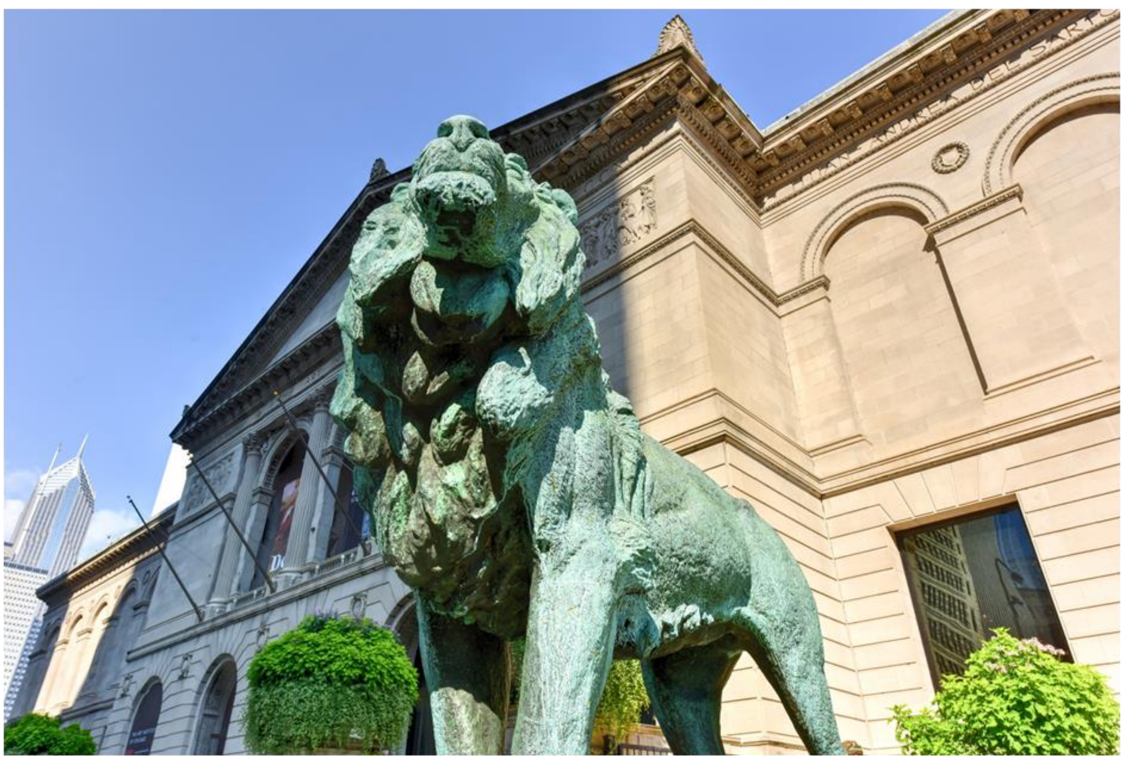
# LGIMA L&G CIT and LGIMA Private Funds' Corporate Governance and Responsible Investment Principles



Legal & General
INVESTMENT MANAGEMENT AMERICA

# Contents



This document sets forth LGIMA's principles that govern our proxy voting decisions but do not impact the making of investment decisions for our clients' accounts. Our approach to key topics we believe are essential for an efficient governance framework and building a sustainable business model are set forth herein.

These Corporate Governance and Responsible Investment Principles set out the Legal & General Investment Management America ("LGIMA") approach and expectations with respect to key topics we believe are essential for an efficient governance framework, and for building a sustainable business model.

While local best practice codes may adopt different approaches, we expect all companies on a global scale to seek to closely align with these principles which we believe set out the fundamentals of corporate governance. LGIMA will take into account these principles in conjunction with our regional specific policies, included herein, and our voting and engagement activity with all companies globally.

While there is no "one-size-fits-all" solution to building a sustainable business model, LGIMA looks for companies we invest in to demonstrate that sustainability is effectively integrated into their long- term strategy and their daily operations. Our Sustainability Principles set out our expectations in this regard.

# General principles

LGIMA acts as the investment adviser to equity index accounts, a Collective Investment Trust ("CIT") maintained by Reliance Trust Company of Georgia, and LGIMA-sponsored Private Funds. For accounts where LGIMA has been delegated proxy voting authority, LGIMA has adopted the Global Corporate Governance and Responsible Investment Principles (the "Principles). We believe that these Principles, set forth below, align with both the best interest of our clients and the long-term success of companies. Further, LGIMA has engaged with our affiliate, Legal & General Investment Management, Ltd. (LGIM), independent Corporate Governance Responsible Investing team to research, engage and make proxy voting recommendations on behalf of LGIMA clients. Moreover, LGIMA has engaged Institutional Shareholder Services ("ISS") to administer the proxy votes. Proxy votes cast on LGIMA's behalf will be based on our pre-determined Principles which are intended to vote proxies in our client's best interest. Please refer to the LGIMA Proxy Voting and Corporate Actions Policy – Equity Securities for more information regarding our proxy voting procedures.

# Company board

**The board of directors is responsible for the management and long-term success of the company, taking into account the best interests of the company and its stakeholders. It should act as a steward of stakeholders' interests which is the role that is delegated to them by stakeholders.**

The board has the most important task of setting the strategy and direction of the business, ensuring that the necessary resources are available to enable its implementation and that appropriate risk management and internal controls are in place. It sets the philosophy for the company, ensuring that stakeholder views are considered and embedded in its culture. The board is expected to take into account environmental, social and governance considerations and to report on company performance in these areas. It is also responsible for ensuring the integrity of the company's accounting and reporting, and the effectiveness of internal control systems. Lastly, the board is ultimately accountable to investors and other stakeholders and should make sure board decisions are effectively communicated to them.

We acknowledge that the structure of the board may vary between companies and countries. However, **LGIMA believes that the key elements of an effective board are universal.**

## Board leadership

LGIMA believes that having the right composition at the top of a company is an essential element of its success. We expect each director on the board to fully exercise their duties and promote the long-term success of the company.

### The board chair and the chief executive officer

The responsibilities of the board chair (the "chair") include leading the board, setting the agenda for board meetings and ensuring directors receive accurate and timely meeting information. **Under his or her direction, there should be a good flow of information within the board and the board committees.** The chair is also responsible for leading the appointment process of the CEO.

The chair should be able to challenge the executive directors and encourage the non-executive directors to actively participate in board discussions. It is the chair'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.

Given the importance of the role, **LGIMA expects the chair to be independent at the time of appointment.**

LGIMA would therefore **not expect a retiring CEO to take on the role of chair.** As these two roles involve different responsibilities and a different approach to board relations and the company, we have concerns that a hands-on CEO may find it difficult to become a hands-off chair. Where a company would find the presence of the former CEO on the board beneficial in times of transition, we encourage the company to allow the CEO to be consulted by the board but not be a formal board member and would stipulate for this to be for a maximum period of one year.

There are also some instances where a company may, for a short period, be governed by an executive chair. This tends to be when the company is undergoing a shift in its structure or management, or is under severe stress. In such circumstances, **LGIMA would expect companies to commit to re-split the roles within a short pre-set timetable.** In addition, we expect that a **deputy chair also be appointed** to ensure that no person has unfettered powers of decision.

### The case of the combined chair and CEO

The roles of chair and CEO are substantially different, requiring distinctly different skills and experience. Therefore, **LGIMA expects the two roles to be separated.** We acknowledge the different regional approaches on this topic. However, 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.

Where companies have historically combined the positions of CEO and chair and have chosen to keep this structure, **LGIMA expects a strong, senior or lead independent director, or deputy chair to be appointed and for a meaningful explanation and justification to be provided in annual disclosures.**

However, where a company currently separates the roles of chair and CEO, **LGIMA strongly discourages the company to re-combine the two roles.** This decision should also be put to a shareholder vote for approval given that these are key board risk functions.

#### Japan market – the chairman and the chief executive officer

The Company Law does not require the separation of the roles of chairman and CEO. In a company with a two-tier board structure, the board of directors is required to appoint a representative from within the board. In a company that adopts a unitary board structure, the board of directors appoints an executive officer (typically a CEO), and a representative executive officer (chairman or president), who represents the company and can legally bind it.

We regard the separation of the principal roles of CEO and independent chairman as essential for the effective discharge of board duties. A board that is run by an insider may be less amenable to innovative approaches to company strategy. LGIMA supports the appointment of an independent director (gichou) to set the agenda for the meetings and lead the sessions, independently of the insider chairman.

### Senior or lead independent director

The senior or lead independent director plays an essential role on the board and should lead the succession process of the chair and appraise the chair's performance. Additionally, they should **meet investors**[1] regularly in order to stay well informed of key concerns.

They can also be a key contact for investors, especially when the normal channels of the chair, CEO, or chief financial officer have failed to address concerns or are not the appropriate avenues.

**LGIMA expects the senior or lead independent director to be a fully independent non-executive director.** This is of extra importance when the company has a combined chair and CEO.

Please see the LGIM website for a thought piece on the **role of the senior independent director**[2]**.**

### Non-executive directors

LGIMA expects non-executive directors to use their skills and experience to constructively contribute to board discussions and help develop proposals on strategy. **They are expected to**



[1]Source: Board investor Dialogue, Marion Plouhinec, 2018, LGIM.com, http://www.lgim.com/files/_document-library/capabilities/lgim-guide-to-board-investor-dialogue.pdf

[2]Source: The role of the Senior Independent Director, January 2017, http://www.lgim.com/files/_document-library/capabilities/the-role-of-the-senior-independent-director.pdf

**oversee management performance and challenge the executive directors.**

Given the responsibility the role involves, non-executive directors must make sure they have sufficient time to perform their duties. LGIMA expects non- executive directors to take this into account when they take on outside board roles.

