Active ownership

Positive engagement to enhance long-term value

Active ownership means using our scale and influence to bring about **real, positive change to create sustainable investor value**. Our Annual Governance Report explains how we achieved this in 2016.

Legal & General
INVESTMENT MANAGEMENT

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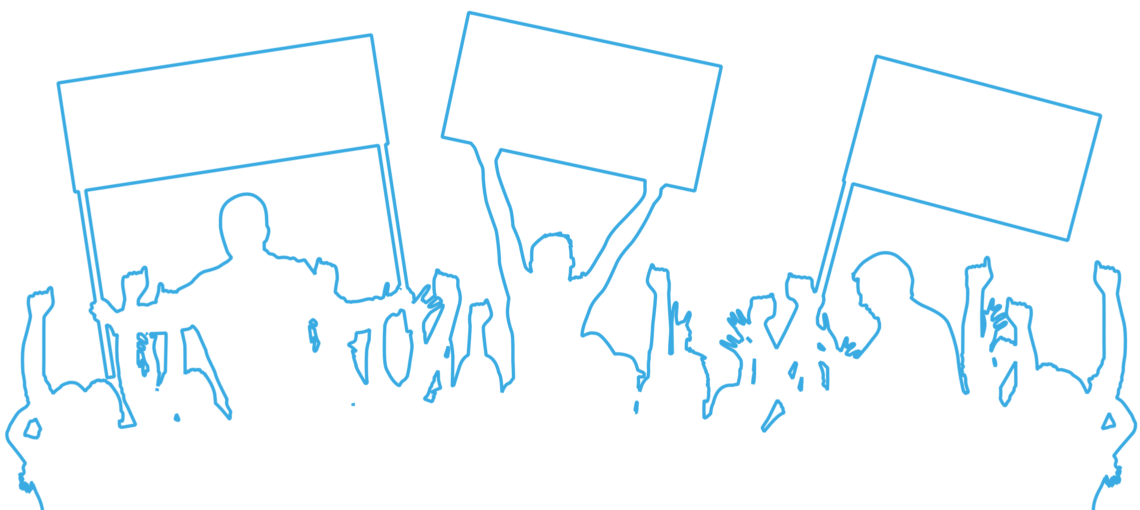


Our vision

"Caring for our clients' future by empowering the companies in which we invest to create sustainable long-term value."

Welcome to our 6th Annual Corporate Governance Report. Looking back at our first report, it is amazing to see how the prominence and breadth of the ESG (environmental, social and governance) topics we cover have developed. I'm genuinely excited by the pace of change from clients, companies and media in bringing ESG more into mainstream investing. The report uses many examples and statistics to bring last year's work to life. I hope you enjoy the variety of topics.

Our role is to help bring positive change to the companies in which we invest – all the work outlined in this report has that overriding aim. The team's top five topics across the 500 company meetings we had in 2016 were board composition, pay, company strategy, succession planning and climate change. 39% of these meetings were with overseas companies, covering a broad range of subjects. Although pay is the number one media topic in governance (and we voted against 136 UK remuneration resolutions), it's pleasing to see the other important subjects being requested by our clients.

Corporate governance is not just about company engagement or voting; it also involves collaborating with regulators and other investors to help improve markets. LGIM's new Climate Impact Pledge sends a powerful message – one that came about as a result of our clients increasingly pushing for action in this area. I would like to thank our clients for helping evolve our policies. If I can leave you with one thought around these ESG issues, it is that they are a part of long-term risk management and therefore a fundamental part of clients' fiduciary duty.

Lastly, I would like to say that the volume and broad range of topics discussed in this report wouldn't have happened without the huge effort, commitment and work of the team. As always, we are happy to hear feedback from our clients.

Sacha Sadan
Director of Corporate Governance
Legal & General Investment Management (LGIM)

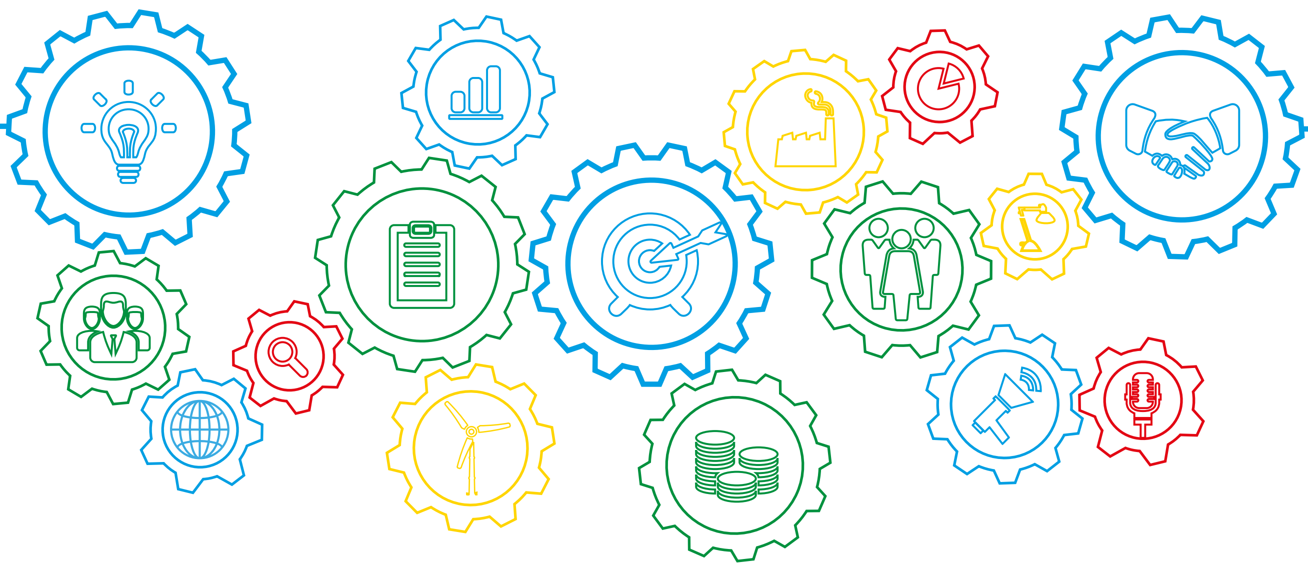
Our mission

To use our influence to ensure that:

Companies integrate **environmental, social and governance** (ESG) factors into their culture and everyday thinking.

&

Markets and regulators create an **environment** in which **good management** of ESG factors is valued and supported.



Our focus

1 Holding boards to account

To be successful, companies need to have people at the helm who are well equipped to create resilient long-term growth. By voting and engaging directly with companies, we encourage management to control risks and benefit from emerging opportunities.

We seek to protect and enhance our clients' assets by engaging with companies and holding management to account for their decisions. Voting is an important tool in this process and one which we use extensively.

2 Creating sustainable value

We believe it is in the interest of all stakeholders for companies to build sustainable business models that are also beneficial to society. We work to prevent market behaviour that destroys long-term value creation.

LGIM wants to safeguard and grow our clients' assets by ensuring that companies are well positioned for sustainable growth. Our investment process includes an assessment of how well companies incorporate relevant ESG factors into their everyday thinking.

We engage directly and collaboratively with companies to highlight key challenges and opportunities, and to support strategies that can deliver long-term success.

3 Promoting market resilience

As a long-term investor for our clients, it is essential that markets are able to generate sustainable value. In doing so, companies should become more resilient to change and therefore benefit the whole market.

We use our scale and influence to ensure that issues impacting the value of our clients' investments are recognised and appropriately managed. This includes working with key decision-makers such as governments and regulators and collaborating with asset owners to bring about positive change.

Q&A

With Sacha Sadan, Director of Corporate Governance

What were your corporate governance highlights in 2016?
Companies, regulators and clients are increasingly recognising the role that LGIM can play as one of the largest index investors. We are no longer asked what passive managers can do to encourage good corporate governance. We are now challenged if we are doing enough. That is a much better conversation to be having. It shows a growing recognition that index investors do not have to be passive on corporate governance or stewardship issues. There has also been continued interest in executive pay.

We held 500 meetings with 293 companies in 2016, demonstrating that we meet many companies several times to encourage them to further integrate environmental, social and governance (ESG) topics into their everyday thinking.

One of the most striking statistics from last year was that sustainability topics (environmental and social) were raised at 47% of our company meetings, up from 35% in 2015. This is the highest ever. We had a greater focus on climate change last year and our clients are also pushing us to engage more on social factors such as employee relations, company supply chains, child labour and food waste.

Nearly 40% of our meetings were with companies from outside the UK. We are engaging more with international companies and directors in the US and Europe are more willing to engage with investors than in the past.

Top five themes discussed in meetings:

- Board composition, e.g. diversity, board refreshment, quality, skills
- Remuneration
- Strategy
- Nomination and succession
- Climate change

You have mentioned climate change as a key theme last year. Are you concerned that the change in the US administration could affect momentum here?
The focus on climate change risks is an economic trend that is not going away. The reason the US invests significantly in solar and wind projects is because they are becoming the cheaper option, not just that they have been told to do so by the government.

Despite policy uncertainties, energy transition risks and opportunities are well recognised. We see continued interest from pension funds, endowments and charities (see pages 14-19 on climate change).

We also saw a wave of shareholder unrest over executive pay last year. Do you expect the shareholder spring to continue in 2017?
It is a shame that executive pay is again hitting the headlines and seizing the attention of regulators, the electorate and our clients, because it suggests that some companies have not grasped societal trends.

We have been pressing for pay that reflects long-term performance for many years. The majority of companies are getting the message, but there is still a significant minority who are benchmarking against each other, rather than thinking about the wider impact of their pay policies. That is why we published our revised pay principles three months earlier than usual last year and sent them to the UK's largest 350 listed companies. We took a stronger line on using annual bonuses to incentivise long-term performance and called for companies to publish the pay ratio between the median employee and the CEO (see pages 22-25 on remuneration).

During 2016 in the UK, we voted against 118 pay resolutions and against 18 named directors on pay. We voted against 14% of companies just on pay alone.

The increasing pay gap is certainly having an impact on society and pressure will only increase. Company directors need to relate to their entire workforce more than ever before, rather than operating in a vacuum. Firms have to pay their workers enough to buy the products and services that support the economy – hence why we think the publication of pay ratios has a part to play.

We have made these points in our submission to the government's consultation on corporate governance reform, but this is about more than just pay. We have responded with many suggestions on areas including directors' duties, the role of asset managers, disclosure of shareholder voting and the role of regulation.

Are asset managers themselves likely to come under more scrutiny in 2017?

I think there will be a lot more discussion of conflicts of interest within asset managers. There are always conflicts, but how they are managed and mitigated will become a much higher profile issue in 2017. If an asset manager runs money for a client, is it prepared to vote against that company?

Our structure helps us here. We are an independent team, reporting directly to LGIM's CEO and the corporate governance committee, which includes two non-executive directors. In addition, the team works for all asset classes and this structure reduces conflicts.

Climate change is a good example of the conflicts that can exist. A fund manager may have selected funds with a specific focus on climate change, but may not follow through with a strong stance on climate change on all its other assets, which could be worth many times that.

One side of the business negates the other. That is why we launched our Climate Impact Pledge last year. Under the pledge, we will exclude companies from any portfolio within the Future World strategy if they fail to embrace the transition to a low-carbon economy. In all other funds where we cannot divest, we will vote against the chair of the board on this issue. This is a powerful message to companies when engagement is simply not working (see page 17 on the Climate Impact Pledge).

Would you highlight any other key trends?

The debate about integrating ESG into fixed income investing will become much more mainstream. With rates so low, clients are looking at fixed income strategies and they need to think more about the longer-term risks. ESG plays an important part in this. We are starting to get more questions from clients, particularly about how long-term risks are integrated into fixed income investing. Clients, consultants, fund managers and ratings agencies such as Moody's and S&P are all moving in this direction. There is greater integration with our fixed income managers in engaging on ESG issues.

Active and influential

Our approach to corporate governance

Our clients trust us to manage, safeguard and help grow the value of their assets. We believe that effective corporate governance can help us achieve this. We take our responsibility to act as good stewards and influence change seriously, devoting significant resources to this effort.

Our team's mission is to bring about real change. We have a wide range of backgrounds and specialist knowledge to enhance our engagement with companies and focus our key activities. The team's structure has been designed to reduce potential conflicts of interest, with a framework focused on achieving the best outcome for our clients.

Harnessing our scale

As one of the largest global asset managers, we can use our scale to bring about positive change and represent our clients in an influential way. We seek to improve performance across the markets in which we invest by addressing key long-term issues.

Our engagement efforts include addressing challenges with climate change, diversity, evolving regulatory hurdles and shifting societal demands. To achieve our desired outcomes, we engage with governments, regulators, other investors and wider stakeholders.

Creating value by considering material risks and opportunities

Focusing on material issues

Our engagement and policy activities include meaningful dialogue on anything that impacts our clients' long-term financial returns. We work closely with LGIM's portfolio managers, analysts and other investment specialists, combining financial analysis with ESG factors to address material issues that can impact a company's profitability and creditworthiness.

Building trusted long-term relationships

Ongoing dialogue with companies is a fundamental component of LGIM's commitment to responsible investment. As long-term investors, we provide an important perspective and aim to be trusted advisers to the management and boards of the companies in which our clients invest. Combined with our scale and breadth of knowledge, our engagement approach is central to influencing and changing behaviours rather than just creating 'noise'.

Integrating ESG into the investment process

ESG factors are increasingly recognised as playing a role in determining asset prices. We therefore integrate our work across our investment teams to supplement their fundamental analysis.

We also work closely with LGIM's product teams to provide solutions for clients wishing to manage these risks directly.

To find out more, please read our Stewardship Code, which is available on our website.

During 2016, the Corporate Governance team:

- Held meetings with **293** individual companies
- Held **500** meetings with companies in total
- Raised sustainability topics in over **47%** of all meetings
- Met with companies based outside of the UK in over **39%** of our meetings

Voting and engagement

	UK			Europe			US and North America			Japan			Asia Pacific			Emerging Markets		
Number of companies voted at	641			337			632			484			332			668		
Annual General Meetings (AGM)	629			333			621			484			327			641		
Extraordinary General Meetings (EGM)	121			30			48			5			50			274		
Total number of votes	10,709			6,366			8,207			6,439			2,602			10,009		
	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain
% of resolutions	97	3	0	82	18	0	89	11	0	85	15	0	85	15	0	86	13	0
% of companies where we did not support at least one resolution	23%			66%			65%			77%			47%			64%		

LGIM voted against at least one resolution at 23% of UK companies

Examples of ongoing engagement

GlaxoSmithKline

In it for the long run. We have had a long-standing engagement with GlaxoSmithKline regarding the performance of the company versus global pharmaceutical peers. We are engaged with the company concerning its remuneration policy, its profitability reporting, the importance of having board members with a background in science and board succession in general.

Wells Fargo & Co

Not guilty but definitely responsible. The company was implicated in an internal cross-selling scandal involving 1.5 million fraudulent customer accounts, The CEO is ultimately responsible and accountable for the company and its employees, yet the board only chose to claw back approximately $40 million of his pay and he remained in office. Our engagement contributed to an outcome which included the Chair/CEO stepping down from the company.

Sports Direct International

What bugged us. Long before the high-profile investigation into the labour scandal at Sports Direct we identified several governance concerns which we have voiced to the company. We have advocated for the appointment of a permanent finance director to ensure proper oversight of financial strategy, especially given recent deterioration of financial performance. In addition, our engagement with the company has also focused on poor succession planning, lack of board refreshment and poor management of conflicts of interests.

