oversight of the investment trust, and we expect NEDs to attend 100% of their designated Board meetings unless there are mitigating circumstances. We appreciate that being a NED of an investment trust (particularly in the equity space) is very different to being on the Board of an operating company, however, we monitor the number of Board positions and will vote against NEDs where we believe there is an issue.

Board skills: Boards should have the right skills and experience to be able to constructively challenge the investment adviser. An independent Board without the right skills will not be able to challenge the manager and protect shareholder interests. Boards should have access to independent advice when needed.

Diversity: we expect Boards to be diverse and to work towards the FCA diversity targets, (including FTSE Women Leaders and Parker Review targets). Additionally, we encourage Boards to reflect on recruitment processes and whether they have access to the wider pool of candidates.

Board effectiveness: this can be harder to define succinctly – as there are several qualitative elements.

Communication: both Boards and shareholders need to work at this – Boards should be willing to engage with shareholders. This includes communication regarding the rationale behind Board decisions, for example capital allocation.

Board responsiveness: a key element of it is the Board's ability and willingness to interact with shareholders. An example would be a trust that we have engaged with over several years and on a variety of issues, some of which where we and the Board fundamentally disagree. The point is that the chair and the SID have always been willing to engage and have the hard conversation which is the key to our goal of acting as partners, not adversaries. We may not like what each other is saying, however, having the conversation means that there is a relationship and an openness which has resulted in, for example, us providing very specific feedback on how the Board reports the approach to responsible investment.

Director shareholdings: we believe that NEDs investing in the investment trust is one of the best ways of aligning the NEDs with the shareholder experience. However, setting a strict threshold of shares might deter NEDs from different socioeconomic backgrounds from joining the Board. Therefore, we encourage Boards to allow flexibility in this area. We do accept that for some NEDs this is not feasible. In this instance we expect to understand why this is not possible.

Board evaluations: external Board evaluations should be carried out every three years; we also believe that an interview-led approach is more productive. Additionally, we would like to see shareholders being a part of this evaluation.

Disclosures: when we invest in an investment trust on behalf of our clients, we become shareholders of the investment trust and not of the investment adviser. We expect the information provided to be relevant to the holdings in the investment trust.

The best practice disclosure includes details of the responsible investment due diligence carried out before purchasing new assets and the responsible investment considerations when it comes to selling them. For the asset's holding period, we want to see evidence of how the investment adviser engages with the holdings to manage responsible investment risk. Metrics and data should be disclosed and explain how they are being used and how they relate to the sustainability strategy. Environmental and social targets should be concrete, quantifiable and remain unchanged to allow for tracking progress. Best practices include disclosing greenhouse gases emissions for Scope 1, 2 and 3, and net-zero transition plans. For certain niche sub-industries, where there are no standardised reporting frameworks, we still expect to see disclosures about how the Board plans to mitigate risks related to responsible investment.

Voting: when applicable we expect investment trusts to use their voting rights in a manner that will benefit their shareholders. Best practice is to disclose overall voting outcomes, including votes against as well as where shareholder proposals have been voted on. However, it is important to describe the voting process and how the investment adviser has come to that decision. In our view this is best achieved through providing examples of the voting rationale explaining the process and the engagements that lead to a voting decision.

Engagement: investment trusts should engage with their underlying holdings and then disclose these. We do not expect a transcript of every conversation, but we want to understand the process of the engagements. Again, giving examples of significant engagements and outcomes is a good way of doing this.

ESG integration: investment trusts should be specific and clear in explaining how ESG factors are integrated into the investment process. In some disclosures there can be ambiguity of how ESG data is being used.

Outcomes to date

Over the last 18 months we escalated our engagement with six alternatives trusts for various issues during this period. Our escalation process included writing formal letters to the Board, follow-up meetings and voting against directors. However, it is important to consider that this is a long-term engagement, and, in most cases, we would not expect immediate changes. We acknowledge that we are not the sole owners of these investment trusts. As a result, the Board is accountable to multiple stakeholders and not just us. Therefore, we cannot measure the effect that our engagement had on this outcome.
The exception is the cases where we have received confirmation that our engagement played a role in the decision-making process. Some of our outcomes to date include:

- **Removal of non-independent director:** After indicating our intention to vote against the non-independent manager representative, the manager representative withdrew his re-election proposal a few days before the AGM. The Board became fully independent as a result.
- **Removal of non-independent director:** We had a conversation with the chair of a Board that had two non-independent manager representative NEDs. After we wrote to the Board expressing our intention to vote against both non-independent directors, the trust announced one would not stand for re-election. Almost a year later, the Board announced that the second manager representative would not be standing for re-election.
- **External provider disclosure:** After reading our report, at least two Boards that did not disclose the names of the external firms used for executive search and Board evaluation have checked their annual report to ensure the correct disclosure of the names.
- **SID:** We recently talked with the Board members of a newly listed investment trust that did not have a Senior Independent Director (SID). We shared our expectations with the Board that all Boards should have a SID. Following the conversation, we sent a formal letter to the Board reiterating our position. A few weeks later, the trust announced the nomination of one of its existing NEDs as the new SID.

What's next?

We are moving on to the final phase of our thematic engagement, the property sector. Our focus will be on engaging with the Boards of our monitored Real Estate Investment Trusts (REITs) while ensuring that they adhere to our framework and expectations for governance effectiveness and disclosure. We will also include open-ended funds in our assessment to allow us to compare the various levels of disclosure and governance between close-ended and open-ended vehicles.

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