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Introduction

ABOUT LGIM
LGIM is one of the largest asset managers in Europe, with £500billion in funds under management as at 30 September 2015. LGIM is a major equity investor in the UK and also a significant shareholder of assets globally and aims to use its position as a major long-term shareholder to help improve board practice and performance in its invested markets.

Below are diagrams which illustrate the breakdown of asset classes and regions in which LGIM is invested.

Assets under management by asset class:

- Total: £550,327m
- Equity: £181,943m
- Total: £181,943m
- Multi-Asset: £19,425m
- LDI: £95,960m
- Property: £13,004m
- Fixed Income: £177,676m
- Commodities: £149m
- Cash Equivalents: £12,099m
- Private Equity: £98m

Equity breakdown by region:

- Total: £181,943m
- UK: £54,773m
- Europe ex-UK: £24,466m
- North America: £41,693m
- Asia Pacific: £9,061m
- Developed Middle East/Africa: £9,061m
- Japan: £9,328m
- Emerging Markets: £10,196m
- Far East: £143m
- Global: £26,696m
- Far East: £143m
- Developed Middle East/Africa: £9,061m

As at 30 September 2015

CORPORATE GOVERNANCE AND RESPONSIBLE INVESTMENT

“The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the Company.” (The Financial Reporting Council).

LGIM believes that companies which demonstrate good corporate governance and have policies for a sustainable business model will deliver enhanced shareholder value.

LGIM approaches Environmental, Social and Governance (ESG) issues in an integral way through its engagement and voting policies, in order to exert influence over companies to drive best practice and reduce the risk of corporate failure.

The ultimate goal in doing so is to protect, align and maximise shareholders’ interests for the benefit of its clients.
**LGIM’s Approach**

**THE TEAM**

The team is headed by the Director of Corporate Governance, Sacha Sadan, who is responsible for monitoring and developing LGIM’s corporate governance policy and activities.

The team also comprises Meryam Omi, Head of Sustainability, and Angeli Benham, Clare Payn, David Patt, Catherine Ogden, Jeanette Andrews and Tom McGarrity managing ESG topics globally.

Collectively, the team has an average of 13 years’ investment experience and is independent from the active equity managers, operating within Chinese Walls. However, fluid communication is maintained with fund managers in order to enhance ESG and financial dialogues with the companies in which LGIM invests. This organisational structure allows the team to receive inside information and provide helpful advice to companies from an investor perspective, without impacting the ability of portfolio managers to deal in the company’s shares.

Sacha reports directly into LGIM’s Chief Executive Officer (CEO), Mark Zinkula. This structure, as well as the ability to engage with two independent non-executive directors on LGIM’s board, ensures that conflicts of interest are appropriately managed.
LGIM’s Approach

VOTING, ENGAGING AND MONITORING

Corporate governance and responsible investment means exercising voting rights, engaging in dialogue with companies to promote best practice and continuing to monitor companies where it leads to protection and the enhancement of shareholder value.

Monitoring

LGIM monitors its investee companies over the long term, rather than presuming that changes are effectively implemented following its voting or engagement activities. Some issues may take a number of years to resolve, but LGIM, as a long term investor, strives to keep communicating with the company in question and that pressure is increased appropriately through an escalation procedure.

As stated above, LGIM uses various sources to monitor changes in companies and uses independent research providers and the media, rather than relying solely on company disclosures. When written disclosure provided by a company is considered inadequate and requires further explanation, LGIM will contact the company directly for further information and will provide constructive feedback.

Engagement process

Ongoing dialogue with companies is one fundamental aspect of LGIM’s responsible investment commitment and it may undertake this independently or collaboratively with other investors. Engagement will be triggered in a variety of ways such as a voting issue, general knowledge of the company, or a media report. Illustrated below are the types of sources that may trigger an engagement effort.

LGIM has an established policy based on the escalation of engagement. If initial discussions fail to result in improvements or if concerns are not being addressed, then LGIM will usually escalate the issue sometimes resulting in a collaborative engagement initiative.

Collaborative engagement is a useful medium that allows LGIM to forge alliances with other investors, especially when dealing with companies where investor communication is limited.

Such engagement on company specific issues may be informally carried out amongst like minded investors to LGIM, or more formally through networks such as the Investment Association.

When participating in collaborative engagement, due regard is placed on LGIM’s internal conflicts of interest and insider dealing policies, as well as the guidance issued by the Takeover Panel and the Financial Services Authority.

Environmental, social and governance (ESG) integration

While the team is independent of active fund managers, ongoing communication is maintained to understand the company fundamentals, which enhances ESG and financial dialogues with the companies. What’s more, ESG factors are increasingly recognised as playing a role in determining asset prices. We therefore integrate our work with the active equity and fixed income teams in order to supplement their fundamental analysis process by identifying sector-specific risks and opportunities.