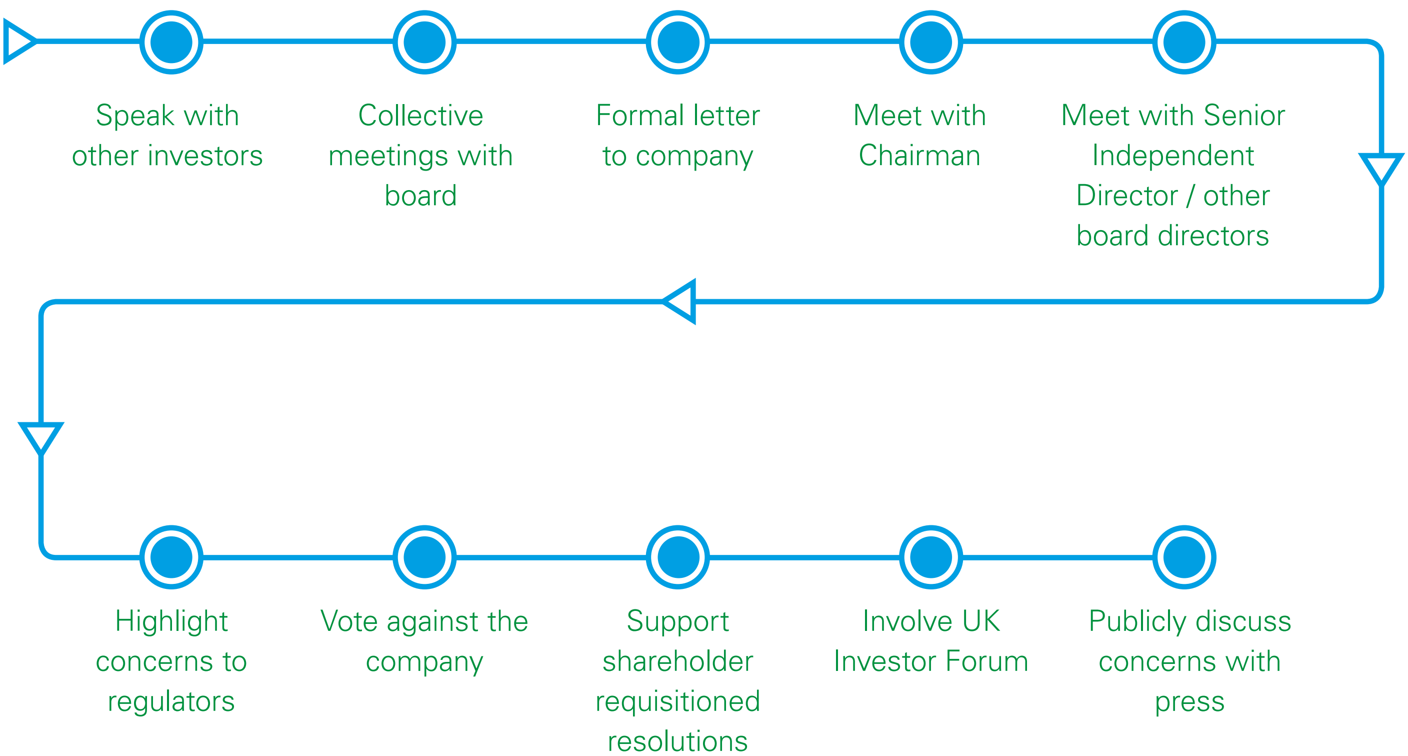
SVG Capital

Getting the right price. In September 2016, we received information regarding a hostile bid for SVG to be launched by HarbourVest, a private equity company. SVG's shares were priced at £5.68 compared to the initial offer by HarbourVest of £6.50. We were one of the four larger shareholders who actively supported this bid. Our public involvement contributed to a revised offer of £7.15 per share.

For more detail, see page 36

Using escalation to bring about change

Should our initial engagement not lead to an appropriate outcome, we have a number of escalation tools at our disposal. These include using our voting rights to hold management to account. The voting and engagement table on page 10 gives a high-level summary of our engagement and voting activities in 2016.



Dialogue with companies ensures we learn about their strategy, challenges and opportunities. Engagement with companies may take place independently, in collaboration with other investors or with LGIM's fixed income and active equity teams. We may meet with the Chairman, other board non-executive directors, executive management or other stakeholders.

In 2016, LGIM received the Institute of Chartered Secretaries and Administrators (ICSA) award for 'Best Investor Engagement' for the second consecutive year.

Our team's priority is to influence companies by voicing our concerns and pushing for change. Our position as a long-term shareholder enables us to build trusted relationships with companies and monitor changes over time. Ongoing dialogue with companies means that we can express our concerns before votes are cast. In many instances, multiple meetings with a company during the year are undertaken to secure our desired outcomes.

As illustrated in the voting and engagement table on page 10, we take our responsibility to exercise client voting rights very seriously and hold boards to account when necessary.

- In all regions, there has been an increase in the number of companies where we have not supported at least one resolution

- We voted against at least one resolution at 56% of companies in the main FTSE World Indices (compared to 52% in 2015)

- We seek to avoid abstentions to send a clear message to companies. Almost no abstentions were cast in 2016

Climate change: it's in our hands

Climate change was a key topic of discussion with our clients during 2016. Investors are increasingly concerned about their investments being negatively impacted by changes in regulation, technology and consumer demand, as well as increasingly adverse weather patterns.

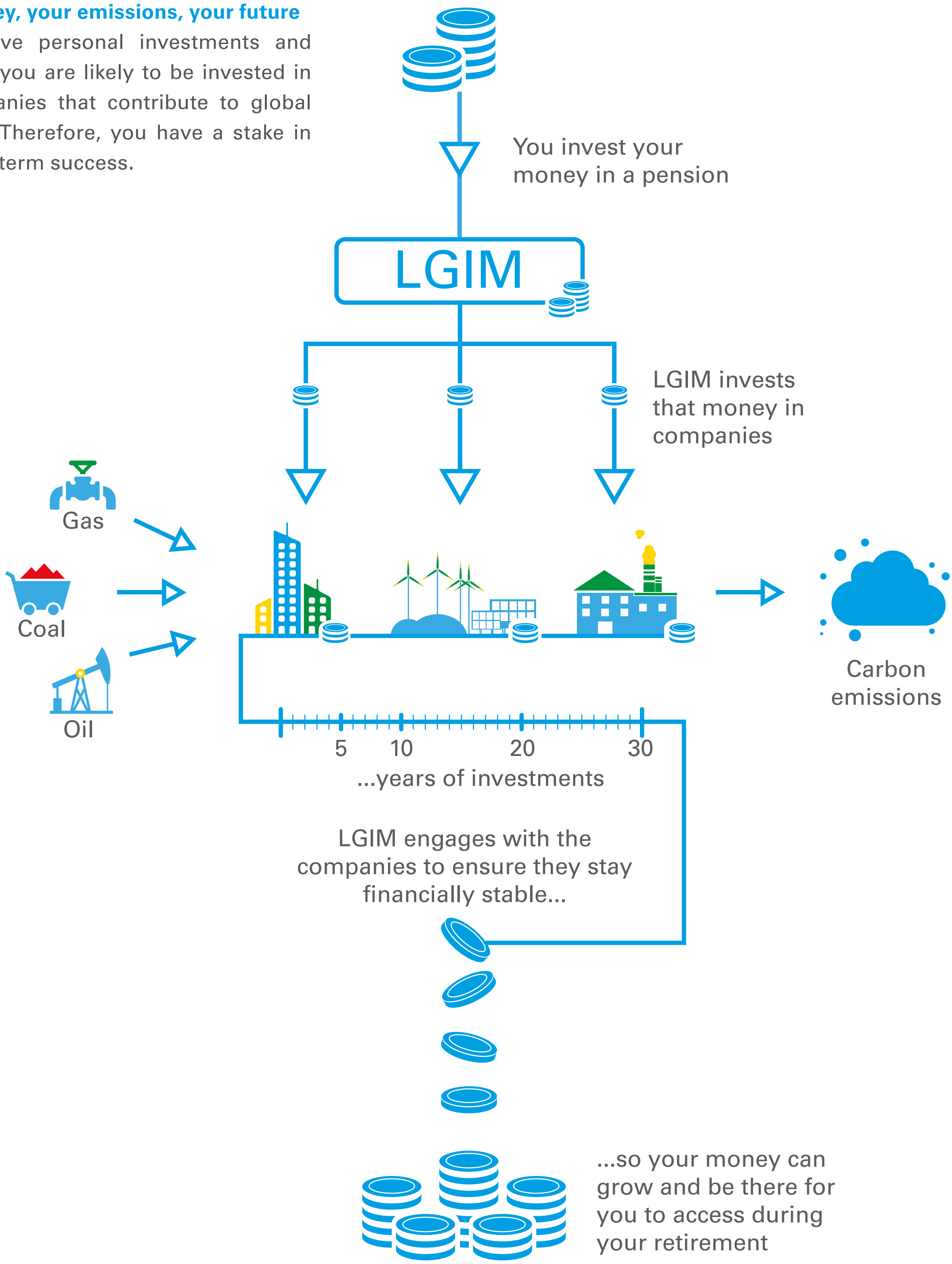
In response to rising pressure from individuals, companies, investors and governments across the world have committed to tackling climate change. This was emphasised on 4 November 2016 when the historic Paris Agreement came into effect. This committed to keeping the global average temperature rise from pre-industrial levels to below 2°C.

Following the recent change in the US presidency, the journey to a low carbon future may not be smooth, but neither is the outlook for traditional fossil fuels. Renewable energy employs more people in the US than all of the fossil fuel extraction jobs put together[1]. Globally, fossil fuels receive four times the government subsidies that renewables do[2]. Even in countries like India, renewables are starting to beat coal in price competitiveness in some regions[3]. Globally, the negative health impact of air and water pollution means traditional modes of transport and industrial businesses are also under threat from climate change.

1. Bloomberg, May 2016
2. FT, July 2016, from IEA (International Energy Agency)
3. Bloomberg, December 2016

Your money, your emissions, your future

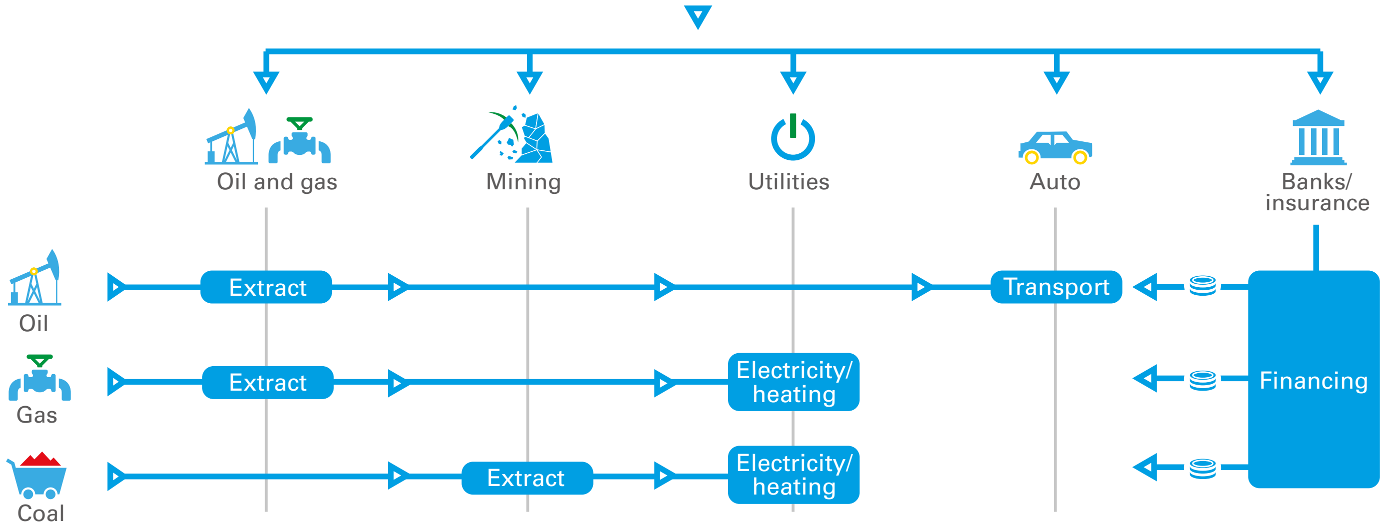
If you have personal investments and pensions, you are likely to be invested in big companies that contribute to global warming. Therefore, you have a stake in their long-term success.



Some companies make a much larger and more direct contribution to global emissions than others. For example, utilities generate energy by burning coal and gas directly. Automobile companies manufacture cars and other vehicles which use fossil fuels, while oil and gas and mining companies extract fossil fuels from the ground.

Sectors such as agriculture play an indirect but important role. The ever-growing demand for food globally is currently being met by a number of inefficient agriculture practices, deforestation and significant food waste. These practices produce large amounts of carbon emissions. Companies in the food retail and distribution sectors are in charge of their supply chain and can help address these issues.

All companies, whether they emit carbon or not, need financing. They require banks, pension funds and insurance companies to buy their shares and debt. How they invest and allocate capital holds the key to a world in which temperatures only rise by 2°C rather than 3 to 4°C. What is financed today drives the world we build for the future.



Institutional Investor Group on Climate Change

Policy matters! As investors of global companies, we are actively engaged with governments and policymakers to create a favourable regulatory environment to move to a low carbon economy. This includes working collectively with other investors to send a consistent message. For example, we are a leading participant of an investor network, IIGCC (Institutional Investor Group on Climate Change) who have been playing a pivotal role in shaping the climate and energy agenda in the UK and Europe. LGIM was elected to sit on their board in 2016 to further shape the investors' voice in the political arena and to collectively provide low carbon investment solutions. In response to our sustained and collective investor push, governments globally have been putting forward specific climate pledges NDCs (National Determined Contributions) which help to accelerate the investments into low carbon opportunities.

During 2016, we committed to LGIM's '**Climate Impact Pledge**'

Our commitment is to engage directly with the largest companies in the world who hold the key to the low carbon transition. These companies will be assessed rigorously and ranked for the robustness of their strategies, governance and transparency. We will also engage directly with the companies with the aim of improving their performance.

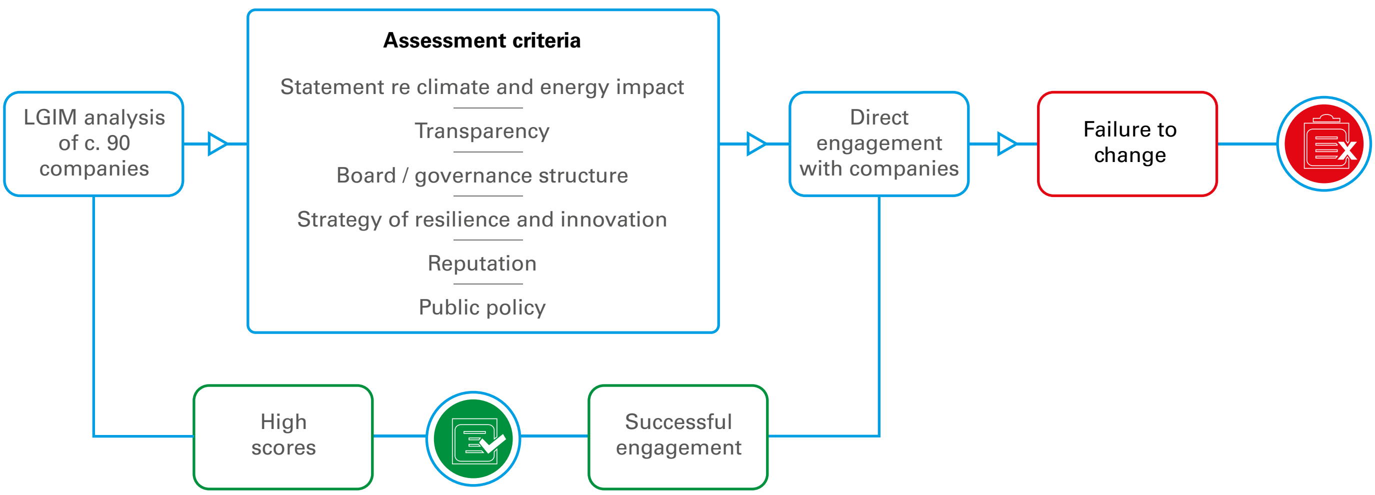
After one year of engagement, some of the companies which fail to meet our minimum standards will be removed from any portfolio within the Future World strategy. In funds where we are unable to contractually divest, we will vote against the Chair of the board of the same companies. This approach means that our Pledge has a direct link to all of the assets that LGIM manages globally.

We believe that the combined approach of ranking, engaging, voting and divesting where possible, can send a powerful message that investors are serious about tackling climate change. With over $1 trillion of assets under management on behalf of our clients, our collective voice can carry a lot of weight.

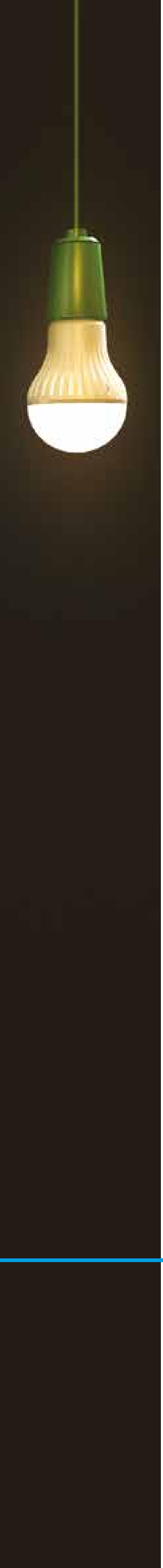
Over time, our goal is to improve standards and practices that help companies become more resilient to policy changes, more successful in providing low carbon solutions and, ultimately, more prosperous.

We believe this targeted engagement can lead key industries to be more prepared for the challenges of the future. In turn, our clients who hold stakes in these companies should stand to benefit from their long-term financial success, as well as the market as a whole.

As part of our pledge, we rank c. 90 of the largest companies



Climate change may feel like a dauntingly vast and complicated issue, but the solutions don't have to be. With **innovative investment options and active engagement**, our clients can seek to protect and enhance their investments for the long term.



How to take action

Although climate change is a global issue, it still requires individual action. During 2016, we made sure to bring this issue to our clients' attention by providing information on climate change, including **what it is**, **why it matters** and **how you can help** to address it.

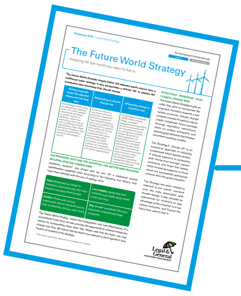
Please explain what climate change has to do with my money

In May 2016, we held our first climate change seminar to explain to investors how and why they should address climate change.

We held several client/consultant meetings to explain the ways in which energy transitions can be addressed in the investment portfolio.

How much is my investment exposed to climate risks and low carbon solutions?

We published a guide on carbon footprinting and green revenue exposure.



How can I protect my investments from potential climate risks?

We have a range of investment solutions suited to your needs.

How can I increase the influence my money has?

