

# Global Corporate Governance and Responsible Investment Principles



# Contents

<b>Company Board</b> .....	3
Board leadership.....	4
Structure and operation.....	5
Board effectiveness .....	7
Stakeholder engagement .....	8
Culture.....	9
Board committees .....	9
<b>Audit, Risk and Internal Control</b> .....	11
External audit .....	11
Internal audit .....	12
Whistleblowing .....	12
Cyber Security .....	12
<b>Remuneration</b> .....	13
Key principles .....	13
Fixed remuneration .....	13
Incentive arrangements .....	14
Service Contracts and Termination Payments .....	15
Benchmarking .....	15
Discretion .....	16
Shareholding Guidelines .....	16
Pensions .....	16
Non-executive Directors' fees .....	16
<b>Shareholder and Bondholder rights</b> .....	17
Voting rights and share class structures.....	17
Amendments to the company's constitution.....	17
Virtual / electronic general meetings.....	17
Transparency.....	18
Capital Management .....	18
Mergers & Acquisitions.....	19
Shareholder proposals.....	20
Political donations .....	20
<b>Sustainability</b> .....	21
Material risks and opportunities .....	21
Sustainability as part of business strategy.....	21
Policies to mitigate key risks.....	21
Management systems to mitigate risks.....	21
Target setting .....	21
Public disclosure .....	21
Governance and accountability.....	22
Financial impact quantification .....	22
Engagement transparency .....	22
Why adherence to these principles is important for LGIM .....	22

This Principles document sets out LGIM's approach and expectations with respect to key topics we believe are essential for an efficient governance framework, and for building a sustainable business model.

While local best practice codes may adopt different approaches, we expect all companies on a global scale to seek to closely align with our principles which set out the fundamentals of corporate governance. LGIM will take into account these principles in conjunction with our [region-specific policies](#) in our voting and engagement activity with all companies globally.

LGIM publicly discloses its voting decisions on a monthly basis, including the rationale for votes against management. These reports are accessible on the [corporate governance section](#) of the LGIM website.

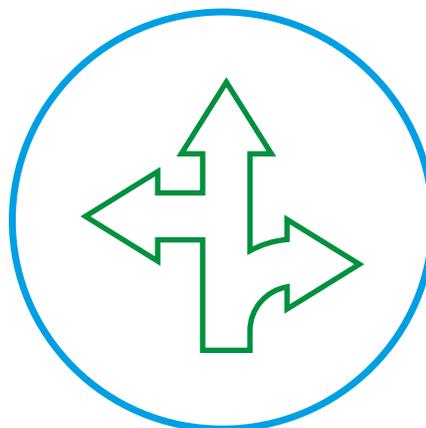
While there is no "one-size-fits-all" solution to building a sustainable business model, LGIM looks for companies we invest in to demonstrate that sustainability is effectively integrated into their long-term strategy and their daily operations. Our Sustainability Principles set out our expectations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

# Company board

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

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

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



## BOARD LEADERSHIP

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

### The Board Chair and the Chief Executive Officer

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

The Chair should be able to challenge the executive directors and encourage the non-executive directors to actively participate in board discussions. It is the Chair's role to regularly assess whether the board members have the adequate skills and diversity to make a positive contribution.

By contrast, the CEO has the responsibility of executing the strategy agreed by the board and of leading the business.

Given the importance of the role, **LGIM expects the Chair to be independent at the time of appointment.**

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

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

For more details, please refer to our Board Guide on the nomination of the board chair available at: <http://www.lgim.com/files/document-library/capabilities/a-guide-to-the-nomination-of-board-chairs.pdf>

### The case of the combined Chair and CEO

The roles of Chair and CEO are substantially different, requiring distinctly different skills and experience. Therefore, **LGIM expects the two roles to be separated.** However, this division of responsibilities ensures that a single individual does not have unfettered powers of decision at the head of the company, thereby securing a proper balance of authority and responsibility on the board.

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

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

From 2020, LGIM will be taking a stronger stance on combined roles as we believe it can have a negative impact on culture, board discussions, remuneration and shareholder rights. We will start to vote against the election or re-election of any individual holding such a combined role.

