

# UK Stewardship Code

LGIM Response to UK Stewardship Code Principles



# Introduction

At LGIM we take our stewardship responsibilities seriously and devote significant resource to ensure our clients' assets are protected.

We take an active and impactful approach to stewardship by using our scale as a global investment manager to influence and change company and market behaviours. In doing so, we strive to achieve positive societal impacts, in the belief that it will create more sustainable long-term value.

We do this through:

- Company engagement
- Using our voting rights globally
- Integrating environmental, social and governance factors into portfolio management
- Addressing systemic risks and opportunities
- Influencing governments, regulators and policy makers
- Collaborating with other investors and stakeholders

We believe that real change is achieved by being an engaged and active owner.

We are active proponents of the benefits of stewardship codes to improve the quality of stewardship and ownership across the markets in which we invest.

As a strong supporter of the Stewardship Code, LGIM feels that it is its duty to be accountable for its clients' assets and ensure that it upholds the highest corporate governance standards in the global financial market.



**Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.**



UK Stewardship Code, FRC  
September 2012

# The Seven Principles of the UK Stewardship Code<sup>1</sup>

The next section shows how LGIM applies the seven principles of the UK Stewardship Code in its corporate governance activities. This policy will be reviewed on a regular basis.

The latest review was on September 2016.

For more information on how LGIM implements the Stewardship Code, please refer to:

 **Corporate Governance Annual Report**  
[http://www.lgim.com/library/capabilities/CG\\_Annual\\_Report\\_2015.pdf](http://www.lgim.com/library/capabilities/CG_Annual_Report_2015.pdf)

 **Regional specific policies**  
<http://www.lgim.com/uk/en/capabilities/corporate-governance/policies/>

 **Conflicts of Interest**  
<http://www.lgim.com/library/capabilities/Conflicts-of-Interest.pdf>



1. The UK Stewardship Code replaced the 2005 ISC Statement of Principles and Responsibilities for Institutional Shareholders and their Agents and provides guidance to investors on how to behave and act responsibly.

# Principle 1



## Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

LGIM's Corporate Governance and Responsible Investment Policy sets out its expectations of investee companies in terms of corporate governance and outlines how LGIM exercises its voting and manages its engagement and monitoring activities. The policy also demonstrates to clients the purpose of stewardship and the aim to enhance and protect the value of clients' assets.

LGIM discloses its Corporate Governance and Responsible Investment Policy publicly, as demonstrated on the website. The General Policy is supplemented by regional specific policies.

 <http://www.lgim.com/uk/en/capabilities/corporate-governance/policies/>

### MONITORING AND ENGAGEMENTS

When monitoring and engaging with companies, we take a progressive and pragmatic approach to enhancing corporate behaviour. We monitor a number of areas as part of our stewardship activities including strategy, risk management, capital structure and corporate governance. Furthermore, we also conduct thematic engagement with companies on topics including:

- **Board accountability:** executive pay, board effectiveness, audit tender, board tenure
- **Diversity:** gender, board independence, appropriate board skills and experience, management/employees
- **Climate change and energy:** transition to a low carbon economy
- **Short termism:** quarterly reporting, strategy

- **Cyber security and audit governance:** risk management procedures
- **Supply chain:** food waste, health and safety, forestry, labour standards/human rights, child labour
- **Transparency:** tax
- **Financial transactions:** capital raising, M&A

Further company specific examples can be found in our annual report:

 [http://www.lgim.com/library/capabilities/CG\\_Annual\\_Report\\_2015.pdf](http://www.lgim.com/library/capabilities/CG_Annual_Report_2015.pdf)

LGIM has extensive dialogue with the management of investee companies throughout the year on a range of topics, e.g. governance, financial performance and strategy. The objective of LGIM's engagements is to have an open dialogue that is constructive and helpful. LGIM's approach to engagement has led to it being consulted on many aspects of governance where constructive feedback has led to companies altering their management and policies. Furthermore, the Corporate Governance team can be made available as 'insiders' early to help companies and provide a long term shareholder perspective on issues such as succession planning. Voting is one of the tools available to LGIM to ensure companies behave responsibly and have sustainable policies for long-term growth.

### INTEGRATION INTO THE INVESTMENT PROCESS

Environmental, Social and Governance (ESG) factors are increasingly recognised as playing a role in determining asset prices. We therefore integrate our work with the

index, active equity and fixed income teams in order to supplement their fundamental analysis. This means that we identify sector-specific risks and opportunities, and focus our attention on the material impact of ESG on a company's bottom line and creditworthiness.