## Structure and operation

### Diversity

LGIMA believes a suitably diverse mix of skills, experience and perspectives is essential for a board to function and perform optimally. Several studies have demonstrated that **a good level of diversity has the ability to improve business decision making, minimize business risk, improve the sustainability of profits growth and therefore maximize long-term returns for investors.**

Therefore, when recruiting members, a board should be cognizant of all elements of diversity that appropriately represent the company's operations, including gender, age, nationality, ethnic origin, background and experience. Consideration should also be given to the geographies in which the business operates, its future strategic international expansion plans and its consumer base.

**LGIMA expects all companies to have at least one female on their board. We also expect companies to seek to promote diversity below board level, at executive committee, senior management and workforce level.** However, note that we have set stricter criteria and targets in some regions.

Companies should ensure that candidates with appropriate skills and 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. Companies should also be prepared to look outside of the usual pool of candidates to include those from a less traditional "corporate board" background. They should also be willing to recruit those without previous board experience as many, if not all, of the board members will have this experience and this will help to expand the candidate pool and the board's cognitive diversity.

**LGIMA also requests that companies disclose diversity data at board, executive committee and senior management levels, and also for the rest of the workforce as well as their policy on diversity.** A diversity policy should include meaningful information demonstrating how the company is working on its challenges. This will allow investors to be able to assess the extent to which diversity is embedded in the company's strategy and its efforts and progress towards better diversity levels.

#### UK market - diversity

LGIMA publicly supports the initiative for companies to achieve a minimum of 30% women on FTSE350 boards; and for 30% women at senior management level of FTSE100 companies by 2020. In addition, we support the similar target developed by the UK Government's Women on Boards Report, the Davies Review and the Hampton-Alexander Review.

To provide investors with a comprehensive understanding of their diversity policies, we expect companies to be transparent regarding the procedures used to find new members for the board and at senior management level, and how that process ensures a diverse board and senior executive pipeline. **We expect all UK companies to disclose a breakdown of board directors, executive directors, managers and employees by geography, main skill set and gender,**

**along with the information on its gender pay gap and what initiatives it has in place and action it is taking in order to close any stated gap.**

**For 2018, we expect FTSE350 companies to have at least 25% women at board level.**

We expect companies to take targeted action to increase the levels of diversity at board and executive committee levels in order to reach the minimum 30% target by 2020, and to reduce the gender pay gap. **By the end of 2020 we expect all companies in the FTSE350 to have at least 30% women at board level.**

## Japan market – structure and operation

The vast majority of Japanese companies use the traditional two-tier board structure with Kansayaku.

### Traditional two-tier board

The traditional two-tier board consists of a board of directors and a board of statutory auditors (Kansayaku). The role of Kansayaku is to audit the directors' conduct and processes. The legal position of Kansayaku is that of a fiduciary and their legal duties include: attendance of all board meetings, determination of audit policy, and methods for monitoring and investigating the company, accounts auditing, and reporting breaches of directors' duties.

Yet Kansayaku are not integrated into the board's formal decision-making process and do not have the authority of directors. Although they have the right to express their opinions on any matter at board meetings, they do not have voting rights. 'The de facto role of Kansayaku is to serve as an adviser to senior management on what is happening deep within the organization and how to improve management' (ACGA, 2013, p. 12*).

An increasing number of Japanese companies are adopting the US-style unitary board.

### Unitary board

This structure, also known as a 'three-committee board', consists of three committees responsible for audit, nomination and remuneration. Permission to adopt this model was granted in 2003 as an amendment to the Corporate Code. The role of the three committees is to audit the legal duties and compliance of directors and executive officers, and the financial statements of the company.

For auditing purposes, this structure is considered preferable because the audit committee is an integral part of the board. As board directors, committee members have the right to vote and the ability to exert direct influence on board decisions. As a result, they are considered to have greater capacity to positively influence the robustness of a company's internal controls.

Hybrid board structures have also emerged, wherein some companies have established the committees in addition to Kansayaku. This is considered a positive development, providing the external directors are independent. In many cases, however, such committees are chaired by the CEO or other senior executives, which may undermine the purpose of independent oversight.

## Independence

An independent board is essential to ensure the board exercises efficient oversight and consistently acts in the best interests of the company and its stakeholders. Its importance on the performance of a company has been shown is several academic studies. Therefore, as a minimum standard, **LGIMA expects the board of directors of all companies to comprise at least 30% independent directors.**

LGIMA 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 12 years** from the date of first election
- Represents a **significant shareholder**

LGIMA also recognizes 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 maximize value as long as the board remains balanced. In this instance, **LGIMA expects the company to fully explain how the non-independent director provides valuable input into the business.**

### North America market – independent director

LGIMA expects the board of directors of all companies to comprise at least 50% independent directors.

### UK market - independence

LGIMA supports the criteria set out in the UK Code on Corporate Governance to measure the independence of directors.

As long as board balance is maintained, LGIMA will support a company if they want to retain a non-executive director beyond the recommended 9 years. However, the company must provide a full explanation of the benefits to the company of extending their services for another term.

### Japan market – independence

The Japanese Company Law requires companies to have at least two outside directors or Kansayaku, whereas the TSE Listing Rules require at least one. Amendments to this Corporate Law are due to be come in force during 2014 where a 'comply or explain' rule would be imposed on companies to explain 'why they believe the appointment of outside directors is inappropriate'. Under Japanese law, 'outsiders' are defined as having no previous employment history with the company or its subsidiaries. This definition is extended under the TSE Listing Rules to include candidates with close family ties, clients, service providers or significant business partners.

**An outside director is someone who:**

- Is not an employee of the company or group;
- Has not been an employee of the company or group within the last five years;
- Is an outsider that represents less than 10% of the company's voting common stock; or
- Does not have close family ties with any of the company's advisers, directors, or employees.

**An independent director is someone who:**

- Is not an employee of the company or group;
- Has not been an employee of the company or group within the last five years;
- Is not an employee at the main lenders or banks to the company;
- Is not an employee at the lead underwriter(s) of the company;
- Has not worked at the company's audit firm;
- Is not offering, or has not previously offered, professional services such as legal advice, financial advice, tax advice or consulting services to the company; or
- Does not have close family ties with any of the company's advisers, directors, or employees.

Unaffiliated outsiders should bring an independent mind and an external perspective to boardroom discussions. They should raise issues and suggestions that are pertinent to the company, but which inside directors may not have thought of or may be reluctant to address. 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.

It is important that directors are independent of one another, and that any interlocking board relationships are disclosed and explained. In Japan, provision of biographical information on directors is sparse. This limits the ability of shareholders to make an informed decision about the appropriateness of nominee directors.

Once appointed, directors should be given appropriate training in order to familiarize themselves with company affairs, and pertinent environmental, social and governance issues. This is essential to effective contributions to internal discussions.

LGIMA considers that Japanese companies should focus on establishing a board that meets the international 'best practice' trends in order to remain competitive and attractive to foreign investors. Notwithstanding, LGIMA recognizes that reaching the optimum level of independence will be a continuous, iterative process; and companies need time to test the dynamics of new board composition.

To balance these considerations, the short term target proposed by LGIMA calls for a minimum of 1/3 outsiders and an outline of the steps to be taken to increase independence in the future. The selection of this target was based on our past experience, which demonstrates that a minimum of three outsider directors is necessary to engage the board in meaningful debate.

LGIMA's requirement for outside directors is one third. It should be noted that this target for both independence and the outside director requirement will be raised going forward, to bring it into line with other developed markets.

This rule applies to both two tier and unitary boards, and when the companies are controlled by majority shareholders.

However, note that our regional policies take into account regional best practice and therefore we have set stricter criteria and targets in some regions.

LGIMA also recognizes 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 maximize value as long as the board remains balanced. In this instance, LGIMA expects the company to fully explain how the non-independent director provides valuable input into the business.

## Succession planning

Succession planning is a vital component of an efficient board. It ensures board continuity, and that individuals with the right sets of skills sit on the board.

**LGIMA expects companies to put in place a formal and transparent procedure for the appointment of new directors. The external board evaluation[3] exercise should assist in this task.** We encourage companies to disclose this information in its annual disclosures. This includes what skills the company is looking for and why the selected individual is the right fit for the board.

## Re-election of directors

To ensure the successful composition and functioning of the board, it is essential that shareholders have the ability to effectively exercise their voting rights by holding directors accountable. LGIMA is opposed to the practice of bundled proposals which prevent shareholders from approving individual nominees to the board.

In addition, we acknowledge that the regulations that govern the frequency for director re-election vary greatly from one country to another. However, **LGIMA encourages companies to allow shareholders to vote on directors' elections annually.**

In order to allow investors to be able to assess the profile of the board directors proposed to election or re-election and to make sufficiently informed voting decisions, **we expect companies to disclose the name of the directors proposed for election or re-election and a detailed biography.** We would also encourage the **disclosure of attributes and skills which the director brings to the board and how these fit with the long-term strategic direction of the business.**

### North America market – majority vote

Some companies in this market still elect directors by a plurality vote standard. Under this standard, if one shareholder holding only one share votes in favor of a nominee, then that nominee 'wins' the election and takes a seat on the board. LGIMA expects companies to implement a majority vote standard for board elections whereby a nominee would have to receive the support of a majority of the shares voted in order to be elected. The election of directors is a fundamental shareholder



[3]Source: Board Effectiveness Reviews: Guiding Principles, January 2016, LGIM.com, http://www.lgim.com/files/_document-library/capabilities/board-effectiveness-reviews-jan-16.pdf

right and so should be undertaken in a democratic way.

## Board effectiveness

### Board tenure

The regular refreshment of the board contributes to ensure that its members remain independent from management and third parties. That different perspectives feed into board discussions and that skillsets remain relevant. A regularly refreshed board is more likely to be willing to question established practices, avoid "group think", and therefore exercise more efficient oversight over management and stay ahead of market changes.