During 2014 we further enhanced our ESG integration work. Our proprietary scoring tool assesses the ESG risk of each company compared to its peers and aims to supplement the fundamental assessment of companies. The result is that around 11,000 companies can be easily scored against a set of criteria on an ongoing basis and each investment team can customise the tool to supplement its own process. We believe such quantitative measures are an important complement to the qualitative research and engagement process we carry out, and help to communicate the value of ESG activities to our clients.
LGIM’s Approach

Voting process

LGIM provides its clients with a valuable service in applying its knowledge and judgement to exercise clients’ voting rights. LGIM is able to strive for maximum influence at companies by pooling all its clients’ assets, giving it a more powerful position.

The voting decisions are based on this Corporate Governance & Responsible Investment Policy, supplemented by country specific policies. It is a cyclical process where decisions are based on a variety of information: external research providers, company disclosure and internal views on company performance. The final decisions are made by the Corporate Governance Team based on what is deemed to be best for long term shareholder value. Highly contentious issues will be discussed with the CEO, the non-executive directors of LGIM, and the Corporate Governance Committee before votes are submitted. It is LGIM’s policy to not abstain on voting resolutions in the UK market and globally abstentions are minimized.

The process is illustrated below:

It is important to note, however, that voting decisions are not formulaic and the team uses many different resources when evaluating issues including 13 years’ investment experience. In addition, communication with companies is essential to thoroughly understand any issues, and decisions are made on a case by case basis taking into account the specific circumstances.

Stock lending

We operate a stock-lending programme in selective overseas equity markets under strict conditions on the credit rating of counterparties and the quality and extent of collateral. For example, we insist on 105% collateral in the form of G7 government bonds (but currently excluding Italian bonds) or AAA supranationals, and we do not accept cash collateral.

The programme is administered by the fund’s custodian, Citibank, on an agency basis.

We do not currently engage in stock lending in the UK for three main reasons:

1. Revenue potential in the UK is limited due to the massive supply/demand imbalance. The only way to boost this revenue is to compromise on the quality of the collateral and the counterparty, leading to an unacceptable level of risk.
2. The right to scrip dividends is lost when a stock is lent. Scrip dividends are not infrequent in the UK and can be very valuable. Historically, they have added up to 0.03% p.a. to the performance of the UK Equity Index fund.
3. In practice, voting rights are lost when a stock is lent. As one of the largest shareholders of UK equities, clients expect us to take corporate governance responsibilities seriously and be able to vote at all times.

All stock lending revenue, less external administration costs, is reinvested in the pooled fund for the exclusive benefit of unit holders. We do not believe it is right to take a share of the stock lending revenue as this can lead to conflicts of interest.

Disclosure

LGIM’s clients receive quarterly reports detailing the voting and engagement activity executed on their behalf. LGIM’s UK voting decisions for its internal clients are publicly disclosed on the Corporate Governance section of the LGIM website www.lgim.com/corporategovernance
LGIM’s Approach

CONFLICT OF INTERESTS MANAGEMENT
LGIM’s duty to act in the best interest of all its clients and beneficiaries is at the heart of its investment philosophy and activities.

For more information on our policy, please see the separate Conflicts of Interest document which you will find on the website – www.lgim.com/corporategovernance

INDUSTRY CODES
LGIM participates in industry and regulatory dialogues, responding to consultations in various markets as we try to influence new approaches and raise industry standards.

UK Stewardship Code
LGIM is fully supportive of and complies with the UK Stewardship Code, the Japan Stewardship Code and Malaysian Stewardship Code for institutional investors. We believe that the combination of healthy stewardship and company engagement should be encouraged throughout the investment community.

For more information, please see the separate documents on the Stewardship Codes which you will find on our website – www.lgim.com/corporategovernance

Principles of Responsible Investment (PRI)
The PRI is a United Nations-backed network of international investors working together to put the six Principles for Responsible Investment into practice.

We signed up to the aspirational principles in September 2010, in order to demonstrate our commitment to engage with companies on ESG issues and work together with other investors and asset owners in driving the responsible agenda forward.

For more information, please see the separate document on PRI which you will find on our website - www.lgim.com/corporategovernance
Company Board

This policy sets out Legal & General Investment Management (LGIM’s) expectations of investee companies in terms of corporate governance and applies to companies globally, but is supplemented and should be read in conjunction with the country-specific policies.

INTRODUCTION

Every company should be headed by an effective board whose members are responsible for the management and long-term success of the company. The term “board” refers to both the executive team and the non-executive directors but the structure of a board will vary from company to company and country to country. A company’s board may also differ according to the company’s size, complexity, country of domicile, type, maturity of business and its ownership structure. However, certain elements of an effective board are universal such as its role, structure, operation, and accountability to shareholders.

ROLE

The board has the most important task of setting the strategy and direction for the business and ensuring that the necessary financial and human resources are in place to enable its implementation. In setting this strategy, the board should also agree on the level of risk that is sustainable and that effective controls are put in place to enable these risks to be assessed and managed. The board needs to communicate the core values of the business throughout the company and to its shareholders.

The chairman and the chief executive officer

The chairman should be independent at the time of appointment and has the responsibility of leading the board, setting the agenda for board meetings and ensuring directors receive accurate and timely meeting information. Under his direction, the company secretary should ensure that there is a good flow of information within the board and the board committees. He is also responsible for leading the appointment process of the chief executive officer (CEO).

