

# Corporate Governance Guidelines (CGG)

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These guidelines set out expectations of investee companies in terms of good corporate governance. They apply to holdings in funds managed in the Europe, Middle East and Africa (EMEA) region.<sup>1</sup> They also apply to voting undertaken on behalf of clients of our **reo**<sup>®</sup> (responsible engagement overlay) engagement service.

The voting policies are applied to all institutional client portfolios within the context outlined above. However, each of these institutional clients has ultimate control over the determination and execution of voting policy with regard to their assets. A voting stance may be recommended but the client may choose to vote otherwise. In cases where an individual client's voting preference is at odds with the recommended position, it will be applied solely to that client's funds, and shall under no circumstances apply to the voting instructions issued on behalf of other client portfolios. A full report of their funds' voting record is available to institutional clients on a quarterly basis. The clients have the option of publishing it if they wish. All voting records are disclosed the day after the shareholder meeting on the website.<sup>2</sup> These voting and governance policies underpin our engagement activities with investee companies, and guide our voting at annual general meetings (AGMs) and extraordinary general meetings (EGMs).

Under normal circumstances this document is updated annually, to reflect regulatory changes, evolving market practices and any other relevant developments.

In addition to these guidelines, general and country-specific voting guidelines are maintained and applied within the voting process. Voting guidelines are drawn from the Corporate Governance Guidelines, but are more granular in nature and provide greater detail on resolutions that will and will not be supported. In executing votes, where companies put forward a strong case for not complying with our voting guidelines, we will take this into account and adjust our vote if we believe the company is acting in the best interests of shareholders.

<sup>1</sup> There are certain exceptions. Separate governance policies currently apply to some assets managed by Pyrford International, Thames River (Thames River Capital LLP and Thames River Multi-Capital LLP), F&C Portugal S.A. and BMO Real Estate Partners. In some cases clients may not mandate us to vote or engage within a segregated account

<sup>2</sup> <http://vds.issproxy.com/SearchPage.php?CustomerID=3660>

# 1. Overview of key principles and approach

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These guidelines establish a consistent philosophy and approach to corporate governance and the exercising of voting rights. The approach is based on the overarching principles of:

- An empowered and effective board and management team;
- Appropriate checks and balances in company management structures;
- Effective systems of internal control and risk management covering all material risks, including social, environmental, ethical and governance issues;
- A commitment to promoting throughout the company a culture of transparency and accountability that is grounded in sound business ethics;
- Remuneration policies that reward the creation of long-term shareholder value through the achievement of corporate objectives; and
- A commitment to protecting the rights and interests of all shareholders in the company.

We recognise that such principles may be expressed differently in different markets. Therefore, our voting policies take account of local practices and are applied in a pragmatic fashion that reflects an integrated understanding of local and international good practice. In all cases, we aim to achieve the same result: the preservation and enhancement of long-term shareholder value through management accountability and transparency in reporting.

Achieving best practice in corporate governance is a dynamic process between the board, management and shareholders. We encourage companies to engage in the process of shaping and meeting evolving standards of best practice. Although our voting is strongly rooted in a clear set of corporate governance principles, it strives to approach each company's case on its merits and relies on staff expertise, discretion, and dialogue with companies to do so<sup>3</sup>. For this reason, we encourage companies to contact us with information about particular governance practices and challenges unique to the company. When we do not vote with the company's recommendations we may choose to inform the company of our voting decision and provides comments to explain the specific concerns with the resolutions that we did not support.

<sup>3</sup> These votes will usually be by proxy, except where specific circumstances make attendance by a representative of our company desirable.

## 2. Role, structure and operation of boards

We use the term “board” to cover the unitary board, the two-tier board and the unitary board supported by an executive body whose members may or may not be members of the public company board. The board is ultimately responsible for the management of the company. This is mainly achieved through the delegation of powers to the executive management. The board should receive the report of executive management on the conduct of the business, and it should question management on these matters. However, certain matters should be reserved for the board. It is responsible for setting and testing strategy proposed by the executive, determining risk appetite for the business, ensuring independence and effectiveness of external audit, and for succession planning of both the executive and the board as a whole.

The structure, composition and operation of boards will vary from country to country and company to company. Certain elements of effective boards are universal, and these are detailed below under the following sub-headings:

- Roles and independence;
- Competence, objectivity and renewal;
- Effective functioning of boards; and
- Communication and accountability to shareholders.

Other factors will vary depending on the nature of the company's business, its country of domicile, its size and complexity, its stage of development, its ownership structure, the goals of the board and the skills of the individuals on the board. Wherever possible, we will strive to reflect in our voting the individual circumstances facing each company, based on its understanding of how they may affect its long-term profitability. We welcome and encourage the initiative from companies to draw attention to specific areas where they believe departures from these guidelines are justified.

### Roles and independence

The composition of the board is of the utmost importance. Boards should have meaningful representation of both executive and non-executive directors. Non-executives should normally be wholly independent of the company, although we recognise that, in certain cases, connected non-executives have a valuable role to play. In building an effective board, the company should seek candidates from the widest pool of relevant talent so as to ensure properly informed board discussions.

### The role of the chairman and separation of principal roles

The chairman<sup>4</sup> sets the agenda of the board in consultation with the company secretary, the executive and the directors. He is the person ultimately responsible for the appointment and removal of the chief executive officer (CEO).

The roles of chairman and CEO are substantively different and generally should be separated. We regard separation of the roles as important for securing a proper balance of authority and responsibility between executive management and the board, and preserving accountability within the board. If for any reason the roles are combined, e.g. over an unexpected transitional period, this should be explained and justified in the report and accounts. In all such cases, a strong senior independent non-executive director should be nominated.

We would not expect a retiring CEO to assume the role of chairman. In such cases, we would look for reasoned justification from the company to explain this deviation from good practice.

### Executive directors

Including executives in board meetings is essential to enhance discussion and allow independent directors to gain the fullest understanding of company operations. We encourage the appointment of key executives to the board alongside the CEO and the chief financial officer (CFO). The presence of other executives provides additional company knowledge for the board and also ensures that the board is not solely dependent on the CEO for input relating to the company's operations and strategies. However, the number of executive directors should not outweigh the number of independent non-executives.

Boards that lack meaningful executive participation through board membership should use the board evaluation report to describe how the board achieves interaction between its directors and company executives.

<sup>4</sup> We recognise the widespread use of alternative terms to describe the role of chairman, including “Chairwoman”, “Chairperson” and “Chair”, and encourages companies to nominate competent male and female board members. For simplicity, we use the terms “chairman” and “he”, “his” and “him” irrespective of the gender of the individual or serving as chairman or as a board director.

## Non-executive directors

Non-executive directors have a valuable contribution to make to the development of the company. This is a demanding role.

We pay attention to the number of directorships an individual director holds, and seek to be satisfied that directors have sufficient time and energy to discharge the role properly, particularly during occasions requiring exceptional commitments of time. Factors that determine the appropriate number of directorships are the size of the company, its complexity, its circumstances, other commitments that a director has and the results of board evaluation, among others. We consider that holding multiple directorships in large companies can be excessive for even a full-time non-executive director, especially if participating in board committees. Multiple directorships should be avoided for a full-time executive. For complex companies particularly in developed markets, we may vote against non-executive directors who hold more than four directorships. In emerging markets, where the pool of talent for non-executive directors may be limited we have a higher threshold, but may vote against non-executives who have over six directorships (not including directorships within a single corporate group). In addition, nominating committees should carefully consider the time required for other demanding leadership roles, such as the boards of private companies and large non-profit organisations.