Board tenure is assessed in two different ways:

- On an individual director basis: we consider optimum tenure for a director to be between 3 and 12 years;
- On an average board tenure basis: average tenure across all board members should be between 4 years and 9 years.

While different regions have different best practice guidance on this issue, **LGIMA expects all companies to put in place an individual director term limit of a maximum of 12 years.**

#### North America market – board tenure

The discussion around board tenure has become a key focus in this market, as it directly impacts diversity and skillsets: considerations that have historically been much weaker in this region. While the majority of board members in this market do not have tenure limits, many companies do apply retirement ages for their directors. However, LGIMA does not consider retirement ages to be an adequate limitation on board tenure as these can be, and often are, easily extended. Instead, LGIMA supports an explicit limitation of board tenure, whether this comes through a formal policy or through a more informal approach. Either way, we believe external board evaluations are an important exercise in order to appropriately assess tenure.

In essence, we expect that average board tenure does not exceed 15 years; (that regular board refreshment take place we would have concerns where this has not occurred for 5 years); and that an individual director tenure in the roles of lead independent director or as chair of a key committee not exceed 15 years (as this impacts independence).

### Board mandates

LGIMA believes 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.**

LGIMA would encourage executive directors not to undertake **more than two outside non-executive directorships** of an unrelated listed public company. We also encourage non-executive directors to limit their number of board positions to a total of **5 public company board roles**. We consider an independent board chair role to count as two board roles due to the extra complexity, oversight and time commitment that it involves.

In order to help investors assess how directors with other board mandates are performing their duties, we would like to see disclosure of how much directors are expected to contribute to the role and how their other mandates do not prevent them from effectively exercising their duties.

### UK market – board mandates

A director has a duty of care to ensure they have sufficient time to contribute effectively to each directorship. **LGIMA expects non-executive directors not to hold more than five roles in total.** We consider a board chair role to count as two directorships due to the extra complexity, oversight and time commitment of this role. **A practicing executive director should not hold more than one non-executive director role within an unrelated listed company.**

### North America market – board mandates and over-boarding

LGIMA's limit on the number of board mandates it believes is appropriate is slightly stricter in this market, as we have general concerns around the tenure of directors, and over-boarding directly impacts this issue. Therefore, **LGIMA expects that a full-time CEO at a large public company should not undertake more than one other non-executive directorship at an unrelated company.** This is especially important in this market as many company chair and CEO roles remain combined. **For non-executive directors, LGIMA would expect individuals to hold no more than four public company board roles.** LGIMA considers an independent board chair role to count as two roles.

### North America market – skillsets

LGIMA expects the company to disclose separate information on the skillsets of board members within the proxy statement, and/or annual disclosures, enabling shareholders to easily understand the composition of the board in terms of skills. This could be provided via a matrix or another illustrative graphic. **Some narrative explaining why the specific skillsets identified are important for the company and aligned with its long-term strategy should also be provided.**

### Board meetings and attendance

Regular board meetings are vital for the board to effectively perform its duties.

LGIMA believes the chair should **hold separate meetings with the non-executive directors** to discuss the performance of the executives. In addition, the non- executives should have at least **one meeting during the year without the chair present.**

Director attendance at board meetings is a vital part of the role to ensure contributions to board decisions and of fulfilling fiduciary duties to investors. We therefore expect companies to allow investors to assess directors' attendance at board and committee meetings by disclosing attendance records in their annual disclosures. **LGIMA expects directors to have attended no less than 75% of the board and committee meetings held.** Where a director does not attend a board or committee meeting, the company should report to investors the reasons for non-attendance. LGIMA would not expect to see a trend in a director's non-attendance at meetings.

### Board size

LGIMA believes a company should put in place a board of a **size that is appropriate for the size of the company and complexity of the business.** It is essential that the size of the board does not compromise exchange of thought, challenge, and efficient decision-making and therefore should not be so large as to be unwieldy which can impact this efficiency.

### Board evaluations – internal and external

The evaluation of directors is a key way of improving board effectiveness and ultimately its performance as well as to improve on what may be an already constructive board for the future. It is also a way for investors to determine from the outside the quality of debate and interaction between board members.

**LGIMA expects an internal board evaluation[4] to take place annually.** This evaluation should be led by the most senior independent director of the board, or if managed externally, by an independent third party. **We expect an external evaluation of the board to take place at least every three years.** These should be performed by an independent third party to avoid conflict. External reviewers can also bring different perspectives on the functioning of the board as well as experience of how other boards operate.

In the interests of transparency, we expect the process and general outcomes of such evaluations to be disclosed in the company's annual disclosures, as well as progress on the outcomes of previous board evaluations. Any potential conflict of interest with external reviewers should also be disclosed.

### Japan market – re-election of directors

Our affiliate, LGIM, has engaged in constructive dialogue with Japanese companies in order to express its views on board composition and LGIMA supports these actions. The outcome of these engagements is expected to generate an increase in independence and disclosure of directors' associations. In the event that this does not occur, LGIMA will signal disapproval and recommend voting against the chairman. If the chairman is not present, we will vote against the most senior member in the ballot. This strategy will apply to both two-tier and unitary board structures. In Japan, it is common to vote against the CEO in order to cast dissatisfactory votes. However, we believe that, as the CEO is responsible for running the company, voting the CEO out due to inadequate board structure is not the most prudent course of action. Instead, it is preferable that the chairman be mandated to take responsibility for ensuring that the board structure is robust and competitive.

### Re-election of Kansayaku

The Company Law stipulates that half of Kansayaku should be outsiders, but with no obligation for them to be independent. It is vital that true independence from the company is maintained in the Kansayaku committee, especially as half of the members are company executives and therefore are less likely to flag issues to outside shareholders. As such, we vote against insider and affiliated outside directors, where Kansayaku committee are composed of less than 50% independent directors.

### Board size

We consider board effectiveness optimized when membership sits between five and 15 members, depending on the size of the company. By their nature, small boards that are suitably diverse are better equipped to facilitate active, constructive debate and agile decision making processes.

Although Japanese boards have historically been larger than in other markets, smaller boards are beginning to emerge. We will generally support resolutions that intend to reduce the board size. The proportional percentage requirements in independent directors aim simultaneously to reduce the number of directors on the board.

### Annual elections

In Japan, directors are to be elected every two years according to the Company Law. However, an increasing number of companies have put forward



[4]Source: Board Effectiveness Reviews: Guiding Principles, January 2016, LGIM.com, http://www.lgim.com/files/_document-library/capabilities/board-effectiveness-reviews-jan-16.pdf

proposals to reduce the term to one year. We would support such proposals from the companies and encourage others to do so.

### Japan markets

**We will oppose the election of the most senior member of the board if:**

- The company does not qualify the abovementioned outsider requirements;
- The company is a controlled company without at least 1/3 of independent directors, in addition to voting against the representative-shareholder from the parent company; or
- The candidate is an inside director nominee who has attended less than 75% of board meetings during the year under review. This rule would be reviewed, case by case, for independent directors due to their difficulty in attending meetings at short notice, and in meeting the requirements of potentially excessive meeting frequencies.

**We will oppose the election of Kansayaku if:**

- They are all insider or affiliated Kansayaku, if the Kansayaku committee is not 50% independent;
- They are insider or affiliated Kansayaku that have attended less than 75% of meetings of the board of directors or board of Kansayaku during the year under review; or
- The Kansayaku is judged to be responsible for is management or shareholder-unfriendly behavior.

**We will oppose the chairman if:**

- The board has more than 15 members. This is applicable to both board structures.

### Non-executive director induction

The chair is also responsible for ensuring that incoming non-executive directors (NED) receive a comprehensive induction to the company on joining the board and that training is available on an on-going basis. This will allow new directors to contribute to board meetings as soon as possible. **This is especially important if the chair is considering a board member who does not have previous corporate board experience.** LGIMA 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. The corporate secretary can also be an important training resource for non-executive directors.

Directors should be encouraged by the chair 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. One way to remain up to date is to regularly meet with investors, along with other relevant board members, to gain knowledge and to hear various perspectives.

We would also encourage new board members to use their investors as a resource to help them in performing their duties. Our affiliate, LGIM, regularly organizes environmental, social and governance (ESG) related seminars for board of directors aimed at discussing views on key ESG topics. Furthermore, LGIM also regularly publishes worldwide **thought leadership pieces**[5] on relevant topics related to corporate governance, stewardship and responsible investment that can be accessed through their website.

## Stakeholder engagement

**LGIMA believes companies should be managed to take into account the interests of their stakeholders on material issues.** Understanding and taking into account key stakeholders' views allows boards to create better alignment between the company and its stakeholders' interests. We expect companies to report in their annual disclosures how engagement with key stakeholders has fed into board discussions.

- **Employee voice**
  We acknowledge that different countries, through regulation or best practice codes, may have different approaches to how boards should consider the views of their employees. LGIMA believes investors should be able to hold directors accountable for their consideration of employee views.

  Where hard or soft law does not provide any guidance, we encourage companies to set up a structure they find appropriate. They may prefer the appointment of employee representatives on the board or the use of forums or advisory panels. For instance, in the UK, our affiliate, LGIM, encourages the nomination of a current independent non-executive director to seek out employees' views at different levels of the business and to regularly report these back to the board.

- **Investor dialogue**
  We believe that engagement constitutes a vital risk mitigation tool for the board. Engagement with investors should be a two-way discussion. Board directors should aim to use engagement meetings with investors as an opportunity to explain company decisions and to make sure they are well understood by the market. Such meetings should also be an opportunity to listen to investors, use their experience and act on their feedback.

Our position on **Board-investor dialogue**[6] is available on LGIM's website.

## Board committees

Board committees ensure that specific directors are responsible for key board functions.