For more details, please refer to our Board Guide on the topic, available at: <http://www.lgim.com/files/document-library/capabilities/separating-the-roles-of-ceo-and-board-chair.pdf>

### Senior or Lead Independent Director

The Senior or Lead Independent Director plays an essential role on the board and should lead the succession process of the Chair and appraise the Chair's performance. Additionally, they should [meet investors](#) regularly in order to stay well informed of key concerns.

They can also be a key contact for investors, especially when the normal channels of the Chair, CEO, or Chief Financial Officer have failed to address concerns or are not the appropriate avenues.

**LGIM expects the Senior or Lead Independent Director to be a fully independent non-executive director.** This is of extra importance when the company has a combined Chair and CEO.

Our thought piece on the role of the Senior Independent Director on UK boards is also available at: <http://www.lgim.com/files/document-library/capabilities/the-role-of-the-senior-independent-director.pdf>

### Non-executive directors

LGIM expects non-executive directors to use their skills and experience to constructively contribute to board discussions and help develop proposals on strategy. **They are expected to oversee management performance and challenge the executive directors.**

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

## STRUCTURE AND OPERATION

### Diversity

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

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

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

Companies should ensure that candidates with appropriate skills and qualities are sought through the widest possible means such as the use of recruitment consultants, public advertisements, and the leverage of other relationships in the industry. Companies should also be prepared to look outside of the usual pool of candidates to include those from a less traditional "corporate board" background. They should also be willing to recruit those without previous board experience as many, if not all, of the board members will have this experience and this will help to expand the candidate pool and the board's cognitive diversity.

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

For more details on LGIM's position, please refer to our publications on the topic available at: <http://www.lgim.com/uk/en/capabilities/corporate-governance/influencing-the-debate/>

### Independence

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

LGIM would consider a director to be non-independent if he or she:

- Has been an **employee** of the company or group within the **last five years**
- Has, or has had within the **last three years, a material business relationship** with the company either directly, or as a partner, shareholder, director, or senior employee of a body that has such a relationship with the company
- Has received or receives **additional remuneration** from the company, apart from a director's fee, such as the company's share option, performance related pay, or pension scheme
- Has **close family ties** with any of the company's advisers, directors, or senior employees

- Holds **cross-directorships** or has **significant links** with other directors through involvement in other companies or bodies
- Has served on the board for **more than 12 years** from the date of first election
- Represents a **significant shareholder**

However, note that our regional policies take into account regional best practice and therefore we have set stricter criteria and targets in some regions. Please refer to our regional policies available on our [website](#) for more details.

LGIM also recognises that non-independent, non-executive directors can offer significant skills and sector knowledge. This can help a company to perform at its best and to maximise value as long as the board remains balanced. In this instance, **LGIM expects the company to fully explain how the non-independent director provides valuable input into the business.**

### Succession Planning

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

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

### Re-election of directors

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

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

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

## BOARD EFFECTIVENESS

### Board tenure

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

Board tenure is assessed in two different ways:

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

Whilst different regions have different best practice guidance on this issue, **LGIM expects all companies to put in place an individual director term limit of a maximum of 12 years.** Please refer to our [regional policies](#) for more details on regional expectations on tenure.

### Board mandates

LGIM believes it is important for executive directors to seek external board appointments as this will help

broaden their skills and knowledge, enabling them to provide more input on board discussions. **However, when taking up external appointments, they should be mindful of the time commitment required to exercise their duties on multiple boards.**

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

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

### Board meetings and attendance

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

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

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

### Board size

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

### Board evaluations – internal and external

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

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

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

### Non Executive Director induction

The Chair is also responsible for ensuring that incoming non-executive directors receive a comprehensive induction to the company on joining the board and that training is available on an on going basis. This will allow new directors to contribute to board meetings as soon as possible. **This is especially important if the Chair is considering a board member who does not have previous corporate board experience.** LGIM supports the view that companies should hold regular briefings or presentations to the board from divisional directors to

ensure that all directors are kept informed of all aspects of the business. The Corporate Secretary can also be an important training resource for non-executive directors.

Directors should be encouraged by the Chair to continually update their skills and knowledge and should agree on their specific training and developmental needs which should include all aspects of social, environmental, ethical and reputational risks faced by the business. One way to remain up to date is to regularly meet with investors, along with other relevant board members, to gain knowledge and to hear various perspectives.