While the team is independent of active fund managers, on-going communication is maintained to share knowledge and information. The team is structured such that the analysts have specialist ESG knowledge in specific sectors. This enables the analyst to have constructive conversations in-house with fund managers or with numerous companies in the same industry to discuss similar ESG topics. Our approach, which combines financial analysis and ESG, is continually evolving in line with best practice. We continue to formalise our processes and improve how we communicate and report our work to internal and external stakeholders.

### VOTING

In terms of our voting policy, LGIM votes FOR or AGAINST resolutions and keeps abstentions to a minimum. LGIM uses ISS's "ProxyExchange" electronic voting platforms to electronically vote clients' shares.

Voting decisions are taken in accordance with the LGIM voting policy and previous engagement determines the manner in which voting decisions are made and cast on the platform. LGIM also utilises the voting information services of ISS and IVIS who conduct thorough analysis and research on companies. Where LGIM has submitted a vote against a resolution at a UK listed company, this is generally followed up with a letter to the company. The letter will explain the rationale for the decision taken and these concerns will then be discussed at a future meeting with the company.

The policy applies to all of the funds which hold UK shares where the client has given discretion to LGIM.



# Principle 2



## **Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.**

There are a number of potential conflicts of interest inherent in the corporate governance activity at LGIM.

Where do conflicts of interest potentially arise?

- A large number of our clients are trustees of pension schemes that are associated with the companies in which LGIM invests
- Legal & General Group plc might try to influence LGIM's activities on Corporate Governance, rights issues, takeovers etc
- Depending on the asset class (e.g. equities/fixed income), the investment strategies for active/index and funds are very different particularly in terms of the number of stocks held and the time scale for holding investments
  - The department receives and processes a great deal of "inside" or price-sensitive information relating to a company's activity, such as management succession, financing, or M&A activity

LGIM owes each of its clients a duty of care and loyalty with respect to all services undertaken for clients, including proxy voting. LGIM places its clients' interests ahead of its own and must cast proxy votes in a manner consistent with the best interest of its clients.

### **LGIM PRACTICE**

- Take reasonable steps to avoid conflicts of interests
  - The team is structured and supported to minimise potential and perceived conflicts of interest. The team reports directly to the Chief Executive of LGIM and its activities are monitored and supported by two Non-Executive Directors. This acts as a safeguard and ensures we are able to engage on any topic, wherever needed, to achieve the best outcome for all clients.
  - The LGIM Corporate Governance Committee, which includes the two Non-Executive Directors, meets quarterly to monitor LGIM's activities.
- Treat confidential material appropriately
- Train new front office staff in conflicts of interest
- If in doubt refer upwards to a Director, the CEO of LGIM, or NED's of LGIM (H)
- Have a register of conflicts which are reported to LGIM (H)
- L&G Group plc shares are held by Swiss Re for the benefit of LGIM pooled funds as they cannot be held directly. These shares are voted independently of LGIM
- For shares directly held by trusts and segregated funds, LGIM will seek clients' informed direction on voting

## WALL-CROSSING

As a major investor LGIM is contacted by investment banks to discuss price sensitive issues, such as a placing of new shares, before the information has become public. This is termed “inside information”

The procedure is for the Director of Corporate Governance or the Heads of Equities and Corporate Governance to be notified in the first instance when a company, or investment bank wish to make LGIM an insider.

If a fund manager is called inadvertently, they will direct the call to the Head of Equities. In their absence, the Director of Corporate Governance/Manager may take the call. On taking the call the individual records that they have been made an insider on the Order Management System (OMS). They also record the nature of the inside information, and the date at which it is expected to become public. They then decide who else in the organisation needs to be notified of the inside information and records this within OMS.

On inputting to OMS the fact that LGIM is in possession of inside information on a stock, this generates an email to compliance who record the situation on the dealing

system. Any individual or department that is included as being in possession of “inside information” is restricted from dealing in the stock as is any member of staff wishing to deal in a stock in a personal capacity.

In the situation of a share placing a pre-marketing meeting may take place where LGIM’s feedback is sought. The Head of Equities will normally attend this meeting with a member or members of the active equities team. There may also be a member of the corporate governance department in attendance. Following the meeting, the Head of Equities will feed back to either the company or the investment bank LGIM’s views on the situation having discussed it with his colleagues.

Once the situation becomes public, the stock is removed from the inside list on OMS.