## Proportion of non-executive directors on the board

Strong decisions arise from open and direct interplay between boards and company executives. It is important to have enough independent non-executive directors for an adequate diversity of views and to fulfil committee memberships. We expect all widely-held companies to have a majority of independent directors.

For companies with controlling shareholders, we encourage companies to have boards that have a majority of independent directors. However, in cases where the controlling or majority shareholder opts to put forward a majority of non-independent directors to the board, there should be a sufficient number of independent non-executives on the board to allow key committees – audit, remuneration and nomination—to operate with independence. For this to be achieved we would, in most cases, expect there to be a minimum one-third fully independent directors on the board.

## Independence of non-executive directors

Independence of individual directors is valued, but a well-balanced board is valued above all. We will support non-independent directors when they bring skills, sector knowledge and other experience that justify their presence on the board, particularly where the appropriate balance of independence is maintained.

The criteria for the independence of directors draw on a variety of standards, including the OECD Principles of Corporate Governance, national corporate governance codes, listing rules and guidance given by the International Corporate Governance Network, among others. We favour a principles-based approach, which seeks to ensure that directors are able to act in the interests of the company and its shareholders. Companies should consider using the corporate governance report or annual proxy to explain the board evaluation process, and to justify the value that non-independent directors bring to the board.

For public companies, independent non-executive directors should:

- Not be former executives of the company. We do not support the idea of a “cooling off” period for former executives, although in the case of individuals who have served in a junior capacity, a hiatus may be appropriate;
- Not have close family ties with the company’s advisors, directors or senior employees;
- Not have served on the board for more than 12 years, as they may lose their independent perspective;
- Not hold cross-directorships or have significant links with other directors (see ‘Interlocking boards’ below);
- Not be major shareholders or representatives of any special interest group, including government representatives in cases of state ownership or representatives of affiliated companies;
- Have no significant commercial involvement with the company as professional advisers, major suppliers or customers;
- Not be entitled to performance-related pay, stock options, pensions, or benefit from large donations to charitable causes of their choice;
- Not normally hold other directorships in companies in a closely-related industry.

## Interlocking boards

We seek to ensure that directors are not only independent from the company, but also of one another. We expect companies to disclose interlocking board relationships and to explain how the independence of individual directors is preserved when directors jointly serve on two or more of the same boards<sup>5</sup>.

<sup>5</sup> Such interlocking relationships can raise concerns when there is an imbalance of power between the two directors. The most common situation is when one of the individuals is an executive on the first board, and, therefore, is evaluated and remunerated by his fellow director. Therefore, on the second board where he is expected to serve as an independent non-executive, his independence may be compromised.

## Extensive board service and independence

Prolonged membership on a board jeopardises independence as directors may become close with management and overly invested in prior strategic decisions. After a certain length of board service, directors may not be considered fully independent and it may be inappropriate for such directors to serve on committees, such as the audit committee, where independence is a key criterion. We recognise that there is no fixed time period that can automatically trigger a director's loss of independence, but use a 12-year benchmark as a general guidance. If a board values such a director's experienced perspective, he should be considered an affiliated director.

Effective boards rely on directors with fresh perspectives. While balanced boards may include some long-standing directors, boards should strive to have a substantial majority of directors with less than 12 years' tenure to prevent board entrenchment. The nominating committee should review the mix of new and long-standing directors necessary to achieve a balanced board. We consider that no more than one-third of non-executive directors should have served for more than 12 years.

In markets where board entrenchment is widespread and considered a significant governance risk, we encourage companies to establish tenure limits for non-executive directors, and to adopt a pro-active approach to non-executive succession planning and board refreshment.

## Independence of employee representatives

While a number of countries have legislation mandating a certain percentage of employee representatives on the board, we do not consider these individuals to be fully independent. Hence, we expect companies domiciled in countries with mandatory co-determination or employee representation to ensure that the board and its committees have adequate representation of truly independent directors.

## Other associations that might impact independence

The nominating committee should also evaluate the impact that other relationships between directors might have on their independence. For instance, relationships through academic institutions, charities, or social clubs could impact independence and should be reviewed during the director evaluation process.

## Competence, objectivity and renewal

### Diversity, competencies and perspectives

A relevant and suitably diverse mix of skills and perspectives is critical to the quality of the board and the strategic direction of the company. Companies should therefore strive to widen the pool of potential candidates for board and management roles to ensure that they draw on the richest possible combination of competencies and outlooks. In particular we believe that the promotion of gender diversity is important as part of enhancing long-term board effectiveness. The use of specialist recruitment consultants, who are willing and capable of producing candidate lists with desired diversity characteristics, and other appropriate sources, including public advertisement, should be considered.

In all cases, candidates must be selected for their ability to enhance company performance. Boards should recruit members with the required combination of skills and experience, and should affirm the value of individual diversity, including diversity of gender, ethnic origin, nationality, professional background and many other factors that may enhance the board's overall performance. While boards cannot be transformed overnight, we look for a statement that sets out the board's approach to promoting diversity at the board and executive management level and throughout the company. We welcome disclosure of specific diversity targets set by the board and reporting on performance against these targets.

### Re-election of directors

To ensure that it retains an open and critical perspective, the board needs to be continually renewed. For this reason, all directors should be required to submit themselves for re-election at regular intervals. We prefer to have all directors standing for annual election to strengthen the accountability of the board to shareholders. Failing that, we encourage the chairman of the board, as well as the chairmen of the audit, remuneration and nomination committees to stand for annual re-election to strengthen accountability on the core functions of the board. We also believe that a minimum of one-third of board members should stand for election annually.

After 12 years, directors should be subject to annual re-election. In many jurisdictions, local law allows shareholders to propose a shareholder resolution for removing a director or local codes of governance best practice recommend tenure limits to ensure boards are subject to continual refreshment. Where this is not the case, all directors should be required to submit themselves for annual re-election. Where companies do not facilitate such a process, we may withhold our support from the chairman of the nomination or governance committee or, where such a committee does not exist, the chairman of the board.

## Nomination of directors

We strongly believe that a board nominating committee composed of a majority of independent non-executive directors is best placed to identify and put forward suitable candidates for the board. Shareholders should only put forward candidates where there is clear evidence of ineffective board oversight and unwillingness to correct the problem or where a cumulative voting system or similar arrangements encourage direct shareholder participation in board nominations. We expect companies to put forward only one candidate for each available position as an indication that the company is clear about the value individual directors bring to the board. We encourage companies to specify the candidate's qualifications, experience and skills that are of particular relevance and importance to the board.

## Balanced composition

We will consider voting against the chairman or members of nominating committees who have not constructed appropriately balanced, independent boards. Indicators include: an over-reliance on long-standing members where one-third of non-executive directors have served for more than 12 years; an over-reliance on affiliated directors; and a lack of appropriate diversity characteristics, including gender, race, nationality, ethnicity, etc, that reflect the nature, scope and aspirations of the business. We consider that extended service on the board erodes non-executives' independence due to their involvement in previous business decisions. Therefore, after 12 years, directors should be subject to annual re-election, and should not serve on key board committees.