We would also encourage new board members to use their investors as a resource to help them in performing their duties. LGIM regularly organises Environmental, Social and Governance (ESG) related seminars for board directors aimed at discussing views on key ESG topics. We also regularly publish [thought leadership pieces](#) on relevant topics related to corporate governance, stewardship and responsible investment which can be accessed through our website.

## STAKEHOLDER ENGAGEMENT

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

### Employee voice

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

Where hard or soft law does not provide any guidance, we encourage companies to set up a structure they find appropriate. They may prefer the appointment of

employee representatives on the board or the use of forums or advisory panels. For instance, in the UK, LGIM encourages the nomination of a current independent non-executive director to seek out employees' views at different levels of the business and to regularly report these back to the board.

- **Investor dialogue**

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

For more details on LGIM's position, please refer to our publications on the topic available at: <http://www.lgim.com/files/document-library/capabilities/lgim-guide-to-board-investor-dialogue.pdf>

## CULTURE

Culture has been an increasingly discussed topic in recent years amongst businesses, investors and even regulators, and its measurement and assessment is an exercise we expect the Board to undertake.

For investors to understand company culture, requires disclosure from the board, given its role in setting values. Investors need reassurance that the CEO and management really drive the cultural message and set the tone from the top, and that this is regularly discussed and challenged by the board, as well as monitoring how the cultural message filters down to the rest of the organisation.

For more details on LGIM's position, please refer to our publications on the topic available at: <http://www.lgim.com/uk/en/capabilities/corporate-governance/influencing-the-debate/>

## BOARD COMMITTEES

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

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

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

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

### Audit Committee

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

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

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

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

### Nomination and Succession Committee

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

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

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

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

### Remuneration Committee

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

The chair of the remuneration committee should have appropriate knowledge of the business to align the

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

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

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

### Additional Board Committees

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

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

### Advisory Committees

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

# Audit risk and internal control

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

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

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

## EXTERNAL AUDIT

An external independent audit provides verification and assurance of the financial statements of a company to its investors. The opinion of the auditors is to provide assurance that the financial statements give a true and fair view of the financial health of the company. Any concerns raised by the auditors ought to be fully explained by the board, including how the concerns have been addressed.

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

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

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

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

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

### INTERNAL AUDIT

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

### WHISTLEBLOWING

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

### CYBER SECURITY

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



# Remuneration

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

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

In addition, in order for investors to be able to appropriately assess directors' pay, we expect disclosure of the executive remuneration structure, including quantum<sup>1</sup> and a description of the metrics and targets used under incentive plans where applicable and within the limit of what the company is publicly allowed to disclose.

Whilst we are cognisant of the variations in executive pay practices globally, we expect companies to consider our principles below when setting pay policies for their executive board. Please also refer to our regional policies for further details on our expectations in various markets.

## KEY PRINCIPLES

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

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

## FIXED REMUNERATION

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

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

1. Total pay

## INCENTIVE ARRANGEMENTS

### Annual Incentive

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

LGIM would expect companies that are exposed to high levels of environmental, social or reputational risk to include relevant targets that focus management in mitigating these risks.

In order to more closely align with investors and company performance, we ask companies to pay a portion of the bonus in shares deferred for at least 2 years. Additionally, the bonus should be set as an appropriate proportion of base salary and should not be uncapped. We also expect companies to put in place contractual and statutory provisions that may allow for a reduction or forfeiture of the annual bonus component in exceptional circumstances.

### Long-Term Incentives Plan (LTIP)

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

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

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

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

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

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

### Holding Periods

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

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

### Equity dilution

LGIM believes that strict guidelines should be adhered to in relation to the issuance of shares for incentive schemes, in order to limit potential dilution to shareholders. As a general rule, **LGIM expects no more than 10% of a company's equity to be used for all share schemes over a 10 year period and no more than 5% in 10 years for discretionary schemes. The annual run rate or burn rate should also be reasonable; approximately 1%.**

These limits may vary in certain regions and any variance will be highlighted in the relevant regional policy. Treasury shares should be included within these limits. Such restrictions should apply to all shares whether they are market purchased or newly issued. LGIM encourages companies to provide transparent explanations regarding the issuance of shares and for share schemes to have performance conditions attached.

