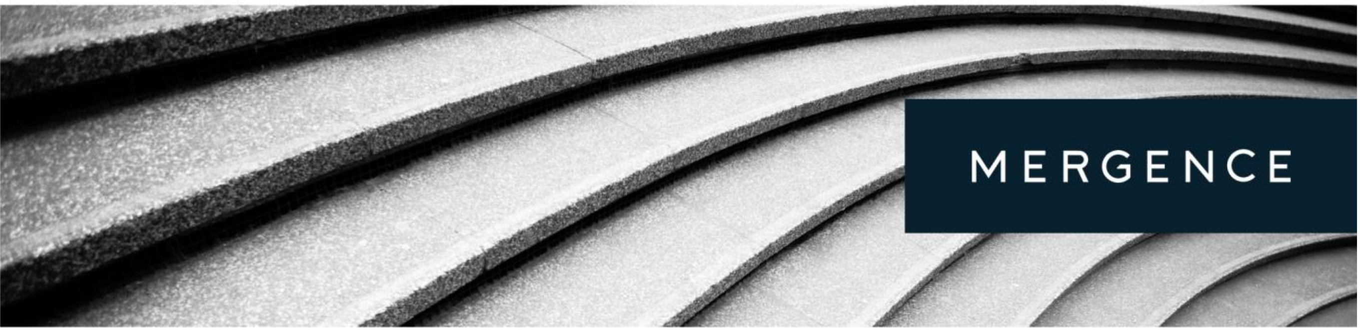

Economic, Social & Governance (ESG) Report

2nd Quarter 2016

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Introduction

In this report we highlight some of the ESG research and engagements we have undertaken over the past quarter on behalf of our clients. We aim to make this a regular report and to add content to it over time. We would welcome any feedback or suggestions for any further information that you would find useful in future issues.

Proxy voting

The tables below summarises how we have voted on average on behalf of our clients over the past quarter:

	Mergence	Resolutions Passed
Number of resolutions	845	845
Resolutions vote for	775	845
Resolutions voted against	70	0

Type of Resolution	
Issue shares or place under control of directors	17
Remuneration or remuneration policy	32
Financial assistance	7
Appointment of directors	5
Disapply preemptive rights	1
Miscellaneous	8

As you will notice, we have voted against a large number of remuneration policies[1]. While we have been critical in the past of executive remuneration policies and the growing wage gap between South African executives and the average employee, we do not make these decisions lightly. Our primary objective is to ensure that our client's receive an attractive return on their capital and a highly skilled and well incentivised management team is a key driver of these returns. We are therefore, in principle, not against executives being well compensated for running good businesses that will generate returns for shareholders. What is important is that remuneration policies are well structured and that shareholders hold management and boards accountable to ensure that executive compensation is driven by performance against suitably demanding targets.

We detail the reasoning behind two of our votes below to highlight some of the complex issues involved in these decisions.

[1] It is important to note that the table presented counts number of resolutions voted against, not companies. Some companies split their votes on director's remuneration into votes per board committee. The result is that some of these votes may apply to a single company.

Standard bank

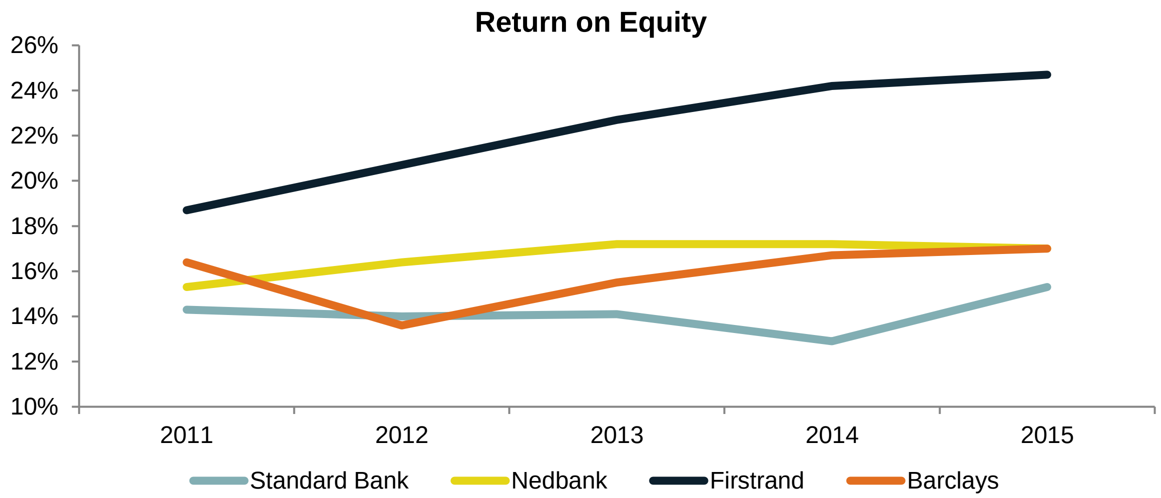
We voted against Standard Bank's remuneration policy based on a number of issues but two key concerns drove the decision. Firstly we have been significantly concerned by a number of missteps by the bank over the past two years. We believe these raise serious concerns regarding the management team's oversite of various operations and the culture of accountability in the organisation. Furthermore Standard Bank's Return on Equity has lagged both its peers and its own internal target for a number of years. Against this backdrop we find the remuneration committee's assessment of management's performance to be too generous and out of line with the company's performance.