The chairman should be able to challenge the executive directors and encourage the non-executive directors to actively participate in board discussions. It is the chairman’s role to regularly assess whether the board members have the adequate skills and diversity to make a positive contribution.

By contrast, the CEO has the responsibility of executing the strategy agreed by the board and of leading the business.

The roles of chairman and CEO are substantially different, requiring distinctly different skills and experience, and therefore LGIM expects them to be separated. This division of responsibilities ensures that a single individual does not have unfettered powers of decision at the head of the company, thereby securing a proper balance of authority and responsibility on the board. Additionally, LGIM would not expect a retiring CEO to take on the role of chairman, as a hands-on CEO may find it difficult to become a hands-off chairman.

Where companies are looking to depart from best practice with a combined CEO and chairman, or a CEO becoming chairman, LGIM expects meaningful explanation and justification in the report and accounts. LGIM will consider the merits of both situations and will evaluate the issue on a case by case basis but in both instances expects a strong senior independent director or deputy chairman to be appointed.

Non-executive directors

Non-executive directors should constructively challenge the executives and help to develop proposals on strategy. To enable them to discharge their normal duties as non-executives they should have access to independent professional advice at the company’s expense. They should also have access to the company secretary who is responsible for ensuring that board procedures are complied with.

It is a demanding role and, although LGIM does not have rigid guidelines on the number of roles a non-executive can undertake, the individual must have sufficient time and input to perform the role properly. The determination of the appropriate number of roles will depend upon many factors such as the size and complexity of the business, whether the individual will sit on key board committees, whether it is a part-time or full-time role, and any other commitments the director may have. LGIM will consider the appropriate number of roles a non-executive director can undertake on a case by case basis by taking into account all of these factors.

Senior independent director

The senior independent director should be a non-executive director who is fully independent and can act as a counsel and guide for the chairman and to serve as an intermediary for the other directors when necessary. This person should also act as a key contact for shareholders and be available to answer any concerns. Given the importance of the role, it is vital that the candidate has good strength of character in order to be able to challenge the executive directors when representing the best interests of shareholders. The candidate should be mindful of the time commitment of such a role when taking up outside directorships and LGIM believes that additional fees should be paid to the senior independent director to reflect this responsibility.
STRUCTURE AND OPERATION

The success of a board is solely down to its members’ contribution and how the different roles work together. The table below explains the terms used to explain various forms of directors who may sit on a board:

<table>
<thead>
<tr>
<th>Role</th>
<th>Executive</th>
<th>Non-executive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent</td>
<td>N/A</td>
<td>A director with no affiliation to the company</td>
</tr>
<tr>
<td>Non-independent</td>
<td>A director who works for the company</td>
<td>A director who does not work for the company but has a strong affiliation to the company e.g. significant shareholder</td>
</tr>
</tbody>
</table>

**Diversity**

A suitably diverse mix of skills, experience and perspectives is essential for a board to function and perform optimally. A good level of diversity has the ability to improve business decision making, minimise business risk, improve the sustainability of profits growth and therefore maximise long-term returns for shareholders. When recruiting members, a board should be cognisant of all elements of diversity that appropriately represent the company’s operations, including gender, age, nationality, ethnic origin, background and experience. Companies should ensure that candidates with such qualities are sought through the widest possible means such as the use of recruitment consultants, public advertisements, and the leverage of other relationships in the industry. Nevertheless, candidates should ultimately be selected for their skills and experience and the most appropriate fit with the board in accordance with the future growth strategy of the company. For more information, please see our Fundamentals article, “Healthy Debate” which you will find on our website; www.lgim.com/corporategovernance

**Independence**

The independence of non-executive directors is important and valuable. As such, LGIM expects the board of large companies, excluding the chairman, to comprise of a majority of independent non-executives, with smaller companies having at least two independent non-executives.

LGIM would consider a director to be non-independent if he or she:

- Has been an employee of the company or group within the last five years;
- Has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director, or senior employee of a body that has such a relationship with the company;
- Has received or receives additional remuneration from the company, apart from a director’s fee, such as the company’s share option, performance related pay, or pension scheme;
- Has close family ties with any of the company’s advisers, directors, or senior employees;
- Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- Has served on the board for more than nine years from the date of first election;
- Represents a significant shareholder.

LGIM also recognises that non-independent non-executive directors can offer significant skills and sector knowledge. This can help a company to perform at its best and to maximise value, and therefore LGIM would support the company in their appointment as long as the board remains balanced. In this instance, LGIM expects the company to fully explain how the non-independent director provides valuable input into the business.

**Re-election of directors**

To ensure the successful composition and functioning of the board, directors should submit themselves for re-election at regular intervals, subject to continued satisfactory performance. The regulations that govern the frequency for director re-election vary greatly from one country to another. Please refer to each country voting policy for further details.
Company Board

**Board nominations**
There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board which should be undertaken by a nomination committee composed of a majority of independent non-executive directors. LGIM expects the chairman of the board or a suitable independent non-executive director to chair the committee. The nominating process should be transparent, demonstrable and should consider and promote all forms of diversity.