**LGIMA expects all listed companies to put in place three separate board committees responsible for the core board functions of audit, nomination and succession, and remuneration.**

Companies may also choose to put in place **additional board committees** where necessary and appropriate, such as a risk committee or governance committee.

In order for investors to assess the effectiveness of board committees, LGIMA expects **disclosure** of the **role and composition of all board committees** as well as **for committees to report on their activities to investors** in the annual disclosure documents.

### Audit Committee

The audit committee is responsible for monitoring the integrity of the financial statements of the company, appointing external



[5]Source: LGIM.com, http://www.lgim.com/uk/en/capabilities/corporate-governance/influencing-the-debate/

[6]Source: Board investor Dialogue, Marion Plouhinec, 2018, LGIM.com, http://www.lgim.com/files/_document-library/capabilities/lgim-guide-to-board-investor-dialogue.pdf

auditors, monitoring their qualifications and independence as well their effectiveness and resource levels. This committee is also responsible for the overall risk management of the company to ensure that sound and robust internal controls are in place to appropriately manage the company's financial, operational and reputational risks.

As the audit committee plays a vital role in safeguarding investors' interests, LGIMA expects all companies to have an audit committee comprised **entirely of independent non-executive directors**. In order for the committee to operate effectively it should comprise **at least three members**, with at least **one member with financial expertise**.

Non-independent directors may attend audit committee meetings by invitation but should not be members of the committee. The company chair may be a member of the committee if considered independent on appointment but should not chair the committee.

Members should have **sufficient time** to examine company financial statements and to liaise with both internal and external auditors. The chair of the audit committee should be available to answer investors' concerns on specific audit issues.

### Nomination and Succession Committee

The nomination and succession committee is responsible for overseeing all board and senior executive appointments, ensuring an orderly and successful board and executive succession process. The committee should ensure the board has the right composition, taking into account important governance considerations such as skillsets, diversity, tenure, and over-boarding.

Focus of the committee should, however, not be restricted to the board but it must also seek to include alignment with the rest of the workforce in terms of human capital policies. The committee should also work closely with the remuneration committee to ensure that appropriate service contracts are in place.

Given the key role of this committee in board composition matters, LGIMA expects it to be **entirely composed of independent non-executive directors**. The committee should be **chaired by the company chair if the individual is considered independent on appointment.**

The committee chair should be answerable to investors if it is felt that appropriate succession plans are not in place or where there are concerns over the composition of the board.

### Remuneration Committee

The remuneration committee is responsible for the setting and operating of the company's remuneration strategy for executive directors and senior executives. **It should also have awareness of and an overview of remuneration policies within the rest of the company, below executive management level.**

The chair of the remuneration committee should have appropriate knowledge of the business to align the remuneration with its strategy. For this reason the person appointed to the role of remuneration committee chair should ideally have served as a member of the board for at least a year prior to appointment as chair of the committee.

LGIMA expects the committee to **consist exclusively of independent non-executive directors. The company chair can be a member of the committee if considered independent on appointment but should not chair the committee**. Non-independent directors may attend remuneration committee meetings by invitation but should not be members of the committee.

The remuneration committee should seek independent advice. It should therefore have the

**authority to appoint its own independent external remuneration advisors** to assist it by providing external data and other information. The use of such advice, including fees, should be reported in public annual disclosures.

### Additional Board Committees

Companies may consider it appropriate to set up additional board committees to assist the board in its discussions. **These committees are useful where the board could benefit from an increased focus on an issue that is directly linked to its long-term success** or where the company operates in a high risk sector.

For example, we commonly see the implementation of Risk, Governance, Sustainability, Health and Safety, Research and Development, or Technology committees.

### Advisory Committees

In other cases, boards may consider the need for direct access to independent and external advice and expertise from third parties or stakeholders. We are supportive of companies setting up advisory committees. We consider this a flexible option to obtain specific and relevant information to assist the board and management in their decision-making without having to impact the size and composition of the board.

# Audit risk and internal control

The board is responsible for determining and disclosing the company's approach to risk, its risk appetite, setting its culture, and monitoring the outcome and controls in place for effective risk management.

The board is also responsible for presenting the true and fair view of the financial position and future prospects of the company to its investors. Therefore, the established processes and procedures to ensure the independence and robustness of the internal and external audit functions, and the level of oversight from the board is expected to be demonstrated and explained to investors.

Assessing the effectiveness of and the resources available for the internal and audit functions forms part of the board's responsibilities. We expect the board to report to investors their conclusions of this review along with bespoke narrative as to the assessment and noted areas. These should be reported in the company's annual disclosures.

## External audit

An external independent audit provides the verification and assurance as to the financial statements of a company to its investors. 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. Any concerns raised by the auditors ought to be fully explained by the board, including how the concerns have been addressed.

The external auditors are also responsible for producing the auditors' report which is a formal opinion and evaluation of the financial statements. **We support and encourage the use of the extended audit report to provide greater insight to investors of the auditor's assessment of the accounts.**

The board is responsible for appointing the company's external auditor. The company is expected to clearly disclose the audit firm used, the audit partner who led the audit, the tenure of that firm, and why the board considers the auditor to be independent. **LGIMA supports the role of the external auditor to be put to tender[7] on a regular basis, at least every 10 years, with the total tenure of the auditor not exceeding twenty years.**

**The fees for the external audit ought to be disclosed in the annual reporting. Non-audit related services should not regularly be undertaken by the auditor.** Where the external auditor does provide non-audit related services, these should be fully explained and disclosed in the appropriate annual disclosures. **LGIMA does not expect excessive non-audit work to be conducted by the company's external auditors, as this will bring into question the independence of their judgment.** Non-audit related services are not expected to exceed 50% of the value of the audit services in any given year.

LGIMA considers that auditor liability is an important and proportional approach to supporting a high quality audit. We are not supportive of a fixed auditor liability or restrictions on that liability.

Recommendations arising from the external audit, are to be overseen by the board or the audit committee, and should be reported to investors where material.



[7] Source: Tendering your audit matters to shareholders, September 2016, LGIM.com, http://www.lgim.com/files/_document-library/capabilities/tendering-your-auditor.pdf

#### Japan market – audit and risk

The appointment of external audit firms is typically only put to a shareholder vote when companies intend to appoint a new audit firm. Auditors sit for a one year term, and can be reappointed without shareholder approval. In addition, audit firm rotations are not mandated by regulations. Accordingly this is not a matter that is frequently put to vote.

Auditors are an essential feature of an effective and transparent system of external supervision. To minimize potential conflicts of interest, the auditor's primary line of reporting should be to the audit committee, where one exists, and not to senior management. The auditors are ultimately employed to serve the shareholders, not the managers. Therefore, shareholders should be given an opportunity to vote on their appointment or re-appointment at each annual general meeting.

**We will oppose the appointment of a new auditing firm if:**

- There are serious concerns relating to the appointment of auditors.

## Internal audit

Companies should have an effective and sufficiently resourced internal audit system in place which is designed to take into account new and emerging risks that will affect its business objectives and identify the level of risk taken. The process and procedures in place to manage such risks should be embedded into the risk–based control system for the company, and summarized in the annual report to investors. The audit committee should have responsibility and oversight of the internal audit function.

## Whistleblowing

**LGIMA expects companies to establish a whistleblowing policy that is integrated into its Code of Conduct.** The policy ought to be publicly disclosed and open to third- party use. The whistleblowing reporting channels should be easily identified and sufficiently independent from external management, with a direct line to the Board or audit committee to allow for appropriate oversight and independent escalation where necessary. Companies should also report how the risks associated with bribery and other illegal behavior are being monitored and addressed.

## Cyber security

The breakdown of a company's cyber-security program can have a material financial impact. Therefore, we expect a risk- based approach to be taken to address the issue of cyber- security and data protection. It should be integrated into the control functions of the business, and overseen from a strategic perspective by the board. It is the board's role to understand the infrastructure needed in the business to protect valuable information assets and key intellectual property and therefore cannot be delegated. **The issue should also be a regular board discussion agenda item and where there is an incident, we expect this to be disclosed to the market and customers in a timely manner.**

# Remuneration

LGIMA is increasingly concerned about the misalignment of both the structure and the quantum of executive pay versus company performance, and the current social sensitivities around income inequality.

As a long-term and engaged investor, we entrust the board to ensure executive directors' pay is fair, balanced and aligned with the strategy, and long-term growth and performance of the business. In order to be able to hold the board to account where it fails to do so, **we expect all companies to allow shareholders an annual vote on executive directors' pay and non-executive directors' fees at the annual shareholder meetings.**

In addition, in order for investors to be able to appropriately assess directors' pay, we expect disclosure of the executive remuneration structure, including quantum and a description of the metrics and targets used under incentive plans where applicable and within the limit of what the company is publicly allowed to disclose.

While we are cognizant of the variations in executive pay practices globally, we expect companies to consider our principles below when setting pay policies for their executive board.

## Key principles

We apply a set of simple pay principles when looking at remuneration structures:

1. The structure of remuneration and the payments awarded should be fair, balanced and understandable. This means: fair in terms of what the company has achieved; balanced in terms of quantum to the executive, employees and investors; and understandable for the recipient, the board and investors;
2. Awards should incentivize long-term thinking by management and be aligned to and support the achievement of the business strategy and objectives
3. Executives should have meaningful direct equity holdings while employed and thereafter; buying shares is one of the best ways of aligning the interests of management and investors;
4. Boards should retain ultimate flexibility to apply discretion and 'sense-check' the final payments to ensure that it is aligned with the underlying long-term performance of the business
5. Companies should be transparent on why rewards have transferred to the executive, setting out targets that were set, their relevance to meeting long term goals, which targets were met and fully justify all adjustments made to accounting measures for remuneration purposes.