### SERVICE CONTRACTS AND TERMINATION PAYMENTS

Executive contracts should provide for a maximum notice of 12 months. LGIM does not support provisions within service contracts that enhance contractual terms for loss of office following a change in control.

Contracts of key people should provide the company with the authority to apply claw-back of both unvested and vested awards.

### New Joiners

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

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

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

### Departing directors

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

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

### BENCHMARKING

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

### DISCRETION

Companies can build trust with investors if they can demonstrate restraint, consistency and alignment with them. Discretion applied to any earned award by executives' is one way to demonstrate this alignment.

**We define discretion as anything that alters the monetary outcome of total remuneration.**

LGIM expects the company to state:

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

### SHAREHOLDING GUIDELINES

LGIM expects companies to encourage their directors and senior executives to build up and to retain a meaningful interest in the shares of the company they manage. This is an essential part of aligning directors' interests with those of investors. **The level of shareholding should be linked to the size of the company and the level of reward that the director receives.**

### PENSIONS

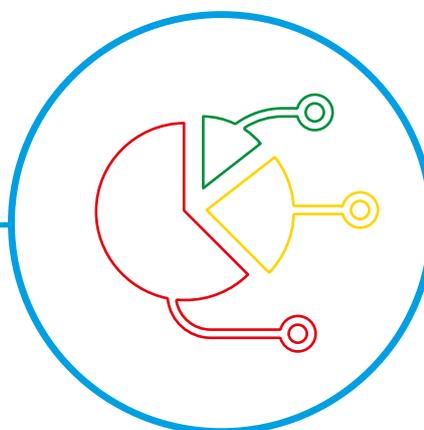
Pensions are a significant cost and risk for a company as well as an element of remuneration that is not linked to performance, therefore the cost of providing a pension should be taken into account when evaluating a remuneration package. **LGIM will not support pension enhancement payments at retirement or when a contract is terminated early.** Additionally, LGIM will not advocate an individual being compensated for changes in tax. Companies should aim to reduce their pension fund liabilities and costs when recruiting new executives.

Pension provisions should be disclosed in full in the report and accounts and any changes to pension benefits should be fully explained.

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

### NON-EXECUTIVE DIRECTORS' FEES

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



# Shareholder and Bondholder rights

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

## VOTING RIGHTS AND SHARE CLASS STRUCTURES

**LGIM supports the “one share one vote” philosophy and favours share structures where all shares have equal voting rights and those rights are equal to economic value held.**

LGIM does not support the issue of shares with enhanced or impaired voting rights. In some markets, however, differential voting rights is a long-standing structure and where this exists, the structure should be transparently disclosed. In the case of controlled companies, LGIM will review the issuance of shares with enhanced voting rights to understand why these would be necessary. In general, LGIM encourages companies to eliminate differential voting rights over time.

## AMENDMENTS TO THE COMPANY’S CONSTITUTION

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

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

## Company bylaws

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

LGIM also expects companies to put bylaw amendments that have the potential to reduce or negatively impact shareholder rights to a shareholder vote.

## VIRTUAL/ELECTRONIC GENERAL MEETINGS

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

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

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

**However, we believe that such technology should be used in parallel with the in-person meeting, and should not lead to companies adopting a virtual-only approach.**

The shareholder meeting is the only time that the whole board must be publically accountable to all its shareholders. The attendance of the board to such meeting is a demonstration of its commitment to hear and understand the views of shareholders.

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

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

## TRANSPARENCY

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

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

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

## CAPITAL MANAGEMENT

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

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

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

### Share issuance

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

The existence of pre-emption rights is fundamental to protect shareholders from excessive dilution. It gives the right conveyed to shareholders to be offered any new shares, pro-rata to their existing holdings, ahead of these being offered to non-shareholders. More information on specific guidance on limits can be found in our regional policies which take in to account the different local business practices and laws.

### Share repurchases or buybacks

Share repurchases or buybacks can be a flexible way to return cash to shareholders. We expect the board to be transparent in how the share buyback authority will be used in relation to other uses of capital (such as dividends, internal investment or externally by mergers & acquisitions).

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

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

Please note that some regions have an annual limit on the amount of shares that can be bought back in any year which is discussed in the relevant regional policy.