Over the past 24 months Standard Bank has suffered from a number of regulatory fines and instances of fraud. These include:

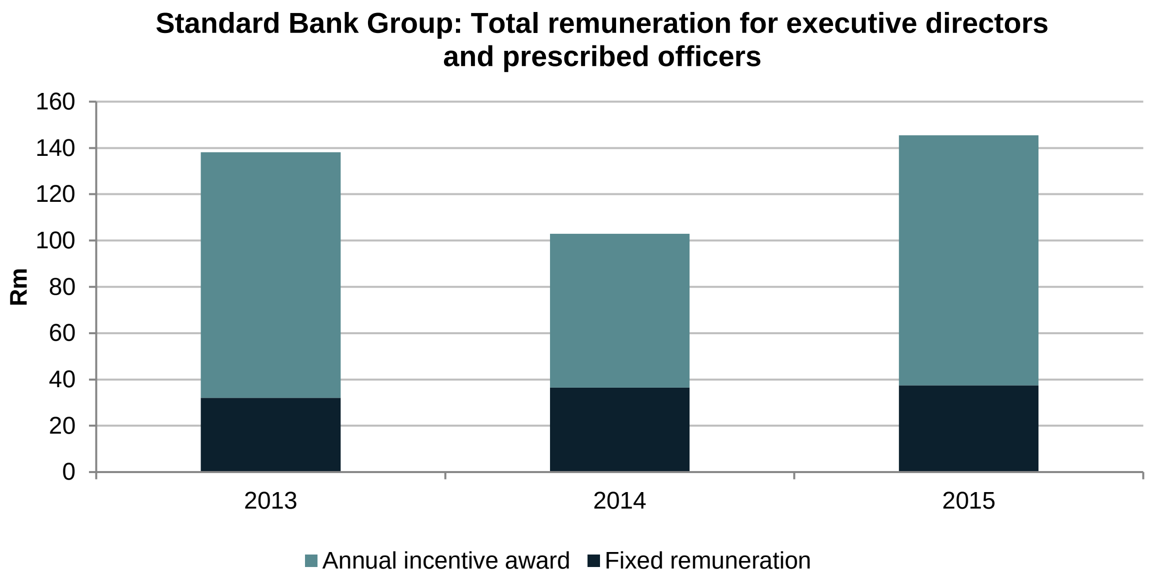
- 2014 Chinese Aluminium fraud
- 2014 SARB fines for FICA controls
- 2015 Deferred Prosecution Agreement relating to Stanbic Tanzania
- 2015 Allegations of misstatement of the Stanbic IBTC financial statements by the Financial Reporting Council of Nigeria
- 2016 Sanctioned by Angolan central bank for failure to comply with foreign exchange rules
- 2016 Fraudsters accessed details of Standard Bank credit cards and withdrew up to R300m illegally from Japanese ATMs

We estimate that before any insurance claims the total cost of these various issues is over R2.5bn. While we understand that in a multinational banking operation these types of issues may occur at times, the frequency and magnitude of issues related to Standard Bank are however of concern.

