

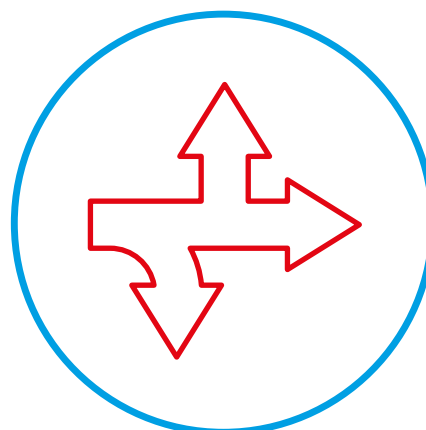
Corporate Governance and Responsible Investment Policy

UK 2019



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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.

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. These two roles involve different responsibilities and a different approach to board relations and the company. Additionally, 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, 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 to be appointed to ensure that no person has unfettered powers of decision.

The case of the combined Chair and CEO

Although UK listed companies generally do not adopt such a board structure, it is important to provide guidance on LGIM's views.

We believe that the roles of Chair and CEO are substantially different, requiring distinctly different skills and experience. Therefore, LGIM expects the two roles to be separated. 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 independent director, or deputy chair to be appointed and for a meaningful explanation and justification to be provided in annual disclosures.

Any decision to combine these roles should be subject 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.

Senior Independent Director

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

Please see the LGIM website for a thought piece on the Role of the Senior Independent Director.

<https://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 provide sufficient constructive challenge at board meetings.

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

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.

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

LGIM 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. In this instance, subject to board balance being maintained, LGIM will support a company if they want to retain a non-executive director beyond the recommended 9 years. However, the company must provide a full explanation of the benefits to the company of extending their services for another term.

In relation to the Chair's independence, LGIM will continue to treat the Chair as independent until they have served for

twelve years on the Board. While we recognise the changes to the UK Corporate Governance Code in 2018, we believe companies need time to adjust to comply with these changes. LGIM will start to apply the nine-year rule from Jan 2021. In exceptional circumstances where a Chairman is required to remain beyond the twelve years, we would encourage early engagement with LGIM to provide an explanation.

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.

To provide investors with a comprehensive understanding of their diversity strategy, we expect companies to be transparent regarding the procedures used to find new members for the board and at senior management level, and how that process ensures a diverse board and senior executive pipeline. We expect all companies to disclose a breakdown of board directors, executive directors, managers and employees by geography, main skill set and gender, along with the information on its gender pay gap and what initiatives it has in place and action it is taking in order to close any stated gap.

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.

For the UK market, LGIM has publicly supported the initiative for companies to achieve a minimum of 30% women on FTSE 350 boards; and for 30% women at senior management level of FTSE 100 companies by 2020. In addition, we support the similar target developed by the UK Government's Women on Boards Report, and the Hampton-Alexander Review.

We expect companies to take targeted action to increase the levels of diversity at board and executive committee levels in order to reach the minimum 30% target by 2020, and to reduce the gender pay gap. This action could be supported by establishing an aspirational target to ensure that progress continues.

By the end of 2020 we expect ALL companies in the FTSE 350 to have a minimum of 30% women at board level. For smaller companies we expect at least one woman at board level.

For 2019, we expect FTSE 350 companies to have at least 25% women at board level.

As the diversity conversation has broadened beyond gender, we would expect companies to start to collect their data on ethnicity throughout all levels of the company. As 2019 has seen the first consultation by the Government on reporting on the ethnicity pay gap, we would expect companies to understand their data on this area of diversity going forward.

Our article on diversity can be found here:

<http://www.lgim.com/uk/en/capabilities/corporate-governance/influencing-the-debate/>

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. A skills matrix linked to the strategy of the company would be a useful diagram. In addition, we would welcome an explanation of how any newly appointed directors fit into the matrix and the minimum time commitment needed to fulfil the role.

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 on an annual basis.

To help us make an informed decision on director elections, it would be useful for the company to disclose the minimum annual time commitment required from each director.