## Retiring directors

We would not normally expect a retiring executive director to retain a seat on the board as a non-executive director, except in highly unusual circumstances. However, for two-tier boards, we recognise that there may be instances in which the contribution of former directors will be valuable in enhancing the supervisory board's understanding of the business. In such cases, we would accept that no more than one member of the supervisory board be a retiring executive, but would expect that all other members be fully independent. Particular scrutiny would apply in the case of retiring CEOs if nominated for chairman (See "Role of chairman" above).

## Effective functioning of boards

### Board size

In the case of a two-tier board structure, neither board should be large: between five and 10 members typically is appropriate. A unitary board normally should have between five and 15 members. In the case of overly large boards and in the absence of a commitment to reduce board size, we may withhold support from one or more directors, unless clear justification has been provided explaining the need for such a large board.

### Two-tier boards

We are agnostic as to the merits of a two-tier board as opposed to a unitary board, and we recognise that a two-tier board structure is the norm in many markets. At the same time, we are aware that there can be challenges in communication between a supervisory board and a management board. Where there is more than one body forming the board, companies should maintain an effective mechanism for the various elements of the board to work together, and should explain how this happens. This system should ensure that the most effective use is made of all the individuals involved in the governance process, so that companies can capitalise on the unique skills and experiences of their directors.

### Board evaluation

Evaluation is an important tool for improving board performance. All boards should implement an evaluation process that considers the effectiveness of the entire board, the contributions made by each member, its systems for interaction between the board and company management and any areas for improvement. The nominating or governance committee may oversee the evaluation process and should report general findings and areas for improvement publicly to shareholders. All companies should utilise professional assistance to facilitate evaluations on a periodic basis.

### Board meetings & attendance

The board should meet at regular intervals to ensure effective oversight of the company. We regard six meetings per year as a minimum guidance, and often more frequent meetings are necessary.

Director attendance at board meetings is crucial for making valuable contributions to the board and fulfilling fiduciary duties. We also expect directors to attend the annual meeting, and to facilitate communication with the shareholders whom they represent. The company should disclose the attendance record of individual directors in the annual report, as well as mechanisms for shareholders to communicate directly with the board. We may withhold support from directors with a poor attendance record or boards who fail to accommodate shareholder dialogue.



### **Non-executive director (NED) only meetings**

NEDs should meet without executive board members present on a regular basis and when circumstances demand. They should also have at least one meeting per year to hold an unconstrained discussion away from day-to-day business matters. Ideally, this should be chaired by a senior or lead independent director, although the chairman may be present provided he is a non-executive. Conversely, in the case of two-tiered boards, supervisory boards should meet with executives on a regular basis to minimise the risk that NEDs will become marginalised from the business.

### **Training**

All directors should receive appropriate training when appointed, and subsequently on regular occasions, in particular as a consequence of the board evaluation process. We encourage companies to develop director training plans that include educating directors on relevant environmental, social and governance matters.

### **Role of the corporate secretary**

The corporate or company secretary provides an important conduit for shareholders to address the board, and communicate with non-executive directors. The company secretary is responsible to the board of the company rather than the company's management, and should therefore be appointed and employed specifically by the board as a whole, rather than by the company. The board as a whole is the only body that should have the authority to dismiss the corporate secretary.

### **Communication and accountability to shareholders**

The board should proactively make itself available for consultation with shareholders on any substantive matter, whether or not it forms the subject of a vote, and should, to this end, appoint a senior or lead independent director to fulfil a formal liaison role. This is most important in cases where the CEO also holds the Chairman position, the Chairman has executive responsibilities or was not independent on appointment. Directors should consult shareholders, particularly the company's principal institutional shareholders, prior to seeking approval for resolutions at the annual general meeting (AGM) and other meetings where any resolution could be considered contentious or consultation is otherwise deemed appropriate.

The NEDs should also seek to establish lines of communication with the principal institutional shareholders, in separate meetings and by joining periodically the regular meetings that executive directors hold with institutional shareholders. In particular, we have been advocating that companies adopt a communications forum in which company NEDs can interact with shareholders about matters relating to governance ahead of annual general meetings.

## 3. Board Committees

We encourage companies to move towards fully independent audit and remuneration committees, as well as a nomination committee composed of a majority of independent directors. All board committees should report on their activities annually to shareholders (see section on “Reporting” below).

### Audit

The audit committee provides an important safeguard for shareholders and for other stakeholders that rely upon the integrity of the report and accounts as a basis for their dealings with the company.

The audit committee should consist exclusively of NEDs, all of whom should be independent, and number at least three individuals. At least one should have recent and relevant financial, accounting or audit experience, and all audit committee members should be financially literate. The committee should be responsible for assessing the effectiveness, independence, qualifications, expertise and resources of the external auditors as well as the quality of audit, and oversee the process of review and issue of the accounts.

If there is no formal risk management committee in place, the audit committee normally should be accountable for the proper oversight of risk management and internal controls. This includes reviewing all significant financial and extra-financial risks.

The audit committee should also be responsible for monitoring and approving related-party transactions, and should ensure that any material related-party transactions do not disadvantage minority shareholders. If the audit committee includes non-independent directors, the review of related party transactions should be conducted exclusively by independent audit committee members. This is particularly important for related party transactions that involve executive management or controlling shareholders.

In countries where it is not customary to have a board audit committee (such as Italy, Japan and Brazil), the individual statutory auditors should be independent and fulfil the role of the committee. We do not consider this system to be as robust, since it separates the audit oversight from the core responsibility inherent in being a director.

The audit committee is also responsible for publishing the annual audit report, which is essential for investors’ ability to evaluate the overall health of the business (see section on “Reporting” below). In the event of a significant restatement of accounts or material weakness in internal controls, the chairman of the audit committee, possibly in conjunction with the senior auditor, should make himself available to shareholders upon request.

### Remuneration

The remuneration committee is responsible for setting the remuneration of executive directors and senior executives and should co-ordinate with the company’s human resources function to develop a coherent and effective remuneration strategy throughout the company. As a best practice we believe that remuneration committees should consist exclusively of independent non-executive directors. We encourage remuneration committees to engage in direct dialogue with their largest institutional shareholders so as to seek their input in developing remuneration policies. (See “Remuneration Committee Report” below).

The remuneration committee must consult with other board functions to ensure that pay mechanisms are well aligned with strategic goals and the corporation’s appetite for risk. In particular it must work with the board to determine the appropriate balance in the allocation of profits to employees as incentive payment, to shareholders as dividends and for retention or reinvestment in the business itself. The committee’s fiduciary duty is also to ensure that the quantum of payment to management is fair and appropriate. Finally, the committee should be attentive to compensation across the corporation to assure itself that management is driving risk and strategy properly and addressing other important issues linked to pay such as discrimination and glass ceilings.

### Nomination

A nomination committee should oversee all board and senior executive appointments. Normally it should be a committee of independent non-executive directors and the company chairman, drawing on executive advice as required. We prefer a fully independent committee. However, we recognise that in some instances, a non-independent director or representative of a large shareholder may be appropriate.

### Corporate governance

We recognise that companies may choose to have the nominating committee or a specific corporate governance committee responsible for corporate governance practices and procedures. Regardless of the structure, the committee should monitor emerging regulatory and industry standards, strive to achieve global good practice and should consult with institutional shareholders to understand investor expectations.

### **Corporate responsibility and sustainability**

We believe that a corporate responsibility, ethics or sustainability committees are highly desirable. In some cases, such as those of large companies exposed to significant social and environmental risks, they are essential. Such committees should both serve as a source of external perspectives on emerging business and societal concerns, and ensure that the company has proper internal control systems to identify and manage any risks that such issues may pose to the business.