**Board size**
The board should not be so large as to be unwieldy. For a two-tier board a typical size would be between five and 10 members, and for a unitary board between five and 15 members. In either case, the size of the board should be appropriate for the size of the company and complexity of the business. No individual or small group of individuals should be able to dominate the board’s decision making.

**Board mandates**
LGIM believes that it is important for executive directors to seek outside board appointments as this will help broaden their skills and knowledge, enabling them to provide more input on board discussions. However, when taking up outside appointments, they should be mindful of the time commitment required to exercise their duties on multiple boards.

**Meetings and attendance**
Regular board meetings are a crucial aspect of running a successful company. The board should meet at regular intervals to ensure effective oversight of the company. The chairman should hold separate meetings with the non-executive directors to discuss the performance of the executives, and the non-executives should have at least one meeting during the year without the chairman present.

Director attendance at board meetings is a vital part of the role for making contributions to board decisions and of fulfilling fiduciary duties to shareholders. LGIM expects directors to have attended no less than 75% of the board and committee meetings held and to facilitate engagement with the shareholders they represent. Companies should disclose the attendance record of directors.

**Training**
The chairman is also responsible for ensuring that directors receive a comprehensive induction to the company on joining the board and that training is available on an on-going basis. LGIM supports the view that companies should hold regular briefings or presentations to the board from divisional directors to ensure that all directors are kept informed of all aspects of the business.

Directors should be encouraged by the chairman to continually update their skills and knowledge and should agree on their specific training and developmental needs which should include all aspects of social, environmental, ethical and reputational risks faced by the business.

**Board evaluation**
The evaluation of directors is a key way of improving board performance as it highlights the effectiveness of the entire board, how it interacts with company management, and the contributions made by each member. LGIM encourages evaluations to be undertaken and for the process and general outcomes of these evaluations, including potential conflicts of interest, to be disclosed in the company report and accounts. This will allow shareholders an insight into boardroom behaviour and its effectiveness.

LGIM believes that such evaluations performed by an independent third party can bring great value to the company and expects larger companies to seek such external assessments.

**Board tenure**
The tenure of board members is of significance as this can impact on independence, and overall board effectiveness. Term limits help to foster board refreshment, which brings a natural cycle and evolution to the board bringing fresh insights. Guidance for the departure of an NED helps with succession planning and whilst different regions have different best practice guidance on this issue it remains one of importance and a point on which LGIM will expect to engage.
BOARD COMMITTEES

Audit & Risk committee
The audit committee is responsible for monitoring the integrity of the financial statements of the company, appointing external auditors, monitoring their qualifications and independence as well their effectiveness and resource levels. The committee should have at least three members and should consist exclusively of independent non-executive directors. LGIM also expects an audit committee to have at least one member with recent and relevant qualified experience (such as an accountancy qualification) to ensure that the committee is equipped with the financial expertise needed to carry out its function. In addition, all members should be financially literate in order to be able to understand the internal and external audit functions. The company chairman may be a member of the committee, if considered independent on appointment, but should not chair the committee.

This committee is also responsible for the overall risk management for the company to ensure that sound and robust internal controls are in place to manage the company’s financial, operational and reputational risks appropriately. The committee should meet on a regular basis. For financial institutions and other high risk sectors, a separate risk committee may be established. Further explanation on this is provided in the Audit and Risk section.

Nomination committee
The nomination committee is responsible for overseeing all board and senior executive appointments and should have a fully independent membership of non-executive directors. The committee should be chaired by the company chairman, if considered independent, and should also be involved in making appointments to the next tier of directors as this is a valuable pool of talent for sourcing future board directors. The committee chairman should be answerable to shareholders if it is felt that appropriate succession plans are not in place.

Remuneration committee
The remuneration committee is responsible for the setting and operation of the company’s remuneration strategy for executive directors and senior executives. The committee should have at least three members and should consist exclusively of independent non-executive directors. The company chairman is permitted to be a member of the committee if considered independent on appointment but should not chair the committee.

The committee should have the authority to appoint its own independent external remuneration advisors to assist them on issues by providing external data and other information. The use of such advice should be disclosed in the report and accounts.

Corporate Responsibility, Ethics or Sustainability committee
Some companies may choose to have a corporate responsibility, ethics or sustainability committee of which LGIM is supportive. LGIM considers such a committee to be essential for companies which are particularly exposed to social and environmental risks that can harm operational integrity over the long term. The committee should not only stay informed of external developments, but should also ensure that risks and opportunities identified in the committee meetings are embedded into the company’s overall strategy to help build a sustainable business model for the company. The committee should maximise such profitable opportunities.

Corporate Governance committee
Companies may choose to have a corporate governance committee responsible for corporate governance practices and procedures. The committee should monitor industry and regulatory standards and strive to achieve best practice as well as engage with the company’s major shareholders.

ACCOUNTABILITY
The directors of a company should be accessible to shareholders and should make themselves available to engage on any issues whether or not related to a vote at the company’s annual general meeting (AGM). Concerns raised by investors should be managed effectively by the board – see the section on Dialogue with Shareholders.

