



Corporate Governance: Operational Guidelines

General

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1. Key trends

These Guidelines set out F&C Management Ltd. (F&C)'s expectations of investee companies in terms of good corporate governance and explain how F&C exercises its votes. They apply to all holdings globally, but are supplemented by country-specific guidelines¹. They should be read in conjunction with F&C's "Responsible Ownership" policy², which describes F&C's overall philosophy and approach to voting and engaging with companies.

The Guidelines are structured as follows:

- Preamble
- Overview of key principles and approach
- Role, structure and operation of boards
- Board committees
- Reporting
- Remuneration
- Shareholder rights
- Voting matters.

Note on stocklending

Stocklending is an important factor in preserving the liquidity of markets, and in providing investors with an additional return on their investments. It does, however, impair the ability of the lender to exercise its voting rights. F&C considers that the balance to be struck between stocklending and voting is a matter for individual decision by clients. For those clients wishing to be involved in stocklending, F&C's policy is to accommodate this while retaining a minimum shareholding at all times, thereby ensuring that a vote is cast and any concerns are expressed directly through a letter to the company. Where significant voting issues arise, F&C will stop any further lending of stock, and, if necessary, will seek, on a reasonable efforts basis, to recall all lent stock over the voting period. F&C also accommodates clients who do not wish to engage in stocklending at all should they prefer to vote all stocks at all times.

Preamble

The following outlines F&C's Corporate Governance policies and guides its voting on all stocks. It applies to all F&C retail portfolios, and the resultant voting record is published each month, along with detailed explanations, on F&C's website³.

F&C's 'House' voting policies are also applied to F&C's institutional client portfolios. However, each of F&C's institutional clients has ultimate control over the determination and execution of its voting policy. F&C will recommend a voting stance to its clients on the basis of these policies, but will defer to its clients in individual cases where these may choose to vote otherwise. In cases where an individual client's voting preference is at odds with the F&C recommended position, this will be applied solely to that client's funds, and shall under no circumstances apply to the voting instructions issued on behalf of other F&C client portfolios. F&C House policies are disapplied should a client demand it, though they always reflect our voting behaviour on all F&C retail funds. As regards institutional client funds, these policies apply at all times, except in cases where individual institutional clients may wish to amend voting decisions on particular stocks held within their own portfolios. At no time shall individual client voting decisions affect the decisions taken on behalf of other F&C clients. Institutional clients receive a full detailed report of their funds' voting record on a monthly basis, and have the option of publishing it if they wish. F&C's voting and governance policies underpin its engagement with investee clients, and guide its voting at AGMs and EGMs.

F&C will apply these guidelines when voting on behalf of clients, unless otherwise instructed.

F&C's corporate governance operational guidelines underpin its engagement with investee companies, and guide its voting at company meetings.

F&C expects to update this document annually, to reflect regulatory changes, evolving market practices and any other relevant developments.

1. Country specific guidelines for the UK are available within the Governance and Sustainable Investment section on the F&C website <http://www.fandc.com/new/aboutus/Default.aspx?id=63889>

2. F&C's Responsible Ownership Guidelines are also available for download from the website above.

3. <http://www.fandc.com/new/relations/>

Key principles

F&C has established a global philosophy and approach to corporate governance and exercising its votes. Its approach is based on the overarching principles of:

- 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 all significant issues, including corporate responsibility issues;
- A commitment to promoting throughout the company a culture of transparency and accountability that is grounded in sound business ethics;
- Remuneration policies that rewards the creation of long-term shareholder value through the achievement of corporate objectives.

F&C's approach

As a global investor, F&C recognises that such principles may be expressed differently in different markets. Therefore, its voting policies take account of local practices and are applied in a pragmatic fashion that reflects an integrated understanding of local and international good practice. In all cases, F&C aims to achieve the same result: the preservation and enhancement of long-term shareholder value through management accountability and transparency in reporting.

Achieving best practice in corporate governance is a dynamic process between the board, management and shareholders. F&C encourages companies to engage in the process of shaping and meeting evolving standards of best practice. While F&C's voting is strongly rooted in a clear set of corporate governance principles, it strives to approach each company's case on its merits and relies on staff expertise, discretion, and dialogue with companies to do so.⁴ For this reason, F&C encourages companies to contact it with information about particular governance practices, directors and challenges unique to the company. When F&C does not vote with directors' recommendations, it writes to the company and explains the reasons why.