In addition to the biographical details of each director we 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. A skills matrix linked to the strategy would be useful.

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 skill sets remain relevant. A regularly refreshed board is more likely to be willing to question established practices, avoids group think, and exercise more efficient oversight of management and stay ahead of market changes.

LGIM expects all companies to put in place an individual director term limit of a maximum of 12 years.

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 outside appointments, they should be mindful of the time commitment required to exercise their duties on multiple boards.

This is because as the number of companies a director serves on increases, so does the risk that they will become less effective. This risk increases further depending on the role played on each board and the size and complexity of the company itself. A director has a duty of care to ensure they have sufficient time to contribute effectively to each directorship.

LGIM expects non-executive directors not to hold more than five roles in total. We consider a Board Chair role to count as two directorships due to the extra complexity, oversight and time commitment of this role. A practising executive director should not hold more than one non-executive director role within an unrelated listed company.

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.

Board size

LGIM believes a company should put in place a board of a size that is appropriate for the size 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.

Board evaluations – internal and external

The evaluation of directors is a key way of improving board effectiveness and ultimately its performance. 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 Chairman, with assistance from the Company Secretary. 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 of the Nominations Committee is 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 Company Secretary can also be an important training resource for non-executive directors.

Directors should be encouraged 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 holds an annual event, usually in September, that is aimed at Non-Executive Directors and covers environmental, social and governance topics of interest. We also regularly publish worldwide 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 taking account of the interests of their stakeholders on material issues. Understanding and taking account of 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

LGIM believes investors should be able to hold directors accountable for their consideration of employee views.

We encourage companies to set up a structure they find appropriate for their company. The UK Corporate Governance Code provides 3 alternative approaches to consider.

- To appoint a worker director who will sit at board meetings and be allowed to speak and provide feedback. e.g. Sports Direct, Capita plc.
- To establish a formal workforce advisory panel, e.g. Marks & Spencer plc
- The third is to appoint a non-executive director as a designated point of contact for workers, e.g. L&G plc

LGIM has been a proponent of using a designated non-executive director as a point of contact for workers with a designated email address and half yearly meetings with the workforce. Companies may select any of the alternatives or a combination. What is more important is that whichever method selected is operated effectively to ensure employee buy-in and useful feedback 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.

LGIM's position on [Board-investor dialogue](#) is available on our website.

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 remuneration.

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

To enable 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, 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. The committee 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 and continues to be independent but should not chair the committee. LGIM assesses the Chair's independence on an annual basis.

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.

To provide further transparency, LGIM would expect the auditor's report to provide information about potentially material issues that were raised by the Auditor as a concern that was then dismissed by the Board and the reasons for the dismissal.

Nomination Committee

The nomination 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 account of important governance considerations such as skill sets, 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 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 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 have served as a member of the board for at least a year prior to their 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 and continues to be independent but should not chair the committee. LGIM will assess the Chair's independence on an annual basis. Non-independent directors may attend remuneration committee meetings by invitation but should not be members of the committee.

We expect the Committee to set the remuneration policy for the executive directors, the chair and senior management

The Committee should:

- Seek independent advice. External advisors, consultants and internal employees advising the committee should be fully accountable to the committee. The committee should exercise its own independent judgment when considering any advice provided by third parties
- Consider carefully and be able to demonstrate how they have reviewed the pay and related policies of the workforce when setting pay for the executive team and be able to demonstrate how this is aligned with the culture of the company
- Give consideration to the views of their shareholders. Most institutional investors' pay policies are available on their corporate website

LGIM will vote against the election of individual board directors where we do not support remuneration for the second consecutive year. LGIM may also vote against individual directors where there are particularly contentious issues

A large voting opposition (>20%) to the remuneration proposals should not be ignored. The Remuneration Committee should:

- Hold themselves accountable for the decisions taken that led to the high vote against remuneration

- Publish an explanation for the dissent when disclosing the voting outcomes including what the board is doing to address concerns. This should be sent to the Investment Association for inclusion in the Public Register. An explanation should also be included in the chairman's statement in the next annual report
- Consider re-tendering the remuneration consultant contract if the decisions of the Remuneration Committee were based on the advice of the consultant.