## Fixed remuneration

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

Salary increases should not be automatic each year. Any increase to salary levels should be commensurate with what is offered to the general workforce and its impact on total remuneration should be assessed before approval.

## Incentive arrangements

### Annual incentive

Companies may choose to award annual incentives to executive directors. LGIMA believes that any annual incentive should be geared to delivering the strategy of the business. A significant portion of the annual incentive should be linked to the delivery of financial performance. In addition, **achieving a threshold level of financial performance should be a pre-requisite for payment of any bonus that is based on personal objectives or strategic objectives.**

LGIMA would expect companies that are exposed to high levels of environmental, social or reputational risk to include relevant targets that focus management in mitigating these risks. In order to more closely align with investors and company performance, we ask companies to pay a portion of the bonus in shares deferred for at least 2 years. Additionally, the bonus should be set as an appropriate proportion of base salary and should not be uncapped. We also expect companies to put in place contractual and statutory provisions that may allow for a reduction or forfeiture of the annual bonus component in exceptional circumstances.

### Long-term incentives plans (LTIP)

LGIMA believes that a company should motivate and reward executives by granting long-term equity incentives plans which will align their interests with those of long-term investors. Incentives should be structured to motivate management to build a sustainable business which will generate positive returns to investors over the longer term. LGIMA therefore strongly encourages all companies to put in place a long term incentive plan.

In the interest of simplicity, LGIMA advocates the adoption of one long-term plan. **We strongly discourage the adoption of any additional incentive plan which would complicate the remuneration structure** e.g. matching schemes **or which would reward executive directors for motives which should already be addressed by the LTIP** e.g. retention plans or transaction bonus type schemes.

The LTIP should not have too many performance conditions but should include at least one measure that is linked to shareholder returns. Other measures should be linked to the strategy of the business, such as Key Performance Indicators (KPIs) which are selected by the board. **We expect at least 50% of awards made to be linked to performance conditions that cover a period of not less than 3 years.**

**In addition, all LTIPs should be capped either as a percentage of salary or a fixed number of shares.** Where a fixed number of shares are used, LGIMA would expect the number of shares being offered to be reviewed every 3 years to ensure they are offering a commensurate level of reward as when first adopted. Any increase to levels of reward should be subject to shareholder approval.

In order for investors to assess the appropriateness of long-term incentive arrangements, **we expect companies to disclose the metrics and targets used under the plan, within the limits of what they can disclose.** We expect the Remuneration Committee to maintain sufficient authority to exercise discretion when there is not a clear link.

Note **that LGIMA does not support retrospective changes to performance conditions that have been pre-set.** We also expect companies to put in place contractual and statutory provisions that may allow for a reduction or forfeiture of the long-term incentive component in exceptional circumstances.

### Holding periods

LGIMA encourages the use of post vesting holding periods as we find this helps aligning the remuneration structure with long-term performance.

In addition, to encourage the right values and behavior of directors to drive the business for the long term benefit of investors **we would encourage all companies to consider requiring directors to continue to hold at least half of the minimum shareholding requirement for two years post retirement.**

### Equity dilution

LGIMA believes that strict guidelines should be adhered to in relation to the issuance of shares for incentive schemes, in order to limit potential dilution to shareholders. As a general rule, **LGIMA 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. LGIMA encourages companies to provide transparent explanations regarding the issuance of shares and for share schemes to have performance conditions attached.

## Service contracts and termination payments

Executive contracts should provide for a maximum notice of 12 months. LGIMA 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 provide the company with the authority to apply claw-back of both unvested and vested awards.

### New joiners

When setting remuneration of a new executive who lacks experience of the company and/or the role, **LGIMA would encourage the remuneration committee to consider placing the individual on a lower salary than their predecessor;** with a view to increasing their pay over an extended time period, subject to performance. Where possible, the existing remuneration arrangements should be used to incentivize new appointees.

New recruits should be encouraged to purchase shares in the company. Additional benefits in relation to the appointment, such as assistance to re-locate, should be time limited. Executive Directors should retain shares in the company for at least two years post exit, at the higher of two times salary or half the minimum shareholding requirement (valued at exit).

### Departing directors

The use of 'golden hello' payments is not supported. Where a buy-out of existing awards from a previous employer is necessary, it should only cover the expected loss of value, and be awarded predominately in shares and subject to performance.

**LGIMA expects the company to ensure that there have been no rewards for failure.** Therefore the remuneration committee should take into account poor performance or any exceptional events, i.e. loss of life, when determining whether a director should be paid a bonus for the period worked.

With the exception of dismissal for cause and/or poor performance where awards should be lapsed, any outstanding awards of leavers should be time pro-rated and allowed to run their course subject to the same vesting conditions that applied at grant.

## Benchmarking

When using benchmark data, the remuneration committee should take into consideration a number of factors: size of the company, its geographic spread and performance relative to the benchmark peers. The peer group used should not be too large or too small as both extremes could produce misleading results. **Companies should ensure they disclose meaningful information on the benchmarking data used and why it has selected the benchmark group.** Directors at underperforming companies should not expect to be remunerated as highly as directors of companies with outstanding performance.

## Discretion

Companies can build trust with investors if they can demonstrate historic restraint, consistency and alignment with them. Discretion applied on any earned award by executives' is one way to demonstrate this alignment. **We define discretion as anything that alters the monetary outcome of total remuneration.**

LGIMA expects the company to state:

- The main reasons that might give rise to the application of discretion
- Whether discretion would be applied upwards as well as downwards
- The elements of pay to which discretion may be applied

## Shareholding guidelines

LGIMA 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 investors. **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. **LGIMA will not support pension enhancement payments at retirement or when a contract is terminated early.** Additionally, LGIMA 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 explained.

LGIMA expects companies to set a target to make pension payments to their executive aligned with what is offered to the general workforce.

## Non-executive directors' fees

Non- executive directors' fees should reflect the level of responsibility and time commitment of the role. The use of share options or other performance related pay is not supported but a proportion of the fixed fees being paid in shares is encouraged.

### North America market – compensation

### Hedging of stock

LGIMA believes the **hedging of shares by executives in the shares of the companies where they are employed severs the alignment of interests of the executive with shareholders.** We believe companies should adopt strict policies to prohibit executives from hedging the economic risk associated with their share ownership in the company.

### Pledging of stock

LGIMA believes investors benefit when employees, particularly senior executives, have ‘skin in the game’. LGIMA therefore recognizes the benefits of measures designed to encourage employees to both buy shares out of their own pocket and to retain shares that they have been granted.

**Pledging shares can present the risk that an executive with significant pledged shares and limited other assets may have an incentive to avoid a forced sale of shares in the face of rapid stock price decline.** To avoid substantial losses from a forced sale to meet the terms of the loan, the executive may have an incentive to boost the stock price in the short term in a way that is unsustainable and so hurts investors in the long term. Concerns regarding pledging may not apply to less senior employees, given the latter group’s limited influence on a company’s stock price. Therefore, the issue of pledging shares should be reviewed in that context, as should policies that distinguish between the two groups.

### Pay ratio

In 2015, the SEC adopted a final rule requiring public companies to disclose the ratio of the compensation of its CEO to the total compensation of the median company employee. The disclosure will begin in the 2018 proxy season. The company will be permitted to select its methodology for identifying its median employee’s compensation every three years. Non-US employees from countries in which data privacy laws or regulations make companies unable to comply with the rule can be excluded.

To identify the median employee, the SEC rule would allow companies to select a methodology based on their own facts and circumstances. A company could use its total employee population or a statistical sampling of that population and/or other reasonable methods. A company could, for example, identify the median of its population or sample using:

- **Annual total compensation as determined under existing executive compensation rules; or**
- **Any consistently applied compensation measure from compensation amounts reported in its payroll or tax records.**

We encourage companies to use its total employee population and to identify the median by using annual total compensation as determined under existing executive compensation rules. **We encourage this so that the information provided is consistent and therefore comparable between companies.**

Disclosing this information will heighten scrutiny on executive compensation practices, with specific focus on how CEO compensation compares to the median employee. Depending on the magnitude of pay ratios, the new disclosures may exacerbate existing concerns among investors about executive compensation.

The pay ratio disclosure will provide shareholders with additional company-specific information that can be used when considering a company's executive compensation practices, an important area of corporate governance on which shareholders now have advisory votes. This disclosure illustrates to what extent the dangers of disparity in pay levels are recognized. If used effectively, the data can be applied by compensation committees to better moderate pay packages and reduce the trend of pay disparity. The changes in CEO-to-worker pay ratios will be a useful measure of CEO pay levels and will hopefully reduce CEO pay levels and encourage boards to also consider the relationship of CEO pay to that of other company employees. Companies with high pay ratios will have to explain and justify the ratio to their investors, placing more focus on the reasons behind potentially large CEO remuneration.

LGIMA will use the pay ratio information on a relative basis across sectors rather than an absolute basis, allowing us to compare the employee compensation structures of companies over time and against their competitors. **Such disclosure will provide valuable information about which companies are investing in their human capital, an increasingly important contributor to investor value and strong business culture.** However, LGIMA will use this information as only one part of the assessment of overall compensation.

### Service contracts and termination payments

Under the Dodd-Frank Act, companies are required to disclose additional compensation arrangements with executive officers in connection with merger transactions, known as 'golden parachutes'. All agreements should be disclosed, including those between the acquiring and target companies have with the executive officers of both companies.

LGIMA expects companies to provide a separate shareholder advisory vote to approve 'golden parachute' arrangements in connection with a merger, acquisition, consolidation, proposed sale or other disposition of all or substantially all assets.