### Debt issuance

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

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

### MERGERS & ACQUISITIONS (M&A)

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

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

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

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

### Takeover defence plans – poison pills

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

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

For more details, please refer to our Board Guide on the topic available at: <http://www.lgim.com/files/document-library/capabilities/a-guide-to-mergers-and-acquisitions-board-oversight.pdf>

#### Related party transactions

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

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

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

#### SHAREHOLDER PROPOSALS

LGIM considers all shareholder proposals tabled at a company's AGM in the wider context of the corporate governance practices at the company, and also in relation to the long-term benefits for investors. LGIM expects

companies to provide a meaningful discussion of the proposals to enable shareholders to make an informed judgment.

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

#### POLITICAL DONATIONS

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

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

# Sustainability

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

## MATERIAL RISKS AND OPPORTUNITIES:

Material environmental and social (E&S) risks will vary between sectors and from company to company, depending on a range of factors. However it is **important that all companies across different sectors undertake an analysis of E&S issues that could be material to their business** over varying timeframes. A dynamic risk mapping exercise should identify the degree to which a company is exposed to each risk element. It should also be used to identify business opportunities such as new products, services, and efficiency gain potentials that the company may face in changing policy, technology and business environments.

## SUSTAINABILITY AS PART OF BUSINESS STRATEGY

**Building a sustainable model should be at the core of business strategy, rather than seen as a side element** in the form of ethical obligations. Where material risks and opportunities have been identified, there should be a clear link to the overall business framework.

## POLICIES TO MITIGATE KEY RISKS

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

## MANAGEMENT SYSTEMS TO MITIGATE RISKS

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

## TARGET-SETTING

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

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

## PUBLIC DISCLOSURE

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

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

### GOVERNANCE AND ACCOUNTABILITY

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

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

### FINANCIAL IMPACT QUANTIFICATION

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

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

### ENGAGEMENT TRANSPARENCY

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

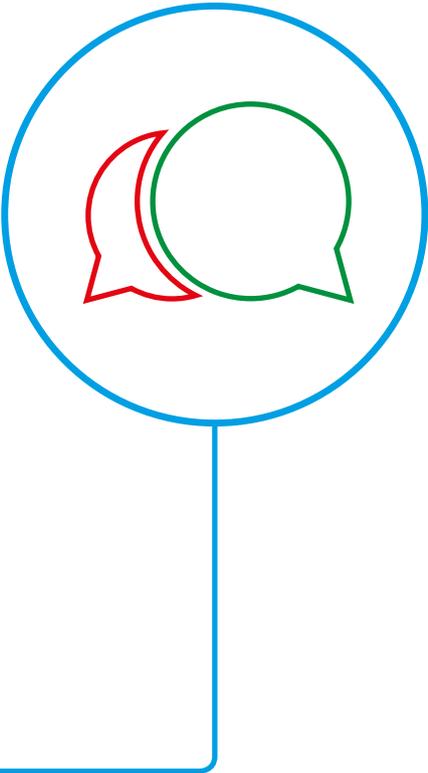
We expect companies to be transparent in disclosing their public policy engagement activities, whether this be individual engagement, or collaborative engagement as part of an industry association.

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

### WHY ADHERENCE TO THESE PRINCIPLES IS IMPORTANT FOR LGIM

We believe that integrating environmental, social and governance considerations into investment processes can help mitigate risks and improve long-term financial outcomes. This is why we embed both top-down and bottom-up ESG analysis into our investment processes. In addition, positive and negative externalities generated by companies can have consequences for the economy and society at large. We therefore believe that investors have a responsibility to the market as a whole. We need and expect companies to play their part. Our sustainability principles set out our minimum expectations of companies with regards to planning, management and disclosure of sustainability issues. These principles naturally feed into our voting and investment decisions, and for certain themes we have very structured processes in place.

Where we deem insufficient action is being taken, we have already publicly committed to vote against the chair of the Board on the issue of [climate change](#) on a global basis. Our global standard on [diversity](#) means that where there are no women on the board we have pledged to vote against the Chair and/or the Chair of the Nomination committee. Where companies fail to meet minimum standards of globally accepted business practices, as set out in [LGIM's Future World Protection List](#), LGIM will vote against the election of the Chair of the Board, across our entire equity holdings



## CONTACT US

For further information on anything you have read here or to provide feedback, please contact us at:

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