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 to its investors for presenting the true and fair view of the financial position and future prospects of the company. 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 as 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 account of 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 report. 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 management, with a direct line to the audit committee to allow for appropriate oversight and independent escalation where necessary. Companies should ensure their policy safeguards the identify of any whistleblower and that they are protected from internal harassment. 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 trust the board to ensure executive directors' pay is fair, balanced and aligned with the strategy and long-term growth and performance of the business.

The Remuneration Committee Chair's statement should explain:

- Why the outcome of the single figure is appropriate taking account of delivery of Key Performance Indicators (KPIs), employee pay and shareholder experience in terms of value created
- Why the chosen remuneration award level is appropriate for the company. Any explanation should avoid as its main argument comparisons with peer median pay
- Details of engagement undertaken with all stakeholders. Referencing any engagement that has taken place with the workforce to explain how executive remuneration aligns with the wider company's pay policy. Engagement with shareholders and the impact this has had on remuneration policy and outcomes should also be set out
- Evidence of the exercise of discretion (up or down) during the year. We would define discretion as any change that alters the monetary outcome. Where discretion is applied upwards, and remuneration increases, we would expect to be reminded of when downward discretion was previously applied. When discretion is applied, up or down, we would also expect to understand what the monetary outcome would have been had the discretion not been applied. This will help us in applying our own judgment on the level of fairness.

We expect companies to consider our principles below when setting pay policies for their executive board.

KEY PRINCIPLES

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

1. The structure of remuneration and the payments awarded should be fair, balanced and understandable. This means: fair in terms of what the company has achieved; balanced in terms of quantum (total pay) 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.

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 operational performance. 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.

Additionally, the bonus should be set as an appropriate proportion of base salary and should be capped.

In line with LGIM's focus on long term growth and performance, we would encourage the reduction of short-term annual bonus levels. A bonus of 200% of salary should be reserved for the largest global companies. LGIM will not support any increases to the annual bonus going forward.

To highlight the integrity of the target-setting process, companies should disclose as many components of the bonus targets as possible, retrospectively.

Targets that are commercially sensitive to the business should be disclosed retrospectively, within a year after payment; if this is not possible, an explanation of why the target continues to be commercially sensitive is expected. Strategic/qualitative and personal targets should be fully explained and the degree to which they were achieved should be demonstrated. LGIM expects personal performance to be no more than 25% of salary.

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.

To more closely align with investors and company performance, we ask companies to pay a portion of the

bonus in the form of shares that is deferred for at least 2 years. 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. To provide clarity, what constitutes exceptional circumstances should be set out.

Long-term Incentive 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.

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 level of award being offered to be reviewed every 3 years to ensure they are offering a commensurate level of reward as when the Plan was first adopted. Any increase to levels of reward should be subject to shareholder approval.

The board should determine what the right metrics are to deliver the strategy, and what level of stretch in the target is appropriate to deliver the right outcomes for all stakeholders. Metrics should be linked to long-term strategy, stretching but achievable without undue risk taking.

Performance targets should use the reported numbers without further adjustments, save for share buy-backs and other capital changes. Any adjustments should be consistent, explained and reconciled with reported numbers.

The LTIP should not have too many performance conditions, more than 4 conditions would increase complexity. At least one measure should be 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.

Long term incentive performance should be measured over a period of not less than 3 years.

To enable investors to assess the appropriateness of long-term incentive arrangements, we expect companies to disclose the metrics and targets used under the Plan.

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 align 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 a significant proportion of the minimum shareholding requirement for two years post retirement.