The accelerated vesting of equity due to a change in control does not reward performance and would not be an element LGIMA would support. Instead, equity should move to the newly merged companies and should vest over a period of time if performance conditions are met. **If the board considers accelerated vesting appropriate, then this should only be triggered if a change of control has occurred and the executive loses their job in the company – known as a 'double trigger'.** Accelerated vesting should not occur simply on a change of control with the executive remaining employed in the new company – known as a 'single trigger'. Such accelerated vesting of awards made under a change in control situation should be done on a pro-rata basis so that only awards that have met performance conditions are given.

### Tax gross-ups

LGIMA does not expect companies to provide tax gross-ups to its executives in severance payments. In agreeing to tax gross-ups on service contracts, the compensation committee may be committing the company to paying excessive amounts in the event of a change in control. **LGIMA does not support such payments and many companies have phased out such tax gross-ups in new service contracts.**

### UK market – remuneration

**The Remuneration Committee should consider carefully and be able to demonstrate how it has reviewed the pay policy of the entire workforce when setting pay for the executive team.** It should be willing to meet with employee representatives at least annually to receive any appropriate input and explain how it has exercised this duty.

The Investment Association, a trade body that represents investment managers in the UK, maintains a register of companies who have had a 20% vote against a resolution at a shareholder meeting. A large voting opposition (>20%) to the remuneration proposals should not be ignored. The Remuneration Committee should:

- Publish an explanation for the dissent when disclosing the voting outcomes including what the board is doing to address concerns.
- A copy of this should be sent to the Investment Association to include in the Public Register

### Remuneration report - (remuneration committee chairman's statement)

Executive remuneration is a board decision, supported by the remuneration committee. The remuneration committee chair should support the process of setting pay and this should be evidenced in the annual report. **Therefore, LGIMA regards the statement made by the remuneration committee chair to shareholders as an important and direct message to explain the policies that have been adopted and why.** We would encourage the committee chair to personally write this statement and to consider:

- A summary of the strategic direction of the company;
- How the performance measures selected under the annual bonus and long-term incentive plan aid the achievement of these objectives;
- A summary of the performance achieved over the year;
- A confirmation that the board believes that the pay outcome is justified given the overall performance of the business, the KPI's achieved and the shareholder experience;
- A pay ratio outlining the pay of the CEO relative to the median pay in the business along with an explanation of why the board considers this ratio to be appropriate for its business;
- An explanation of the discretion applied whether upward or downward; and
- A summary of what was discussed by the remuneration committee during the year; any changes that are being introduced as a result, together with a rationale for the changes.

### Remuneration policy table

The policy table provides an opportunity to simply explain the company's remuneration structure. LGIMA will particularly look for:

- How the company will address salaries over the next 3 years;
- Details of the maximum awards under the bonus / long-term plans;
- The size of normal awards if they differ from the maximum;
- Performance measures that will apply under the annual bonus and long term plan including the weightings between the measures;
- An explanation for the total potential award.

### Pay ratio

**All companies should produce a pay ratio of their UK employees, comparing the median employee with the CEO's single figure total pay.**

Global companies should explain how this compares with the ratio when all employees are taken into account.

## Key elements of pay

### Annual bonus

- We encourage the reduction of short term annual bonus levels.
- 200% of salary should be set aside for the largest global companies.
- Performance targets should be disclosed retrospectively. All targets should be disclosed within 2 years.

### Benefits and pensions

- Pensions are a significant cost and risk for the company as well as an element of remuneration that is not linked to performance.
- Pension benefits should be closely aligned with what is being offered to staff.
- Re-location expenses should mirror what is being offered to employees at all levels. Any additional benefit for executive directors should be limited to 2 years.
- Pension contributions should be reduced over time to be more closely aligned with what is offered to all employees.

### Long term incentive plans

LGIMA encourages companies to operate a single long term incentive plan that is purely for executive directors.

### Restricted share schemes

This structure is not appropriate for all companies and they should justify why this type of arrangement is appropriate and why an existing arrangement is no longer suitable.

For those companies considering adopting a restricted scheme, we have set out the criteria of what would be acceptable to LGIMA as a shareholder in your company:

- The Company should be able to demonstrate a history of a sensible approach to remuneration. For example, no high votes against previous proposals and can evidence where appropriate discretion and judgment has been used;

- Historic vesting rates should be used as a guide when determining the appropriate discount rate to apply. A 50% discount rate is the absolute minimum that should be applied;
- This should be a long-term scheme that is applied through different business cycles;
- Shareholding guidelines should be set at a higher limit than is currently in place;
- Companies should introduce a post exit shareholding requirement, as part of the plan rules.
- For leavers, unvested restricted shares should be pro-rated for time and subject to the same vesting time frame and holding requirements as set out above;
- Discretion should be applied to reduce awards if at the end of the holding period the performance of the company and the shareholder experience is not aligned. (See: p23, para. 2 of the **Executive Remuneration Working Group report**[8])
- The Company should be fully transparent: targets, vesting criteria, adjustments to KPIs should be disclosed prospectively for all elements of remuneration.

## Japan market – remuneration

### Introduction

We regard appropriate remuneration levels as fundamental to recruit, incentivize and retain directors of the quality required to manage the company successfully. LGIMA seeks disclosure and justification of chosen remuneration structures and levels.

In general, Japanese companies are less prone to excessive remuneration structures than companies in other markets. Due to the nature of long tenure of employees in the same company, the interests of executives in Japan are fundamentally long term.

However the Japanese disclosure requirements associated with executive pay are weak. The requirement for individual disclosure is limited to directors and executives who receive above ¥100 million per annum.

Cash retirement bonuses constitute a significant portion of executive remuneration, and the majority of these are not reflective of performance. In addition, equity-based incentives, mainly stock options, have not yet gained traction among Japanese executives. LGIMA considers that Japanese companies should adjust their executive remuneration structures to align with company performance and shareholder value creation. Accordingly, remuneration disclosure should focus on the structure of incentive arrangements.

### Annual bonuses for directors and Kansayaku

We consider that outside directors should not receive annual bonuses. These bonuses should be limited to insiders and be awarded on the basis of performance. Receipt of bonuses can erode independence, and negatively



[8]Source: Executive Remuneration Working Group Final Report, July 2016, The Investment Association, https://www.theinvestmentassociation.org/assets/files/press/2016/ERWG Final Report July 2016.pdf

influence the veracity with which management is scrutinized.

### Retirement bonuses

Retirement bonuses are standard practice in Japan, and comprise a significant portion of lifetime remuneration for directors and Kansayaku. The details of bonus proposals, such as the amounts paid and the status of recipients, are seldom disclosed. This prevents shareholders from assessing the merits of bonus proposals, and potentially undermines investor confidence in the company's capital management practices.

### Special payments in connection with abolition of retirement bonus system

We consider that outsider directors should not receive special payments. Receipt of special payments can erode independence, and act as a disincentive for outside directors or Kansayaku to speak out against management.

### Deep-discounted stock option plans

It is common for Japanese executive remuneration to be based on fixed compensation, which does not expose directors to the risks or rewards faced by shareholders. In general, stock option plans should be promoted as a tool to better align the interests of directors with those of shareholders.

We consider that the extent to which stock option plans can benefit or disadvantage independent shareholders is dependent on the way in which the plan is designed. LGIM's evaluation of these plans is conducted in terms of potential dilution, option recipients, exercise period and price, and the presence of performance hurdles.

### Director and Kansayaku's compensation ceiling

Japanese companies are less prone to excessive or misaligned remuneration structures than companies in other markets. Notwithstanding, the management of Japanese remuneration requires structural realignment.

Performance-based remuneration still occupies a relatively small portion of total pay. LGIMA will generally support proposals calling for an increase in the director compensation ceiling if this increase is intended to introduce or increase the performance-based pay component. If proposals seek an increase in nonperformance based director pay, or it is unclear whether pay is performance based, LGIMA will examine these on a case-by-case basis. LGIMA will vote against proposals seeking to increase director compensation in cases where there are concerns of mismanagement.

**We will oppose the approval of annual bonuses for directors/Kansayaku if:**

- Recipients are outside directors;
- There is clear evidence of mismanagement on the part of the recipient;
- The company's performance has been poor.

**We will oppose the approval of retirement bonuses or special payment if:**

- Recipients are outsider directors;
- Neither the individual payments nor the aggregate amount of the payments is disclosed, or it is

disclosed but it is not deemed appropriate;

- There is clear evidence of mismanagement on the part of the recipient.

**We will oppose the deep discounted option plans if:**

- Total dilution from proposed plan(s) and previous option plans exceeds 5% for mature companies, or 10% for growth companies;
- Recipients include individuals who are not in a position to influence the company's stock price, including employees of business partners or unspecified 'collaborators';
- The maximum number of options that can be issued per year is not disclosed;
- No specific performance hurdles are specified.

**We will support an increase in a director's compensation ceiling if:**

- The specific reasons for the increase are explained and we believe it will create positive incentives; or
- The company is introducing or increasing a ceiling for performance-based compensation.

# Shareholder and bondholder rights

The provision of shareholder and bondholder rights is a basic entitlement for investors. LGIMA expects companies to acknowledge and respect the rights of investors through adhering to the highest market standards. This includes providing high quality disclosures and equal treatment of shareholders. Below, we have outlined guidance on the topical issues that concern LGIMA as an investor:

## Voting rights and share class structures

**LGIMA supports the "one share one vote" philosophy and favors share structures where all shares have equal voting rights and those rights are equal to economic value held.**

LGIMA 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, LGIMA will review the issuance of shares with enhanced voting rights to understand why these would be necessary. In general, LGIMA encourages companies to eliminate differential voting rights over time.

## Amendments to the company's constitution

It is common to see requests from companies seeking approval to update/amend the company's constitution as they impact members' rights.

LGIMA expects these changes to be clearly outlined and disclosed in the notice of meeting. Approval at the general meeting should also be sought as separate resolutions, not bundled. While LGIMA assesses bundled resolutions on a case-by-case basis, we initially view them negatively as they could potentially undermine the value of a shareholder vote and it may be a source of confusion.

