

# Investment Stewardship

Conflicts of interest policy



# Introduction

## Conflicts of interest policy

**The Legal & General Investment Management (LGIM) Investment Stewardship team has responsibility for engaging and voting with listed companies to safeguard and enhance our clients' assets, and identifying and engaging on emerging governance topics. As part of this process, it is necessary to be able to take informed positions, and to be able to actively support companies, in order to obtain the best outcome for our clients. Using our scale can influence investee companies on important decisions.**

Being seen to identify, manage and mitigate both actual and perceived conflicts is essential to our activities, so that clients understand their interests are always put first. Additionally, the management of conflicts is important in building long-term relationships with the companies in which we invest, as in order to drive change and have an impact on the market we need to be seen as a trusted, fair and transparent investor.

### Putting clients' interests first

LGIM owes each of its clients a duty of care with respect to all services undertaken on their behalf. We place our clients' interests ahead of our own, and undertake activities and cast proxy votes in a manner consistent with the best interests of all clients. The team is structured and supported in a way that aims to minimise potential conflicts of interest, but when these arise we are able to act to achieve the best outcome for all clients.

### Potential conflicts of interest

There are a number of potential conflicts of interest inherent in the corporate governance activity undertaken at LGIM. Detailed below are some of the frequent conflicts of interests that we identify and resolve through the application of the conflicts of interest policy. This is not an exhaustive list and the Investment Stewardship team may encounter additional conflicts not detailed in this policy.





# Potential conflicts

## Legal & General Group plc (L&G)

(LGIM's listed parent company)

- Reputational conflicts may arise through the parent company not currently adhering to the best practice espoused by the LGIM Investment Stewardship team
  - The parent company may have commercial relationships and connections with companies and stakeholders with whom the Investment Stewardship team is engaging
  - The parent company may try to influence LGIM's activities on corporate governance, takeovers and public stances on key topics
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## LGIM clients or prospective clients

- Many of our clients are corporate-sponsored pension schemes that are associated with the companies in which LGIM invests
  - Clients may not support the voting and engagement activities of LGIM. For example, where we are casting votes against the sponsor management or engaging on issues where they do not adhere to best practice
  - There may be conflicts between clients, for example in the prioritisation of team resource or identifying and engaging on material aspects and topics of engagement
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## Internally within LGIM

- Active equity and active bond mandates have different investment strategies and time horizons to passive strategies
  - The interests of equity and bond investors may diverge, for example at the time of a debt issuance, a rights issue or a merger and acquisition scenario
  - The views of internal portfolio managers may differ between each other and with the Investment Stewardship team. A negative stance from the Investment Stewardship team may impact other interactions with the company
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## Companies in which LGIM invests

- LGIM often receives and processes commercially and price sensitive information
  - The companies LGIM engages with and votes on may be direct competitors of LGIM or L&G
  - The companies LGIM engages with and votes on may contain directors who also sit on the LGIM or L&G board
  - There may be personal contacts and connections at the investee company
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# Conflicts identified, mitigated and managed

Practical processes are in place to identify, manage and mitigate potential conflicts as set out below. We have also provided historic case studies to provide further explanation of where such conflicts have arisen in the past, and how we dealt with that risk to act in the best interests of our clients.

## Identification of conflicts

The early identification of potential or actual conflicts of interests is essential in order to implement effective mitigation strategies or processes which help to manage that conflict before it is realised.

- Staff training to identify and manage conflicts of interest adequately
- Annual review to identify any new conflicts and to review controls around existing
- The Investment Stewardship team or the Investment Stewardship Director meets regularly with the equity, Fixed Income and Index teams, LGIM management and the parent company to assist in the identification in potential future conflicts.

## Case study of identifying conflicts: Royal Bank of Scotland plc (RBS)<sup>1</sup>, rights issue litigation

As a large investor in RBS LGIM was contacted by numerous parties about litigation in the respect of the RBS rights issue in 2008.

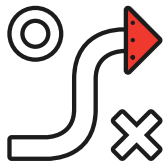
LGIM performed due diligence to see whether this was the right action on behalf of our clients. On inspection we monitored the conflicts of interest and put into place our LGIM Conflicts of Interest policies.

The first step was to identify where the conflicts were.

- LGIM is still a large investor in RBS
- RBS is a large pension client of LGIM
- LGIM and L&G have many business relationships with RBS
- The UK government owns a large stake in RBS and LGIM has many relationships with the UK government

LGIM managed these conflicts in accordance with the policies, and the non-executive directors were informed. LGIM Holdings (LGIM(H)) had a board meeting and many briefings on the risks and rewards of taking litigation. In summary, LGIM decided to proceed with litigation and monitor the relationships and conflicts. During this period of litigation, LGIM held many meetings with the RBS board on governance topics and gave constructive advice on a range of issues.