Restricted Schemes

We do not believe that this structure is right for all companies. Therefore, companies will have to justify why this type of arrangement is appropriate and why the existing arrangement is no longer suitable. In order for LGIM to support a restricted scheme the following should be considered:

- Award levels should be reduced to 50% or less of the normal long-term incentive grant, to take account of certainty of reward

- Restricted schemes should be long-term and applied through different business cycles
- Shares should be held for a minimum of five years prior to release
- The release of shares should be subject to an underpin that requires the Remuneration Committee to be satisfied that over the five years since the grant, the company's overall performance and individual's leadership is such that the release of shares is warranted
- Discretion may be applied to reduce awards, if at the end of the holding period, the performance of the company and the shareholder experience is not aligned. (See: p23, para. 2 of the Executive Remuneration Working Group report)
- For leavers; unvested restricted shares should be pro-rated for time, and subject to the same vesting time-frame and holding requirements as set out above
- Annual bonus targets should be disclosed in full, retrospectively, if not in advance
- A shareholding guideline must be in place that is material while in employment and following their departure from the Board (see below)

Malus & Clawback

Employment contracts should be designed to enable the application of malus and clawback, which should apply to all elements of variable remuneration.

To provide clarity for all stakeholders, the Remuneration Committee should set out the circumstances under which malus and clawback will be applied. These circumstances should not be too narrowly defined

Equity dilution

LGIM believes that strict guidelines should be adhered to in relation to the issuance of shares for incentive schemes 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%.

Treasury shares should be included within these limits. Such restrictions should apply to all shares whether they are market purchased or newly issued.

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.

LGIM would expect the notice period to be the same for employer and employee.

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. The intention to adopt this policy should be highlighted to shareholders in the annual disclosures until the executive has reached market rates for the role.

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 mirror what is being offered to employees at all levels and have a time limit of two years.

The use of 'golden hello' payments is not supported. The use of buy-out awards is discouraged; however, where it is considered 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 account of 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 factors such as: 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 set out:

- The main reasons that might give rise to the application of discretion
- Whether their discretion policy would 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. As a minimum, the shareholding requirement should be linked to the value of share-based annual variable pay. However, LGIM has set out below the levels of shareholding we would encourage companies to achieve over a 5-year period:

FTSE 1 – 30 – 5 x salary

FTSE 31 – 50 – 4.5 x salary

FTSE 51 – 100 – 4 x salary

Directors should be encouraged to buy shares to meet the shareholding guideline.

To promote long-term strategic decisions and shareholder alignment, directors should continue to hold a meaningful number of shares even after departure from the company. A post exit shareholding requirement of vested shares should be set that is meaningful and held for two years post exit. As a guide, for FTSE 100 companies this should be not less than three times their salary.

Vested shares, deferred bonus shares and shares subject to a holding period can count towards meeting shareholding guidelines.

Except in cases of dismissal for poor conduct or to avoid payment for failure, share-based awards outstanding should be time pro-rated and subject to the same vesting conditions that applied at grant.

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 account of 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.

Pension arrangements should be reduced over time so that they are more closely aligned with the general workforce. At the next remuneration policy review, LGIM expects companies to introduce a pension provision for new board directors that is aligned with what is being offered to the general workforce. In addition, where contracts are being re-negotiated for existing directors we expect pension provisions to be lowered. From 2020, LGIM will vote against any new remuneration policy that has not introduced changes to address the disparity in pension provisions unless the company can demonstrate that similar arrangements are available to the workforce. Although we would not force existing directors to reduce their pension provisions, we would encourage them to do so voluntarily.

NON-EXECUTIVE DIRECTORS' FEES

Non- executive directors' fees should reflect their 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.

OTHER DISCLOSURES

Consultants fees

A breakdown of fees paid to remuneration consultants, i.e. between fees for executive remuneration advice to the remuneration committee and fees for other pay-related services to the company.

The pay ratios

The Companies (Miscellaneous Reporting) Regulations 2018 were published in August 2018, requiring companies with an average number of UK employees of 250 or more to provide a set of pay ratios based on the CEO total single figure remuneration vs the 25th percentile; 50th percentile and 75th percentile employee. Companies were offered 3 methods to select from in calculating these ratios.

LGIM expects all companies to provide a pay ratio regardless of whether they have 250 full time equivalent UK employees or not. Where they do not have 250 UK employees a statement to this effect can explain the basis on which the ratio was calculated.