#### Japan market – article amendments

It is common to see requests for amendments relating to various issues including capital increases, changes to capital structures, changes to board size and composition, as well as takeover and defense related plans, bundled together as a single voting resolution.

Bundling potentially undermines the value of shareholder votes and may be a source of confusion. LGIMA assesses bundled resolutions on a case-by-case basis, examining those resolutions that may compromise current or future shareholder interests.

### Company by-laws

**LGIMA believes that exclusive forum by-law provisions limiting a shareholder's choice of legal venue are not in the best interests of shareholders.** Such clauses may effectively discourage the use of shareholder derivative claims by increasing their associated costs and making them more difficult to pursue. LGIMA does not encourage limitations on shareholders' legal recourse including limiting themselves to a single jurisdiction without compelling evidence that it will be of benefit, and expects companies to provide a compelling argument on why the provision would directly benefit shareholders.

LGIMA also expects companies to put by-law amendments that have the potential to reduce or negatively impact shareholder rights to a shareholder vote

## Virtual/electronic general meetings

LGIMA believes that general meetings are fundamentally important to the exercise of shareholder rights and integral to a good corporate governance system. Furthermore, we view physical shareholder meetings as providing an important mechanism by which a Board is held publically accountable to all their shareholders, both institutional and retail.

Shareholder meetings provide an invaluable opportunity to raise particular concerns with a board in a public forum and investors are able use this mechanism as part of their stewardship activities. For example, it could be utilized as an escalation tool which enables shareholders to make statements and ask questions to the whole board.

On virtual shareholder meetings, investors are cognizant that companies are keen to make sure that their shareholder communications keep pace with developing technology and those conducting shareholder meetings electronically is an area of particular focus. We also agree that using technology, such as webcasting the meeting, to complement the physical shareholder meeting could be beneficial and could increase investor participation.

**However, we believe that such technology should be used in parallel with the in-person meeting, and should not lead to companies adopting a virtual-only approach.** The shareholder meeting is the only time that the whole board must be publically accountable to all its shareholders. The attendance of the board to such meeting is a demonstration of its commitment to hear and understand the views of shareholders.

Virtual only shareholder meetings remove this accountability due to the remoteness of participants. The public nature of AGMs and full attendance of the board is also important to allow LGIMA to bring matters to the board's attention. Removing this tool impairs our ability to hold boards to account on behalf of our clients. Companies who adopt a 'virtual-only' approach may also risk giving the impression that they are attempting to filter questions or participation of shareholders and do not want to be subject to the varied questions of their investors.

Therefore, LGIMA is not supportive of the move towards fully virtual-only shareholder meetings. **Any amendments to a company's constitution in relation to electronic meetings should confirm that a physical meeting will continue to be held.**

## Transparency

LGIMA encourages companies to allow investors to be able to appropriately identify and assess their performance on material ESG issues.

**We expect companies to adopt an open approach to the public disclosure of information, within the limits of what they can disclose.** We would also encourage disclosures to be made in English to allow access to information by a greater number of investors.

Improved transparency facilitates informed voting, engagement and integration of ESG into investment. It allows investors, who sit outside board discussions, to have access to key ESG data and be able to appropriately assess the ESG performance of companies, taking into account the board's rationale in instances where the company does not comply with best practice

## Capital management

The board has a key responsibility in ensuring a company has sufficient capital, overseeing the capital management of the company, ensuring an efficient capital allocation and, when additional capital is required, it is raised in an appropriate way.

Balancing the long-term investment needs of the company with shorter-term returns to investors is a critical role of the board.

Therefore, **we support the right of shareholders to have a separate vote on the tools and authorities provided to the board to manage its capital structures.** Such rights protect shareholder interests whilst balancing the need for board flexibility. For example, share issuances are not dilutive and capital is being raised in the long-term interests of investors.

### Share issuance

LGIMA supports a company's entitlement to issue shares to raise capital. However, **such issuances should be limited to what is necessary to maintain business operations and should not expose minority shareholders to excessive dilution of their shares.**

The existence of pre-emption rights is fundamental to protect shareholders from excessive dilution. It gives 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.

#### UK Market - share issuance

A general authority to issue shares should be limited to two thirds of the issued share capital. Any issue of new shares in excess of one third of the issued shares capital should always apply pre-emption rights.

A request to increase the authorized share capital without pre-emption rights should be limited to 5%. The revised Pre-Emption Group guidelines permits the issue of an additional 5% of share capital where the additional 5% is for the purpose of financing an acquisition or other specified capital investment that has been disclosed. LGIMA supports the template resolutions published by The Pre-Emption Group and expects such requests to be proposed as separate resolutions for shareholder approval.

**LGIMA will not support the re-issue of shares at a discount to their net asset value.**

#### Japan market –issuance of shares

Japanese boards have the discretion to issue shares within the authorized capital (a maximum of four times the current issued capital) on the condition that the issuance price does not constitute an advantage. In the event that a price is considered advantageous, shareholder approval will be required.

LGIMA regards pre-emption rights as fundamental to protect shareholders' investment in a company, and to foster investor confidence. However, it is common for Japanese companies to undertake significant private placements without offering pre-emption rights to existing shareholders. Companies should consider alternative means of raising capital that does not expose minority shareholders to excessive dilution of their shares.

LGIMA may consider voting against the re-election of directors, if need be after the event, if there are serious concerns with capital management.

### Share repurchases or buybacks

Share repurchases or buybacks can be a flexible approach of returning cash to shareholders. We expect the board to be transparent in how the share buyback authority will be used in relation to other uses of capital (such as dividends, internal investment or external by merger & acquisition).

However, the benefits of using this approach is dependent on a number of factors including the price of the shares at which it is bought back, the company's individual financial circumstances and wider market conditions at the time.

**When utilizing this authority, LGIMA expects companies to take into account its impact on other issues.** For example, on remuneration, as performance conditions governing incentive schemes may be impacted as a result of a company undertaking a buyback authority. Furthermore, given the reduction in the number of shares in the market, the holdings of large shareholders will also increase giving them more control.

#### UK market - share repurchases or buybacks

LGIMA expects the authority to repurchase or buyback shares to be subject to shareholder approval and should be an annual authority limited to 15% of the issued share capital.

Earnings per share metrics used in incentive plans should be adjusted to strip out any enhancement that has resulted from buy back activity.

Share repurchases or buybacks can trigger Rule 9 of the Takeover Code where there is a significant shareholder. Under such circumstances, LGIMA would expect the company to ensure that a buy back does not result in the significant shareholder's holding increasing. LGIMA would not support a Rule 9 waiver under these circumstances.

#### Japan market – share repurchase

In the Japanese market, companies often attempt to remove the requirement to seek shareholder approval for share repurchase schemes. Since 2005 when the Company Law was amended, Japanese companies have had the option of waiving the requirement for shareholder approval for share repurchases provided they are funded with retained earnings.

LGIMA generally supports share buyback policies that deliver shareholder value.

### Debt issuance

Good transparency and disclosure by the company on the issuance of bonds is important for debt investors. In its reporting, LGIMA expects a company to include a:

- Timely release and public availability of prospectuses both before new issue and while bonds remain outstanding
- Commitment to provide public access to on-going financials and disclosures; and
- 5 year financial history of the company.

## Mergers & acquisitions (M&A)

LGIMA supports proposals that create value for investors over the long term.

In order to make an informed assessment, we expect management to be transparent on the terms of the merger, and its financial and cultural integration implications on the long-term business strategy. We expect all companies to explain how the transaction is expected to yield significant long-term benefits for the company and its stakeholders, including its investors.

LGIMA also encourages the company chair and the non- executive directors to **hold separate meetings with investors without management present,** and to have honest conversation about the risks and opportunities of the transaction. In a contested takeover, LGIMA will aim to meet with both parties before making a final decision

In addition, LGIMA believes that a **strong governance framework** is essential during any M&A activity. Companies should therefore make sure the independent non-executive directors are **informed at an early stage** and can obtain independent advice at the cost of the company, with advisors remunerated on a fixed fee basis. A strong process should be in place to ensure there are **no conflicts of interest.** The **skillset of the board** must also be reviewed, including past M&A experience, to ensure the board is appropriately equipped to successfully lead the transaction and its impacts on the company. The board may also consider putting in place a **separate ad-hoc committee of independent NEDs.**

**Japan market – merger and acquisitions**

LGIMA 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 LGIMA 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 significant impact on the company's financial health.

### Takeover defense plans – poison pills

Poison pill is the term given to an artificial device implemented by a company to deter takeover bids. Well- designed poison pills may strengthen the board's negotiating position and allow it to obtain more favorable terms from an acquirer.

**Japan market – takeover defense plans (poison pills)**

Japanese companies have frequently adopted powerful takeover defenses. Well-designed poison pills may strengthen the board's negotiating position and allow it to obtain more favorable terms from an acquirer. However, it is vital that this process is controlled by a fully independent board that is more concerned with shareholder value than with protecting its own position.

LGIMA will not support a poison pill if it entrenches management and protects the company from market pressures, which is not in shareholders' best interests. LGIMA will assess each case carefully; although the lack of independence within many Japanese boards means that it is difficult to achieve a poison pill that is unaffected by bias.