The process went smoothly and in 2017 RBS agreed to settle the litigation, to the benefit of a variety of parties, including LGIM clients. LGIM continues to be a major shareholder in RBS, and it remains a client of LGIM.



## Mitigation of conflicts

LGIM has implemented a number of structures and process to avoid potential conflicts, to reduce the risk of an actual conflict arising and to mitigate the impact of such conflicts where they do arise.

### Structure of the Investment Stewardship team

The team is structured to mitigate and manage potential internal conflicts of interest. The director of Investment Stewardship reports directly to LGIM's chief executive officer (CEO), is a member of the LGIM board and regularly communicates with the LGIM(H) non-executive directors.

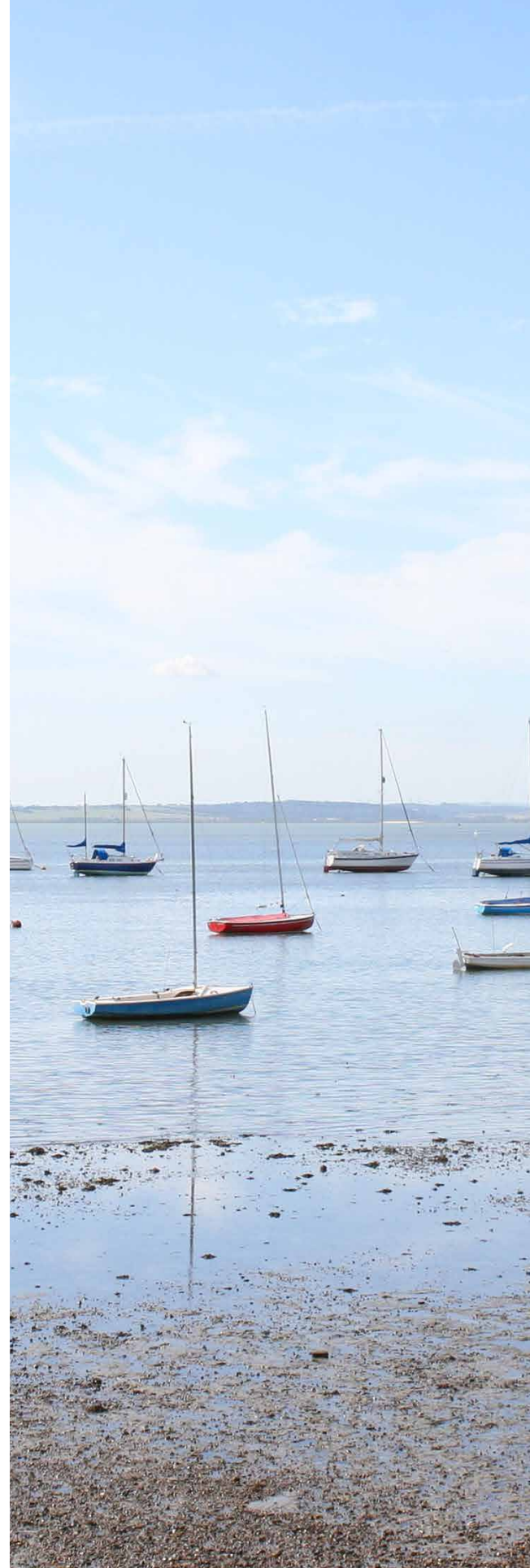
The Investment Stewardship team does not share line management reporting lines with any of the LGIM Investment Desks, including the active equity or active fixed income teams. The independent reporting line to the board allows the team to form a view and take decisions that are in the long-term interests of LGIM clients, notwithstanding the investment time horizon and strategy of the underlying portfolio.

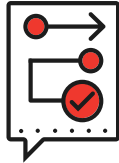
### Legal & General Group equity and bonds

L&G shares are held externally and voted independently of LGIM. For L&G shares held by trusts and segregated funds, should any conflicts of interest arise, we would inform the client and seek instruction. As part of the investment policy for all our fixed income funds, it is not permitted to buy L&G bonds. We are not permitted to buy L&G bonds in our active fixed income portfolios. For index fixed income products, L&G bonds are held in accordance with their benchmark weight.

### Transparent and fair implementation of policies

Our corporate governance, stewardship, voting and conflicts of interest policies are publicly available on the LGIM website. All policies have been approved by the LGIM Corporate Governance Committee (please see below) and are regularly reviewed. The transparency and governance of these policies ensures they are fairly and consistently applied, thereby assisting in the mitigation of potential conflicts.