### **Business ethics**

Whether it is through a committee such as the audit committee or a general board review, it is important that the board affirm its responsibility for reviewing internal business ethics systems, and ensuring that there is an effective mechanism for the internal reporting of wrongdoing, whether within the company itself, or involving other parties, such as suppliers, customers, contractors or business partners. Particularly given extraterritorial anticorruption legislation – such as the US Foreign Corrupt Practices Act and the UK Bribery Act – there is scope for more rigorous enforcement of bribery and corruption. As a result, anticorruption measures should come under particular scrutiny by the board. Business ethics control systems should include employee hotlines and other appropriate “whistleblowing” mechanisms related to financial fraud and any other breach of company policies and ethical codes. The audit committee may serve as the body to receive whistleblowing reports where no other acceptable body exists.

## 4. Remuneration

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Levels of remuneration and other incentives should be designed to promote the long-term success of the company and reflect the work carried out and the executives' contribution to the company. No director should be involved in setting his own remuneration. Given the strong upward trend in total remuneration, we expect a careful use and robust justification of benchmarks and comprehensive disclosure of performance targets as well as actual performance against pre-set targets. We also expect justification of base pay levels awarded, and that a significant proportion of total remuneration should be variable and subject to appropriately challenging performance conditions. We do not set guidelines for levels of remuneration beyond the principles mentioned below.

### Quantum

We are aware that the quantum of pay has become a standalone issue in many markets, and has resulted in significant reputational and regulatory risks for companies and industries where pay levels were seen by regulators, investors and general public as excessive and insufficiently aligned with performance. We expect boards to demonstrate understanding of and sensitivity to the views and expectations of shareholders and other key stakeholders in their main markets when setting executive pay.

### Relationship to strategy and risk

We expect companies to demonstrate the alignment of their remuneration policy with their overall business strategy and planning. Performance metrics should relate to the company's articulated strategy and risk tolerance. Targets should be constructed to align executive incentives to the interests of long-term shareholders, and should not create incentives for executives to undertake short-term risks that might imperil longer-term performance. We advocate the introduction of risk-related underpins—or preconditions—to bonus awards, to ensure that in appropriate incentive payments are not awarded in the event the company's financial strength or credit quality might deteriorate.

### Disclosure

We seek appropriately detailed disclosure of board and management remuneration packages (See "Remuneration committee report" below). The purpose of the remuneration report should be to enlighten and enhance understanding; it should not be used simply as a compliance document. The annual remuneration report should disclose the total amount of remuneration including cash, options, stock and benefits that executives may receive under different performance scenarios.

Following the award of the bonus, companies should provide a meaningful analysis in the remuneration report of the extent to which the relevant targets were actually met. Pension arrangements for executives and employees should be disclosed in detail, including expected funding, pay-out scenarios and differences in contribution rates for executives and the general workforce. Companies should also include details on how, and in which cases, the remuneration committee might exercise its authority to withhold or reclaim all or part of non-base pay from executives. The remuneration report should be written in plain language and include the tax implications for the company.

At a minimum, the remuneration of all directors, including all non-executive and executive directors, should be disclosed individually. We look for banded disclosure of those individuals at sub-board level who make a significant contribution to the group. This enables shareholders to better understand the company's remuneration strategy and succession planning.

### Executive contracts

We encourage executive contracts not to be for more than 12 months, except in unusual cases, for example where an initial 24-month period is required for recruitment. In such cases, the notice period should reduce month by month until the agreed period of no more than 12 months is attained. We also believe that, prior to agreeing employment contracts, companies should actively consider the potential rewards on severance in the event of inadequate performance, and clarify the performance conditions under which such severance benefits are to be payable. We encourage companies to seek mitigation in case a director has taken up employment elsewhere and to adjust the length and size of any payments accordingly. We regard one year's base pay and pension entitlements as sufficient severance and recommend that companies make larger severance packages the subject of a shareholder vote.

## Share schemes

We believe that strict guidelines should be observed with regard to the issue, or potential issue, of shares for incentive schemes, both as to the proportion of shares issued and to the rate at which these are issued each year. By way of guidance, we would expect no more than a total of 10% of a company's equity to be used for all share schemes within a 10-year period, with no more than 5% being available for discretionary schemes during this period. Treasury shares should be included within these limits. Good practice is to include all shares used, whether market purchase or newly issued, within these limits. We will deviate from these limits where we are convinced that the commercial drivers outweigh the dilution impacts. If the company is insufficiently transparent regarding the details of such schemes, we may abstain or even vote against them.

## Equity Incentive Plans

We support the principle of motivating and rewarding executives through the granting of equity incentives.

Performance targets for equity incentive plans should be clearly disclosed and challenging. We believe that the remuneration committee is in the best position to determine the most appropriate performance metrics for driving the long-term business strategy. However, overall remuneration packages should reflect a range of performance targets and should not rely too heavily on the achievement of a single performance metric. In cases where a relative performance measure, such as total shareholder return, is employed, use of an absolute performance metric can serve as an underpin to ensure that rewards are scaled back when the company's overall performance suffers. Generally, we believe executive pay plans should reflect a balance of financial, operational, and relative performance targets.

We strongly believe that exceptional performance over a significant period merits an exceptional level of remuneration. We oppose retesting of performance conditions and may withhold support of remuneration plans where the remuneration committee has used its discretion to relax any performance targets previously approved by shareholders.

We will consider one-off equity awards on a case-by-case basis in light of justification provided by the company. However, frequent use of exceptional awards raises questions over the adequacy of the overall remuneration strategy and effectiveness of succession planning. We will take particular care when reviewing equity awards granted for the purposes of recruitment or retention when such awards are not linked to meaningful performance targets.

We encourage the inclusion of social, environmental and other non-financial goals for performance bonus payments where these factors have a significant impact on the company's performance. We also expect a discussion of the process undertaken by the company to identify such factors and an explanation as to why it considers these factors to be relevant. If the company chooses not to include any such factors in an industry where they are significant contributors to business success, the company should explain the reasons for this.

## Holding periods, vesting and malus/clawback policies

Bonus payments and long-term incentive schemes should be structured to reward long-term growth in shareholder value, and be subject to performance-vesting conditions. We encourage a portion of a short-term bonus to be satisfied in deferred shares. Longer-term incentive plans should be fully share-based, and vesting periods should extend from at least three to five years or longer. We also encourage companies to require longer-term holding periods post vesting. As an alternative to promote a long-term perspective, a strictly enforced shareholding requirement could be adopted. No shares could be sold until the shareholding requirement was met, and the requirement would be substantially higher than is currently typical – perhaps four to six times base salary.

The remuneration committee should maintain a "malus" authority to withhold all or part of performance-based pay from executives before it has vested in cases where it deems it appropriate. The remuneration committee should also have "clawback" authority to recover sums already paid out to executives. This might occur following a significant restatement of accounts, where previously granted awards were paid on the basis of inaccurate figures or where the long-term outcomes of a specific strategy result in significant value destruction for shareholders.

In particular, where representations that executives made to the audit committee about the integrity of controls have been revealed to be inaccurate, or where executives have failed to exercise due caution in the discharge of their duties, the company should consider seeking the reclamation of performance awards. Clawback policies may also be supplemented with extended deferral periods for share and bonus plans.