2. Role, structure and operation of boards

Introduction

F&C uses the term "board" to cover the unitary board, the two-tier board and the unitary board supported by an executive body whose members may or may not be members of the public company board. The board is ultimately responsible for the management of the company. This is mainly achieved through the delegation of powers to the executive management. The board should receive the report of the executive on the conduct of the business, and it should question the executive on these matters. However, certain matters should be reserved for the board. It is responsible for setting and testing strategy proposed by the executive, and for succession planning of both the executive and the board as a whole.

The structure, composition and operation of boards will vary from country to country and company to company. Certain elements of effective boards are universal, and these are detailed below under the following sub-headings:

- Roles and independence
- Competence, objectivity and renewal
- Effective functioning of boards
- Accountability to shareholders.

Other factors will vary depending on the nature of the company's business, its country of domicile, its size and complexity, its stage of

development, its ownership structure, the goals of the board and the skills of the individuals on the board. Wherever possible, F&C will strive to reflect in its voting the individual circumstances facing each company, based on its understanding of how they may affect its long-term profitability. F&C welcomes and encourages overtures from companies to draw its attention to specific areas where they believe such departures from its guidance are justified.

Roles and independence

The composition of the board is of the utmost importance. Boards should have meaningful representation of both executive and non-executive elements. Non-executives should normally be wholly independent of the company, although F&C recognises that, in certain cases, connected non-executives have a valuable role to play. In building an effective board, the company should seek candidates from the widest pool of relevant talent so as to ensure properly informed board discussions. F&C's more detailed expectations are set out below.

The role of the chairman and separation of principal roles

The chairman⁵ sets the agenda of the board in consultation with the company secretary, the executive and the directors. He is the person responsible for the appointment and removal of the chief executive officer (CEO).

4. F&C expects to vote at all company meetings. These votes will usually be by proxy, except where specific circumstances make attendance by a representative of F&C desirable.
5. F&C recognises the widespread use of alternative terms to describe the role of chairman, including "Chairwoman", "Chairperson" and "Chair". For simplicity, F&C uses the terms "chairman" and "he", "his" and "him" irrespective of the gender of the individual occupying that post.



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. If for any reason the roles are combined, e.g. over an unexpected transitional period, this should be explained and justified in the report and accounts. In all such cases, a notably strong senior independent non-executive director must be nominated. F&C would not expect a retiring CEO to assume the role of chairman. In such cases, F&C would look for reasoned justification from the company to explain this deviation from good practice.

Executive directors

Including executives in board meetings is essential to enhance discussion and allow independent directors to gain the fullest understanding of company operations. Executives who attend most meetings should be members of the board, but their number should not outweigh the number of independent non-executives.

Non-executive directors

Non-executive directors have a valuable contribution to make to the development of the company. This is a demanding role. While F&C does not have hard rules about the number of directorships an individual can hold, he⁶ must have sufficient time and energy to discharge the role properly, particularly during occasions requiring exceptional investments of time. Factors that determine the appropriate number of directorships are the size of the company, its complexity, its circumstances, other commitments that a director has and the results of board evaluation, among others. F&C considers that holding over four directorships in large companies is likely to be excessive for even a full-time non-executive director, especially if participating in board committees. A reasonable number is likely to be lower for a full-time executive. In addition, nominating committees should carefully consider the time required for other demanding leadership roles, such as the boards of private companies and large charitable organisations.

Proportion of non-executive directors on the board

Strong decisions arise from open and direct interplay between boards and company executives. It is important to have enough independent non-executive directors for an adequate diversity of views and to fulfil committee memberships. However, while F&C expects all large companies to have a majority of independent directors, the board should also ensure that it has other executive directors in addition to the CEO. F&C's voting reflects its belief that

a balance of executives and non-executives on the board is more important than a fixed proportion of non-executive directors. Boards that lack meaningful executive participation through board membership, should use the board evaluation report to describe how the board achieves meaningful interaction between its directors and company executives.