## Management of conflicts

On the occasions where conflicts are identified and cannot be fully mitigated, we have clear structures in place to ensure the proper and right decision will be taken in the interests of our clients, not withstanding any conflicts of interest.

### Independent oversight

Our Investment Stewardship Committee meets quarterly and has explicit responsibility to provide oversight in relation to potential conflicts of interests and contentious corporate governance issues. The committee is chaired by an LGIM independent non-executive director and comprises a further independent director, and the CEO, chief investment officer, and the chief risk officer. The Conflicts of Interest Committee is a committee of LGIM(H). Its purpose is to provide independent oversight of LGIM(H) firms' identification, management and disclosure of conflicts of interest and potential conflicts of interest. The Committee is chaired by a non-executive director and membership is drawn from the second line functions.

### Formal escalation process

Where conflicts are identified outside of the Investment Stewardship Committee, the two independent non-executive directors of LGIM(H) are available to the Investment Stewardship team for the escalation of how a (potential or actual) conflict should be addressed and to oversee this process. Additionally, the CEO of LGIM may be informed, if not linked to the conflict. This ensures any conflict is always managed in the long-term interests of clients.

# Case study

## Conflicts identified and mitigated

Scentre Group<sup>1</sup> owns and operates a portfolio of properties in Australia and New Zealand, including approximately 42 Westfield living centres and over 12,000 retail outlets.

### What is the issue?

LGIM was set to vote against three resolutions related to executive pay at the company's AGM in April 2020. The main issues that led us to these decisions were:

**Annual bonus** – There was no malus/clawback provision which we believe is an important mechanism. There was a lack of specificity in the weighting of the bonus measures for us to understand which element triggers the biggest pay-out and whether it is justified. This was compounded by the fact that there was no clear disclosure on the actual targets. The transparency was very poor to explain why the CEO achieved 78% of the maximum bonus for the year.

**LTIP** – Development return was one of the performance measures used in the 2019 LTIP award, and the company wanted to remove it a year into the performance period. They proceeded to use it again as a performance condition in the 2020 award. It is LGIM's policy to vote against retrospective changes to performance conditions.

### Why is this an issue?

Both our Active Equity and Index Funds held shares in Scentre Group.

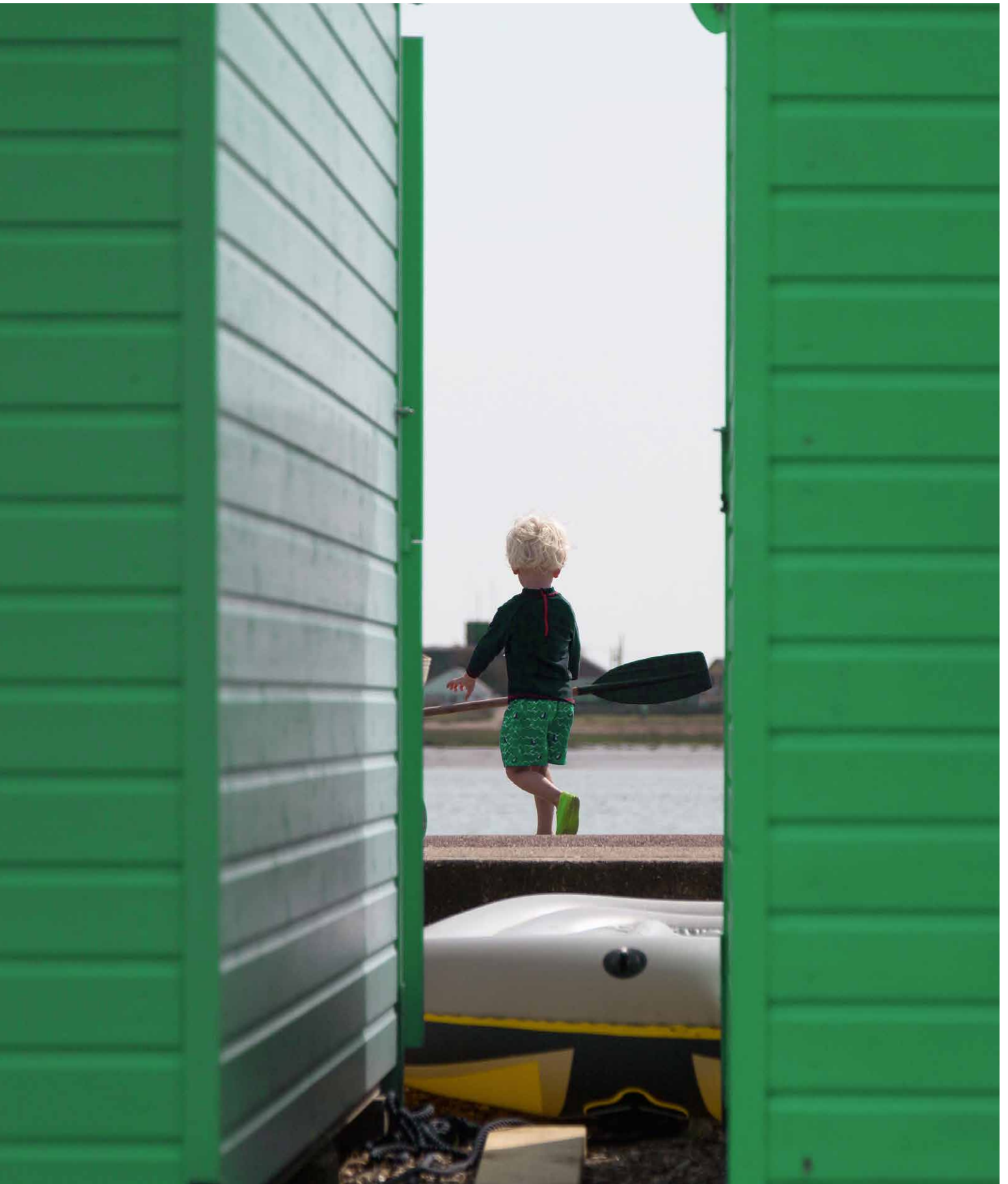
The Active Equity team has a good constructive relationship with the CEO who they and the wider market consider to be highly regarded.

