Corporate Governance: Responsible Ownership

Policy and Principles for Corporate Governance

January 2010

F&C Investments

Expect excellence

What is Responsible Ownership?

Proper management is fundamental for creating shareholder value over the long term. F&C believes that shareholders have a responsibility to use their influence to promote the prudent management of significant **environmental, social** and **governance (ESG)** issues.

Corporate governance is the system by which businesses are directed, controlled by shareholders and held accountable to their stakeholders.

Good practice embodies a number of key principles:

- An empowered and effective board and management team
- Appropriate checks and balances in company management structures
- Effective systems of internal control and risk management covering relevant financial, operational and reputational risks, including material ESG risks
- A commitment to promoting a "governance culture" of transparency and accountability that is grounded in sound business ethics
- Remuneration policies that reward the creation of long-term shareholder value through the achievement of corporate objectives.

F&C's responsible ownership policy is aimed at using both its votes and its voice to encourage companies to achieve these goals. A summary of our expectations for companies is set out below ("What does F&C expect of companies?"). These are underpinned by detailed operational guidelines and engagement policies that are available on the F&C website at www.fandc.com/governance.

What does responsible ownership mean in practice?

Responsible ownership means voting on all holdings worldwide, and engaging in dialogue with companies to promote the adoption of best practice where this can protect or enhance shareholder value. Specifically, F&C is committed to:

- **Voting** in line with its responsible ownership policy across global holdings;
- **Communicating** its concerns to companies wherever its votes do not support directors' recommendations;
- **Engaging** in on-going dialogue with companies on significant matters related to ESG issues, so as to encourage good practice;
- **Integrating** ESG issues into its investment process; and
- **Reporting** on its votes and engagement to clients and, in the case of F&C retail funds, to the wider public.

F&C's approach is underpinned by the following **guiding principles:**

Pragmatism and consistency

F&C has a universal commitment to evaluating ESG impacts, which it marries with a pragmatic approach to implementing its policies worldwide. It recognises that legal or cultural differences across markets may give rise to differing interpretations of appropriate practice. While F&C takes account of a company's compliance with industry guidance, national and international regulations and global best practice, it seeks to understand each company individually, and will consider departures from established standards on a case-by-case basis where proper explanation is provided. F&C does not subscribe to a "box-ticking" approach.

Effective use of influence

F&C seeks to develop dialogue with companies in order better to understand individual market circumstances and company practices and to encourage improvements. F&C also co-operates, where appropriate, with like-minded investors or other stakeholders in order to emphasise shared concerns. F&C will, as a general rule, avoid public comment on the details of its engagement with companies in order to enable in-depth, constructive discussions in a climate of trust and confidentiality. However, where discussions have not been satisfactory on an issue of major significance, F&C may file a shareholder resolution or comment publicly.

Transparency and accountability

F&C considers itself accountable to all its customers. For this reason, F&C provides regular reports to its clients and to the public, outlining its engagement activities and detailing its voting record. It also shares its voting policies with investee companies, and systematically informs companies when and why it has voted against, or abstained on, directors' recommendations.

Practising what we preach

F&C seeks to achieve best practice within its own business and, as a UK-listed company, follows the principles of corporate governance outlined in the Combined Code of the Financial Reporting Council (FRC) which was revised in June 2006. It also endeavours to behave in a socially and environmentally responsible manner, which it believes supports long-term value creation.

F&C endorses and follows the Institutional Shareholders' Committee statement on the Responsibilities of Institutional Shareholders and Agents, and is supportive of the Stewardship Code that has been developed in the UK to provide a standard of best practice for institutional investors in the area of company engagement and monitoring.

The F&C board has set up a Corporate Governance Committee comprised of senior company managers. This committee is responsible for reviewing annually F&C's policies and guidelines for responsible ownership, as well as monitoring the effectiveness of F&C's voting and engagement procedures. The F&C board has also set up a Corporate Responsibility Committee to oversee F&C's management of social, ethical and environmental issues within its sphere of influence.

What does F&C expect of companies?

F&C takes as its starting point international codes such as those produced by the Organisation for Economic Co-operation and Development (OECD) as well as relevant national codes such as the UK Combined Code, the Dutch Code on Corporate Governance and the New York Stock Exchange corporate governance listing standards. Its approach is also informed by codes relating specifically to social, ethical or environmental issues, such as the OECD Guidelines for Multinational Enterprises and the Association of British Insurers' (ABI) Disclosure Guidelines on Socially Responsible Investment.