Independence of non-executive directors

Independence of individual directors is valued, but a good balanced board is valued above all. F&C will support non-independent directors where it is aware of particular circumstances that justify their presence on the board.

F&C's criteria for the independence of directors draw on a variety of standards, including the OECD Principles of Corporate Governance, national corporate governance codes and listing rules and guidance given by the UK National Association of Pension Funds, among others. F&C favours a principles-based approach, as it seeks to ensure that directors are able to act in the interests of the company and its shareholders. Companies should consider using the corporate governance report or annual proxy to explain the board evaluation process, and to justify the value that non-independent directors bring to the board.

For public companies, independent non-executive directors should:

- Not be former executives of the company. F&C does not support the idea of a "cooling off" period for former executives, although in the case of individuals who have served in a junior capacity, a hiatus may be appropriate;
- Not have close family ties with the company's advisors, directors or senior employees
- Not have served on the board for more than 12 years, as they may lose their independent perspective;
- Not hold cross-directorships or have significant links with other directors where there is a power imbalance between the directors (see '*Interlocking boards*' below);
- Not be major shareholders or representatives of any special interest group;
- Have no significant commercial involvement with the company as professional advisers, major suppliers or customers;
- Not be entitled to performance-related pay, stock options, or pensions;
- Not normally hold other directorships in companies in a closely-related industry.

6. F&C encourages companies to nominate competent male and female board members. However, for simplicity, F&C uses the terms "chairman" and "he", "his" and "him" irrespective of the gender of the individual occupying that post.

Interlocking boards

F&C seeks to ensure that directors are not only independent from the company, but also of one another. F&C expects companies to disclose interlocking board relationships and to explain how the independence of individual directors is preserved when directors jointly serve on two or more of the same boards.⁷

Extensive board service and independence

Prolonged membership on a board jeopardises independence as directors may become close with management and overly invested in prior strategic decisions. After 12 years, directors cannot be considered fully independent and should not serve on the audit, compensation or nominating committees. If a board values such a director's experienced perspective, he should be considered an affiliated director.

Effective boards rely on directors with fresh perspectives. While balanced boards may include some long-standing directors, boards frequently overstate the special contributions made by directors with many years' tenure. Boards should strive to have a substantial majority of directors with less than 12 years' tenure, and the nominating committee should review the mix of new and long-standing directors necessary to achieve a balanced board. F&C considers that no more than one-third of non-executive directors should have served for more than 12 years.

Independence of employee representatives

While a number of European countries have co-determination legislation mandating a certain percentage of employee representatives on the board, F&C does not consider these individuals to be independent. Hence F&C expects companies domiciled in countries with mandatory co-determination to ensure that the board and its committees have adequate representation of truly independent directors. Employee directors may attend committee meetings but should not be members of the audit and remuneration committees.

Other associations that might impact independence

The nominating committee should also evaluate the impact that other relationships between directors might have on their independence. For instance, relationships through academic institutions, charities, or social clubs could impact independence and should be reviewed during the director evaluation process.

Competence, objectivity and renewal

Competencies and perspectives

A relevant and suitably diverse mix of skills and perspectives is critical to the quality of the board. Companies should therefore strive to widen the pool of potential candidates to ensure that they draw on the richest possible combination of competencies and outlooks. The use of specialist recruitment consultants and other appropriate sources, including public advertisement, should be considered.

In all cases, candidates must be selected for their ability to enhance company performance. Boards should recruit members with the best possible combination of skills and experience, and should affirm the value of individual diversity, including diversity of gender, ethnic origin, nationality, professional background and many other factors that may enhance the board's overall performance. While boards should not be transformed overnight, F&C looks for an equal opportunities policy or diversity statement, and seeks evidence that the basic principles of openness and effectiveness are achieved.

Re-election of directors

To ensure that it retains an open and critical perspective, the board needs to be continually renewed. For this reason, all directors should be required to submit themselves for reelection at regular intervals. After 10 years, directors should be subject to annual re-election. In many jurisdictions, local law allows shareholders to propose a shareholder resolution for removing a director. Where local law or practice does not allow shareholders to do this, all directors should be required to submit themselves for annual re-election. Where companies do not facilitate such a process, F&C may withhold its support from the chairman of the nomination or governance committee or, where such a committee does not exist, the chairman of the board.