LGIM expects listed companies to have an audit, nomination, and remuneration committee. This ensures that specific directors are responsible for these key board functions.
INTRODUCTION
LGIM believes that the board is responsible for determining the company’s approach to risk, setting its culture and monitoring the controls in place to manage it effectively. The board is also responsible for disclosing and communicating the financial health and risk appetite of the company to its shareholders.

INTERNAL AUDIT
Companies should have a robust internal audit system in place which is designed to identify the level of risk taken, the process and procedures in place to manage such risk, and in which is embedded a risk-based control system for the company. This enables the company to accomplish its strategic objectives by taking disciplined approaches to risk management ensuring the company’s integrity in the long run.

LGIM supports The Turnbull Guidance – http://www.frc.org.uk/corporate/internalcontrol.cfm which underlines the importance of a sound internal control system. LGIM expects companies to have an effective system that takes into account new and emerging risks that will affect its business objectives.

Companies should also establish a whistle-blowing policy that is integrated into its Code of Conduct for employees. This will maintain high standards of business ethics, honesty, openness and accountability. Reporting channels for whistleblowing should be clear and procedures should promote individual responsibility. How bribery and any other illegal behaviour is tackled should also be reported.

The responsibility of setting out an internal audit function lies with the audit committee. However, LGIM supports a company deciding to have a separate risk committee, particularly in financial institutions and high risks sectors, as they would benefit from having an independent oversight on the financial, operational and reputational risks taken by the business.

The internal audit function should also carry out extensive due diligence when considering related-party transactions. LGIM will not support such deals if they negatively impact shareholder value.

EXTERNAL AUDIT
An external audit is the verification of the financial statements of a company by its auditors. The opinion of the auditors is to provide assurance that the financial statements are presented fairly and give a fair view of the financial health of the company. The external auditors are also responsible for producing the auditors’ report which is a formal opinion and evaluation of the financial statements.

The board is responsible for appointing the company’s external auditor and LGIM expects the role of the external auditor to be put out to tender on a regular basis.

Furthermore, disclosure on non-audit related services should be disclosed fully in the company’s report and accounts (e.g. consultancy work, tax). LGIM does not expect excessive non-audit work to be conducted by the company’s external auditors because this will bring into question their independent judgement. LGIM will enquire about any work that goes beyond auditing and the safeguards in place in order to retain this independence.

LGIM takes the view that auditor liability should be proportionately measured whereby each party is liable for a portion of the loss corresponding with their responsibility for it. LGIM is not supportive of a fixed cap as there is no certainty that the calculation methodology used reflects the true underlying cost to shareholders.

If the report and accounts receives a qualified opinion from the company’s auditors, LGIM would expect a full explanation as to why this is the case.

BOARD OVERSIGHT
By acting as an independent watchdog over the company’s audit affairs, the audit committee should receive reports from internal and external auditors in order to be able to conduct a review of the effectiveness of this audit function. It is also the responsibility of the audit committee to monitor the implementation of the auditor’s recommendations and to oversee the audit service.
Audit & Risk

CYBER SECURITY

Cyber attacks are a reality for many large organisations today – the UK government highlights these as threats equal to natural hazards or terrorist incidents. Insufficient security can mean many things – from the loss of confidential client records to corporate espionage – and can have significant financial implications. As such, this represents a significant financial and operational risk to the companies in which we invest. We don’t see this as an issue that can simply be delegated to the IT function of an organisation.

We believe that a company should take a risk-based approach to the issue and therefore the board should be assessing this matter strategically. It is the board’s role to understand the infrastructure needed in the business to protect valuable information assets and key intellectual property. Therefore, during our engagement with companies, we have been discussing the board’s approach to assessing cyber related issues and the impact on their business.
Remuneration

INTRODUCTION
Remuneration levels should be sufficient to recruit, incentivise and retain directors of the quality required to manage the company successfully. Due to the substantial upward trend in remuneration levels, LGIM seeks improved disclosure and justification of chosen remuneration structures and levels. Additional explanation is required if the company uses benchmark data and the link between performance targets selected and the strategy should also be fully explained. LGIM expects a significant proportion of remuneration to be variable and long-term and to be dependent on rigorous and transparent performance conditions. LGIM believes that strong long-term alignment with shareholders is crucial to delivering sustainable earnings and maximising value.

Remuneration practices vary from country to country and therefore details of LGIM’s expectations are covered in more depth in the country-specific policies. However, some common themes are outlined below.

BASE SALARY
We would expect a base salary for executives to be commensurate with the size and complexity of the company and although salary levels at peer companies should be considered, these should not set a definite benchmark.

LGIM expects companies to exercise caution when setting salary levels and to consider what the impact may be of significant pay increases. All increases to salary levels should be explained in the remuneration report. Non-executive directors’ fees should reflect the level of responsibility and time commitment of the role. These fees could be paid in shares, but share options or other performance related pay should not be awarded.

ANNUAL BONUS
LGIM believes that annual bonusus should be geared to delivering the strategy of the business. Achieving a threshold level of financial performance should be a pre-requisite for payment of any bonus that is based on personal objectives. LGIM would expect companies that are exposed to high levels of environmental, social or reputational risk to include relevant targets that focus on management in mitigating these risks.