Our Climate Impact Pledge is an engagement plan with real consequences. Companies who fail to meet our requirements will be divested / have their board Chair voted against.

Improving board effectiveness

We continue to believe that enhancing board composition and performance is a critical element of company success.

We want to ensure that directors are contributing to board discussions and are aligned with shareholder expectations and interests. To this end, we have been helping company directors think about important factors that can help them to be top performers: including diversity, succession planning and better board reviews.

Case study: Omnicom
Market cap: $20.1bn
Sector: Communications
Country: US
Engagement topics: Board nomination and succession

A change is as good as a rest. Our first engagement with Omnicom resulted in a detailed discussion around board tenure and refreshment. The company currently has an average board tenure of 18 years which is long for a media company; the average tenure at similar companies is about nine years. After a majority-supported shareholder proposal in 2015 to split the Chair and CEO roles (which we also supported), the company has responded by replacing its lead director and strengthening this role, as well as putting in place a board refreshment timeline. However, we still have concerns around the executive structure and believe that the roles should be split. We continue to engage with the company to push for a change in its structure.

Case study: General Motors
Market cap: $55.5bn
Sector: Automotive
Country: US
Engagement topics: Board composition, shareholder rights

Open and informative – but not a result. We spoke with General Motors five times in 2016. One of the main issues we discussed was the board's unilateral decision to re-combine the roles of Chair and CEO at the end of 2015. We spoke to the former Chair and current lead director to further understand the board's decision to change both the leadership structure and the process to find the best candidate for the Chair role. The meeting was open and informative. We continued to oppose the combination, along with a substantial proportion of the shareholder base. We also emphasised the importance of shareholder engagement and that the company needs to strengthen its practices in this area going forward, to understand and react better to concerns before these translate into an even larger negative vote.

Non-executive director education

We hosted an exclusive seminar for both new and established non-executive directors (NEDs), with the aim of helping them to understand key topical issues from an investor's long-term perspective. The seminar offered practical and direct advice on many aspects of the non-executive director role from the both LGIM's team and a number of high-profile UK Plc board members. A breadth of topics was discussed including board diversity, executive pay, audit and tax, cyber security and climate change. The session was well received as an efficient way for NEDs to understand investor perspectives on a diverse range of issues that they can take back to their respective boards.

Board effectiveness reviews

A powerful way to help a company's board improve is to conduct board effectiveness reviews. We expect companies to be using these assessments as a catalyst for refreshing the board as new needs arise. As investors sit outside of the boardroom, it can also be difficult to judge the quality of debate between executives and non-executives.

We expressed our views on this back in 2014 and to follow up, we set out some guiding principles to help external consultants in undertaking these reviews with companies in early 2016. We continue to be encouraged by companies' positive experiences of how valuable and worthwhile the exercise is. We are engaging with more US companies on this topic as the practice of external board evaluations is not common; only 32% of S&P 500 boards do internal full board evaluations. We have always been strong proponents of these assessments and continue to advise companies that the process can be a useful way to help improve board effectiveness.

Senior Independent Director education

The role and importance of the Senior Independent Director (SID) has grown enormously in recent years. Despite the role existing since 2003, best practice is still evolving and examples exist where early planning and a clear job description would have helped companies in tough situations.

LGIM worked with Zygos to produce a guide on what the SID's role actually is, including best examples from both our firms' different experiences of working with Senior Independent Directors.

Case study: Banco Santander

Market cap: €75.0bn

Sector: Financials

Country: Spain

Engagement topics: Varied

Meeting new people. The role of the SID is extremely important in the oversight of the board, and particularly at Santander as the Chairman was not considered to be independent upon appointment. As one of the largest banks globally, we try to meet with the SID at least annually. In 2016 we had two meetings to understand the effectiveness of the board and future priorities. The engagement covered board diversity, group and local employee culture, tax disclosure and the future impact of the transition to a low carbon economy.

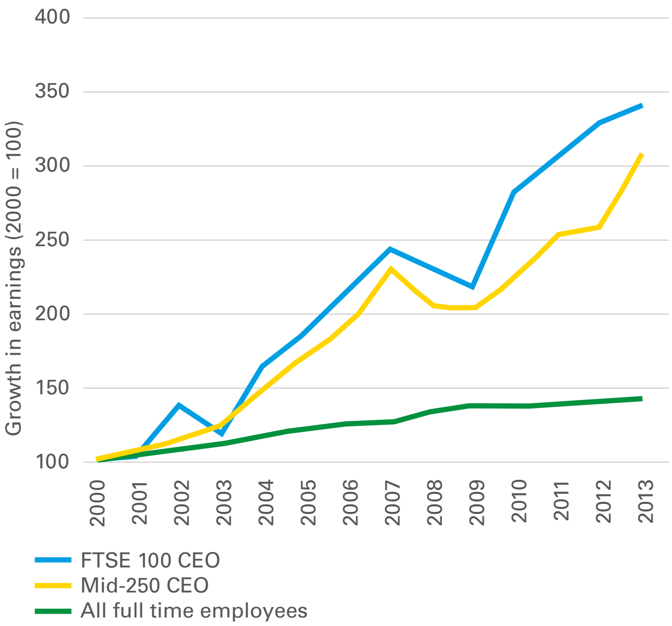
Executive remuneration

Reducing the pay and performance gaps

A number of incidents of 'payment for failure' following the financial crisis led to the introduction of remuneration legislation in 2013. This legislation provides more transparency and a tri-annual binding vote on the remuneration policy to promote linking pay to long-term performance. Before the first three-year cycle of policies has expired, however, the debate around excessive executive pay has returned to the forefront of political debate.

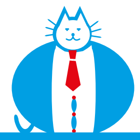
We believe there is clear evidence that the gap between executive pay and that of the workforce has continued to widen, as shown in the following graph:

Indexed FTSE 350 lead executive and full time employee earnings growth 2000 to 2013

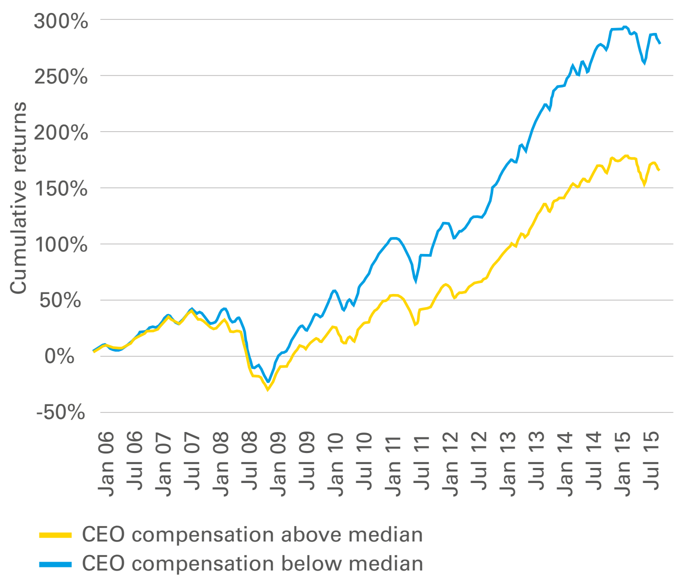


Source: High pay centre

There is also evidence that pay in many companies is not always linked to long-term performance.



US companies with CEOs paid above median underperformed those paid below-median



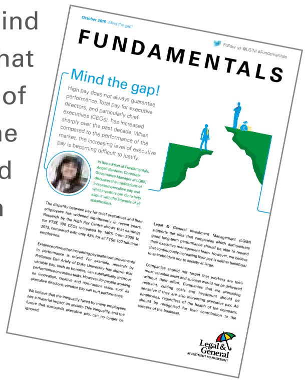
Source: 10-year Total Shareholder Return Time Series, based on above and below peer summary pay medians / returns shown are equal-weighted

We not only owe a duty of care to our clients to grow the value of investments, but also to ensure that companies treat their entire workforce fairly. 'Pay for performance' is a guiding principle.

We develop policies around executive pay and engage with companies that have remuneration policies that do not meet our principles. We escalate our concerns by voting against unsatisfactory outcomes at shareholder meetings.

If necessary, we also use our discretionary power to vote against individual directors where we have escalated our concerns.

What steps is LGIM taking to improve the link between pay for performance and to reduce the pay gap between executives and the wider workforce?



In October 2016, we published "Mind the Gap" to highlight the fact that we are aware of the inequality of pay between executives and the wider workforce. We outlined some steps that remuneration committees should take to address the widening pay gap, including reducing the disparity in pension provisions. We note that a couple of companies have already made adjustments to their pension provisions and we will continue to monitor progress during 2017.

We also asked companies to publish the pay ratio between the median employee and the CEO and to explain the difference when compared with their competitors. In our response to government-led consultations (including the Green Paper), we have encouraged existing independent non-executive directors to hear the views of employees and to take them into account when setting executive pay. This two-way exchange should be documented in annual reports.

We published our revised pay principles three months earlier than usual and distributed them to the UK's largest 350 listed companies. We took a stronger line on the use of annual bonuses to incentivise performance. Although long-term performance cannot be met without some element of short-term decision making, it is the long-term sustainability of the business that should be driving these short-term decisions. We will not generally support further increases to annual bonuses. We expect only the largest global companies and some complex companies to have potential bonuses of 200% of salary.

Despite supporting pay for long-term value creation, we may at times not support further increases to long-term incentives. In some cases, the multiples of salary have reached levels where we do not believe further increases will generate incremental value.

Some large global companies offer a long-term incentive plan (LTIP), with multiples of salary in excess of four times. In many cases the salary of the CEO is at or above £1 million. It is hard to determine the added value these multiples of pay bring to shareholders. The historic reasons why LTIP multiples have grown never really came to pass – there was no great defection to the US or private equity. The balance was driven purely by benchmarks. London-listed companies are now the third highest payers of executive remuneration in the world.

We will not support increases that are based solely on benchmark exercises. We want companies to recognise that offering many multiples of salary to the top team isn't a guarantee of good performance. A good corporate culture and motivated workforce are likely to deliver greater value over the long term. LGIM supports the use of restricted shares for some companies, as we see this as a means of reducing quantum (pay) while introducing simplicity, however, we will not support the use of restricted schemes to increase pay. A company that wants to introduce restricted schemes has to acknowledge that this is a means of simplifying the remuneration structure, providing certainty to management and a means of re-adjusting a system that has become imbalanced.

We continue to believe that long-term incentives have a place in providing motivation for executives. Shareholders like the fact that it is only paid for delivering long-term performance. However, we do not see the need for more than one type of long-term incentive plan to be used as that adds complexity to the structure and will usually reward the same outcomes. Matching schemes are largely a thing of the past, with most companies removing them from their structures.

LGIM advocates a remuneration policy that is simple, aligned and proportionate to the complexity of the role and the pay for the rest of the workforce.

In January 2016, we introduced a new principle requiring company executives to hold at least 50% of their shareholding guideline for two years after leaving. We believe that this is a good way to ensure that management remains committed to the long-term success of the company even at the time of departure. A little too often, in recent times, we have witnessed the departure of a successful CEO who has been highly remunerated during his tenure and leaving the new CEO to manage an under-invested business or other issue that has an impact on the value of the company. We re-emphasised the importance of ensuring this long-term commitment is in our letter to the top 350 UK companies. We are now witnessing a number of companies introducing a post-exit holding into their pay policies, which is a positive outcome, that is becoming standard practice.

Improving the link between pay and performance

The main reason behind the divergence between pay and performance is that when times are hard, management re-set their targets to lower levels. However, these reductions are not generally matched by lower pay awards.

Sometimes the re-setting is down to economic reasons which management can have little control over and few levers to push to compensate. Other times it is due to poor strategy and/or its execution.

We want the remuneration committee to take more control over executive pay, exercise discretion appropriately and reduce awards.

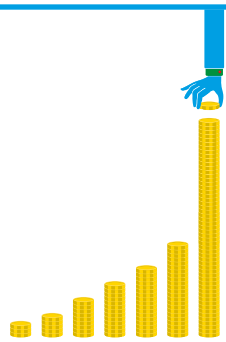
Remuneration committees should also reduce the need to consult shareholders when they want to make changes to executive remuneration. Instead, the committee should read their top shareholders pay policies. We have responded to over 100 consultations on this between September and December 2016.

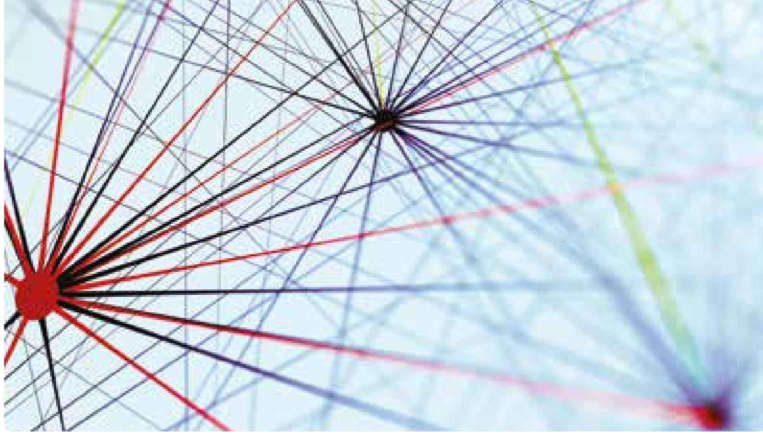
We would prefer remuneration to form part of the normal engagement with the Chairman where the remuneration committee Chair could also attend. We believe the remuneration committee Chair should only be held by someone who has been a member of the board for at least one year. If this is not possible the appointment should be accompanied with an explanation of why it was not possible. We believe serving at least a year on the committee gives them time to get to know the individuals they are incentivising, to hear worker views and engage with shareholders.

At LGIM, we listen to our clients' views; we have a representative that sits on the remuneration committee of the Investment Association where views of investors are shared. Some of our peers have recently published their own guidance and they are not dissimilar to our own.

Time for remuneration committees to increase control

LGIM believes it is time for remuneration committees to increase control. They should only reward good performance and, when doing so, be mindful of the general market sentiment, shareholder policies and worker views. They should also have the courage to adjust pay down as well as up. LGIM will vote against remuneration committee Chairs where we feel this is not occurring.





Remuneration engagement

During the year, we have undertaken extensive engagement with companies globally on the issue of remuneration. Remuneration was our second most frequent discussion point in face-to-face meetings with companies.

Some of these discussions have been successful in influencing the outcome and structure of remuneration. In other cases, we have not supported the final remuneration structures and awards put forward by companies for shareholder approval.

Case study: BP
Market cap: £91.2bn
Sector: Oil and gas
Country: UK
Engagement topics:
Remuneration

Shareholder revolt. In 2016, 59% of shareholders, including LGIM, voted against BP's remuneration report due to concerns regarding the exercise of discretion in awarding annual bonuses and granting maximum LTIP awards. We were actively engaged with BP throughout the year on a number of issues including strategy and governance. At the beginning of the year, prior to the AGM, we met the company five times, including specific meetings on remuneration where we fed in our views and concerns. We informed the company of our voting decision early so they were aware of our dissent. Post the AGM we have met with the company a further three times to discuss remuneration policy and structures. Our engagement with BP is on-going but has already led to positive changes.

Case study: Freeport McMoRan
Market cap: $20.2bn
Sector: Mining
Country: US
Engagement topics:
Remuneration

Challenging questionable remuneration. We voted against the company's remuneration due to a large severance payment to a former executive under an employment agreement despite the fact he will remain as a consultant to the company and will be compensated approx. $1.5m annually for this role. We engaged with the Chair of the company and expressed our concerns with this payment and were assured that the company no longer enters into employment agreements. 40% of shareholders voted against the resolution.

Case study: Shire
Market cap: £41.5bn
Sector: Pharmaceuticals and biotechnology
Country: UK
Engagement topics:
Remuneration

Not playing by their own rules? We voted against the remuneration report at Shire Plc's AGM in April 2016 following engagement with them throughout the previous year. Our primary concern related to a 25% increase in salary for the CEO, which we did not consider to be sufficiently justified according to the criteria set out within the company's own remuneration policy. The pay resolution passed with 50.5% support from shareholders. The company wrote to shareholders promptly following the large vote against, which was welcomed and in accordance with best practice. We continue to engage with the company in the lead up to the 2017 AGM.

Stewardship and corporate governance reform

As global investors we are well positioned to share best stewardship and governance practices internationally, whilst still maintaining the local qualities that drive economic growth and competition.

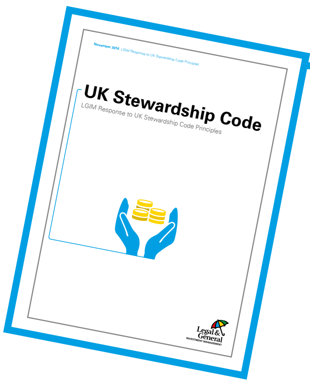
We are active proponents of the benefits of stewardship codes for investors, and the strengthening of local corporate governance codes, as mechanisms for companies to improve governance. Voluntary 'comply or explain' mechanisms, such as codes or guidance documents, can be useful tools for changing practices across the whole market. However, where such voluntary actions fail to achieve the desired outcomes we will call for regulatory reform. **We focus on four areas to improve business practices globally**:

1. Corporate governance:

We believe in the development and strengthening of corporate governance codes for companies as mechanisms for improving governance and encouraging the adoption of best practice.