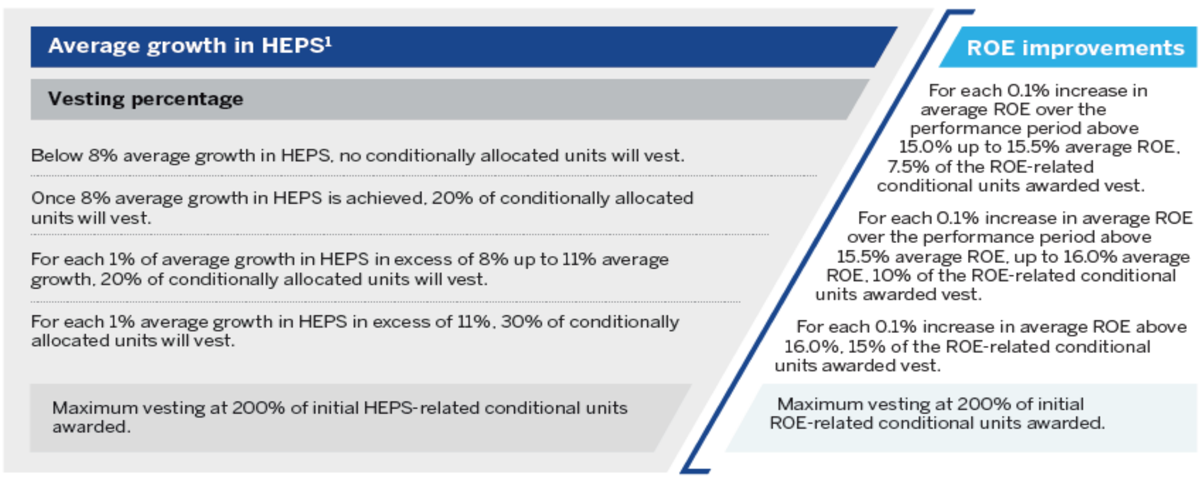
Standard Bank management targets an ROE of 15% to 18%. The chart below shows that they have largely missed this range as well as underperformed peers for the past five (5) years.

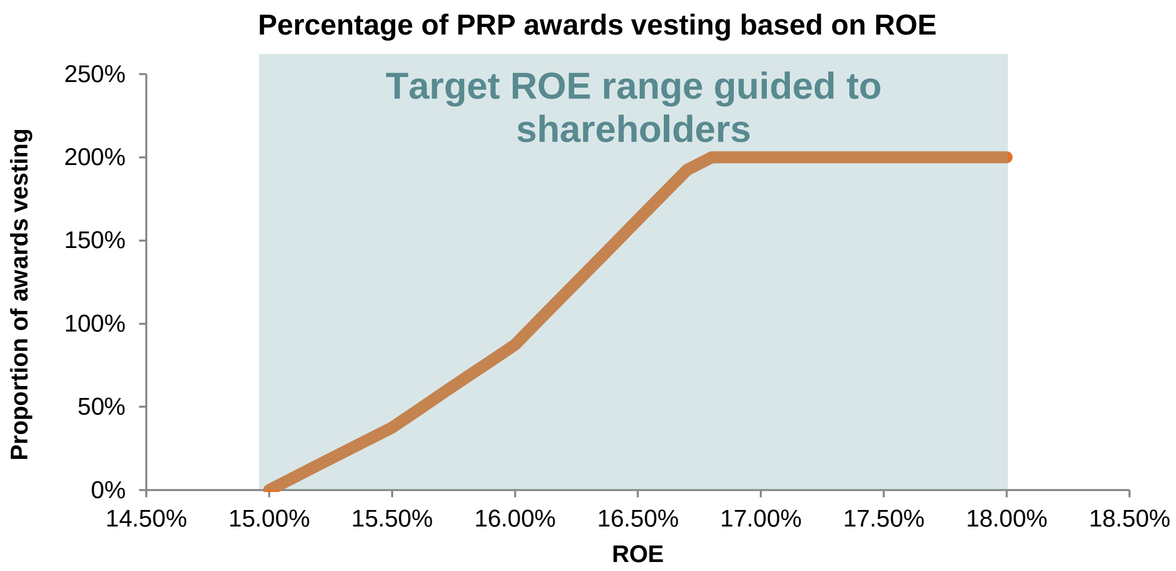


It is against this back drop that the remuneration committee awarded the top five executives total compensation exceeding R140m in 2015. It is also notable that this is higher than both 2013 and 2014 figures and that the variable portion of this compensation is in excess of 2.5 times the fixed compensation portion, an outcome that we believe reflects performance at the top end of targets.