LONG TERM INCENTIVES
LGIM believes that a company should motivate and reward executives for long-term performance. An example of this could be the granting of long-term equity incentives which will align directors’ interests with those of long-term shareholders. These incentives should be structured to motivate management to build a sustainable business which will generate positive returns to shareholders over the longer term. LGIM supports the use of share options, provided awards are not excessive and are linked to stretching performance conditions to determine the number of options that can be exercised.

Equity dilution
LGIM believes that strict guidelines should be adhered to in relation to the issuance of shares for incentive schemes, limiting potential dilution to shareholders. As a general rule, LGIM expects no more than 10% of a company’s equity to be used for all share schemes over a 10 year period and no more than 5% in 10 years for discretionary schemes. The annual run rate or burn rate should also be reasonable, approximately 1%.

These limits may vary in certain regions and any variance will be highlighted in the relevant regional policy. Treasury shares should be included within these limits. Such restrictions should apply to all shares whether they are market purchased or newly issued. LGIM encourages companies to provide transparent explanations regarding the issuance of shares and for share schemes to have performance conditions attached.
Remuneration

SERVICE CONTRACTS AND TERMINATION PAYMENTS
Executive contracts should provide for a maximum notice of 12 months. If the company requires a longer term for recruitment purposes then the period should reduce each month until the 12 month term is reached. LGIM does not support provisions within service contracts that enhance contractual terms for loss of office following a change in control.

Contracts of key people should not only set out the details of the job description and what is expected of them. Contracts should also include a claw-back and mitigation clause.

BENCHMARKING
When setting remuneration, the remuneration committee should take into consideration the size of the company and its performance relative to its peers. When benchmarking information is considered the committee should take into account the geographic spread, size and profitability of the companies in the benchmark group. This group should not be too large or too small as both extremes would produce misleading results. Directors at underperforming companies should not expect to be remunerated as highly as directors of companies with outstanding performance.

DISCLOSURE
LGIM considers that transparency surrounding a company’s remuneration policy and report is a key governance element as it allows shareholders to judge whether remuneration levels are fair, appropriately reflect performance, and are linked to the company’s strategy.

LGIM encourages the use of a table in the remuneration report to highlight the total pay earned during the year. This should include salary, bonus earned, cash value of benefits, pension, and face value of any vested options, restricted stock, or other share award.

On a more forward looking basis, shareholders should be informed of the targets set for any discretionary awards that are to be made in the current year, why those targets were chosen and the expected outcome.

SHAREHOLDING GUIDELINES
LGIM expects companies to encourage its directors and senior executives to build up and to retain a meaningful interest in the shares of the company they manage. This is an essential part of aligning directors’ interests with those of shareholders. The level of shareholding should be linked to the size of the company and the level of reward that the director receives.

PENSIONS
Pensions are a significant cost and risk for a company as well as an element of remuneration that is not linked to performance, therefore the cost of providing a pension should be taken into account when evaluating a remuneration package. LGIM will not support pension enhancement payments at retirement or when a contract is terminated early. Additionally, LGIM will not advocate an individual being compensated for changes in tax. Companies should aim to reduce their pension fund liabilities and costs when recruiting new executives.

Pension provisions should be disclosed in full in the report and accounts and any changes to pension benefits should be fully identified and explained.
Shareholder Rights

INTRODUCTION
The rights of shareholders are a fundamental element of corporate governance as they ensure the protection of shareholders as well as allowing shareholders fair access to a company.

DIALOGUE WITH SHAREHOLDERS
LGIM expects a company to be available to enter into dialogue with its shareholders based on the mutual understanding of objectives. Companies should be pro-active in ensuring that important issues are conveyed to shareholders, whilst taking into account inside information rules. LGIM’s structure allows the Corporate Governance Team to receive inside information and provide helpful advice to companies from an investor perspective, without impacting the ability of PMs to deal in the company’s shares.

SHARE ISSUANCE
LGIM supports a company’s entitlement to issue shares to raise capital, but such issuances should be limited to what is necessary to maintain business operations. Pre-emption is the right conveyed to shareholders to be offered any new shares, pro-rata to their existing holdings, ahead of these being offered to non-shareholders. Pre-emption rights are a fundamental right for shareholders to protect their investment in a company. These limits differ in each region so please see the regional policies for more information.

SHARE REPURCHASE
LGIM will encourage a company to return cash to shareholders via a special dividend if it holds a significant amount of cash on its balance sheet that is not required to fund its working capital or for future acquisitions. LGIM believes that not keeping excessive amounts of cash is prudent capital management. A share buyback could be used if appropriate but this will depend on the price of the shares as we would not encourage companies to undertake a buyback if the company is highly valued. Some regions have an annual limit on the amount of shares that can be bought back in any year which is discussed in the relevant policy.

VOTING RIGHTS
LGIM supports the “one share one vote” policy and favours a share structure where all shares have equal voting rights. LGIM does not support the issue of shares with enhanced or impaired voting rights. In some markets, however, differential voting rights is a long standing structure and where this exists the structure should be transparently disclosed. In the case of controlled companies, LGIM will review the issuance of shares with enhanced voting rights to understand why these would be necessary. In general, LGIM encourages companies to eliminate differential voting rights over time.