Introducing US governance principles. During 2016, we worked closely with large US investors managing total assets over $12 trillion, to establish a set of best practices in the US for investor and boardroom conduct. This is an investor-led initiative to improve companies' corporate governance, transparency and dialogue with their long-term investors. The final principles were released on 31 January 2017. LGIM will be on the Steering Group of the principles and will continue to work collaboratively to promote the adoption of these principles by both companies and investors.

Website: *www.isgframework.org*



2. Stewardship:

We are active proponents of the benefits of stewardship codes for investors in improving the quality of stewardship, collaboration and ownership across the markets in which we invest.

Being a tier 1 steward. Since 2010 all UK-authorised Asset Managers have been required to produce a statement of commitment under the Stewardship Code. The UK Stewardship Code has not been updated since 2012, whilst best practices around company-investor dialogue and integration into the investment process have changed substantially in the last four years. We have been engaging with the Financial Reporting Council (FRC), which oversees the Stewardship Code in the UK, for a number of years on the possibility of either strengthening the code or developing a system of identifying best-in-class signatories of the code. The FRC announced in December 2015 that they would be categorising all signatories on the quality of their disclosure in the stewardship code statement.

LGIM was pleased to have its initial UK Stewardship Code Statement assessed as Tier 1 by the FRC as part of its review into reporting of the Stewardship Code. This means we have provided a good quality and transparent description of our approach to stewardship, and explanations where an alternative approach was necessary.

3. Transparency:

We want to see better disclosure on ESG performance for listed companies to allow investors to incorporate this performance into their investment and engagement strategies.

Improving corporate transparency. LGIM believes that improved corporate transparency that provides relevant and understandable information to investors is vital to the creation of a healthy market that is beneficial to all stakeholders. Without appropriate transparency from companies, investors are unable to accurately price their levels of risk and opportunity. Companies also benefit from better transparency by measuring and improving their performance.

During the year, we submitted evidence to a number of consultations seeking to improve the ESG transparency of listed companies, including the Singapore Exchange, the World Federation of Exchanges and the European Union's Non-Financial Reporting Directive. In all consultations, we highlighted that ESG issues are often financially material, therefore in many jurisdictions companies already have an obligation to disclose. We referenced existing reporting frameworks for corporate disclosure – this allows comparability, and also allows investors to know where and how the information will be disclosed.

4. Regulation:

In some instances, voluntary action has not worked or will not be appropriate, in which case we actively call for a regulatory response.

Governance change in the UK. The UK government launched two major consultations in autumn 2016. The consultations follow high-profile governance failures at Sports Direct and privately-held BHS, and increased focus on executive pay and societal inequality. This was the first time the UK government had reviewed governance with a regulatory lens since 2012, and was an opportunity to influence governance in the UK for many years to come.

LGIM submitted evidence to the Select Committee on the current state of corporate governance in the UK, calling for greater accountability of directors to their employees and stakeholders. Additionally, the L&G Group CEO and LGIM Chairman provided evidence to the Select Committee in person. We have also submitted a response in February 2017 to the Corporate Governance Green Paper issued by the Business, Environment, Innovation and Skills (BEIS) Department.

Board diversity

Holding boards to account

Even though the FTSE 100 has reached, on average, the 25% target of women on the board by 2015, we are not softening our stance and continue to hold companies to account on this issue.

During 2016, we engaged with over 50 companies including Standard Chartered, Glencore, and BP on diversity and voted against the Chairman at 12 UK companies for poor board diversity and weak policies.

Case study: GKN Plc

Market cap: £5.9bn

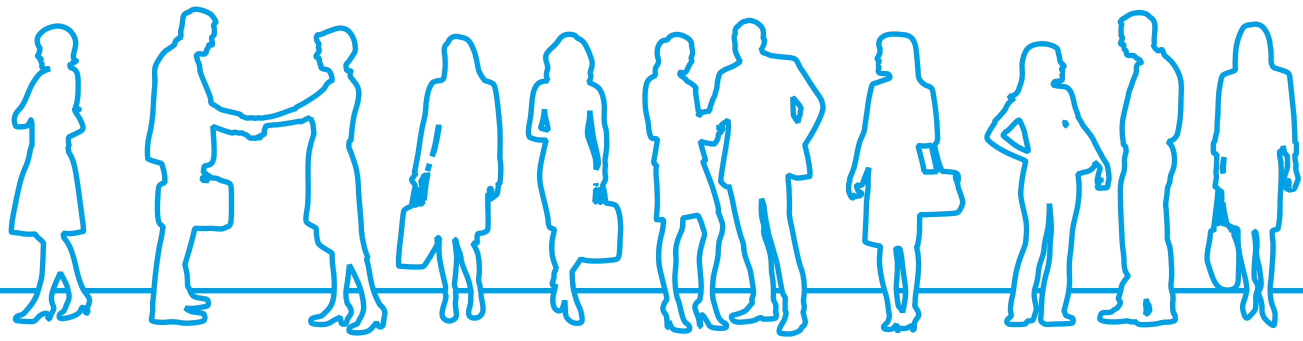
Sector: Industrials

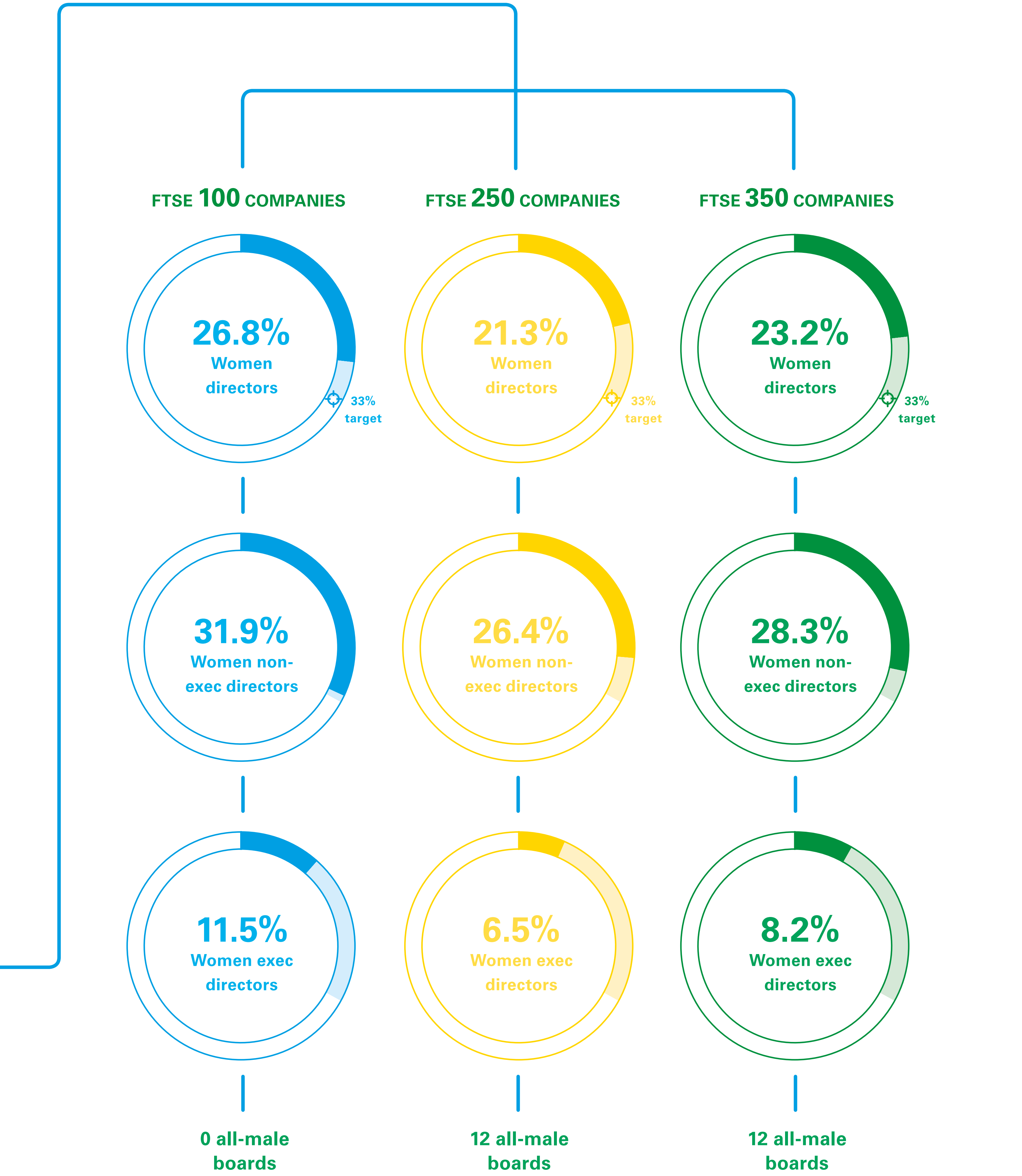
Country: UK

Engagement topics: Board composition

In reviewing the documentation for 2016 AGM it was noted that GKN had only one woman on the board out of nine directors. Along with other shareholders, we met with the Chairman to understand further the balance of skills of the board, and how the company is encouraging greater gender diversity at all levels of the business. We were assured that the board were taking this issue seriously and voted in favour of the board's election. Later in the year, GKN announced the appointment of a non-executive director with extensive experience in the auto sector, who is also a woman.

The new UK government-backed Hampton-Alexander Review has evaluated progress and set a new, even more challenging target of 33% women on boards by the year 2020, while broadening the scope to include the FTSE 350, not just the FTSE 100. It has also set a target of 33% female representation on the Executive Committee and in Direct Reports, combined, by 2020 for the FTSE 100 only. **We fully support the new targets and our principles will strengthen over time, as we expect all boards in the FTSE 350 to be 30% female by 2020.**





Source: Hampton - Alexander Review

US board tenure

We published our first thought piece on the topic of board tenure in the US, and set out voting guidance.

During the year we gained feedback from some of the largest companies with whom we regularly engage. Whilst this is a key issue for companies, most are not prepared for investors to take voting action. However, we will vote against:

- The Chair of the Nomination Committee if the average tenure of the board is 15 years or more
- The Chair of the Nomination Committee if there has not been any new board appointments for 5 years or more
- The Chairs of the key board committees and/or the Lead Independent Director (LID) if they have been serving on the board for 15 years or more

We believe that our voting action will help to maintain independence in the boards' key roles of the LID and Committee Chairs, and encourage robust succession policies for these important roles.

US board statistics

4% Boards setting an explicit term limit for non-executive directors

8.3 Years average board tenure

19% Boards with an average tenure of 11 or more years

39% Boards with a mandatory retirement age of 75 of higher

69 Average age of independent directors

32% Boards that evaluate the full board, committees and individual directors annually

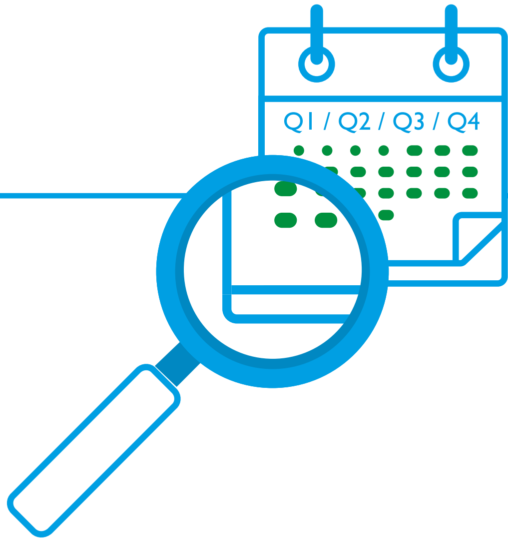
Source: Spencer Stuart US Board Index 2016

Thinking long term about key issues

Quarterly reporting

Quarterly reports, also known as interim management statements, have long been pin-pointed as a catalyst for short-term behaviour in the market.

In 2015, we wrote to the Chairman of all FTSE 350 companies to lend our support to companies considering discontinuing quarterly reporting. There are now 30 companies in the FTSE 100 not producing quarterly reports, including Legal & General Group, National Grid, Imperial Brands and Unilever. We will continue to be vocal on the need for companies to use resources to generate long-term value for their shareholders.



Case study: Prudential

Market cap: £41.7bn

Sector: Financials

Country: UK

Engagement topics: Quarterly reports

A welcome change in reporting. Prudential is listed in four exchanges, including Hong Kong and the US. We spoke to the Chairman during the year about how its listing structure may restrict the board's ability to discontinue quarterly reporting. We gained assurance from this discussion that this topic was on the board's agenda. In November 2016, Prudential combined a shortened third quarter statement with an investor day, providing long-term strategic information to the market. We welcomed the changes made to the reporting.

Cyber security

We have been engaging on cyber security risk since 2011 and it remains a key area of focus. We are an active member of the PRI Advisory Committee on cyber security which aims to raise the profile of this issue. A joint letter with other global investors was sent to Verizon Communications during the year raising concerns on the due diligence conducted on cyber risk as part of their proposed acquisition of Yahoo Inc, and subsequent pricing of the transaction. In 2016, Yahoo reported two of the largest known data breaches in history involving 1.5 billion email accounts dating back to 2013 and 2014.

Our expertise on cyber security as a governance and internal control issue was also recognised when we were invited by the UK Government to sit on the Cyber Security Advisory Committee. In this role, we are able to influence policy developments and best practice oversight.

High quality audit

Of the audits conducted on FTSE 350 companies, 97.5% are carried out by one of four audit firms. We are meeting annually with the independent non-executives of all the large audit firms, including PricewaterhouseCoopers and Deloitte to understand how they maintain audit quality and oversee potential conflicts. We have set out our expectations of what should happen when an external audit is tendered in our *Tendering your Auditor* document. We have also worked closely with the Financial Reporting Council (FRC) and Investment Association in the development of their guidance on this issue.

This year we have regularly presented and explained the value and importance investors place on high-quality and independent audit to a wide range of stakeholders including regulators, accountants, companies, investors and audit committee Chairs.

Case study: Royal Dutch Shell

Market cap: £202.1bn

Sector: Oil and gas

Country: UK

Engagement topics: Audit

Assessing audit quality. EY were announced as Shell's new auditors following a tendering process. Both the auditor and the lead audit partner were auditors at BG Group, which Shell acquired at the beginning of 2016. We were therefore concerned the appointed auditors may face conflicts and not be fully independent. With other shareholders, we engaged with the regulator (the FRC) who oversees audit quality, and voted against the election of EY at the Shell AGM. We met separately with the Chairman of the Audit Committee of Shell and the Independent Non-Executives at EY to understand the auditor appointment process and how the audit will be managed. We will monitor both Shell and EY to ensure the measures introduced continue to mitigate our original concerns.

Child labour

Cobalt is a mineral widely used in smartphones, laptops and electric vehicles, as it is essential to the rechargeable lithium-ion batteries that power them. A large number of global listed companies have been identified with potential links to cobalt supply chains that are exposed to child labour, particularly in the Democratic Republic of Congo, where 60% of the world's cobalt originates*.

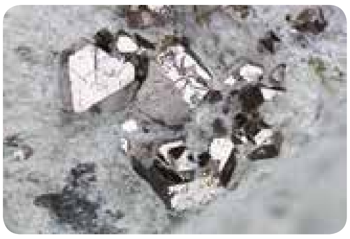
Although supply chain policies are evolving to tackle the problem, many companies are still unable to clearly confirm or deny, and detail their exposure to DRC cobalt linked to child labour and human rights risk.

Case study: Child labour in the cobalt supply chain

Sector: Consumer electronics, automotive, and battery manufacturing

Country: Democratic Republic of Congo (DRC)

Engagement topics: Supply chain due diligence, child labour



LGIM has begun working with a small group of investors to seek greater action by consumer electronics, automotive and battery manufacturing companies on this issue. In mid-2016, the investor group engaged with 13 companies asking for clarity on their exposure to child labour/human rights risks, as well as more detail on their strategies to resolve these risks.

Additionally, we also met with the Electronic Industry Citizenship Coalition (EICC), the body dedicated to electronics supply chain responsibility, as well as engaging with a number of stakeholder organisations to discuss investor expectations. In November 2016, the EICC, alongside the Conflict-Free Sourcing Initiative (CFSI) announced the launch of the Responsible Raw Materials Initiative (RRMI), and similar initiatives are being launched in China.

*Data from FRC, Development in Audit Report, June 2016

Food waste

LGIM has been engaging with food retailers to encourage them to do more to reduce food waste in their business since 2015. Over that period, significant changes in practices have been made by some of the big retailers.

For example, Tesco used technology to reduce store waste by using an App that communicated with local charities to provide a two-way communication of what food was going waste at their local Tesco store and for charities to select any items from that list they wanted to collect. Sainsbury selected a town to educate residents on how to reduce waste and how to re-distribute food they didn't need.

Our engagement in 2016 with retailers has revealed that they all see the benefit of reducing food waste to their business model. Not only does it reduce costs, but the use of food donation is a good way of engaging with the local community.

Food waste in the supply chain is the second largest contributor to food waste behind consumer waste. Increasingly, food retailers are working with suppliers and investing in innovation and new technology to improve crop growth and forward planning. Sainsbury is placing orders up to a year in advance, while Tesco is buying entire crops. This is helpful to suppliers as it gives them certainty and reduces waste in the supply chain.