## Employee ownership

Widespread employee ownership can positively contribute to shareholder value, as it further aligns employees' interests with those of shareholders. Such devices should not, however, be instituted as anti-takeover devices, and should be included within company-wide dilution limits. While we generally support broad-based stock option plans, employee discounts should not exceed 20% on a fixed date, the company should not extend loans to purchase options, and options should not be re-priced without shareholder approval. Non-executive directors should not be entitled to options and therefore should not be included in any such schemes.

## 5. Audit, risk and control

We recommend that the independent members of the audit committee meet on a regular basis with the company's auditors and without company management. This may enable a better flow of information between auditors and the board.

### Appointment of auditors

The auditors' performance and appointment should be reviewed periodically. Where the same firm remains as auditor for a period of time, there should be a policy of regular rotation of the lead audit partner. We believe that systematic rotation of audit firms is both desirable and in the best interest of shareholders. Specifically, we encourage the practice of putting the audit contract out to tender every ten years.

We consider it to be desirable over the medium term to broaden the choice of auditors available to companies, and hence would encourage companies actively to consider using the broadest pool of audit firms wherever these can demonstrably meet the required standard of competence and global coverage. We expect audit quality to be the main consideration in the selection of the auditor and expect that shareholders should be given the opportunity to vote on the appointment and payment of auditors.

### Auditor liability

We recognise the disproportionate risk that joint & several liability may place upon audit firms. However, we will only consider supporting arrangements to cap auditor liability in exceptional circumstances, i.e. where the risk of a catastrophic and disproportionate claim can be demonstrated. In such circumstances, we expect companies to approach auditor liability in a manner consistent with the following guidelines:

1. Directors must assure themselves that audit quality will be preserved and enhanced.
2. Auditor liability should be based on the principle of proportionality rather than a fixed monetary cap.
3. Shareholder approval should be sought on a forward-looking rather than retrospective basis.
4. Audit committees should ensure that a full explanation of the reasons for putting such a resolution to shareholders is disclosed.
5. Directors should ensure that the effect of agreements throughout the group subsidiaries provide for proportionality.

### Fees paid to a company's auditors in addition to audit fees

Where auditors carry out consultancy work in addition to auditing the company, this should be disclosed and the audit

committee should consider whether there is a risk that an auditor's impartiality may be jeopardised. The range, nature and tendering process for any such non-audit work should be supervised by the audit committee, whose responsibilities in this area should be fully disclosed. While we generally discourage non-audit work to be undertaken by the company's auditor, it recognises that there are certain areas of non-audit work where the company's auditors may provide valuable expertise, without compromising independence. However, substantial non-audit fees, or non-audit fees in excess of audit fees, may be an indicator of compromised independence. In the event that non-audit fees exceed audit fees for more than one year, we may not support the reappointment of the auditor or the payment of auditor fees in its voting at AGMs.

### Related-party transactions

Many companies are involved in material related-party transactions, which represent a significant risk for minority shareholders. This risk is mitigated in companies with fully independent audit committees whose responsibility it is to ensure that such transactions are conducted on the basis of arms'-length valuations. We strongly encourage companies to establish such committees (see "Board committees" above) and to secure prior shareholder approval for material related-party transactions. In light of continued concerns, we recommend that each company disclose any shareholdings that its controlling shareholders may have in other companies or investment vehicles that have a material interest in the company.

### Risk management

The board as a whole is responsible for framing a company's risk tolerance relative to its strategy and operations, and is also responsible for monitoring the company's performance relative to defined risks. Financial, operational and reputational risks that are relevant to the company's business should be included in this oversight, including material environmental, social and ethical risks.

Depending on the size and complexity of the company, a standalone risk management committee might be warranted. We do not have a specific expectation that a company establish a risk management committee, but expect that in the absence of such a committee the board can demonstrate that it is alert to, and regularly monitors, company risks on an enterprise-wide basis. A risk management committee is a common feature of large bank boards, for example, but it need not be limited to financial institutions. However, a standalone risk committee may enhance board effectiveness in situations where the audit committee is already very stretched. It is a healthy practice for the board as a whole to review the company's risk management as a standing item of regular board meetings.



## 6. Shareholder rights

### Liaison with shareholders

Companies should be ready, where practicable, to enter into dialogue with institutional shareholders based on an understanding of shared objectives. They should be proactive in making sure important news is imparted, subject to appropriate inside information procedures, and should react helpfully to investor questions. In investment meetings with shareholders, companies should be prepared to address relevant corporate governance, environmental and social issues.

### Issuance of Shares

We respect a company's right to issue shares to raise capital. However, share issuance should be strictly limited to that which is necessary to maintain business operations and drive forward company strategy. We will not support requests to increase authorised share capital that exceed 50% of existing capital, unless specific justification has been provided (e.g. to complete an acquisition or undertake a stock split).

### Pre-emption Rights

We believe that pre-emption rights for existing shareholders are absolutely essential. Shares may be issued for cash without pre-emption or for remuneration purposes, subject to shareholder approval and to strict limits as to the proportion of shares issued in relation to the issued share capital, and also subject to flow rates. While practice varies globally, we normally consider appropriate limits in most developed and emerging markets to range between 5% and 10% in one year for general purposes. We will vote against requests to issue shares without pre-emption rights above these limits, unless companies have provided satisfactory justification.

Investment Trusts and similar closed-end companies should not issue new shares or reissue shares at a discount to net asset value (NAV), unless dilution is limited, the discount is limited to 5%, and any reissuance is at a lesser discount to NAV than the discount when such shares were originally purchased.

### Share repurchase

We expect companies to repurchase shares in the market when it is advantageous for the company and its shareholders. Authority to repurchase shares should be subject to shareholder approval, be limited to one year, and not exceed 10% of the issued equity. Any share repurchase must benefit all holders on equal terms taking account of options adjustments.

### Controlled companies and share classes with differential voting rights

We favour a share structure that gives all shares equal voting rights. We do not support the issue of shares with impaired or enhanced voting rights and are likely to withhold support for capital-raising by companies with a capital structure that involves unequal voting rights.

We recognise that in some markets, differential voting structures are long-standing and widespread. Where differential voting structures exist, this structure should be transparently disclosed to the market. In the case of controlled companies, we will review any request to issue shares with enhanced voting rights to determine why these are necessary and how they will reflect the interests of minority shareholders. We support the principle of one share, one vote, and encourage companies to take steps to eliminate differential voting structures over time or prevent their introduction.

### Voting caps

We oppose voting caps in principle and believes that all shares should be entitled to full voting rights irrespective of the holding period. However, we recognise the widespread use of voting caps in certain markets, and the benefits accruing to shareholders not subject to a cap. Therefore, at a minimum, we expect companies to disclose clearly any caps, and encourage them not to introduce new caps and to phase out existing caps over time.

### Mergers and acquisitions, spin-offs and other corporate restructuring

Takeover bids and corporate restructuring are important as a means to maintain an efficient and competitive environment. However, some bids do not add to shareholder value, so in contested takeover bids, normally, we will seek to discuss matters with management and the bidder. We expect boards to conduct thorough due diligence prior to pursuing any merger or acquisition and to seek to maximise shareholder value in any deal. We will normally support incumbent management, provided the financial terms, synergistic benefits, and management quality are sound.

We consider social and environmental risk implications of any corporate activity as part of its assessment, particularly in high-impact industries. It likewise expects the board to evaluate any potential social, environmental or ethical risks or liabilities of any business combination, including supply chains. We expect companies to take appropriate consultative measures with employees and communities affected by corporate restructuring.