Nomination of directors

F&C strongly believes that a board nominating committee composed exclusively of independent non-executive directors, and the company chairman, is best placed to identify and put forward suitable candidates for the board. Shareholders should only put forward candidates where there is clear evidence of ineffective board oversight and unwillingness to correct the problem. F&C expects companies to put forward only one candidate for each available position as an indication that the company is clear about the value individual directors bring to the board.

7. Such interlocking relationships can raise concerns when there is an imbalance of power between the two directors. The most common situation is when one of the individuals is an executive on the first board, and, therefore, is evaluated and remunerated by his fellow director. Therefore, on the second board where he is expected to serve as an independent non-executive, his independence may be compromised.



Balanced composition

The board as a whole should reflect a diversity of skills, experience, and perspectives that effectively contribute to the strategic direction of the company. F&C will consider voting against the chairman or members of nominating committees who have not constructed appropriately balanced, independent boards. Indicators include: an over-reliance on long-standing members where one-third of non-executive directors have served for more than 12 years; an over-reliance on affiliated directors; and a lack of any gender, racial, national or ethnic diversity. F&C considers that extended service on the board erodes non-executives' independence due to their involvement in previous business decisions. Therefore, after 12 years, directors should be subject to annual re-election, and should not serve on key board committees.

Retiring directors

F&C would not normally expect a retiring executive director to retain a seat on the board as a non-executive director, except in highly unusual circumstances. However, for two-tier boards, F&C recognises that there may be instances in which the contribution of former directors will be valuable in enhancing the supervisory board's understanding of the business. In such cases, F&C would accept that no more than one member of the supervisory board be a retiring executive, but would expect that all other members be fully independent. Particular scrutiny would apply in the case of retiring CEOs if nominated for chairman (See "*Role of chairman*" above)

Effective functioning of boards

Board size

In the case of a two-tier board structure, neither board should be large: between five and 10 members is appropriate. A unitary board should have between five and 15 members. In the case of overly large boards and in the absence of a commitment to reduce board size, F&C may withhold support from one or more directors, unless clear justification has been provided explaining the need for such a large board.

Two-tier boards

Where there is more than one body forming the board, companies should maintain an effective mechanism for the various elements of the board to work together, and should explain how this happens. This system should ensure that the most effective use is made of all the individuals involved, so that companies can capitalise on the unique skills and experiences of their directors.

Board evaluation

Evaluation is an important tool for improving board performance. All boards should implement an evaluation process that considers the effectiveness of the entire board, the contributions made by each member, its systems for interaction between the board and company management and any areas for improvement. The nominating committee may oversee the evaluation process and should report general findings and areas for improvement publicly to shareholders. All companies should consider utilising professional assistance to facilitate evaluations; for large companies this is essential.

Board meetings & attendance

The board should meet at regular intervals to ensure effective oversight of the company. F&C regards six meetings as a minimum, and often, more frequent meetings are necessary.

Director attendance at board meetings is crucial for making valuable contributions to the board and fulfilling fiduciary duties. F&C also expects directors to attend the annual meeting, and to facilitate communication with the shareholders whom they represent. The company should disclose the attendance record of individual directors in the annual report, as well as mechanisms for shareholders to communicate directly with the board. F&C may withhold support from directors with a poor attendance record or boards who fail to accommodate shareholder dialogue.

NED-only meetings

Non-executive directors (NEDs) should meet in executive session, i.e. without executive board members present, on a regular basis and when circumstances demand. They should also have at least one meeting per year to hold an unconstrained discussion away from day-to-day business matters. Ideally, this should be chaired by a senior or lead independent director, although the chairman may be present provided he is a non-executive. Conversely, in the case of two-tiered boards, supervisory boards should meet with executives on a regular basis to minimise the risk that NEDs will become marginalised from the business.

Training

All directors should receive appropriate training when appointed, and subsequently on regular occasions, in particular as a consequence of the board evaluation process. F&C encourages companies to develop director training plans that include educating directors on significant environmental, social and governance matters.