For more details on LGIMs conflicts of interest policy, please refer to:

 [www.lgim.com/library/capabilities/Conflicts-of-Interest.pdf](http://www.lgim.com/library/capabilities/Conflicts-of-Interest.pdf)

# Principle 3



## Institutional investors should monitor their investee companies.

LGIM actively monitors investee companies in order to ensure that they act in the best interest of shareholders and create long term value for their clients. LGIM regularly engages with both management and Non-Executive Directors which provides an opportunity to ask questions relating to company performance, strategy, corporate governance and other issues.

For example, LGIM will monitor the Board's performance and execution of strategy, succession planning, the quality of corporate reporting and disclosure and risk management processes.

The UK Corporate Governance Code works on a 'comply or explain' principle that applies to companies. This means that where companies do not comply with the main principles and guidance in the Code, LGIM will engage and seek an explanation of reasons for its departure and how the company intends to mitigate the risks that stem from not applying the best practice principles. A view is then taken whether the justification from the departure of the code is sufficient. If not, the LGIM will seek to change corporate behaviour by utilising the escalation process.

There are a number of resources which the corporate governance team draws from that form the basis of LGIM's monitoring process. These include:

- Using LGIM's proprietary ESG monitoring tool
- Regular meetings with the in-house investment teams including active/index and equities/fixed income

- Collaborative engagement with other shareholders
- External corporate governance groups or networks
- Daily market news
- The media
- Proxy voting advisors raising concerns
- Proactive engagement on thematic or company specific topics
  - The team is structured such that the analysts have specialist ESG knowledge in specific sectors. This enables the analyst to have constructive conversations in-house with fund managers or with numerous companies in the same industry to discuss similar ESG topics

LGIM's approach to seeking these explanations comes in the form of engaging with the companies directly. This includes face-to-face meetings, telephone conference or email exchange. As a long term investor, there is an escalation procedure whereby if a satisfactory explanation is not given in the first instance, LGIM would continue to engage (one-to-one or collaborate with other investors). In addition, LGIM may cast voting instructions against the related resolution, meet with the Senior Independent Director or in an extreme case may even go public if direct engagement fails to achieve the appropriate outcome.

Following engagement, a clear audit trail is maintained that records the content that was discussed in the meeting and the next steps, if any, that need to be taken to achieve the desired outcome.

# Principle 4



**Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.**

LGIM actively engages with investee companies regardless of whether shares are held actively or in an index fund. The way in which engagement is undertaken is dependent on the circumstances and the issues to be discussed. Therefore, topics and issues where we would likely intervene include:

- Consistent failures or departure from the Corporate Governance Code and an assessment that shareholder interest continues to be at risk
- Concerns relating to the execution of strategy or lack of long-term strategic direction which could damage long term shareholder value in the future
- Poor risk management which threatens the business (including the consideration of Environmental and Social issues)
- Significant or compounding financial under-performance by the company
- Other shareholders raising concerns with the company and collaborating with them to raise similar issues

LGIM believes that Stewardship is not just about voting at company meetings (as highlighted in the UK Stewardship Code by the FRC) but also about long-term engagement with companies and the impact this has on company behaviour and generating sustainable long term returns.



On-going dialogue with investee companies is a fundamental aspect of LGIM's responsible investment commitment and we undertake these both independently and collaboratively with other investors. Engagement gives us the opportunity to learn about the company's strategy, operations, financial and external challenges and opportunities, all of which are essential for us to exercise our duty effectively. Furthermore, it forms a trusting long-term relationship with the company and enables us to enter into constructive dialogue on contentious issues. This is mutually beneficial to both parties as there is a better understanding of views and expectations which forms the basis of high-quality decision making and good judgement.

In addition, we focus our efforts on emerging and systemic issues which are developing in the market and regulatory environment.

From a corporate governance perspective, LGIM's initial contact is usually with the board chairman. If initial discussions fail to result in improvements, LGIM will contact the senior independent director (SID). If engagement with the SID does not deliver any changes LGIM will usually escalate its engagement by collaborating with other institutional investors directly or via the Investment Association and/or the UK Investor Forum. This may result in further meetings with the other independent non-executive directors.

There are also a number of additional tools which LGIM uses to put pressure on companies, such as engaging with the company's advisors and brokers, voting adversely at the company's general meeting and making public statements, although this is used as a last resort.

If there are concerns with wider market practice, LGIM may also engage directly with other regulatory and financial institutions such as the Financial Conduct Authority, FTSE, the Takeover Panel, UK Listing Authority, Department of Business, Energy and Industrial Strategy or the Financial Reporting Council in order to promote best practice.