Improving transparency

Corruption distorts competition, running both direct and indirect risks and cost for business. In 2010 the Dodd-Frank Act was passed in the United States; Section 1504 included measures to improve transparency and bring payments made to governments by extractive industries, into the open. However, in 2012 this rule was successfully challenged by the American Petroleum Institute and the U.S. Chamber of Commerce.

LGIM has been part of an investor group which, for the past five years, have written repeatedly to the Securities Exchange Commission (SEC) in support of strong rules for the implementation of Section 1504. In July 2016, the SEC upheld the ruling, meaning US-listed oil, gas and mining companies would be required to publish details of payments made to governments for the right to exploit a country's natural resources.

More recently, changes in administration have once again brought uncertainty around implementation of this and other Dodd-Frank rules.

Selected company case studies

Our key engagements of 2016

Our general motives and methods to engage with companies are detailed on page 8 of this report. The figures cited on page 10 give a good idea of the significant level of engagement we carried out in 2016; in many cases this engagement is ongoing.

The following case studies give more detail about specific reasons we engaged with companies, how we went about it and what we aimed to achieve.

GlaxoSmithKline

Market cap: £82.4bn

Sector: Pharmaceuticals

Country: UK

Engagement topics: Strategy, board composition

What is the issue?

We have had a long-standing engagement with GlaxoSmithKline Plc (GSK) regarding the performance of the company versus global pharmaceutical peers.

The engagement has taken a significant amount of time and involved discussions with both past and current directors of the board. During 2016, we held four meetings with the Chairman and other board directors in addition to other correspondence.

New board and management

In 2014, LGIM worked closely with the board on Chairman succession, culminating in a new Chairman from the 2015 AGM. Following the Chairman's appointment, which we supported, we encouraged a wide ranging governance review of the board and management.

Throughout 2016 GSK announced a number of management changes at the top of the company, including the appointment of a new CEO, the promotion of the Head of Research and Development to a board position and the retirement of the Chairman of Vaccines.

Additionally, during 2016 there has been considerable refreshment of the board with five long-standing Non-Executive Directors of the board having departed, and the appointment of two others.

Scientific expertise on the board

We had concerns that GSK only had two non-executive directors on the board with science backgrounds. Given the importance of the successful development of products to the value and future of the company, we spoke to the board about the diversity of its skill sets and the potential use of an advisory or board committee to provide support and additional attention to the research and development strategy.

In December 2016, GSK announced that a third scientific or medical expert will be appointed to the board as a non-executive director. The company also announced the creation of a new board Science Committee to provide oversight of the research and development pipeline.

We are pleased with the strengthening of science and research and development at board level, and look forward to understanding how the new structures will work in practice once implemented this year.

Alternative profit numbers

Like many in the pharmaceutical sector, GSK uses a 'core' profitability number to reward management and report to shareholders. This is a different number from the 'reported' profitability number that is in the audited accounts. We are concerned with the increasing disparity between the profitability number reported in the accounts and the 'core' numbers reported by management, and which the management is rewarded for reaching. We have been engaging with GSK on this matter in addition to other pharmaceutical companies.

Rewarding the executives

In 2016 LGIM did not support the remuneration report proposed for approval at the AGM. We had concerns that the payment of a maximum bonus to the executive did not fully reflect the performance of the company. We are currently engaged with the board on its new remuneration policy which will be subject to shareholder approval in 2017.

Wells Fargo & Co

Market cap: $294.1bn

Sector: Banks

Country: US

Engagement topics: Board accountability

Hidden charges

The company was implicated in an internal cross-selling scandal involving 1.5 million fraudulent customer accounts, half a million fraudulent credit card applications and over 5000 employees.

The CEO is ultimately responsible and accountable for the company and its employees, yet the board only chose to claw back approximately $40 million of his pay and he remained in office while offending employees were fired.

Oversight failure

Over the last two years, LGIM has established a good relationship with the company through engagement and the exchange of ideas, primarily with the board's lead director. Following the reporting of the cross-selling scandal, we believed the combined Chair/CEO should have resigned his position due to the clear failure of oversight. We therefore requested a conversation with the lead director to ask that the CEO step down, as well as that the roles of Chair and CEO be separated and an independent Chair be appointed. Also, we requested that this structure be set in the company bylaws going forward, rather than just as an emergency succession process. We had voted against the Chair/CEO in his position as Non-Executive Director on two other US boards due to 'overboarding' and concerns about his ability to commit enough time to all three roles. LGIM believes that the CEO should have sat on only one other outside board.

All change

Following our engagement with the company setting out our expectations, nine days later we were informed that the Chair/CEO had stepped down from the company and that the Lead Director had taken on the role as independent board Chair. The Chair/CEO also stepped down from his Non-Executive roles on the two other US boards. Shortly after this announcement, and six weeks after our engagement, the company also informed us that changes had been made to the company bylaws to require that the CEO and Chair roles be separated and the Chair's role be made independent, effective immediately.

Sports Direct Intl.

Market cap: £1.7bn

Sector: General retailers

Country: UK

Engagement topics: Employee health and safety, strategy, governance

Governance concerns

For a number of years, LGIM has identified several governance concerns which we have voiced to the company. We advocated for the appointment of a permanent finance director to ensure proper oversight of financial strategy, especially given the recent deterioration of financial performance. In addition, our engagement with the company has also focused on poor succession planning, lack of board refreshment and poor management of conflicts of interests.

Deterioration of financial performance

LGIM has had longstanding concerns regarding the company's strategy in respect of the purchase of a number of stakes in various listed companies through derivative positions.

Furthermore, the issue of several profit warnings in 2016 and the company's falling share price resulted in its ejection from the FTSE 100 in March 2016. The company issued a further profit warning in October 2016.

Labour scandal

The company's decision not to sign the Bangladesh Fire & Safety Accord in 2013 raised our concerns about the health and safety policies in place at the company.

Moreover, extensive media coverage of the scandal of the Shirebrook warehouse highlighted the company's working practices and resulted in an investigation by the Parliament Business Select Committee, leading to considerable reputational damage.

Active engagement

LGIM has been engaging with the company to request changes on governance, social and strategy topics since its initial listing in 2007.

We pushed for the appointment of a company secretary to assist the board and were subsequently informed of the appointment of a full-time secretary.

Due to the general lack of progress made by the company in addressing other concerns raised, we decided to escalate our position and we have been voting against the re-election of the Chairman for three consecutive years. In 2016, his re-election was rejected by a majority of minority shareholders. The Chairman gave an undertaking that should he fail to secure minority shareholders support at the AGM in 2017 that he would step down as board Chairman.

Escalation of engagement

At the AGM held in September 2016, LGIM decided to strengthen its voting position to oppose the re-election of all of the non-executive directors. Given the significance of our concerns, we decided to issue a public statement before the AGM and attended the meeting in person.

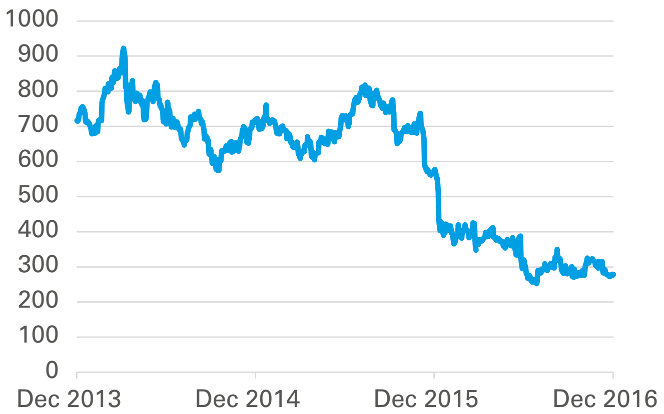
Collaborative engagement

Following the rejection of the shareholder proposal to require management to carry out an independent review into the labour practices at the company at the AGM in 2016, LGIM engaged alongside other shareholders through membership of the Investor Forum to push for an independent review of governance and labour practices. The company subsequently announced that they would be undertaking a review. However, concerns remain about the appointment of the company's long-term law firm to carry out the review given its close links with the company.

The re-election of the Chairman of the board was recently re-submitted to shareholders' vote following strong dissent at the September AGM. His re-election was supported by the founder and major shareholder, leading to his re-appointment in January 2017. However, 54% of independent shareholders, including LGIM, opposed the re-election.

We will continue to engage with the company and monitor the ongoing issues.

Sports Direct share price 2013 - 2016



Source: Bloomberg

SVG Capital

Market cap: £767.4m

Sector: Private equity trust

Country: UK

Engagement topics: Acquisitions, strategy

SVG Capital (SVG) is the third largest private equity trust listed in the UK. We believe that scale is an advantage for the private equity listed investment trust sector, allowing it to often obtain the best terms for transactions and find partners for larger projects.

Similarly to other investment trusts operating in the sector, the share price of the trust has historically been significantly lower than the value of the assets that the trust held. This means that shareholders often do not see the full benefit of their investment until the discount closes or assets are liquidated and returned to shareholders.

SVG Capital also has a major dissenting shareholder, who holds 26% of the trust and has been voting against both the board and management for over four years. This has constrained SVG Capital in its ability to issue new capital and to grow.

Seeking solutions

In September 2016, LGIM received price-sensitive information regarding a hostile bid for SVG to be launched by HarbourVest, a private equity company. SVG's shares were priced at £5.68 compared to the initial offer by HarbourVest of £6.50. We were one of the four larger shareholders who actively supported this bid.

During the consideration period, we held meetings with the Chairman and Senior Independent Director of SVG, as well as communicating with the board, supporting them in seeking alternative solutions to increase shareholder value. Over this period SVG received higher offers from two other parties as well as a revised HarbourVest offer of £7.15 per share.

The outcome

At SVG's General Meeting in December 2016, LGIM voted in favour of the revised offer by HarbourVest. The premium to the value of the underlying assets and the original share price of £5.68 meant that significant value has been realised for all shareholders, including LGIM clients.

UK in focus

We vote on all UK holdings listed in the FTSE All-Share Index. In the UK market, we have not abstained for more than five years, sending a consistent message of our support, or protest, to the boards of these companies.

Over 2016, we voted against at least one resolution at 23% of all AGMs in the UK. This is an increase from 18% in 2015 and reflects a strengthening of our voting policies on remuneration, board composition and diversity. We are also increasingly holding individual board directors to account for their actions as part of our escalation on engagement activity. We cast votes against 89 individual directors in 2016, an increase of 82% compared to the previous year.

Influencing the UK market

We have continued to influence UK market norms. LGIM's Director of Corporate Governance is a member of the Investment Association's Corporate Governance & Engagement Committee, a body which approves Investment Association publications, market-wide expectations and best practice on governance issues. We also have members of the team who are active on the Investment Association's Remuneration and Share Schemes Committee and a member of the independently-chaired Investor Corporate Reporting and Accounting Group. These committees and groups play an integral role in developing best practice for UK listed companies.

Collaborating with others

The Investor Forum facilitates collective engagement in the UK with over 30 institutional members representing around 35% of the UK market investor base. As a founding member of the Investor Forum board, we have been actively involved in all 14 company engagements undertaken by the forum during 2016.

Executive pay was a key topic of focus in 2016. For more detail on our UK remuneration engagement, please see page 25.

Case study: Cobham

Market cap: £2.3bn

Sector: Aerospace and defence

Country: UK

Engagement topics: Capital management, governance

Change at the top. In April 2016, Cobham announced an emergency rights issue due to a potential breach in their covenant but also retained the shareholder dividend. The potential breach in covenant was a surprise and raised our concerns over the financial management of the company. Additionally, we were concerned that a proportion of the money raised would then be returned back to shareholders as dividends, after having incurred the cost and tax of such a transaction. A further profit warning was then announced in November 2016. Working within the Investor Forum, we called for change at the company. By the end of 2016, a new Chairman, CEO and Financial Director had been appointed to the board and began reviewing strategy. Furthermore, in March 2017, the company announced another £500m rights issue. We will continue to monitor progress at the company.

Protecting value in acquisitions

2016 saw a large amount of M&A activity in the UK market. During the year, we had significant engagement on these large deals, lending advice in order to create or preserve shareholder value.

Case study: SABMiller

Market cap: £73.0bn

Sector: Beverages

Country: UK

Engagement topics: Mergers, strategy

Additional value for shareholders. In 2016, the fourth largest merger of all time was agreed between SABMiller and AB Inbev. AB Inbev initially offered SABMiller's shareholders £42.15 per share for the entire company in October 2015. We held sensitive and discrete discussions with the Chairman of SABMiller on the bid process and price and delivered one coherent message: remain an independent company unless the price improves. Both boards then agreed in November 2015 on a revised price of £44 per share. In July 2016, following the volatility post the EU referendum, there was a call for a higher offer due to currency moves. Once more we met with the Chairman and then lent our support to the board to push for an increase. The final offer was increased to £45, yielding significant extra value for all shareholders.

Case study: William Hill

Market cap: £2.3bn

Sector: Leisure

Country: UK

Engagement topics: Merger and board composition

The one that didn't go ahead. Following the release of an open letter by the company's largest shareholder criticising the company's rumoured merger with a Canadian listed leisure company, LGIM privately contacted the Chair of the board. We expressed strong concerns regarding the financial and strategic rationale of the proposed deal. We also discussed the company's governance with regard to board expertise in respect of M&A and the company's difficulties in appointing a permanent CEO. The company subsequently withdrew from the deal and appointed three new non-executive directors.

Engaging on board composition

Having the right people on the board, in the right positions, is fundamental for the board to work effectively, hold management to account and create long-term value for shareholders. We engage with companies and use our voting rights to ensure the boards of UK companies are working as expected.

Case study: Burberry
Market cap: £7.2bn
Sector: Retail
Country: UK
Engagement topics: Board nominations

Retaining focus. In 2014, Burberry's Creative Director was promoted to CEO. We had concerns over whether he had the appropriate skillset to undertake such a role, whilst still retaining sufficient focus on the design and creative side which is required for sustained performance of the company. We met with the Chairman and the Senior Independent Director to discuss how the board were supporting the transition and also encouraged changes in the executive team to further support the combined role of CEO and Creative Director. In 2016, it was announced that a new CEO would be appointed and the current CEO would be resuming full-time responsibility as Chief Creative Officer.

Case study: HSBC Holdings
Market cap: £140.3bn
Sector: Banks
Country: UK
Engagement topics: Board succession

An external Chair. During 2015 and 2016, we have engaged privately with HSBC on their succession plans at the board and executive level. HSBC's Chairman has been in the role since 2010 and we wanted assurance that appropriate succession plans were in place. Finding an individual who has both the ability and willingness to Chair a large international, globally important bank can be difficult. Additionally, HSBC has a history of promoting insiders to the role of Chairman whereas in this instance we called for the appointment of an Independent Chair. In March 2016, HSBC announced that the current Chairman would be departing in 2017 and confirmed the successor would be external to the bank.

Setting out our expectations

A lot of our UK meetings in 2016 were with a new or prospective Chairman. We believe that it's best practice for a new Chairman to meet with shareholders early on in their tenure. This allows us to explain our expectations of the role and raise any problems we are experiencing with the company, so that they are on the new Chairman's agenda from the start.

Case study: Unilever
Market cap: £115.4bn
Sector: Consumer staples
Country: UK
Engagement topics: Board composition, strategy, general governance

Meeting the new Chairman. We met with the new Chairman of Unilever early in his role to talk about our expectations and views around the evolving trends in governance. Also, as a supportive long-term shareholder we talked about strategy, board composition and global trends in consumer behaviour.

Case study: Standard Chartered

Market cap: £24.5bn

Sector: Banks

Country: UK

Engagement topics: Board nominations

Sharing best practice guidelines. Having spent a significant period of time engaging with previous management, we met with the new Chairman to talk about our views on the company, sector and governance in general. We also shared some best-practice guidelines based on our experience with other major companies. We look forward to continuing this long-term dialogue.

Spreading the word

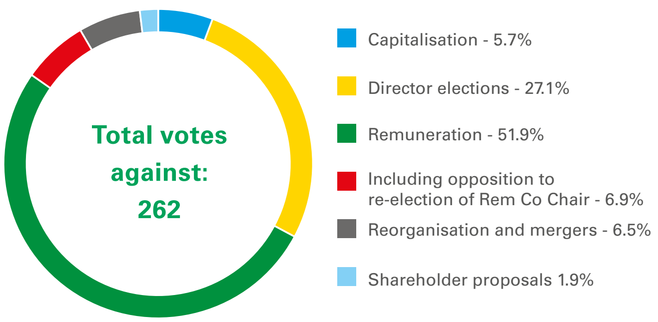
By speaking publicly and making our presence felt at multiple events across the UK on a wide range of subjects, we aim to broaden our reach and spread best practice down the investment chain. For example, we spoke at the UK Investor Relations Society, ICSA: The Governance Institute and the QCA (Quoted Companies Alliance).

Climate change

We continued to engage with the extractive and other key sectors on climate change issues. Please see page 14 for information on how we are holding companies to account under LGIM's Climate Impact Pledge. In the UK market this year, we declared prior to the AGMs our public support for the 'Aiming for A' shareholder resolutions at Rio Tinto, Glencore and Anglo American. These resolutions called for additional disclosure on the risk and opportunities of climate change. Leading up to the AGMs in the first quarter of 2016, we held one-to-one discussions with the respective Chairmen of Anglo American and Rio Tinto and with the Chief Executive of Glencore, all on the subject of climate change.