### **Poison pills**

We regard artificial devices to deter bids, known as “poison pills,” as inappropriate and inefficient, unless they are strictly controlled and of very limited duration. In some markets, the use of shares with enhanced voting rights is common, and may be used to block mergers and acquisitions, thereby functioning as de facto poison pills. We believe that any control-enhancing mechanism or poison pill that entrenches management and insulates the company from market pressures is not in the interests of shareholders. As a result we will normally vote against such anti-takeover devices.

### **Pension and other similar significant corporate liabilities**

Companies should be aware of and report to shareholders on significant liabilities such as those arising from unfunded or under-funded pension commitments. The extent of the liability should be reported and the plans, if any, that have been put in place to cover the deficit should be reported, including a reasonable time scale for action. The principal assumptions used in calculating amounts should form part of this disclosure. Other significant liabilities could include specific operational, environmental or social risks that the company faces. The company should provide some indication of how these risks can result in contingent liabilities.

### **Shareholder resolutions**

We consider all shareholder resolutions that appear on the ballot and votes in accordance with our understanding of the long-term benefit to shareholders. Companies should always provide a comprehensive discussion of management’s position on all shareholder resolutions, and be available to respond to reasonable enquiries from shareholders (see “Liaison with shareholders” above)<sup>6</sup>.

<sup>6</sup> In circumstances where we have serious concerns about a company’s ESG practices and have been unsuccessful in establishing a fruitful dialogue, we may ourselves put forward resolutions to invite other shareholders to support calls for the adoption of better practices.



# 7. Reporting

The report and accounts (or annual report) is an important link in the chain of accountability. The annual report and any proxy voting materials should be made available to shareholders in good time for consideration and discussion prior to the general meeting. We look for a minimum of 20 working days. Such materials should be available in English and easily accessible, preferably on the company website.

Companies should have meaningful and transparent disclosure, so that investors can obtain a clear understanding of all important and relevant issues. The annual report should provide a full review of the business model and strategy; key performance indicators used to gauge how the company is progressing against its objectives; principal risks and any significant factors affecting the company's future performance, including any significant social, environmental or ethical issues; key achievements; and standards followed during the accounting period.

In all markets, we favour reports that are:

- **Comprehensive**, covering the strategic direction of the business and all material issues, including any significant changes in the regulatory context and key ESG issues;
- **Balanced**, with even-handed treatment of both good and bad aspects;
- **Transparent**, with narrative text that utilises plain language, and accounting notes that provide investors with a full understanding of the circumstances underlying the reported figures;
- **Underpinned by Key Performance Indicators (KPIs)** that drive business performance, are comparable over time, and are supported by detailed information on how they are calculated;
- **Consistent and joined-up** with other company reporting, including the remuneration policy and corporate responsibility or sustainability reporting.

## Directors

Adequate biographical information on the directors should be provided for shareholders in advance of the annual meeting. This should include information about directors' qualifications and experience, term of office, date of first appointment, level of independence, board committee memberships and other personal and professional commitments that may influence the quality of their contribution and independence, e.g. other directorships, family and social ties, and affiliations with related companies or organisations. For all newly appointed directors, we encourage disclosure of qualifications, experience and skills that are considered by the board to be of particular relevance and importance to the company.

## Nomination committee report

The committee should report annually on its activity, in particular providing a detailed discussion of its process for identifying and appointing executive and non-executive directors and the processes it employs to ensure that members reflect an appropriate diversity of perspectives, gender, experiences and cultural backgrounds. Where necessary, the report should include a thorough discussion of the board's view of the independence of certain members. The report should also include high-level results of the board evaluation process.

## Audit committee report

The audit committee should report on its conduct during the year and, in particular, on any specific matters of judgement relating to the application of accounting principles or the scope of the audit. It should also comment on the process for ensuring independence of the auditors and for evaluating the impact of non-audit work. The audit committee report should include a narrative description of any related-party transactions, with particular reference to how these might impact the interests of minority shareholders. Any qualification of the audit statement and all matters raised in the auditor's report need to be fully explained.

## System of internal controls and risk management

If the audit committee's purview includes risk management, the audit committee report should also address the board's oversight of enterprise-wide risks. Either as part of the audit committee report or a standalone report, the company should explain the results of the board's review of internal controls, including any identified or potential weaknesses in internal controls and how the board plans to respond to these.

## Remuneration committee report

We expect all companies to publish an annual remuneration report in line with international good governance standards. Good remuneration reporting outlines a company's overall philosophy and its policies and formulas for determining annual, short and long-term pay. We look for remuneration reports to break down fixed versus variable pay and clearly to align total pay packages with long-term shareholder value. The remuneration committee should clearly disclose specific long-term performance targets and total potential pay-outs. If short-term performance targets cannot be disclosed due to commercial sensitivity, we expect retrospective disclosure of short-term targets and of actual performance against these targets.

We recommend that all companies put the remuneration report to a shareholder vote, and encourage companies actively to consult their major shareholders prior to the general meeting. Our experience of voting on remuneration reports in the UK and other countries has shown that this is a valuable mechanism that improves dialogue and understanding between the board and shareholders.

#### **Corporate responsibility or sustainability committee report**

We encourage companies to report on any significant social, environmental or ethical risks and opportunities in their annual reports as well as the systems in place to manage these issues. This may be supported by more detailed disclosure, as appropriate, in a separate corporate responsibility or sustainability report (see Appendix 1).

#### **Code of corporate governance**

Companies should provide a full and clear statement of all matters relating to the application of the principles, sub-principles and provisions of the relevant national code of corporate governance. The way the provisions are put into effect should be clearly discussed, and any deviations supported by meaningful explanations.

#### **Code of conduct**

Companies should maintain and disclose a code of conduct reflecting corporate values and promoting ethical business practices. Such codes should address business-critical compliance issues including anticorruption practices.

#### **Reincorporation in a tax or governance haven**

We will typically vote against resolutions for a company to reincorporate in a new legal jurisdiction offering lower legal and governance protections to shareholders, regardless of whether this results in a lesser corporate tax burden. Aggressive tax strategies, even if structured legally, can pose potentially significant reputational and commercial risks for companies. We expect the company's board to ensure that the company's approach to tax policy is both prudent and sustainable, and to disclose to shareholders that the board is providing appropriate oversight over its tax policy. Companies should provide a suitable amount of information for investors to understand their tax practices and associated risks.

#### **Foreign listings**

Companies that have a listing on a US exchange must detail how they comply with the provisions of the Sarbanes-Oxley Act. Companies with a Standard listing on the London Stock Exchange should seek, wherever practicable, to comply with the corporate governance standards embodied in the UK Combined Code of Corporate Governance, or should highlight and explain the reasons for specific areas of non-compliance. Indeed, we encourage all issuers in the London market to seek a Premium listing. Where companies establish a secondary listing in any other market, they should explain any deviations from local governance practice where these exceed the governance requirements dictated by their primary listing.

#### **Shareholder resolutions and access to the proxy statement**

We encourage companies to engage in constructive dialogue with shareholders and other external stakeholders, to obviate the need for extraneous shareholder proposals. Where engagement is unsuccessful, we support shareholders' right to submit a shareholder proposal for consideration by all investors. In these instances, companies should behave respectfully, by communicating promptly and fully with shareholders and refraining from obstructing the process. The board should provide a full and reasoned response to any shareholder proposal on the ballot. We consider all shareholder resolutions put forward and votes in accordance with its understanding of the long-term benefit to shareholders. We support shareholder resolutions relating to the right to nominate or remove directors and relating to an advisory shareholder vote on pay.