**We will oppose all takeover defense plans:**

- Unless management presents a robust case that the plan will not allow management entrenchment to provide an unbiased assessment of shareholder interests in a proposed deal. This should be supplemented with a board that is composed of a majority of independent directors;
- And the board is one third independent

**We will oppose a proposal if:**

- It would remove the right for shareholders to approve dividend payments

It is vital that this process is controlled by a fully independent board that is more concerned with investor value than with protecting its own position. **LGIMA will not expect a poison pill to entrench management and protect the company from market pressures which is not in investors' best interests.**

### Related party transactions

Related party transactions (e.g. between a controlling shareholder and an issuer) are an important issue for minority shareholders as there is a risk that a related party takes advantage of its position. **Adequate safeguards must therefore be put in place to provide protection for the interests of the company and of the shareholders who are not a related party, including minority shareholders.**

All transactions must therefore be authorized by the board of directors. LGIMA also expects the company to set up a fully independent audit committee which ensures that such transactions are conducted on the basis of an independent and disinterested valuation.

In addition, LGIMA expects companies to disclose sufficient information around such transactions in its annual disclosures to ensure shareholders remain informed of such transactions and are able to make informed voting decisions.

## Shareholder proposals

LGIMA considers all shareholder proposals tabled at a company's AGM in the wider context of the corporate governance practices at the company, and also in relation to the long-term benefits for investors. LGIMA expects companies to provide a meaningful discussion of the proposals to enable shareholders to make an informed judgment.

LGIMA expects majority supported shareholder proposals to be adopted. **And where there has been significant support (25% of more) then we would expect the company to consider the benefits of the proposal and to discuss this with their shareholders and to disclose in annual disclosures.**

## Political donations

**LGIMA will not support direct donations to political parties or individual political candidates by companies.** LGIMA believes that companies should fully disclose all political contributions, direct lobbying activity, and political involvement and indirect lobbying via trade associations. There should be increased transparency around the memberships of and monies paid to trade associations and lobbying groups including:

- A breakdown of payments to political parties, candidates and associations, trade associations, think-tanks, and on direct and indirect lobbying activity on policy and legislative proposals etc.
- Clear explanation of how each of the above associations, contributions and actions etc. benefit the causes the company
- A public statement from the company outlining where it disagrees with the associations of which it is a member on a particular issue, and the reasons why it believes it to be beneficial to remain a member
- Disclosure of where responsibility sits within the company for the oversight of such relationships.

### North America market – shareholder rights

#### Acting by written consent and calling special meetings.

Shareholders should have the right to call special meetings. This allows a shareholder to put resolutions to all shareholders at a specially convened company meeting. **Generally, LGIMA believes that companies should allow shareholders with a minimum holding of 10% to call special meetings as this allows sufficient access but prevents abuse of this benefit.** However, LGIMA will take into account the company shareholding structure when assessing whether the proposed threshold is appropriate. Additionally, there should not be any material restrictions to the ability of shareholders to call this meeting once an acceptable threshold has been set.

If a threshold of 10-25% holding (depending on the company shareholding structure) to call a special meeting is in place and if other governance practices are strong, as well as the company's open engagement with shareholders, then LGIMA will not support the right to act by written consent, as this can disenfranchise some shareholders to the benefit of only a few.

#### Access to Proxy

LGIMA considers proxy access to be a standard shareholder right and expects companies to apply a provision to enable shareholders to propose directors to the board. Therefore, LGIMA will support proposals that allow access for 20% of the board or a minimum of two seats to be proposed to the proxy if a shareholder group of no more than 20 shareholders owns 3% of outstanding shares for three years.

#### LGIMA believes:

- Restrictions on re-nominations when a nominee fails to receive a specific percentage of votes are inappropriate.
- Re-submission requirements are not required for management's candidates, and therefore should not apply to candidates proposed by shareholders.
- Securities on loan should be counted towards the ownership threshold, provided the shareholder shows it has the legal right to recall shares for voting purposes and will vote them at the shareholder meeting along with representation that the shareholder will hold those shares through the date of the meeting.
- A requirement that a nominator provide a statement of intent to continue to hold the required percentage of shares after the annual meeting is unnecessary.
- Nominating shareholders may not know their intent to hold, sell or buy shares until after the election, so the pre-filing holding period of three years, coupled with the requirement to hold the shares through the shareholder meeting, is adequate.
- A prohibition on a nominator from using proxy access for the two annual meetings following an annual meeting at which its nominee is elected to the board (except for the nominee initially elected) is inappropriate.
- A group of funds counts as a single shareholder for the purposes of meeting the 3% ownership threshold with aggregation limits.

### Supermajority vote standard

Supermajority provisions on voting go against the principle that a simple majority of voting shares should be sufficient to effect change at a company. The supermajority provision serves to entrench management by preventing amendments that would be in the best interests of investors. LGIMA expects companies to eliminate such provisions and, where this requires supermajority support to be enacted, that the company make concerted efforts to gain their shareholder support in order to change its bylaws.

### Cumulative voting

Cumulative voting allows shareholders to cumulate their votes for one or more directors on the ballot. Each shareholder is entitled to as many votes as are equal to the number of their shares multiplied by the number of directors to be elected. The shareholder may cast all of such votes for one nominee or may distribute them among two or more nominees at their discretion. LGIMA does not support cumulative voting as it does not protect minority shareholder rights and does not support the democratic election of directors.

## Japan market – shareholder rights

### Cross holdings

Historically, cross holdings in Japanese companies have been high, but are in gradual decline. Cross holding may serve a strategic objective and enhance shareholder value, but can also increase risks. Therefore, management should be prepared to engage in an open dialogue with shareholders to demonstrate the value created through its cross holdings. We encourage companies to disclose the nature of the relationships in their top 30 crossing holdings and any position that exceeds 1% of its capital.

Cross holdings should not be used as a device to protect the company from the possibility of an unwelcome takeover bid.

### Allocation of dividends and profits

Dividend yields in Japan do not adequately reflect the high cash holdings in many Japanese companies. Increasingly, however, companies are starting to define their dividend payout ratios, which should be well balanced between the interests of shareholders and the capital investments required for the business to maintain competitiveness in the market.

LGIMA will evaluate each resolution on a case-by- case basis. Particular attention will be paid to cases where a company proposes to pay a dividend exceeding its net profit, as such payments could damage the company’s long-term financial health.

# Sustainability

As a major global investor, LGIMA has a fundamental interest in ensuring that shareholder and bondholder value is not eroded by a company's failure to manage the risks associated with its natural and social environment. LGIMA believes that if companies take advantage of the need to move towards a more sustainable economy, investors can benefit through protection from future risks and the potential of better long-term financial outcomes.

## Material risks and opportunities

Material environmental and social (E&S) risks will vary between sectors and from company to company, depending on a range of factors. However it **is important that all companies across different sectors undertake an analysis of E&S issues that could be material to their business** over varying timeframes. A 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, and efficiency gain potentials that the company may face in changing policy, technology and business environments.

## Sustainability as part of 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 material risks and opportunities have been identified, there should be a clear link to the overall business framework.

## Policies to mitigate key risks

Where risks have been identified for the business, **robust and comprehensive policy statements should be disclosed** to all stakeholders in order to demonstrate the company's commitment to managing these risks.

## Management systems to mitigate risks

**Managerial systems and procedures should be put in place** for all business operations that either can be considered exposed to environmental and social-related risks, and/or that may produce negative externalities. Where possible, such systems should be externally verified.

## Target-setting

**Companies should set targets for mitigating and managing material E&S risks and impacts**, as well as for maximizing potential positive stakeholder impacts. While it is important for the targets to be achievable, companies may benefit from setting challenging goals in order to maximize overall benefit.

Science Based Targets are de-carbonization targets aligned with the objective of the Paris Agreement. Where material to the business, we encourage the companies we invest in to set Science Based Targets.

## Public disclosure

Transparency and disclosure are key tools which enable investors to undertake a robust analysis of investment risks and opportunities, and allocate capital accordingly. **We expect companies to demonstrate their commitment to the disclosure of sustainability information and data,** through publication in key company reporting; this includes the annual report and accounts, with supplementary information in sustainability reports and on websites.

We encourage companies to disclose to key third-party sustainability agencies, and in-line with best-practice international guidelines. In relation to climate change, we expect to see companies moving to report in-line with guidance of the Taskforce on Climate Related Financial Disclosures (TCFD). We also encourage companies to relate the Sustainable Development Goals (SDGs) to their business strategy and operations, and disclose on this in a clear and consistent manner.

## Governance and accountability

Responsibility for managing a company's societal and environmental impact and the related risks to the business sits with all employees. However accountability should sit at the board level. We expect sustainability commitments to form part of the responsibility of the CEO and the board. We expect companies to disclose the governance processes that are in place to oversee and manage these risks. Where material to the business, we encourage companies to link executive remuneration to delivery of these commitments.

Where climate change is identified as a material issue for the business – whether over the short, medium, or long- term, we expect companies to have sufficient expertise and experience on the board to ensure effective strategic and operational oversight.

## Financial impact quantification

Quantification of sustainability impacts can assist investors to more effectively allocate capital, according to their risk, return and impact objectives.  Companies can also achieve a net benefit in managing sustainability impacts effectively.

LGIMA encourages companies to demonstrate a commitment to best sustainability practices and where possible, seek to quantify the impact in financial terms in order to internalize the associated costs and benefits.

## Engagement transparency

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

We expect companies to be transparent in disclosing their public policy engagement activities, whether this be individual engagement, or collaborative engagement as part of an industry association.

In relation to climate change, we would expect companies to publically disclose any concerns they may have with current or evolving legislation and to publically report on any lobbying activity that is undertaken as a result of such concerns.

## LGIMA's sustainability commitment

LGIMA makes its own commitment to ensure that environmental and social issues are factored into both companies' and investors' decision-making. We set out to do this in a number of ways:

- Market practice, working to create better sustainability standards for the market at large
- Engagement and voting

- Integration of sustainability into active management
- Integration of sustainability into product solutions
- Communication on sustainability issues to the market and our clients

For further information and detail on how we do this, please refer to LGIM's **ESG integration policy**[9].

[9]Source: LGIM.com, http://documentlibrary.lgim.com/documentlibrary/library_55458.html