MERGERS AND ACQUISITIONS
LGIM will normally support a proposal that will create shareholder value, provided the financial terms, quality of management and benefits to synergy are superior. In a majority of cases LGIM will support management if the deal is value creative for shareholders, makes strategic sense, and is considered beneficial to both parties.

The impact of any pension deficits, which may arise through mergers and acquisitions, should be carefully managed as it can have a significant impact on the company’s financial health.

POISON PILLS
Poison pill is the term given to an artificial device implemented by a company to deter takeover bids. A company may implement a poison pill to strengthen its negotiating position in a takeover situation but this would only be beneficial if the board is more concerned with shareholder value than with protecting its own position. Some markets utilise shares which have enhanced voting rights to block mergers and acquisitions which is in effect a poison pill. LGIM will not support a poison pill if it entrenches management and protects the company from market pressures which is not in shareholders’ best interests.

POLITICAL DONATIONS
LGIM will not support direct donations to political parties by companies but appreciates that political dialogue is an important part of a company promoting and protecting its interests as well as contributing to the development of an effective regulatory environment. LGIM believes that companies should produce a report in this area, fully disclosing any political contributions, lobbying activity, and political involvement via trade associations. There should be increased transparency around the memberships and monies paid to trade associations and lobbying groups along with a clear explanation of how these associations benefit the causes the company supports and where the oversight of these relationships lies.

SHAREHOLDER PROPOSALS
LGIM considers all shareholder proposals tabled at a company’s AGM in the wider context of the corporate governance practices and in relation to the long-term benefits of shareholders. Companies should provide a meaningful discussion of the shareholder proposals to enable shareholders to make an informed judgement.
**Sustainability**

**INTRODUCTION**

As a major global investor, LGIM has a fundamental interest in ensuring that shareholder value is not eroded by a company’s failure to manage its impact on its natural and social environment. At the same time, LGIM believes that a company’s value can be enhanced over time through taking advantage of opportunities which arise from identifying efficiency in its operations.

The terms sustainability, corporate social responsibility, ethics, environment and social impact can be interpreted in numerous ways, leading to some confusion among stakeholders in understanding how companies should respond to external pressures. LGIM’s approach is to identify environmental and social risks that can impact the company’s bottom line and valuation in the long run. We are working with them to improve performance and processes in a way that ensures its operational health is maintained. In doing so, the overall standards for the sector in managing extra financial risks should improve as a whole. LGIM believes this approach is not only beneficial to the individual investee companies, but also to the people and natural environment affected as it becomes a catalyst to move the market towards internalising the true cost of business operations.

**ENVIRONMENTAL AND SOCIAL IMPACTS**

In order to demonstrate LGIM’s approach to identifying key engagement topics, the table below briefly summarises how sustainability concerns can potentially impact company operations:

<table>
<thead>
<tr>
<th>Environment</th>
<th>Direct/Indirect effect (regulatory changes apply to all categories)</th>
<th>Effects on investments (risks and opportunities)</th>
</tr>
</thead>
</table>
| Climate change & Energy| **DIRECT**: Flood, Drought, Volatile crop yield, Storms, Loss of flora & fauna, Water availability  
**INDIRECT**: Economic damage cost, Migration, Political instability, Impact on health | Cost of energy/alternative energy  
Cost of carbon  
Productivity  
Tax/Subsidies  
Need for new technologies  
Infrastructure requirements |
| Water scarcity/quality | **DIRECT**: Access to good quality water  
**INDIRECT**: Political instability, Agricultural output, Migration, Dependence on GM, Community protest | Cost of water and land  
Recycling and transport costs  
Loss of licence to operate  
Need for new technologies  
Infrastructure requirements  
Tax/Penalty/Subsidies |
| Biodiversity/Forestry  | **DIRECT**: Loss of fauna & flora, Breakdown of ecology  
**INDIRECT**: Limits on deforestation, Natural reserves | Access to land and resources  
Tax/Penalty/Subsidies  
Limits on transportation |
| Other resource scarcity| **DIRECT**: Hydro carbon, Minerals and metals, Fishery  
**INDIRECT**: Political instability, Marine nurseries, | Cost of commodities  
Higher competition  
Need for alternatives  
Tax/Penalty/Subsidies |
| Waste                  | **DIRECT**: Lack of landfill space, Disposal facilities  
**INDIRECT**: Recycling requirements | Cost of disposal/recycling,  
Raised cost of virgin material  
Need for alternatives  
New product designs  
Tax/Penalty/Subsidies |
| General pollution      | **DIRECT**: Impacts on air, noise, water, soil  
**INDIRECT**: Health, community protest | Tax/Penalty/Subsidies  
Loss of licence to operate  
Need for new technologies |
Sustainability