Our action to vote against the CEO's pay resulted in the company contacting the Active Equity Portfolio Manager to question the votes against. The Active Equity Portfolio Manager had, at that time not been fully briefed on our voting sanctions, and this created tension between the two teams resulting in the Director of Investment Stewardship getting involved.

### Resolution

Although we continued to vote against these resolutions and maintained consistency, the matter was resolved, following a detailed explanation of the rationale for the voting decision, and an offer to engage with the company with constructive suggestions on how they can improve their executive pay policies and disclosure. Explaining this to our investment teams and the company was important to maintain consistency with all our investee companies and helps us achieve best practice in remuneration policies.







## Global Proxy Voting Implementation

# Case study

### Conflicts identified and mitigated

In Q1 2020 we updated our global proxy voting principles to systematically vote against the re-election of combined board chair and CEOs.

#### What is the issue?

We believe that separate roles provide balance of authority and responsibility which enhances the probability of long-term success. The impetus to strengthen the position now was based on a host of market dynamics including companies splitting the roles in times of crisis (e.g. Wells Fargo<sup>1</sup>, Tesla<sup>1</sup>, Boeing<sup>1</sup>), companies recombining after splitting the roles (e.g. Best Buy<sup>1</sup>, General Motors<sup>1</sup>, Bank of America<sup>1</sup>), candid director feedback that consolidated influence is the root of many governance challenges and our interest in taking a visible stand to accelerate separations.

#### Why is this an issue?

Companies across the globe that have the combined structure are sensitive to this stance as it is a direct critique of their leadership structure. The US market is particularly challenged as roughly 47% of S&P 500 companies have combined board chair and CEO. For our US business, which is significant, we have a substantial number of corporate clients

and future prospective corporate clients that have a combined chair/CEO structure. Our public position is not what our distribution teams would prefer as it may cause sensitivities with existing and potential clients who have combined roles.

#### Resolution

The conflict of interest between investor rights and corporate clients as it relates to our proxy voting policy is well known at LGIM. We have structurally added external directors to our corporate governance committee who approves annual Investment Stewardship policy updates specifically to manage these types of conflicts and protect our principles and ensure they are applied consistently.

While we understand the business implications, the integrity of our investment stewardship must be maintained; therefore, we got the support from the committee to continue with our stance. We believe going public was needed to improve the market for all clients. This also helps corporate boards understand in advance and not caught by surprise allowing us to drive the change we sought.

## Contact us

For further information about LGIM, please visit [lgim.com](http://lgim.com) or contact your usual LGIM representative



<sup>1</sup>Reference to a particular security is for illustrative purposes only, is on a historic basis and does not mean that the security is currently held or will be held within an LGIM portfolio. The above information does not constitute a recommendation to buy or sell any security.

### Important notice

**The value of investments and any income from them may fall as well as rise and investors may get back less than they invest.**

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