While F&C's expectations are inspired by established codes, it also recognises that best practice will frequently evolve more quickly than any particular code. F&C will seek to identify evolving standards of best practice wherever they emerge, and encourage their adoption.

Where companies are listed in multiple jurisdictions where differing standards of corporate governance may apply, F&C expects them to seek to comply with the more rigorous standards, or provide adequate explanation for any deviations.

A summary of F&C's expectations of companies is outlined below:

Board structure and composition

The role, structure and composition of boards will vary from country to country and company to company. However, certain guiding principles are universal:

- **Role of the board -** While all operational responsibilities should be devolved to executive management, certain matters should be reserved for the board, including the testing and setting of strategy proposed by management, overseeing internal controls and risk management and the planning for succession of the executive and the board itself.

- **Quality and effectiveness of the board -** Boards should have meaningful representation of both executives and non-executives. Non-executives should normally be independent of the company and selected from the widest pool of relevant talent so as to promote a diversity of views and genuine debate. The board should be large enough for meaningful debate, but overly large boards may become unwieldy and should be avoided. A process to "refresh" the board is desirable, as are robust systems for evaluating director independence and board effectiveness.

- **Independence of non-executive directors (NEDs) -** To be regarded as independent, NEDs should not: be former executives, have close family ties with the company, hold cross-directorships, be major shareholders or representatives of any special interest group, have significant commercial or charitable ties to the company, or be entitled to performance-related pay, stock options or pensions. Prolonged membership on the board may also erode independence.

- **Two-tier boards and boards without significant executive representation -** Where there is a two-tier board or a board comprised primarily of non-executive directors, companies should develop effective mechanisms for the board and executive management to work together.

- **Separation of roles -** The roles of chairman and Chief Executive Officer (CEO) are substantively different and generally should be separated. F&C regards separation of the roles as important for securing a proper balance between executives and minority shareholders, and preserving accountability within the board.

- **Board meetings -** There should be a sufficient number of meetings for the proper management of the company (six annually as a normal minimum).

- **Board Committees -** Independent audit, nomination and remuneration committees are desirable for all companies, and essential for large companies. Corporate social responsibility (CSR) or sustainability committees are recommended, particularly for companies exposed to significant environmental or social risks. If there is no standalone risk committee the audit committee normally should be accountable for the proper identification, management and reporting of all significant business risks, including broader ESG risk factors. In addition, the audit or risk committee must ensure the effective functioning of internal controls, including business ethics and employee hotline (sometimes referred to as "whistleblower" systems.

- **Liaison with shareholders -** The board should make itself available for consultation with shareholders on any substantive matter, whether or not it forms the subject of a vote. F&C encourages boards to consider appointing an Independent Chairman or Lead Director to fulfil this function. All board members should also attend the annual meeting.

Remuneration

Levels of remuneration, including benefits and other incentives, should be adequate to recruit, incentivise and retain key staff, and should reflect the work carried out and the executives' contribution to the creation of long-term shareholder value. Remuneration policies should be set by a fully independent remuneration committee. Remuneration should be tied to performance targets that are clearly disclosed and stretching, and are appropriate to the business. Moreover there should be potential for clawback of short- and long-term performance awards to ensure that incentive payments are not awarded in cases of fraud or clearly failed strategies. All significant rewards should be disclosed to shareholders. F&C encourages companies to put their remuneration policies to an advisory shareholder vote, and welcomes the opportunity to discuss remuneration issues with companies.

Report & accounts

Companies' reports and accounts should be timely, accurate, transparent and accessible, so that investors can obtain a clear understanding of the business and all important issues. The report and accounts should provide a full review of the achievements of the company and of the standards followed during the accounting period. F&C encourages companies to comply with international accounting standards and to disclose clearly and justify any restatements or accounting changes. Any material related party transactions should be clearly disclosed in advance and be subject to a shareholder vote.