We voted against 40% more resolutions in the UK compared to 2015

Votes against management



Source: LGIM

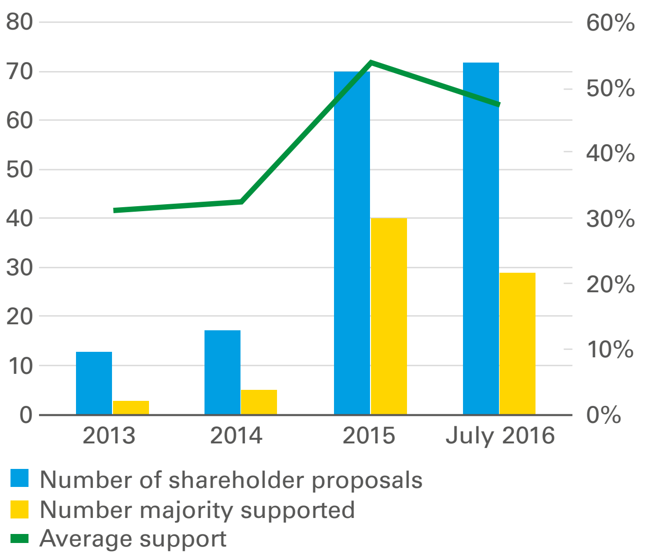
US in focus

We see positive governance progress in the North American market on various issues, from shareholder rights and board structure to pay and climate change. 2016 was another pivotal year for all these issues and we played our part in pushing for progress through our engagement efforts and voting activity.

Board shake up

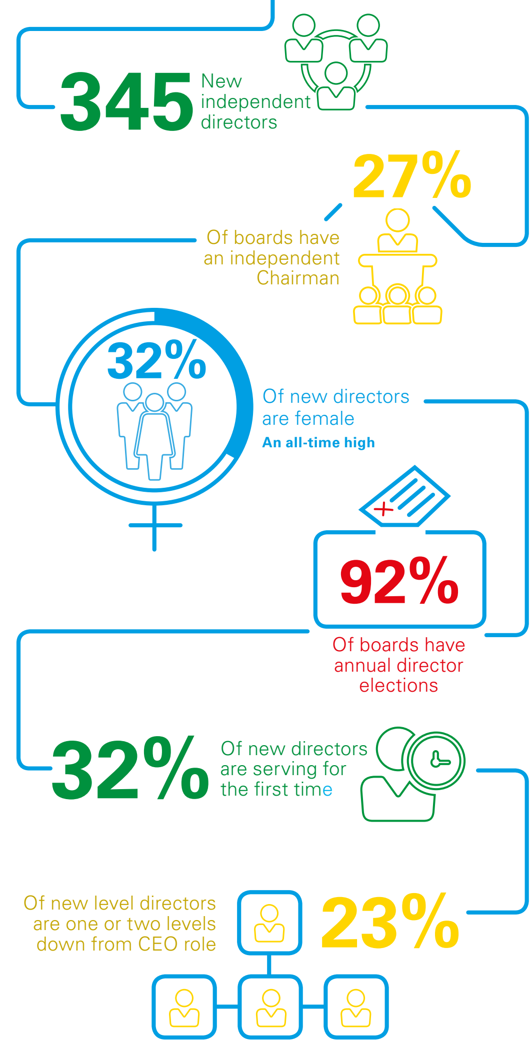
Proxy access is a big focus at the moment in terms of shareholder rights, and we supported 93.5% of these proposals in 2016 as well as spending time engaging with companies to advise on best practice and our own expectations. Approximately 36% of the S&P 500 now has proxy access compared to just 1% in 2014*; a clear illustration of the positive influence investors can bring. We consider this not only an important shareholder right, but an influential factor in board composition as it allows investors to propose qualified nominees. It will be interesting to see how this may change the composition of boards in the future as the focus moves to the diversity and accountability of directors.

Access shareholder proposals, 2013 - 2016



Source: ISS voting analytics database

Board composition



Source: Spencer Stuart US Board Index 2016

*Source: EY Centre for Board Matters

Musical chairs

Following our publication on board tenure, we spent time getting feedback from some of the largest companies to both understand their perspective as well as to highlight that this is an area of continued focus for us, upon which we will begin to take voting action in 2017. Most companies feel that they are in line with our requirements of an evenly-tenured board but are concerned with our principle of voting against the Lead Independent Director once they have served for 15 years or more. The majority of companies with whom we engaged do not consider this period of service to compromise independence and, in fact, tell us that directors are more independent after this length of service. Whilst we appreciate this point of view, we believe that 15 years of service is a generous length of time and that alongside the combined roles of CEO and Chair, we need to be tougher on this very important board role. To help improve the board refreshment process, our publication and engagements have advocated that boards move away from retirement ages, as well as think about implementing periodic external board evaluations, yet we don't see the status quo changing any time soon.

Diversity in the boardroom

Aligning with our focus this year on company boards, we embarked on an engagement project with CalSTRS, OPERS and APG on board diversity and refreshment. We selected companies for engagement where they have only one woman or no women on the board and where they have a long-tenured board. We wrote privately to the 62 companies identified to request an engagement meeting in order to understand how they define diversity and approach the issue, as well as how they talk about it in disclosures. Engagement meetings began late in the year and will continue into 2017 where, as a group of influential investors working together, we hope to encourage improvement in practices and disclosure.

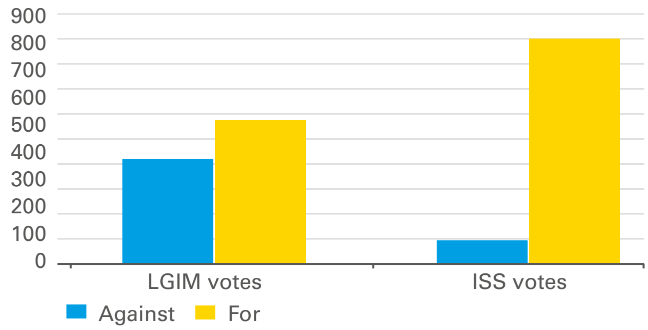
Power in packs

Collaboration with other investors is a powerful tool and one which we have used effectively. We are currently pursuing engagements with Alphabet regarding its tax policies along with three other European investors; with Amazon on its sustainability strategies with four other global and European investors; with ExxonMobil on its public policy and disclosures on climate change with three other UK, European and global investors and asset owners; and have completed an engagement with General Motors on board composition with a US asset owner and European investor.

Poor pay

The topic of remuneration is, of course, never far away. Following the implementation of our custom voting policy for this market, at the beginning of 2016 we strengthened our expectations on the structure of long-term equity awards stating that at least 50% of the awards be based on meeting pre-set performance targets. This has meant that in the last year, we voted against 42% of pay proposals versus Institutional Shareholder Services (ISS) voting against only 9%. An 'against' vote usually triggers a company requesting an engagement meeting to understand the reasons for our vote, enabling us to outline our principles and expectations in further detail. As a result, more and more companies are engaging with us prior to changing compensation plans, which is a very positive trend.

LGIM vs. ISS votes on pay 2016



Source: LGIM

Case study: Citigroup
Market cap: $172.4bn
Sector: Banks
Country: US
Engagement topics: Board composition, remuneration

A say on pay. Ahead of the company AGM (where the say on pay proposal received 37% of votes against), we spoke to the board Chair and Compensation Committee Chair to discuss board composition and executive compensation. We explained that LGIM would vote against the say on pay proposal due to concerns with cash awards under the long-term plan, an uncapped bonus, and an apparent disconnect between pay and performance. Performance had been lagging on a relative basis, yet pay had increased and too much focus was being given to the lower value of previous awards in calculating current pay. LGIM voted against the say on pay proposal; however the company appreciated and listened to our feedback and it was an important opportunity for us to relay our concerns directly to board members. We shall continue to help the company with improvements to their plans going into 2017.

Case study: Honeywell
Market cap: $94.6bn
Sector: Industrial
Country: US
Engagement topics: Remuneration

Keep it simple. Having established a good relationship with the company over several years of engagement, we raised concerns about the complicated structure of the long-term incentive plan, with 33% of shareholders voting against the pay structure in 2016. We explained that although we supported their pay, since there wasn't currently a disconnect with performance and as some changes had been made, the structure of the plan was still far too complicated which could result in the misalignment of pay in future and continuing votes against. We suggested some initial and simple changes the company could make to strengthen the alignment of the plans with shareholders. After proxy season, the company took our comments back to the board and we hope to see some changes.

Modifying the market

Although specific company engagement is important to us and has been a vital foundation of our understanding and influence in this market, as an index investor, we also try to focus on market level issues which will impact all of our companies. Therefore, when the SEC released a consultation on the information that corporates disclose to the market, we made sure to put in a response outlining how investor expectations and needs have evolved. Our response focused on the need for long-term reporting; for consistent and comparable disclosure of ESG information as well as the promotion of a consistent standard for such disclosure; for better information on financial strategies used such as stock buybacks and aggressive tax planning; the disclosure of clearer human capital management metrics; improved corporate political spending disclosure; and the clearer reporting on diversity of corporate boards through skillsets matrices.

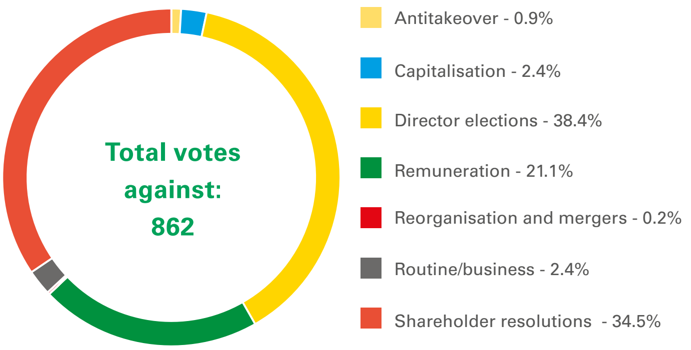
Case study: ExxonMobil
Market cap: $344.8bn
Sector: Oil and gas
Country: US
Engagement topics: Climate change

The risk of methane

We also worked with the Environmental Defense Fund to help them tie governance considerations into their important piece of work: An Investor's Guide to Methane, which aids investors in their engagements with oil and gas companies on how they are managing the risk of methane emissions. LGIM also signed a statement with other investors (representing $3.6 trillion) in support of the joint US and Canadian announcement on limiting methane emissions from the oil and gas industry. These actions at market and regulatory level are all consistent with our continuing focus on the significant risk of climate change.

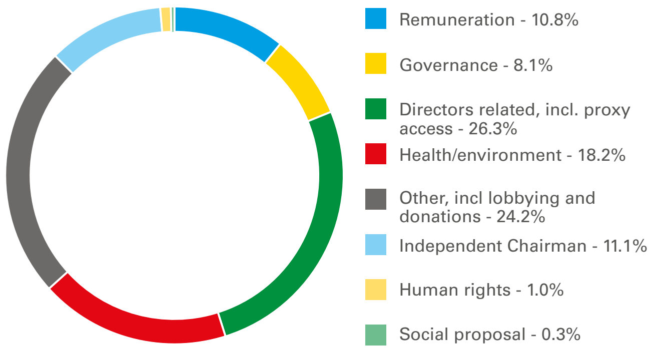
Strength in numbers. The company has consistently failed to acknowledge support of the Paris Agreement on climate change or to report on its portfolio resilience/stress testing in a scenario where the global average temperature rises by 2°C. Due to the commitment by governments of the Paris Agreement to limit climate warming to a 2°C rise, the oil and gas sector is at risk of many of its assets being 'stranded'. This would mean that companies may not be able to burn the reserves they have on their books due to limits on global warming. This presents a financial risk both in the short and long term. As investors, we need transparency around this information to understand what the companies are doing to diversify energy production away from fossil fuels and ensure relevance for the long term. LGIM has had several private conversations with the company over the last 2 years on this issue but has recently joined forces with several other investors and asset owners to ask the company to provide this relevant information. As a result, the company has issued a statement welcoming the entry into force of the Paris Agreement.

Votes against management



Source: LGIM

LGIM supported 297 shareholder proposals in the US in 2016



Source: LGIM

Europe in focus

We vote in the major developed European markets including: Austria, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden and Switzerland.

As in previous years, we have been pleased to see an increased interest from European companies to engage with their shareholders. This year we met with more Chairmen or other non-executive board level directors of large cap European companies, which is a trend that we encourage. These meetings improve the quality of the discussion between shareholders and boards and, in our experience, can result in better outcomes from the engagement activities.

Protecting the minority

Many of the European companies we invest in have a majority, controlling or influential shareholder. Therefore, the fair and equal treatment of all shareholders continues to be a key focus for us at both the national and corporate level.

Minority shareholder protection has come under increased scrutiny in Switzerland in recent years with rules allowing major shareholders to 'opt-out' of mandatory takeover provisions. This could allow a takeover of a listed company without a premium being offered to minority shareholders (as seen at Sika AG). During the year, we met with the Swiss Stock Exchange to discuss the opportunity to strengthen the protection of minority shareholders under its listing rules.

Italy has a unique process to ensure the minority shareholder voice is heard, whereby board seats are set aside for candidates nominated by the minority shareholders – the 'Voto di Lista'. 83% of companies in Italy still have a dominant shareholder base and LGIM strongly supports and actively participates in this board nomination mechanism for providing clear alignment between the board and shareholders. Last year LGIM supported 44 shareholder resolutions in Europe, the vast majority of these related to directors elected under the Voto di Lista system in Italy.

As the shareholding base in some companies becomes more widely diversified, proposed changes to the board nomination system should not undermine the important rights of minority shareholder to nominate directors. During the year, we have twice presented publicly to companies and regulators on the importance of this voting structure in Italy and how we would like to see it strengthen. We have also engaged extensively with local Italian investors and the Italian Investment Management Association. This has been a key focus of our company engagements.

Case study: Volkswagen

Market cap: €74.1bn

Sector: Automotive

Country: Germany

Engagement topics: Pollution, board accountability

Particular engagement. We have been engaging with VW since the emissions scandal broke in September 2015. LGIM's active equity and fixed income teams have been closely involved in the engagement with the company. Volkswagen's credit rating has since been downgraded following the emissions scandal and Fitch commented that "an upgrade is unlikely in the absence of stronger internal controls and corporate governance".

We have had several face-to-face meetings with the Chairman to discuss potential governance reform. Whilst the majority of non-controlling ordinary shareholders, including LGIM, voted against the actions of the management and board at the 2016 AGM as a controlled company, all resolutions passed with the support of major shareholders. We will continue our dialogue with VW in the year ahead with a focus on retaining relationships with minority shareholders, and holding management to account and improving governance standards.

Case study: ENI

Market cap: €52.2bn

Sector: Oil and gas

Country: Italy

Engagement topics: Governance

No scape goats. In July 2016, ENI announced an investigation had been launched by a Sicilian prosecutor against both executives and board directors of ENI. The company had not been informed of the investigation directly, but via a letter received by one of the named individuals. We were concerned with the board's reaction to being informed of the letter, which included a public statement and the removal of a minority-elected director from the risk committee.

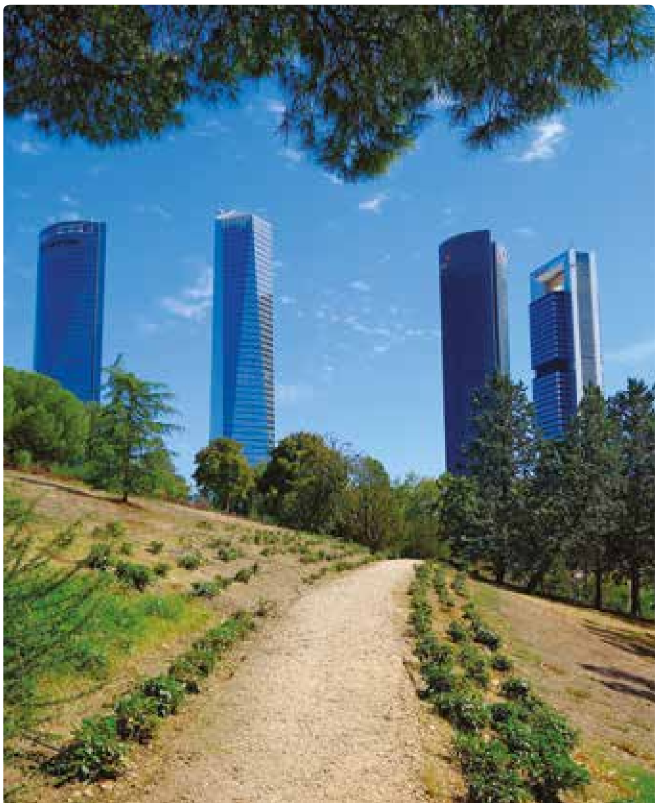
We held private one-to-one meetings and collective meetings with the independent Chairman and other board members to further understand the rationale and due process for the board's actions. In September 2016, the company publicly committed to re-appointing the director back to the risk committee and confirmed that the company would cover all legal expenses. This was welcomed as we had concerns that the full liability being transferred to an individual non-executive would have reduced future high quality external directors from wanting to sit on a board.