## 8. Social and environmental responsibility

Social and environmental factors can present serious risks to corporations and impact the bottom line. A well-run company should have formal systems to identify, assess and manage significant risks including those associated with social and environmental factors. Companies should provide appropriate public disclosure of such factors, and give shareholders a proper accounting of their record in managing these areas, as well as evidence of strategies and targets to achieve good practice.

The US in particular has an open filing process that results in a wide variety of advisory shareholder proposals, particularly on social and environmental issues. The quality and nature of such proposals varies substantially. In general, we evaluate proposals based on the relevance of the issue to the company and the desirability of the specific action requested in the “resolved” clause. We recognise that some proposals may identify important company risks even if the proposal is poorly constructed. In such cases, we vote to encourage companies to identify, mitigate and report on its risk management approach effectively.

### Sustainability reporting

Disclosure of significant social and environmental risk factors should be included in the annual report. Certain high risk or high impact operations that are of substantial interest to investors and the public may require modular reporting alongside reporting that aggregates all company activity. We recommend disclosure in line with internationally accepted standards of best practice which increases our understanding of an organisation’s ability to create and sustain value in the short, medium and long term. We generally support shareholder proposals asking companies to report on implementation of social and environmental policies and assessments where there is reason for concern.

### Audit of social and environmental management systems

We appreciate that auditing and assurance practices for social and environmental systems require further development, but consider third-party auditing of sustainability reports to be best practice. We encourage companies to move towards third-party verification, and will generally support resolutions calling for it where there is reason for concern.

### Labour practices and standards

Companies may incur significant risks as a result of the employment practices (e.g. health and safety, anti-harassment, etc.) of their own operations and those of their suppliers and sub-contractors. Codes of conduct that address such risks, and include detailed and effective procedures for their supply chain, are usually in companies’ best interests. Where there is cause for concern, we favour codes based on internationally recognised standards (e.g. core conventions of the International Labour Organization), independent monitoring or auditing of implementation, and reporting of aggregate audit results. We look for regular, public reporting on code implementation.

### Human rights

Companies may incur extraordinary risks to their operations, staff or reputation as a result of operating in conflict zones or in locations at risk of human rights abuses. Risks may also be encountered via supply chains when primary product inputs are sourced from at-risk areas. Where there is cause for concern, we support resolutions asking companies to develop and implement policies and management systems addressing human rights and security management. These policies should reflect internationally recognised standards (e.g. United Nations Universal Declaration of Human Rights) and should apply to suppliers and sub-contractors.

### Diversity and equal employment opportunity

Recruiting and hiring from the widest possible talent pool is in the best interests of companies, as is maintaining a diverse workforce. We support efforts to strengthen non-discrimination policies, achieve diversity objectives and address “glass ceilings” at all levels within organisations. In the environment where many industries and companies are facing shortages of skilled workers and, therefore, increasing competition for talent, it is advisable and appropriate for company policies and practices to exceed legal requirements in order to attract and retain employees. Where there is cause for concern, we may support resolutions calling for the introduction of practices to this effect.

### **Political and charitable donations**

Charitable and political donations should be consistent with the company's stated sustainability strategy. (See "Reporting" above). We discourage corporate political donations and generally support proposals asking companies to develop a comprehensive policy statement that addresses all relevant aspects of their political involvement and disclose the individuals and organisations that receive political donations as well as substantial dues associated with lobbying organisations. We also recommend that the board provide ultimate oversight for political donations and related activity. In addition, we believe that companies that undertake charitable giving should have transparent policies and undertake charitable giving programs with due regard for the interests of shareholders.

### **Environment**

Companies should determine how key environmental risks and opportunities fit into their core business strategy. As part of this process, companies should identify, assess and manage their environmental impacts. This may include minimising key environmental impacts, reporting on environmental management systems and performance, and discussing related financial impacts. Areas of increasing business interest include energy use, emissions to air and water, waste and the utilisation of natural resources. Where there are matters of concern, we may vote in favour of resolutions seeking improvements in reporting and/or management of environmental practices where these are proportionate to risks faced.

### **Climate change**

Some companies may be exposed to business risks stemming from the effects of climate change either directly on their business operations, or indirectly through taxation, regulation or changing patterns of customer demand. Where these are material risks, companies should describe how their business strategy addresses the question of climate change including disclosure of greenhouse gas emissions and any related targets. Where there are matters of concern, we may support resolutions calling on companies to improve their public disclosure of climate change-related policies and practices.

### **Products**

We will vote on all other matters pertaining to the social, environmental, ethical and brand implications of a company's products, production processes and activities, in accordance with its understanding of shareholders' long-term interests. A company's policies and processes are important in evaluating risks, and we strongly encourage companies to provide appropriate disclosures in the annual report. We look for evidence that companies are well prepared for changes that could have profound implications for their business.

### **Supply chains**

As part of standard social and environmental management and business ethics policies and systems, companies should clarify the extent to which their operational standards and performance expectations apply to their suppliers. This may include anti-corruption, environmental, health and safety, human rights, animal welfare and climate change policies, among others.

## 9. Voting matters

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### Annual general meetings

There should be an annual physical meeting of the shareholders, and all the directors of the company should attend.

### Vote disclosure

We expect companies to disclose the voting results of their general meetings, both at the meeting and on their websites, with a detailed breakdown of votes for and against, as well as abstentions.

We believe that companies have a right to know how their shareholders have voted, and therefore writes to all companies to explain any cases of votes against management and abstentions.

In the spirit of transparency, we also make available to both our institutional and retail fund customers, and to the public a comprehensive record of our voting by publishing all our votes and comments on our website<sup>7</sup>. A summary of our voting statistics can be found in our annual Responsible Investment report<sup>8</sup>.

### Shareblocking

We believe that shareblocking, i.e. the practice of preventing shares from being transferred for a fixed period prior to the vote at a company meeting, acts to discourage shareholder participation and should be replaced with a record date. Where shareblocking exists, we will follow client policy and may be prevented from voting because of concerns about failed trade settlements and extraordinary cost to clients.

### Stocklending

Stocklending is a widespread market practice involving the sale and contractually pre-agreed repurchase of a stock, collateralized by a basket of securities. Insofar as title to the stock passes from the “lender” to the “borrower”, this transaction is not, in fact, a loan, and therefore means that the voting right that attaches to the underlying stock cannot be readily detached and retained by the lender. Stocklending is an important factor in preserving the liquidity of markets and in facilitating hedging strategies; it also provides investors with a significant additional return on their investments because the sale-repurchase transaction includes a profit margin. Importantly, however, if the term of the “loan” coincides with an annual or extraordinary general meeting, the transfer of the voting right impairs the ability of the underlying shareowner to exercise his voting rights. In rare instances, this has led to abuse, where borrowers have deliberately entered into transactions to sway the outcome of a shareholder vote without any intention of owning the stock long-term.

We consider that the balance to be struck between stocklending and voting is a matter for individual decision by clients. For those clients wishing to be involved in stocklending, our policy is to accommodate this while retaining a minimum shareholding at all times, thereby ensuring that a vote is cast and any concerns are expressed directly through a letter to the company. Where significant voting issues arise, we will stop any further lending of stock, and, if necessary, will seek, on a reasonable-efforts basis, to recall all lent stock over the voting period. We also accommodate clients who do not wish to engage in stocklending at all, should they prefer to vote all stocks at all times.