Governance of social, ethical and environmental issues

Effective management of the risks and opportunities associated with significant social, ethical and environmental issues is an important component of good governance practice. Companies that ignore such risks may suffer serious damage to their reputation and brand value, as well as litigation and operational risks[1]. Creating a "governance culture" of transparency and accountability that goes beyond mere compliance with codes and legislation is key to addressing these aspects of performance effectively. Well-known scandals illustrate just how important it is for companies to be alert to the business risks inherent in a broad range of issues, such as fraud, bribery and corruption, insider trading, climate change, human rights, labour standards including those in supply chains and the health impacts of products.

1. F&C's more detailed position on specific issues (e.g. climate change, labour standards, bribery and corruption) can be found at www.fandc.com/governance (see Shareholder Engagement).

Specifically, good governance in this area requires[2]:

- Board-level responsibility for significant ESG issues;
- Director training on new or emerging issues;
- Systems to enable the board to identify and assess the risks and opportunities;
- A commitment to open dialogue with stakeholders;
- Formal policies addressing any significant issue;
- Management systems for the effective implementation of these policies;
- Monitoring of the achievement of policy objectives; and
- Disclosure of the above within the company's annual report to shareholders.[3]

Shareholder rights

A company with a strong governance culture respects and protects the rights of its shareholders equally. Companies should:

- Enter into dialogue with institutional shareholders, where relevant;
- Provide pre-emption rights for existing shareholders;
- Ensure a share structure that gives all shares equal voting rights by avoiding the issuance of shares with impaired or enhanced voting rights;
- Enable considered proxy voting, through timely release of the agenda and supporting materials of the Annual General Meeting;
- Allow separate votes on separate resolutions (rather than "bundling");
- Avoid raising issues that are not on the agenda; and
- Recognise that take-over bids are important as a means of maintaining an efficient and competitive market. F&C regards artificial devices to deter bids, known as "poison pills," as inappropriate and inefficient, unless they are of a strictly controlled and very limited duration.

F&C believes that the above principles and practices are fundamental to long-term value. It is committed, as a responsible owner, to using its votes and its voice to encourage good governance within the companies in which it invests, and to integrating ESG issues into its investment analysis.

2. This is consistent with the UK Association of British Insurers' Disclosure Guidelines on Socially Responsible Investment (www.abi.org.uk).
3. This may be supported by more detailed disclosure in a separate Corporate Responsibility or Sustainability report. Where practical, such disclosure should be in line with internationally accepted guidelines such as the Global Reporting Initiative (GRI).

For further information please contact:

Karina Litvack
Head of Governance and Sustainable Investment
Tel: **+44 (0) 20 7011 4219**
Fax: **+44 (0) 20 7628 8188**
karina.litvack@fandc.com

George Dallas
Director, Corporate Governance
Tel: **+44 (0) 20 7011 4246**
Fax: **+44 (0) 20 7628 8188**
george.dallas@fandc.com

Elizabeth McGeveran
Senior Vice-President, Governance and Sustainable Investment
Tel: **+1 (0) 617 426 9050**
Fax: **+1 (0) 617 426 3433**
elizabeth.mcgeveran@fandc.com

Private Investors
Tel: **+44 (0) 8000 085 2752**

Products

F&C offers a wide range of investment opportunities for pension funds, charities, financial institutions, corporations and other organisations. We offer segregated and pooled portfolio management through a range of onshore and offshore vehicles. These cover developed and emerging markets in equity, bond, cash and property funds.

Please contact us for further details or visit our website at **www.fandc.com**

Contact us

Offices

France
Tel: **+33 (0) 1 78 42 40 92**
Germany
Tel: **+49 (0) 69 308 55 098**
Hong Kong
Tel: **+(852) 3965 3160**
Ireland
Tel: **+353 (0) 1 436 4000**
Netherlands
Tel: **+31 (0) 20 582 3000**
Portugal
Tel: **+351 (0) 21 003 3200**
Spain
Tel: **+44 (0) 20 7011 5398**
Sweden
Tel: **+46 (0) 850 901276**
Switzerland
Tel: **+41 (0) 22 747 7714**
United Kingdom
Tel: **+44 (0) 20 7628 8000**
United States
Tel: **+1 (0) 617 426 9050**

Head Office

Institutional Business
Tel: **+44 (0) 20 7011 4444**
Email: **institutional.enquiries@fandc.com**
Global Distribution
Tel: **+44 20 7011 5111**
Email: **mail@fandc.com**
Broker Support
Tel: **0845 799 2299**
Email: **adviser.enquiries@fandc.com**

F&C Investments

Expect excellence