Examples of topics and issues which we have intervened in the past can be found in our corporate governance annual report:

 [http://www.lgim.com/library/capabilities/CG\\_Annual\\_Report\\_2015.pdf](http://www.lgim.com/library/capabilities/CG_Annual_Report_2015.pdf)



# Principle 5



## **Institutional investors should be willing to act collectively with other investors where appropriate.**

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- Concerns relating to the execution of strategy or lack of long-term strategic direction which could damage long term shareholder value in the future
- Poor risk management which threatens the business (including the consideration of Environmental and Social issues)
- Significant or compounding financial underperformance by the company
- Other shareholders raising concerns with the company and collaborating with them to raise similar issues

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From a corporate governance perspective, LGIM's initial contact is usually with the board chairman. If initial discussions fail to result in improvements, LGIM will then contact the senior independent director (SID). If engagement with the SID does not deliver any changes LGIM will usually escalate its engagement by collaborating with other institutional investors directly or via the Investment Association and/or the UK Investor Forum. This may result in further meetings with the other independent non-executive directors.

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# Principle 6



## **Institutional investors should have a clear policy on voting and disclosure of voting activity.**

As an institutional investor, LGIM has a fiduciary duty to clients to exercise its voting rights responsibly. The right to vote is a basic privilege of share ownership and is important given the division of control between the owners of a company (shareholders) and the agents appointed to manage the company in their interests (directors). In addition, voting is a fundamental tool used by investors to signal support or concern with management actions. This mechanism is one of the valuable methods of promoting good corporate governance in the marketplace.

LGIM votes all UK shares for which it has an authority to do so. It also votes in the Developed Markets and some Emerging Market countries, covering approximately 94% of the FTSE All World Index.

As referred to in Principle 1, LGIM has a general stewardship policy substituted by specific market policies. LGIM uses voting research from ISS and IVIS, and voting decisions incorporate our own research analysis and engagement activities where appropriate. LGIM uses the ISS voting platform “Proxyexchange” to vote its shares.

LGIM will endeavour to inform the company of its voting instructions before the general meeting.

There is currently no stock lending undertaken in the UK market so all shares are available for voting.

LGIM publishes voting records on its public website monthly in arrears for the larger markets, UK, Japan and United States. Please visit [www.lgim.com](http://www.lgim.com) for more details.

We report quarterly to clients and provide a public annual report detailing our engagement and voting activity and statistics in all regions globally.



Link to annual report:

[http://www.lgim.com/library/capabilities/CG\\_Annual\\_Report\\_2015.pdf](http://www.lgim.com/library/capabilities/CG_Annual_Report_2015.pdf)



# Principle 7



## **Institutional investors should report periodically on their stewardship and voting activities.**

LGIM is aware of its duties and accountability to its clients on the management and protection of their assets. LGIM discloses its corporate governance activities through regular client reports and thought pieces on market practice. These reports give an indication of the stewardship activities carried out during the year by LGIM. LGIM also provides Trustee education seminars throughout the year to help clients get a better understanding of ESG as being part of their fiduciary duty.

LGIM is often asked for its views or details of activity in relation to articles in the press that relate to companies in which LGIM invests on behalf of its clients. Many of these will be market sensitive issues or allegations that have been raised in the public domain, but are yet to be proven. LGIM cannot comment in such circumstances due to the nature of the issue and confidentiality placed on the matter.

LGIM's position in relation to specific allegations is clear; LGIM cannot take any action until the judicial process is complete. However, LGIM is aware that such events have an impact and engagement will be initiated in a quiet but assertive way.

We report regularly to clients and provide a public annual report detailing our engagement and voting activity in all regions globally. This report includes a quantitative statistical voting summary (of votes in favour, against and abstentions) broken down by region and topic. In addition, qualitative examples of detailed engagement (individually and collectively) with companies, and thematic topics discussed at industry level, are also provided.

In addition, whilst an engagement may be live and it may be too sensitive to report to clients in detail at the time, we will provide comprehensive disclosure post the event. This will be sent to clients via client emails, website updates, LGIM media activity, thematic thought pieces, client education seminars and meetings and ESG-specific seminars.

LGIM has obtained an independent assurance Opinion on its Stewardship and voting process. The scope of this Opinion includes assurance on LGIM's application of Principles 1, 2, 4, 6 and 7 of the UK Stewardship Code, in line with the AAF 01/06 framework.

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## CONTACT US

For further information on anything you have read here or to provide feedback, please contact us at [corporategovernance@lgim.com](mailto:corporategovernance@lgim.com). Please visit our website [www.lgim.com/corporategovernance](http://www.lgim.com/corporategovernance) where you will also find more information including frequently asked questions.

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