Case study: Banco Bilbao Vizcaya Argentaria (BBVA)
Market cap: €42.2bn
Sector: Banks
Country: Spain
Engagement topics: Governance

The long road to governance reform. LGIM has been engaging with BBVA on their governance reform for a number of years, including discussing the benefits of direct dialogue between board non-executive directors and shareholders. We met with the Senior Independent Director of BBVA and were able to understand directly how the governance reforms were being implemented in practice. We also discussed the role of the Senior Independent Director and our expectations as investors of the board in holding management to account.

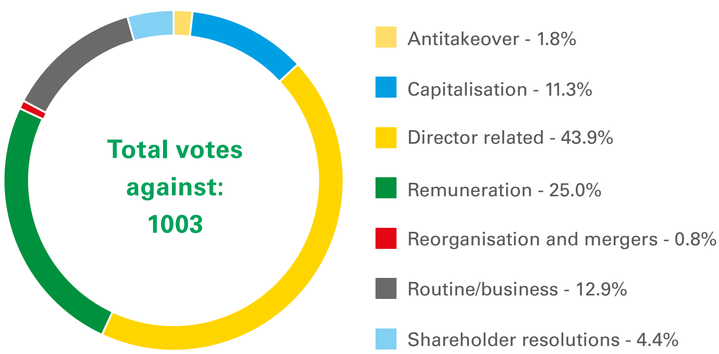
Case study: Repsol
Market cap: €20.8bn
Sector: Oil and gas
Country: Spain
Engagement topics: Climate change

Embedded sustainability. We have been engaging with Repsol on climate change issues for several years, including a request for improved transparency on their research and development investment on climate change. We were pleased to see that Repsol is now providing the market with detailed information on their innovation and technological development programmes as part of their efforts to transition to a low-carbon economy and has embedded sustainability into its overall strategy.



We voted against 14% more resolutions in 2016 compared to 2015

Votes against management



Source: LGIM

Japan in focus

Japanese companies continue to show impressive progress in introducing independent directors to their boards.

78% of Japanese companies had at least two independent directors in 2016* compared to 21.5% in 2014; a significant increase. We have actively helped to open up the dialogue between investors and companies by engaging directly with companies and regulators. Many companies still need to understand why they need to increase board diversity. Our dialogues are important in reinforcing the point that diversity is good for businesses as it promotes healthy debate and innovative thinking. Both are vital for strengthening companies strategic and operational decision making processes.

Stepping up again

In 2014, we launched a collective engagement together with global investment managers and asset owners which aimed to push companies to have at least one third of their board consisting of independent board members. The consequence of this engagement was to start voting against companies which fail to meet the target in three years. To align with this goal, we have been gradually increasing our independence requirements in our voting policy for the last three years, but the deadline is looming. We will be amending our voting policy starting in March 2017 which will set out to vote against the Chair of the boards who failed to meet the required level of independence. We have written to many companies to explain our rationale and purpose of this push and met them individually in the last three years, we do not therefore expect this change to come as a surprise. Fundamentally, we believe that this independence level is not only a minimum global requirement, but will lead Japanese companies to benefit from diverse board discussions that can help the businesses to succeed in the future.

Less is not always more

In November, we visited Tokyo to attend an Asian corporate governance conference where we met key regulatory and industry bodies. Since the introduction of the corporate governance code and stewardship, the Japanese Financial Services Agency (FSA) in particular has been a key driver for meaningful changes in the market.

One issue that came up during the visit was that in the drive for more streamlined corporate reporting, the regulators suggested removing the obligation for companies to produce timely year-end financial reporting to shareholders. Investors use this information to approve, amongst other items, dividends and election of the statutory audit boards (equivalent of audit committees). Japan is a market where the audited annual report is not available prior to related aspects being put to the vote to shareholders. Therefore, reporting the full year results in a timely manner is crucial to be able to invest and vote in an informed manner.

We highlighted this unintended consequence by collaborating directly with other foreign investors and jointly wrote to the Tokyo Stock Exchange (TSE). The letter was signed by over 40 asset managers and asset owners and was supported by two investor associations. The TSE has now acknowledged the collective letter and welcomed international investors' interest and valuable input in the topic. We will continue to engage with them and the FSA, as well as other investor working groups in Japan, on corporate governance reforms.

*TSE (2016)

Case study: Toyota
Market cap: ¥21.1tn
Sector: Automotive
Country: Japan
Engagement topics: Strategy, board composition

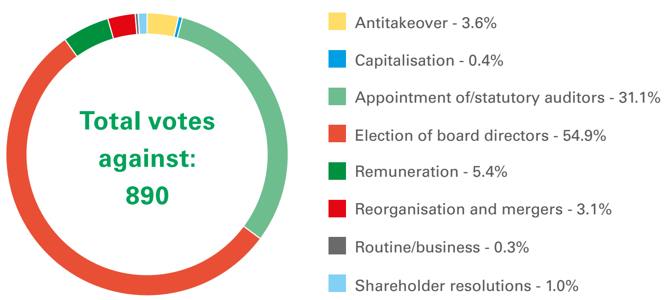
Diversity to reflect change. We met Toyota, the largest car manufacturer in the world, and one of its senior executive directors, the Executive Vice President, to discuss their mid to long-term strategy. We exchanged views on changing dynamics in consumer behaviours. These included growing mistrust of the industry due to safety concerns and emissions scandal by Volkswagen and other manufactures. The impact of increasing pollution controls and emission-free vehicles like electric and hydrogen cars is a key factor for research and development. Shared economy and driverless cars could also alter the scale at which cars will be purchased in the future. Toyota has three outside directors on board but we continue to push for a more diverse board composition that will reflect the technological changes and the global outlook on developed and emerging markets.

Update: In March 2017, Toyota confirmed that the board will comprise of one third independent directors from April 2017. LGIM welcomes this change.

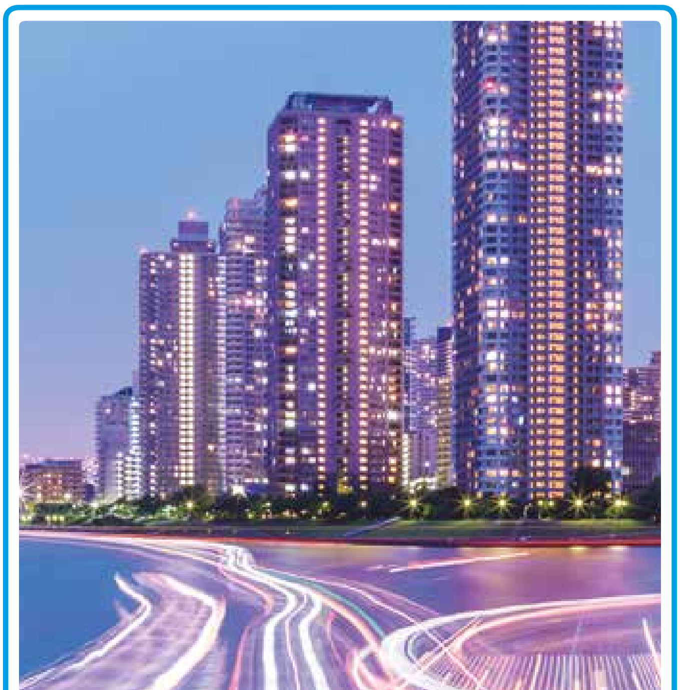
Case study: Nintendo
Market cap: ¥3.3tn
Sector: Electronic and electrical equipment
Country: Japan
Engagement topics: Board composition

Compromised innovation? We met Nintendo to discuss company strategy and corporate governance issues. Nintendo has an all-male, Japanese-only board with one independent director. We felt the lack of diversity and independence at board level was compromising the company's ability to innovate and develop products that appeal to the global electronic market – timely, considering the launch of the Switch console following disappointing sales of the Wii U. Having listened to our concerns, Nintendo stated that they will be addressing the corporate governance issues on their board.

Votes against management



Source: LGIM



Emerging markets in focus

INDONESIA AND MALAYSIA

Ice cream and asset risk

Palm oil is used in a surprisingly wide range of consumer goods. About half of all packaged products sold in supermarkets, including ice cream, chocolate, shampoo, pizza and packaged bread contain palm oil[1]. Indonesia and Malaysia currently produce 85 to 90% of global palm oil[2].

Environmental and social issues relating to palm oil production raise questions over the industry's future growth model, and can lead to significant reputational risk for companies. Palm oil is one of the three highest causes of agricultural-linked deforestation. Alongside devastation to biodiversity, deforestation and forest degradation are key contributors to rising atmospheric carbon dioxide levels and climate change. The direct and indirect impact of climate change pose a significant systemic risk for long-term investors. For palm oil companies, risks include government regulation around deforestation, a loss of clients due to stricter sourcing policies, and a loss of a company's social license to operate. In addition, changes in weather patterns affect the condition of palm trees and therefore, production yields and capacity.

On the ground

As a member of the PRI working group on sustainable palm oil, LGIM joined an investor trip to meet five of the largest palm oil companies across Indonesia and Malaysia. Separate discussions were held with Golden Agri Resources, Sime Darby, Wilmar, Astra Agro Lestari, and IndoAgri. We pushed for better disclosure from the companies whose reporting is insufficient to effectively assess management of palm oil-related business risks. In all our meetings we reiterated the importance of the Roundtable on Sustainable Palm Oil certification: a set of environmental and social criteria

which companies must comply with in order to produce Certified Sustainable Palm Oil. Discussion was also held around how to encourage consumer goods companies, whose products contain palm oil, to further support faster and more effective roll-out of sustainability practices.

Over time we have seen increased commitments from these companies. These include more ambitious targets set on certification and on smallholder engagement and training. Targets have also emerged for protecting high carbon stock forests and high conservation value areas. Programmes and processes for implementing these targets are becoming more innovative and comprehensive. While full and effective implementation of these intentions remains to be seen, we do see a clear shift of focus by government and companies in Indonesia to improving yields, rather than expanding planted areas.

1. http://www.worldwildlife.org/pages/which-everyday-products-contain-palm-oil
2. July 2016, Stranded Assets in Palm Oil Production: A Case Study of Indonesia: Smith School of Enterprise and the Environment; Sustainable Finance Programme

BRAZIL

Taking a stance

As a country looking to encourage outside investment, improved governance standards are necessary in Brazil. Presently, issuers have a strong influence over the governance regulations they are required to comply with; a consequence of a market in which a majority of companies are controlled.

In 2016, we published our first Corporate Governance Policy for Brazil. We also submitted feedback to a review of the governance requirements of the Novo Mercado[3]. This included pushing for an improved level of board independence: current rules require only 20%, whilst we would like to see an increase to 30% over time.

CHINA

Burning questions: Chinese power

Recent years have seen notable changes to the structure of demand and supply in the Chinese power sector[4]. Add to this new waves of regulation, particularly around air and water pollution, and the result is significant uncertainty over Chinese coal-fired power generation plans[5].

A number of Chinese power companies have been planning or have already begun large capital expenditure programmes for new thermal coal capacity. Oversupply, underutilisation, increasing regulatory risk and potential transmission bottlenecks could all contribute to the stranding of assets in this market.

Approvals and construction starts for new Chinese coal-fired power plants surged in recent years, despite stagnant demand and oversupply. In 2016, utilisation rates for plants hit a 38-year low[6]. Declining plant utilisation trends affect financial returns, while transmission bottlenecks can lead to risks of thermal capacity being physically stranded in some provinces. Although new ultra-high voltage transmission capacity will be brought on line, this could increase pricing pressure, while grid constraints mean that provinces may only be able to import power through stranding their own capacity.

In addition, heightened concerns around air quality, CO2 emissions and water stress have led to significant regulatory risk. China's commitments under the Paris Climate Agreement include to peak CO2 emissions by 2030 or sooner. They set out to lower carbon dioxide intensity (CO2 emissions per unit of GDP) by 60-65% from the 2005 level, by 2030, and to increase non-fossil fuels in primary energy consumption to around 20% by 2030[7]. Hydro, solar and wind will have to feed into the grid in order to achieve this, putting further pressure on supply and demand dynamics, grid capacity and ultimately, thermal coal producers. Financial returns are a key risk.

In such an environment, we would expect power companies to be scrutinising their capital expenditure plans. Indeed in early 2017, China ordered 13 provinces to cancel the development of 104 coal-fired power projects (120 GW); of these, 47 (>54 GW) were already under construction[8].

3. Novo Mercado is a listing segment designed for shares issued by companies that voluntarily undertake to abide by corporate governance practices and transparency requirements in additional to those already requested by the Brazilian Law and CVM (Brazilian Securities and Exchange Commission).

4. Demand: lower economic growth; decoupling of power demand growth and GDP growth – industry to services, plus energy efficiency; supply: less reliance on locally generated power; renewable installation up; transmission changes; air, water and carbon driving regulatory change.

5. 2017, Asia Research & Engagement: Time Out: Why China's Power Companies Should Re-evaluate Their Coal Capex Plans

6. 2016, CLSA, Too much, too late

7. 2017, Asia Research & Engagement: Time Out: Why China's Power Companies Should Re-evaluate Their Coal Capex Plans

8. 2017, CLSA

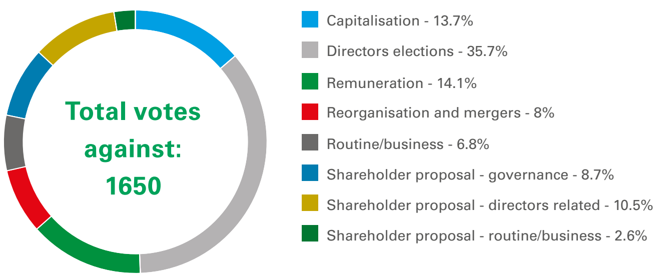
Long-term interests

In 2016, LGIM began working with a group of investors to assess the strategic responses of seven leading listed Chinese power companies to these continuing pressures. This is being done through desk research and company meetings with China Power International, China Resources Power, China Shenhua Energy, Datang International Power, Guodian Power Development, Huadian Power International, and Huaneng Power international.

The objective of the analysis is to determine whether capital expenditure decisions are being made appropriately, and are in long-term investors' interests. Through assessing the investment projects per company, together with plant-level analysis of air and water risks, the research highlights where companies are taking on new capacity utilisation risk, as well as exposing themselves to publicly sensitive regulatory risks. The group has compiled a short guidance for other investors to assist in their engagement with relevant companies on this issue.

The review identified worrying gaps in the companies' strategic responses to the pressures outlined above. As a result, the group will now write to these companies outlining expectations with regards to improved risk disclosure and strategic response and planning.

Votes against management



Source: LGIM

Working with others

Investor Forum

LGIM is a founding and board member of the Investor Forum; our Director of Corporate Governance sits on its board. Membership to the Investor Forum facilitates collaborative engagement with over 30 other members, representing a total of £12.5 trillion of assets under management and ensures investors speak with one, powerful voice. We were involved in all 14 company engagements undertaken by the Forum during 2016.

www.investorforum.org.uk/

Investment Association

The IA provides a structure for LGIM to discuss corporate governance policy and push for collective engagement alongside 200 UK investment managers collectively managing over £5.7 trillion. LGIM is involved within the organisation at board level with LGIM's CEO sitting on the board of directors and the presence of LGIM's corporate governance team on the IA's corporate governance and remuneration committees.

www.theinvestmentassociation.org/

Principles for Responsible Investment

LGIM is a signatory to the PRI. We annually report on our commitment to the six responsible investment principles including the integration of ESG issues into investment practices. We participated in several PRI initiatives during the year including the working group on sustainable palm oil. We also attended the PRI conference in person, in Singapore in September 2016.

www.unpri.org/

Asian Corporate Governance Association

The ACGA is dedicated to working with financial regulators, stock exchanges, institutional investors and companies to develop and implement better corporate governance practices across 12 markets in Asia. As a long-term member, we attended their 16th annual conference in November 2016 in Tokyo which provided us with the opportunity to discuss with other governance professionals the progress made in governance standards in Asia and to identify areas of concerns.

www.acga-asia.org/

International Corporate Governance Network

The ICGN is an investor-led organisation which aims to promote better standards of corporate governance and stewardship worldwide. We attended the ICGN conferences in Frankfurt in March and San Francisco in June, along with over 150 global investors and companies.