A further concern regarding the Standard Bank remuneration policy relates to the portion of the long term incentive plan, the Performance Reward Plan (PRP), driven by Return on Equity (ROE). Executives are granted a number of share awards under the PRP and a proportion of these vest at future dates depending on certain performance measures. A component of these awards vest dependent on ROE performance over the vesting period. In principle we support this structure as it aligns management's rewards to a sensible measure of performance. Unfortunately, in this case, the way the PRP is structured is misaligned with the ROE targets that have been communicated to shareholders. While Standard bank has communicated a target ROE range of 15% to 18%, these particular rewards reach their maximum level of vesting at only 16.75% ROE. We find this to be a misalignment between management reward structure and shareholder expectations.





Old Mutual

Old Mutual is currently in the process of implementing a managed separation process to break up the group into its four underlying companies. This process will be spearheaded by its executive management team of Bruce Hemphill and Ingrid Johnson. The board has proposed a remuneration structure for these executives based on their performance of this unbundling over the next 3 years. This structure has made financial news headlines due to the fact that the CEO could theoretically earn up to 11m British Pounds over the next three years depending on the progress of this unbundling.

The Old Mutual group certainly deserves much praise for certain elements of this structure. This is a complex and unique situation with significant potential for value unlock for shareholders. Aligning senior management with shareholders is important in this instance. Old Mutual has developed a detailed set of objectives against which to measure management's execution and has consulted widely with shareholders while developing it. Unfortunately we believe there are some elements of this structure that negate much of the positive efforts. In short, there is too much discretion given to the remuneration committee in measuring the success of the separation and crucially, the remuneration committee has the ability to retrospectively change any of the targets due to changes in market conditions or the macro-economic landscape. Given that this vote occurred shortly before the UK's vote to leave the EU (so-called Brexit), we felt that the risk of significant changes in the macro economic environment was particularly high. In addition, 40% of the performance measures are based on 'Assessment of the success of the separation of the business units into four separate businesses', an inherently subjective and difficult to measure criterion.

Research

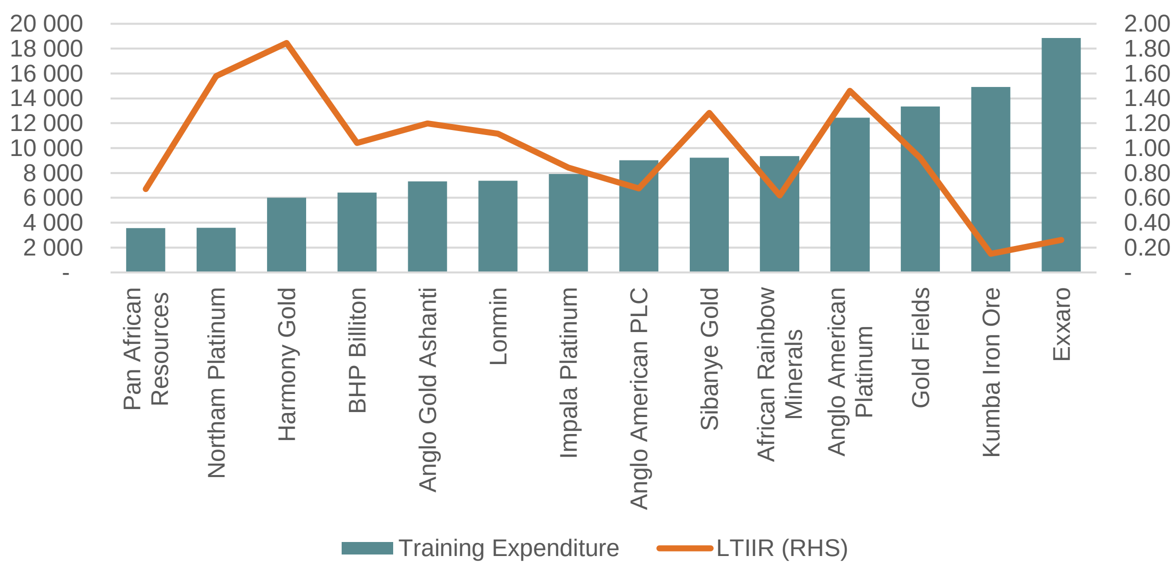
Safety in the South African mining sector

The success of a mining company is intertwined to the safety of its operations. Safe operation in the mining sector is key to operational efficacy and thus financial performance. Mining companies have a social responsibility to provide their employees with a safe working environment. Also, companies have a responsibility to create financial value for shareholders.