Role of the company secretary

The corporate or company secretary provides an important conduit for shareholders to address the board, and communicate with non-executive directors. The company secretary is responsible to the board of the company rather than the company's management, and should therefore be appointed and employed specifically by the board as a whole, rather than by the company. The board as a whole is the only body that should have the authority to dismiss the corporate secretary.

Accountability to shareholders

The board should proactively make itself available for consultation with shareholders on any substantive matter, whether or not it forms the subject of a vote, and may, to this end, appoint a senior or lead independent director to fulfil a formal liaison role. Directors should consult shareholders, particularly institutional shareholders, prior to seeking approval for resolutions at the annual general meeting (AGM)

and other meetings where any resolution could be considered contentious or consultation is otherwise deemed appropriate.

The non-executive directors should also seek to establish lines of communication with the principal institutional shareholders, in separate meetings and by joining a few of the regular meetings that executive directors hold with institutional shareholders.

Voting on board matters

F&C will usually support directors' recommendations for board membership or ratification unless it has justified reservations.

F&C will not support a director if it has strong concerns about the performance, integrity or independence of that individual (see "Voting on board committees" overleaf).

3. Board committees

F&C considers it essential for the board to have fully independent audit and remuneration committees, as well as a nomination committee composed of a majority of independent directors. Ethics, health and safety, governance, sustainability or corporate responsibility committees are desirable, and in some cases essential. All board committees should report on their activities annually to shareholders (see section on "Reporting" below).

Nomination committee

A nomination committee should oversee all board and senior executive appointments. Normally it should be a committee of independent non-executive directors and the company chairman, drawing on executive advice as required. F&C prefers a fully independent committee. However, F&C recognises that in some instances, a representative of a large shareholder may be appropriate.

Audit committee

The audit committee provides an important safeguard for shareholders and for all those that have dealings with that company with regard to the control and financial status of the business.

Composition and principal role

- The audit committee should consist exclusively of non-executive directors, all of whom should be independent, and number at least three individuals. At least one should have recent and relevant financial experience. The committee should be responsible for assessing the effectiveness, independence, qualifications, expertise and resources of

the external auditors and oversee the process of review and issue of the accounts.

- The audit committee should also be accountable for the proper identification, management and monitoring of internal controls. This includes reviewing all significant financial and extra-financial risks. The audit committee is also responsible for reviewing internal business ethics systems, and ensuring that there is an effective mechanism for the internal reporting of wrongdoing, a.k.a. 'whistle-blowing', related to financial fraud and any other breach of company policies and ethical codes. It may serve as the body to receive whistle-blowing reports where no other acceptable body exists.
- The audit committee is also responsible for monitoring and approving related-party transactions, and should ensure that any material related-party transactions do not disadvantage minority shareholders.
- In countries where it is not customary to have a board audit committee (e.g. Italy, Japan), the individual statutory auditors should be independent and fulfil the role of the committee. F&C does not consider this system to be as robust, since it separates the audit oversight from the core responsibility inherent in being a director.
- The audit committee is also responsible for publishing the annual audit report, which is essential for investors' ability to evaluate the overall health of the business (see section on "Reporting" below).



In the event of a significant restatement of accounts or material weakness in internal controls, the chairman of the audit committee, possibly in conjunction with the senior auditor, should make himself available to shareholders upon request.

Appointment of auditors

The auditors' performance and appointment should be periodically reviewed. Where the same firm remains as auditor for a period of time, there should be a mechanism within the auditing firm to ensure that the responsibility for the audit changes hands. F&C does not regard systematic rotation of audit firms as intrinsically desirable or in the best interest of shareholders. However, F&C does consider it to be desirable over the medium term to broaden the choice of auditors available to companies, and hence would encourage companies actively to consider using tier A audit firms wherever these can demonstrably meet the required standard of competence and global coverage.⁸ F&C expects that shareholders should be given the opportunity to vote on the appointment and payment of auditors.

Auditor liability

Where companies choose to limit auditor liability, such a limit should be fair and reasonable and subject to an annual shareholder vote. While generally supportive, F&C would caveat any move towards limited auditor liability with the need for enhanced audit quality.⁹ F&C supports the principle of proportionality in evaluating auditor liability and will generally oppose a fixed cap on auditor liability.