www.icgn.org/

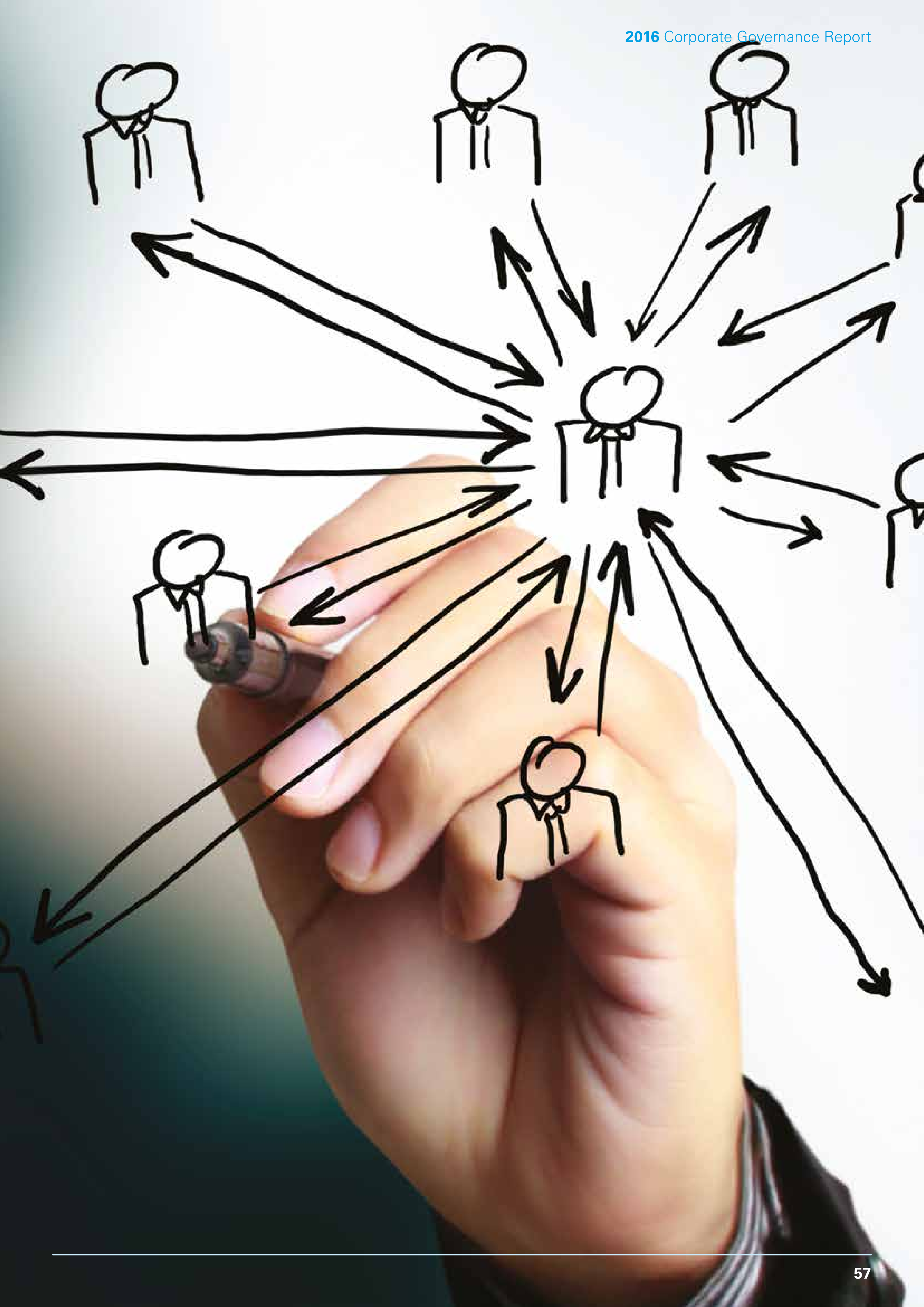
Institutional Investors Group on Climate Change

The IIGCC is a forum for collaboration on climate change for European investors. The forum includes 130 investors representing nearly €16 trillion in assets. We participate in both the Policy and Solutions working groups. We have an impact at board level as our Head of Sustainability and Responsible Investment has been appointed to the board.

www.iigcc.org/

Our other collaboration includes:

- **US Council of Institutional Investors**
- **Forest Footprint Disclosure**
- **Coalition for Environmentally Responsible Economies**
- **30% Club Investor Group**



Industry consultations

We submitted detailed responses to the following consultations:

Name	Topic	Region	Submission date	Description
Singapore Exchange	Consultation paper on sustainability reporting	Singapore	Feb-16	We are a long-term investor in Singaporean equities and are ultimately interested in the value enhancement that is driven by meaningful and sustainable changes taking place in Singaporean corporates. We highlighted four areas of focus: board determined materiality, ESG disclosure, alignment with strategy timeframe and enforcement of material ESG issues disclosure.
The World Federation of Exchanges Ltd	Sustainability reporting	Global	Mar-16	We submitted our views to the WFE for the sustainability guidance reporting consultation paper. We believe that this development will enhance the role of exchanges globally. We highlighted the need for adequate disclosure and encouraged the WFE to adopt a holistic view with regards to disclosure of KPIs by reference to existing guidelines.
EU Non-Financial Reporting Directive	Non binding guidelines for reporting extra-financial information by companies	EU	Apr-16	We believe that reporting on ESG issues is important as they can be financially material at different timeframes. In our consultation, we encouraged the commission to recognise that some of the ESG information is financially material and that companies have an obligation to disclose them to their shareholders. We also referred to the use of existing reporting framework for company disclosure guidance.
TaskForce	Climate-related financial disclosure consultation	Global	May-16	LGIM provided comments to a consultation launched by Chair of Bloomberg on the Task Force on Climate Related Financial Disclosures. We are interested in the value enhancement that is driven by meaningful and sustainable growth by the companies we invest in and therefore welcomed the Task Force's effort to ensure adequate disclosure of material climate risks by companies to minimise threats to financial stability. We emphasised the following three points: clear articulation and focus on the target audience, link between climate risks and capital returns and reduction of the risk of understating potential losses.
FCA	Availability of information in the UK equity IPO process	UK	Jul-16	This consultation initiated by the FCA was the opportunity for us to provide information regarding our experience in Initial Public Offerings. We highlighted the following three main areas: the role of corporate advisors, connected and unconnected research and the IPO timetable.
Securities and Exchange Commission	Corporate reporting and disclosure	US	July-16	We responded to this important consultation on the information that US corporates disclose to the market. Our response focused on the need for long-term reporting; for consistent and comparable disclosure of ESG information as well as the promotion of a consistent standard for such disclosure; better information on financial strategies used such as stock buybacks and aggressive tax planning; the disclosure of clearer human capital management metrics; improved corporate political spending disclosure; and the clearer reporting on diversity of corporate boards through skill sets matrices.

Name	Topic	Region	Submission date	Description
BIS - Corporate Governance Inquiry	Business, Innovation and Skills (BIS) - committee inquiry in to corporate governance in the UK	UK	Oct-16	We responded to the BIS Committee inquiry in to Corporate Governance in the UK which follows on from governance failings and the commitments from the Prime Minister to overhaul corporate governance. As long-term investors, we believe good corporate governance helps improve markets and companies in which we invest. We identified two main themes through our response: support for the UK's current unitary board structure and the need for enhanced transparency to improve accountability.
Office of Communications (OFCOM)	Openreach's strategic and operational independence	UK	Oct-16	We provided our comments to OFCOM on Openreach's strategic and operational independence. As a significant shareholder of all of the UK's major telecommunications and media companies, we supported OFCOM's ambition to ensure that Openreach provides a fair service to all of its customers. We made proposals and expressed our concerns about the corporate governance implications of the proposed structure and the costs of a legal separation of Openreach and BT Plc.
FRC	Stewardship Code Tiering	UK	Nov-16	We reported to the FRC on our commitment to the seven principles of the Stewardship Code. Our statement was assessed as Tier 1 by the Financial Reporting Council as part of its review into reporting of the Stewardship Code. This means we have provided a good quality and transparent description of our approach to stewardship and explanations where an alternative approach was necessary. LGIM's updated UK Stewardship Code Statement can be found here: http://www.lgim.com/library/capabilities/UK_Stewardship_Code.pdf.
Tokyo Stock Exchange	Japan corporate reporting - increasing flexibility of earnings reports and quarterly earnings report	Japan	Nov-16	In this consultation, we responded directly to a TSE consultation on reform of proposals to relax requirements to which companies are subject in their quarterly reporting and annual results. Providing our views is very important as detailed financial information is vital to make informed voting decisions. LGIM worked in collaboration with Standard Life Investments and RPMI Railpen to send a single message of concern to the TSE through a collective letter. The letter was signed by over 40 asset managers and asset owners and was supported by two investor associations.
Regierungskommission	German Corporate Governance Code review	Germany	Dec-16	In this consultation, we provided our comments to proposed changes to the German Corporate Governance Code. LGIM seeks to promote good corporate governance in the market and are willing to be fully engaged on changes to corporate governance in Germany. We used our experience to provide our views on core governance topics such as the role of the Chair of the board, compliance system, committee formation, board composition, independence of directors and their tenure.
Law Commission	Pension Funds and Social Investment	UK	Dec-16	We responded to a consultation by the Department for Culture, Media and Sport into social investment by pension funds. We highlighted the following three points as barriers to broader allocation of capital into social investments: the allocation of capital to social investments require a certain level of diversification into alternative asset classes; the imperative to create a definition of responsible investment in general, and a framework for understanding social investments; and the need to educate on responsible/social investment for all pension stakeholders.

Press and publications

North America's Board Refreshment Challenge-Harvard Law School Forum on Corporate Governance and Financial Regulation

In February 2016, LGIM published an article on the challenge of board refreshment in North America. We also set out our expectations with regards to succession planning and set our voting policy on the subject.

Remuneration – Pay principles, The Guardian

In September 2016, we updated our pay principles which were widely publicised in the press including the publication of an article by the Guardian titled "Legal & General warns firms over bonuses and pay". This article provides a description of LGIM's stance on executive pay and of the actions we've taken on the subject including the writing of letters to all FTSE 350 companies.

Public Statement – Sports Direct, Financial Times

In September 2016, LGIM made a public statement on voting at the AGM of Sports Direct which was widely reported in the press, including by the Financial Times in an article titled "Investors step up pressure in Sports Direct board". Given the on-going concerns with the governance structure and working practices at the company, we made public our view which is a final part of our escalation process.

Remuneration – Investors & Board Responsibility, Financial Times

In October 2016 we published an article in the Financial Times to encourage shareholders to be more active on compensation. This article aims to remind shareholders of their responsibility in addressing the problem of executive pay, by using all the powers at their disposal to hold boards to account.

Launch of Future World Fund, Investment & Pensions Europe

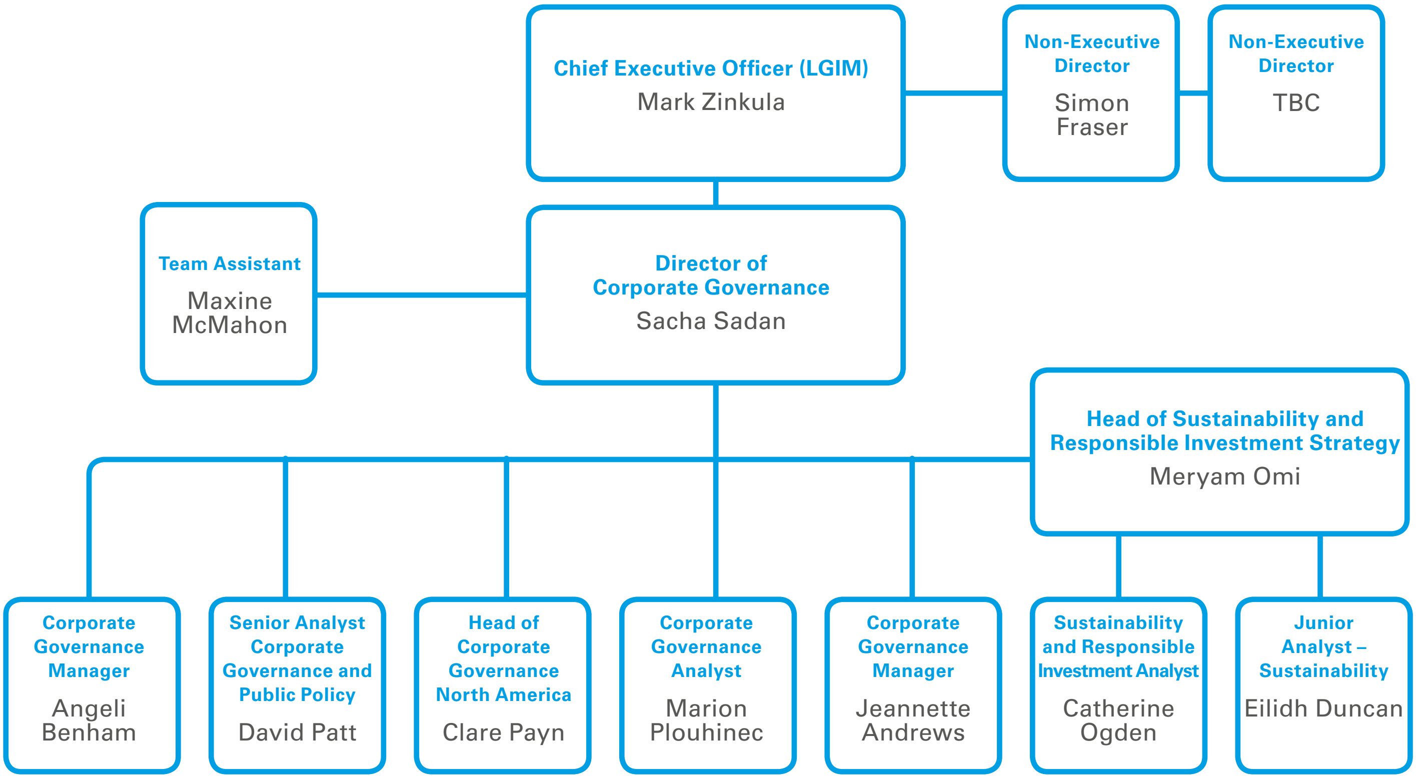
The launch of the Future World Fund in November 2016 attracted media attention. We provided comments to Investment & Pensions Europe for their article 'HSBC UK pension scheme adopts climate 'tilted' fund as DC default'.

ICSA

For the second consecutive year, LGIM's Corporate Governance team received the ICSA award of 'Best Investor Engagement' for 2016. The award aims to reward the investor who has, according to the judgment of FTSE 350 company secretaries, provided the most constructive company engagement during the year.

The Corporate Governance team

LGIM's Corporate Governance and Responsible Investment team is led by the Director of Corporate Governance, Sacha Sadan



A distinction of LGIM is how the Corporate Governance and Responsible Investment team is structured and supported. The team of 10 professionals, with an average investment experience of 12 years, is headed by the Director of Corporate Governance, Sacha Sadan.

The Director of Corporate Governance reports directly to LGIM's CEO. This structure, as well as the ability to engage with two independent non-executive directors of LGIM's board, ensures that conflicts of interest are appropriately managed.

The team is independent from all fund management professionals, therefore can operate within Chinese walls to receive relevant sensitive information. However, fluid communication is maintained with fund managers in order to enhance ESG and financial dialogue with the companies in which LGIM invests.

Team biographies

Angeli

Angeli is a Corporate Governance Manager with responsibility for LGIM's voting and engagement on ESG issues within certain sectors of the UK, Europe and Brazil. She is responsible for developing LGIM's policies in these regions and specialises in executive remuneration. Angeli represents LGIM at the IA Remuneration Committee. She lives with her son and three adorable (but mischievous) miniature dachshunds in Surrey. All things tech, fast cars and executive pay usually get her pulse racing, although not all in a good way.

Catherine

Catherine joined LGIM in 2015, in a new role created to help drive forward ESG integration into mainstream fund research and to strengthen sustainability engagements. Prior to this, Catherine spent four years working with governments in Africa and Asia on the sustainable policy, planning and management of the extractives sector, and five years in sell-side equity research. A keen linguist and sportsperson, she bemuses her colleagues with a love of Capoeira and British Military Fitness.

Clare

Clare is Head of Corporate Governance North America and has overall responsibility for LGIM's ESG engagement, voting activities and policy setting in the North American region. Clare also leads the governance team's work on improving gender diversity on corporate boards. She sits on L&G Group's Diversity and Inclusion Committee which works towards creating an inclusive and diverse culture. Clare is a qualified photographer and enjoys visiting exhibitions. She also loves to travel, run and bake, although perhaps not all at the same time.

David

David is focused on LGIM's UK and European corporate governance activity including voting, engagement and client reporting. He also monitors public policy responding to government / industry consultations in order to position LGIM as thought leaders. Recently engaged, all of his efforts outside the job are focused on planning the perfect wedding with his fiancée.

Jeannette

Jeannette is a Corporate Governance Manager with responsibility for LGIM's voting and engagement within certain sectors in the UK and Europe. Jeannette has over 13 years' experience in corporate governance, having previously worked for one of the UK's largest pension schemes. When she is not reading corporate governance reports, she can be found digging in the garden and having laid her own garden patio and spent the previous summers landscaping, is now planning new ways to humanely remove the slugs.

Marion

The newest member of the team, Marion is a Corporate Governance Analyst involved with LGIM's engagement and voting activities across Europe and the UK. After gaining one law degree in Lille, she hopped the Channel to gain an English one as well. Marion loves the expat life and when not training for a 10K run, she likes to visit the markets, museums and restaurants of London at the weekends.

Maxine

Maxine has amassed over 30 years' experience as an assistant to Directors as well as an Events and Office Manager within the financial services industry. Her organisational skills as a parent cross into her work life and vice versa. Maxine's outside interests include sports and, in a previous role, she qualified as a football referee in the course of setting up the company football team.

Meryam

Meryam is responsible for engaging on sustainability themes globally and development of responsible investment product solutions. Meryam has over 12 years' investment experience in asset management companies, starting her career as a business proposal writer for fixed income funds, eventually creating a dream job. She describes almost everything using food references and has an unbridled passion for linking the 'big picture' to spreadsheets.

Sacha

With over twenty years' experience in Financial Services, Sacha Sadan is a true Londoner - born within the sound of the Bow Bells, he now lives south of the river. He makes good use of the city, regularly going to gigs and the theatre, as well as being a long standing West Ham season ticket holder. He's travelled to every continent apart from Antarctica, but has never learned to drive.

CONTACT US

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

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