LGIM would expect companies to use methodology option A – which requires the company to calculate the pay and benefits of all its UK employees for the relevant financial year, to identify their P25, P50 and P75, and use these numbers when calculating these ratios. Where they opt for another method, we would expect a full explanation of why A was not possible.

Remuneration policy table

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

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

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.

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.

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 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 pose 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 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 is present and publicly accountable to all shareholders. The attendance of the board at such meetings is a demonstration of their commitment to hear and understand the views of shareholders.

Virtual only shareholder meetings remove this accountability due to the remoteness of participants.

Therefore, LGIM is not supportive of the move towards 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.

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.

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

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

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 & acquisition).

However, the benefits of using this approach is dependent on factors such as the price of the shares at which they were bought back, the company's individual financial circumstances and wider market conditions at the time. When utilising this authority, LGIM expects companies to consider the its impact on other issues. For example, on

remuneration, as performance conditions governing incentive schemes may be impacted by the exercise of a buyback authority. Furthermore, given the reduction in the number of shares in the market, the holdings of large shareholders will also increase giving them more control. LGIM expects any buy-back authority to be limited to 10% of the issued share capital.

Rule 9 Waiver

Share buy backs can trigger Rule 9 of the Takeover Code where there is a significant shareholder or a concert party whose shares account for 30% of the issue share capital. In such circumstances, a share buyback can result in an automatic increase to their shareholding and eventual control without paying minority shareholders a premium. LGIM will oppose rule 9 waivers.

Debt issuance

Good transparency and disclosure by the company on the issuance of bonds 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.

To enable making 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.

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 based on 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 and enable informed voting decisions to be made.

In line with the continuing obligation 9 for Listed Companies, companies with controlling shareholders should ensure that they have in place a controlling shareholder agreement. This is to demonstrate that, despite having a controlling shareholder, the listed

company is at all times able to carry on its activities as an independent business.

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 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 those issues where it disagrees with the associations of which it is a member and setting out why continued membership is beneficial
- Disclosure of where responsibility sits within the company for the oversight of such relationships

Sustainability

HOW LGIM TAKES ACCOUNT OF SUSTAINABILITY PRINCIPLES WITHIN OUR VOTING ACTIVITY AND INVESTMENT PROCESSES

Assessing companies on their management of Environmental Social & Governance (ESG) issues is an important element of risk management, and therefore part of investors' fiduciary duty. By incorporating ESG factors into investment decisions, we believe investors can gain an element of protection against future risks and the potential for better 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.

Non-adherence to these principles may influence our ability to assess risk and therefore, our ability to invest through our active portfolios. It may also lead to reduced allocation of capital within certain index funds, as well as divestment across particular investment strategies.

Non-adherence to these principles may influence our voting decisions:

As a global investor, LGIM is committed to addressing the issue of climate change. We believe that recognising the potential risks from climate change and providing solutions to a low-carbon transition is firmly part of our fiduciary duty of managing our clients' assets. The investment risks surrounding climate change have become so urgent that we are going beyond solely engaging with companies in holding them to account on this issue.

Where we deem insufficient action is being taken on the issue of climate change, we have already publically committed to vote against the chair of the Board on a global basis.

Minimum standards of globally accepted business practices:

Companies are intrinsically linked to the economies and societies in which they operate. Investors are collective owners of companies and we therefore believe that we have a responsibility to the market as a whole. As one of the world's largest investment companies, we believe we have a duty to both our clients and wider society to ensure the long-term success of the companies in which we invest. We therefore regularly engage globally with the world's biggest companies, regulators and other stakeholders.

However, 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.

For further details, please refer to our document on the topic available at: <http://www.lgim.com/files/document-library/capabilities/future-world-protection-list-public-methodology.pdf>

LGIM'S SUSTAINABILITY COMMITMENT

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

- Market practice, working to create better sustainability standards for the market at large
- Engagement and voting
- Integration of sustainability into active management
- Integration of sustainability into product solutions
- Communication on sustainability issues to the market and our clients



CONTACT US

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

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