### Record dates

We recommend that a record date be set a maximum of five working days prior to company general meetings for custodians and registrars to establish clearly those shareholders eligible to vote. This will give time for all relevant formalities to be completed and serves the same purpose as shareblocking without the disruptions noted above.

### Voting Systems

All companies should conduct voting by poll, rather than relying on a show of hands.

We believe that shareholders have the right to appoint any reasonable person as proxy to vote their shares, either in person or electronically.

We encourage the introduction of electronic voting systems that are accurate and provide an effective audit trail of votes cast.

<sup>7</sup> <http://vds.issproxy.com/SearchPage.php?CustomerID=3660>

<sup>8</sup> <http://www.fandc.com/corporate/about-us/responsible-investment/>

**Bundled resolutions**

Resolutions put to company meetings should cover single issues, or issues that are clearly interdependent. Any other practice potentially reduces the value of votes, and can lead to opposition to otherwise acceptable proposals. We will normally oppose resolutions that contain such inappropriately bundled provisions.

**Any other business**

We expect to vote on resolutions the contents of which have been made clear to shareholders and are in the interests of the company and its shareholders. Where a resolution invites shareholders to vote on an “any other business”, we will systematically vote against it.

**Political and charitable donations**

We welcome the opportunity to vote on company donations, if material. We support charitable acts at an appropriate level, especially where an active donations policy supports the company’s engagement with its local or wider community. With respect to donations to political parties or to organisations closely associated with political parties, we consider that these are inappropriate and should be strictly avoided. However, in countries where the practice is widespread and deeply rooted, companies should at the very least submit their political donations policy and the past year’s donations record to a shareholder vote.

# Appendix 1

## Sustainability Reporting and Disclosure

We expect high standards of transparency from the companies in which it invests. This should include a narrative account within the annual report about the trends and factors affecting the performance and future development of the business. This is an important mechanism for improving the quality of dialogue between companies and their owners, covering the full range of factors underpinning long-term profitability. This includes material environmental, social and governance (ESG) issues. In high-impact sectors, we expect companies to publish more detailed information for a wider group of stakeholders such as employees, local communities, non-profit organisations, and government representatives. While we recognise that ESG reporting will vary across geography and sector, we have identified some overarching best practice guidelines, set out below.



### Our 12 steps to best practice ESG reporting

#### Basic

- Identify significant ESG risks and opportunities for the business
- Establish and explain board accountability for ESG issues
- Set out policies for significant ESG issues and explain how they are implemented and monitored
- Establish and disclose targets and Key Performance Indicators for significant ESG issues covering global operations
- Describe systems for training board members and staff on ESG issues
- Report on performance against policies

#### Best practice

- Explain how ESG policies link to key operational and financial drivers
- Describe procedures for consulting key stakeholders and provide feedback on the range of views
- Discuss challenges and set-backs as well as success stories
- Describe procedures for verifying data including external verification
- Take account of widely-accepted reporting standards such as the Global Reporting Initiative
- Describe how ESG objectives are embedded into the corporate culture, including how they are reflected in remuneration policies and other performance management tools

# Appendix 2

## Corporate debt and responsible investment

The relevance of fixed-income instruments – as well as other asset classes— as a component of sustainable investment—was identified in the UN Principles for Responsible Investment, originally launched in 2006. While much of the focus in responsible investment to date has been on equities, increasing attention is being paid to other asset classes – corporate debt in particular.

Shareholders play a particular stewardship role by exercising their ownership rights, including voting, to urge companies to pay appropriate attention to the management of material ESG (environment, social and governance) risks. However, it is also the case that a firm’s creditors and bondholders are key financial stakeholders, and share with shareholders a common interest for companies to manage appropriately their ESG risks to contribute to strong long-term financial performance.

### Fiduciary responsibility for fixed-income as well as equity assets

We are reaching out to investee companies, as both a shareholder and creditor, to encourage companies to pursue policies and practices that enhance the sustainability of all corporate asset classes.

This interest has in part been motivated by greater recognition by pension funds and their trustees that fiduciary responsibility to address long-term ESG risks is relevant for bond investments as well as for equities. This is particularly the case for clients whose portfolio “derisking” had the effect of shifting asset allocation from equities into bonds.

### Why ESG issues are relevant to bondholders

In most companies and in most sectors, debt forms a core part of a company’s long-term permanent capital. This is particularly true in the case of financial institutions and many utilities. In this context, a company’s providers of debt capital share a similar exposure to long-term ESG risks as its shareholders.

However, while creditors are theoretically more cushioned from financial problems than shareholders, both are affected by a company’s ability to generate long-term operating profits and cash flows to allow for debt service, dividend payments and capital appreciation. Financial, operational and reputational risks relating to ESG factors can affect a company’s ability to generate stable cash flows to honour its financial obligations.

This is not an abstract notion. A number of visible corporate case studies illustrate well how ESG factors can result in significant financial, operational and reputational risks for all investors. Indeed, there is a clear convergence among corporate creditors and shareholders on many issues affecting a company’s management of risks relating to ESG performance.

It also warrants noting that compared to equity investors, creditors have limited upside potential in investment returns, as income is “fixed”, not variable. This can cause creditors to be relatively risk-averse, and focus on companies avoiding the downside – namely the possibility that their financial contracts will not be honoured. In this regard, robust identification and management of material ESG risks is a form of enterprise risk management that serves to promote the long-term stability of the company and ultimately protect creditor interests, along with the value, performance and liquidity of fixed income portfolios.

### What we expect from bond issuers

As an investor in bonds and other forms of corporate debt instruments, we expect debt issuers to conduct their business in a way to protect creditor interests. This includes showing proper respect for shareholder interests as well, since a sustainable company must maintain access to both equity and debt capital.

Our fixed income engagement focuses on those aspects of governance that reflect a company’s overall risk profile—a key concern for creditors. These include:


1. **Clarity on financial policy.** Companies should be transparent to both creditors and shareholders with regard to their financial policies. Particularly with regard to creditors a company’s reporting should include a policy statement on the use of debt and the level of credit quality the company wishes to manage itself to. It is not wrong per se for a company to pursue a risky strategy involving debt finance. This strategy should be clear to both existing and prospective debt investors so that it can be reflected both in pricing and the fundamental investment decision.
2. **Risk management.** The company’s risk management and risk governance are fundamental concerns for both creditors and shareholders. This certainly relates to basic internal controls, but also to risk management in the broadest enterprise-wide context-- incorporating financial, operational and reputational factors. In this context, environmental, ethical and social factors can present significant risks to the company and its investors.



3. **Board effectiveness.** Bondholders want boards to be aware of creditors' interests, and to demonstrate appropriate regard for maintaining and building the long-term financial health of the firm. Creditors also want strong and effective boards that are able to oversee company management and provide appropriate checks and balances to prevent abuse.
4. **Audit process.** A particular focus of creditors is a robust audit process, including an independent audit, appropriate accounting policies and high standards of transparency and disclosure in financial reporting.
5. **Remuneration.** Performance metrics reflecting a company's own financial strength and stability can and should be reflected in company incentive structures. Such metrics can include relevant environmental, social and governance metrics and feature as a components of a balanced scorecard guiding annual bonus awards.

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