Fees paid to a company's auditors in addition to audit fees

Where auditors carry out consultancy work in addition to auditing the company, this should be disclosed and the audit committee should consider whether there is a risk that the auditors' impartiality may be jeopardised. The range, nature and tendering process for any such non-audit work should be supervised by the audit committee, whose responsibilities in this area should be fully disclosed. F&C recognises that there are certain areas of non-audit work where the company's auditors may provide valuable expertise, without compromising independence. However, substantial non-audit fees, or non-audit fees in excess of audit fees, may be an indicator of compromised independence.

Remuneration committee

The remuneration committee is responsible for setting the remuneration of executive directors and senior executives and overseeing the policy for remuneration throughout the company. It should consist exclusively of independent non-executive directors, at least three in number. F&C encourages remuneration committees to engage in direct dialogue with their largest institutional shareholders so as to seek their input in developing remuneration policies. (See "*Remuneration committee Report*" below).

"Clawback" policies

The remuneration committee should maintain authority to withhold or reclaim all or part of performance-based pay from executives in cases where it deems it appropriate. In particular, this might occur following a significant restatement of accounts. Policies to reclaim bonuses and other awards should enable the board to reclaim previously-granted awards, where these were paid out on the basis of inaccurate figures. If reclaiming awards presents significant administrative or tax burdens for the company, subsequent awards should be adjusted to reflect historic excesses. This is not to be regarded as a punitive measure; it is simply correcting an accounting inaccuracy. Clawback policies should also allow the board to reclaim performance-based pay from top executives where representations made about the integrity of controls have subsequently been revealed to be inaccurate, or where executives have failed to exercise due caution in the discharge of their duties.

Corporate Governance Committee

F&C recognises that companies may choose to have the nominating committee or a specific corporate governance committee responsible for corporate governance practices and procedures. Regardless of the structure, the committee should monitor emerging regulatory and industry standards, strive to achieve global good practice and should consult with institutional shareholders to understand investor expectations.

Corporate responsibility, ethics or sustainability committees

F&C believes that a corporate responsibility, ethics or sustainability committee is highly desirable. In some cases, such as those of large companies exposed to significant social and environmental risks, they are essential. Such committees should both serve as a source of external perspectives on emerging business and societal concerns, and ensure that the company has proper internal control systems to identify and manage any risks that such issues may pose to the business.

Voting on board committees

F&C will not normally support non-independent and affiliated directors who serve on the three key committees. This includes directors who have served on the board for more than 12 years and continue to sit on key committees, as they can no longer be considered fully independent. However, if the company can clearly explain why their presence is necessary, then F&C may vote in favour.

In general, F&C will abstain on the reappointment of auditors where it is concerned that the ratio of non-audit to audit fees puts the auditors' independence into question.

8. As a member of the Association of British Insurers (ABI) Investment Committee, F&C is a signatory to the ABI's Letter on Auditor Choice. The Financial Reporting Council (FRC) is consulting over the public interest issues that may arise from the existing competitive environment for audit services to large companies in the UK and how they might be addressed. See <http://www.frc.org.uk/about/auditchoice.cfm>.

9. This is in line with the provisions of the 2006 Companies Act.

4. Reporting

The report and accounts (a.k.a. annual report) is an important link in the chain of accountability. It should provide a full review of the achievements of the company and of standards followed during the accounting period. It should also outline the strategy for the development of the business.

The annual report and any proxy voting materials should be made available to shareholders in good time for consideration and discussion prior to the general meeting. F&C looks for a minimum of 20 working days. Such materials should be available in English and easily accessible, preferably on the company website.

Companies should have meaningful and transparent disclosure, so that investors can obtain a clear understanding of all important and relevant issues. The annual report should provide a full review of the achievements of the company and of standards followed during the accounting period. It should also outline the strategy for the development of the business and any significant factors affecting the company's future performance, including any significant social, environmental or ethical issues. In producing such reports, companies in the European Union should seek to comply with the EU Accounts Modernisation Directive and related members' state regulations.