Given that safety is pivotal to operating sustainable mining operations, we conducted this research on safety in South African mining companies. We sought to understand if annual training expenditure per employee (permanent) had any effect on a company's safety and if that impacted a company's profitability. With that in mind we collected safety data, which is the lost time injury incident rate (LTIIR), annual training expenditure per employee and earnings performance for fourteen JSE listed companies from 2007 – 2015.

The results of our study seem to suggest that there is a negative correlation between a company's LTIIR and its training expenditure, Figure 1. Except for PAN, companies that have low employee training expenditure seem to have worse-off safety, examples include Northam Platinum and Harmony Gold. On the other hand, companies with high employee training expenditure seem to benefit by having better than average safety, examples include Kumba Iron Ore and Exxaro. Safety and employee training expenditure is far more intricate than what these results might show.

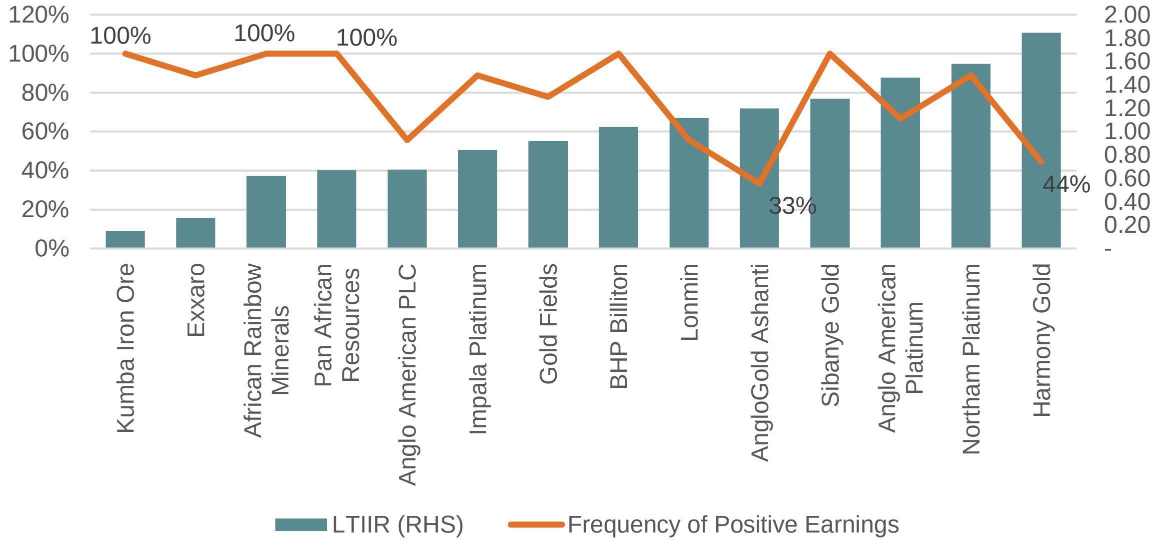
Figure 1: LTIIR and Training Expenditure



Source: Blomberg, Company Reports, Mergence

Furthermore, we looked at average LTIIR over the period and the frequency of having positive earnings in that period. Figure 2, depicts that companies with lower average LTIIR were more frequently profitable, examples include Kumba Iron Ore and African Mineral Resources. On the other hand, companies with higher average LTIIR were less frequently profitable, examples include Harmony Gold and AngloGold Ashanti. There are various factors that affect profitability besides safety and therefore we do not claim higher LTIIR automatically makes a company less profitable. However, in the period under consideration companies that had better safety were more frequently profitable than those with worse-off safety.

Figure 2: LTIIR and Profitability



Source: Blomberg, Company Reports, Mergence

In conclusion, the following was evident from the research:

- Companies with higher annual training expenditure per employee seem to have lower injury rates and have been making losses less often than those that spend less on employee training.
- Northam Platinum and Harmony Gold are underperformers, where lower training expenditure corresponded with higher LTIIR. In particular, Harmony Gold has a low employee training expenditure but high LTIIR which was coupled with frequent losses.
- Kumba Iron Ore and Exxaro seem to have benefited from higher employee training expenditure which corresponded with lower LTIIR and fewer financial losses.