<table>
<thead>
<tr>
<th>Society</th>
<th>Direct/Indirect effect (regulatory changes apply to all categories)</th>
<th>Effects on investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human capital</td>
<td>Skill shortages, Epidemic, Demographic changes, Migration</td>
<td>Talent withdrawal, Cost of labour, Cost of turnover, Cost of training</td>
</tr>
<tr>
<td>Health &amp; Safety</td>
<td>Accidents, Injuries, Sick days</td>
<td>Liabilities/penalties, Cost of turnover, Loss time due to injury, Licence to operate, Cost of healthcare, Additional safety equipments, Back-up requirements</td>
</tr>
<tr>
<td>Human rights</td>
<td>Inequality, Diversity, Sabotage/strikes, Emerging market practises</td>
<td>Loss of customer loyalty, Loss of workers, Loss of contracts, Licence to operate</td>
</tr>
<tr>
<td>Supply chain management</td>
<td>Procurement control, Product life cycle assessment</td>
<td>Competitive advantage, Cost of production, Speed of delivery, Efficiently losses/gains</td>
</tr>
<tr>
<td>Community engagement</td>
<td>Sabotage, Protests, Image building</td>
<td>Licence to operate, Community expenditure, Reputation/brand, Talent pull</td>
</tr>
<tr>
<td>Corruption &amp; Bribery</td>
<td>Illegal deals, Reliance on certain regimes</td>
<td>Liabilities/penalties, Bribery cost, Reputational damages, Licence to operate</td>
</tr>
<tr>
<td>Public health</td>
<td>Access to medicine, Demographic changes, Pandemic</td>
<td>Coverage and cost of health provision, Regulatory changes</td>
</tr>
</tbody>
</table>

Please note these are not exhaustive lists of societal impacts, but a demonstration of possible links between companies’ external environment and financial impacts.

DEMONSTRATION ON SUSTAINABILITY COMMITMENT

While there is no “one-size-fits-all” solution to building a sustainability business model, LGIM looks for the following commitment from the companies to demonstrate that sustainability is effectively integrated into the company’s long term strategy.

- **Identification of material risks**
  Material risk analysis is particularly important for companies with global operations and numerous business segments. Dynamic risk mapping exercise should identify the degree to which a company is exposed to each risk element. It should also be used to identify business opportunities such as new products, services, efficiency gain potentials in changing environments.

- **Linking sustainability to overall business strategy**
  Building a sustainable model should be at the core of business strategy, rather than seen as a side element in the form of ethical obligations. Where the material risks and opportunities have been identified, there should be a clear link to the overall business framework.

- **Accountability at the board level**
  Failure in managing its people and external environment should be accountable to all employees including the board members. Sustainability commitment should form part of the responsibility of the CEO and that board executive remuneration should have links to its achievements.
Sustainability

- **Policies to mitigate key risks**
  Where risks have been identified for the business, robust and comprehensive policy statements should be disclosed to all stakeholders to demonstrate the company’s commitment.

- **Demonstrative management systems**
  Systems and procedures in place should be applied all business operations which can be considered at risk. Where possible, such systems should be externally verified.

- **Meaningful and challenging targets**
  While it is important for the targets to be achievable, companies may benefit from setting challenging goals in order to maximise overall benefit.

- **Public disclosure**
  Commitment, systems, and performance should be clearly stated in the annual report and accounts, with supplementary information in sustainability reports and on websites. Disclosure on key data should follow best international guidelines, such as GRI (Global Reporting Initiative) and CDP (Carbon Disclosure Project). Some key data such as greenhouse gas emissions should also be externally verified.

- **Industry and regulation engagement**
  Companies may benefit greatly from sharing knowledge and experience with their peers by joining and contributing to industry-wide associations. They may also engage with regulatory bodies to promote best practices.

- **Quantitative gains**
  Companies can achieve a net benefit in managing sustainability impacts effectively, which is why LGIM encourages companies to demonstrate a commitment to best sustainability practices. Where possible, they should seek to quantify the impact in financial terms to internalise the associated costs and benefits.

In summary, we are committed to enhancing long term shareholder value by engaging with companies on a range of sector-specific issues. We look for evidence that they are operating appropriately within the social and natural environment while maximising opportunities as they develop. We engage directly and through collaborative means with the ultimate objective of helping companies build a more sustainable model, which will be of longer term benefit to shareholders.

**INVESTMENT OPTIONS**

LGIM believes that its approach to ‘responsible ownership’ is beneficial to all investors, regardless of the type of investments they hold; for example, active or passive, conventional, or ethically screened portfolios.

An example of LGIM’s drive for sustainability within conventional funds lies in the property fund range. The environmental and social sustainability of a portfolio of property has become increasingly linked with core business success. LGIM recognised this trend early and were the first in the industry to provide a six-month training course on sustainable property investment to all property fund managers. Further details on the sustainability record of LGIM Property funds can be found at [http://www.lgim.com/property/about-us/sustainability/](http://www.lgim.com/property/about-us/sustainability/).

Also in the equity and fixed income range, LGIM offers funds for clients who have ethical, social and environment screening criteria, a number of segregated mandates for institutional clients with customised negative screening criteria to suit their investment requirements. Similarly, for retail clients, an ethically screened fund and an environmental opportunity fund are available as part of the thematic fund range.
Approved on: January 2016.

CONTACT US

For any further information on anything you have read in this report or to give us feedback, please contact us at corporategovernance@lgim.com. Please visit our website www.lgim.com/corporategovernance where you will also find more information including frequently asked questions.

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