In all markets, F&C favours reports that are:

- **Comprehensive**, covering the strategic direction of the business and all material issues, including any significant changes in the regulatory context and key ESG issues;
- **Balanced**, with even-handed treatment of both good and bad aspects;
- **Transparent**, with narrative text that utilises plain English, and accounting notes that provide investors with a full understanding of the circumstances underlying the reported figures;
- **Underpinned by KPIs** that drive business performance, are comparable over time, and are supported by detailed information on how they are calculated;
- **Consistent and joined-up** with other company reporting, including the remuneration policy and corporate responsibility or sustainability reporting.

Directors

Adequate biographical information on the directors should be provided for shareholders in advance of the annual meeting. This should include information about directors' qualifications and experience, age, term of office, date of first appointment, level of independence, board committee memberships and other personal and professional commitments that may influence the quality of their contribution and independence, e.g. other directorships, family and social ties, and affiliations with related companies or organisations.

Board committees

Nomination committee report

The committee should report annually on its activity, in particular providing a detailed discussion of its process for identifying and appointing executive and non-executive directors and the processes it employs to ensure that members reflect an appropriate diversity of perspectives, experiences and cultural backgrounds. Where necessary, the report should include a thorough discussion of the board's view of the independence of certain members. The report should also include high-level results of the board evaluation process.

Audit committee report

The audit committee should report on its conduct during the year and, in particular, on any specific matters of judgement relating to the application of accounting principles. It should also comment on the process for ensuring independence of the auditors and for evaluating the impact of non-audit work. The audit committee report should include a narrative description of any related-party transactions, with particular reference to how these might impact the interests of minority shareholders. F&C welcomes the opportunity to vote on the audit report.

Qualified audit statement

Any qualification of the audit statement needs to be fully explained.

System of internal controls

F&C expects companies to have in place robust systems for evaluating and monitoring internal controls, including strong internal reporting, aka. whistleblowing systems. The audit committee is then responsible for receiving the results of these systems wherever necessary (See "Audit Committee" above). The audit committee should explain the results of the company's review of internal controls, including any identified or potential weaknesses in internal controls and how the board plans to respond to these.



Remuneration committee report

F&C expects all companies to publish an annual remuneration report in line with international good governance standards. Good remuneration reporting outlines a company's overall philosophy and its policies and formulas for determining annual, short and long-term pay. F&C looks for remuneration reports to break down fixed versus variable pay and clearly to align total pay packages with long-term shareholder value. The remuneration committee should clearly disclose specific long-term performance targets and total potential pay-outs. If short-term performance targets cannot be disclosed due to commercial sensitivity, F&C encourages retrospective disclosure of short-term targets.

F&C recommends that all companies put the remuneration report to a shareholder vote, and encourages companies actively to consult their major shareholders prior to the general meeting. F&C's experience of voting on remuneration reports in the UK and other countries has shown that this is a valuable mechanism that improves dialogue and understanding between the board and shareholders.

Corporate responsibility or sustainability committee report

F&C encourages companies to report on any significant social, environmental or ethical risks and opportunities in their annual reports as well as the systems in place to manage these issues. This may be supported by more detailed disclosure, as appropriate, in a separate corporate responsibility or sustainability report (see *Appendix 1*).

Code of corporate governance

Companies should provide a full and clear statement of all matters relating to the application of the principles, sub-principles and provisions of the relevant national code of corporate governance. The way the provisions are put into effect should be clearly discussed, and any deviations supported by meaningful explanations.

Foreign listings

Companies who have a listing on a US exchange must detail how they comply with the provisions of the Sarbanes-Oxley Act. Companies with a secondary listing or Depository Receipt programme on the London Stock Exchange should seek, wherever practicable, to comply with the corporate governance standards embodied in the UK Combined Code of Corporate Governance,

highlighting and explaining the reasons for specific areas of non-compliance. Where companies establish a secondary listing in any other market, they should explain any deviations from local governance practice where these exceed the governance requirement dictated by their primary listing.

Shareholder resolutions

F&C encourages companies to engage in constructive dialogue with shareholders and other external stakeholders, to obviate the need for extraneous shareholder proposals. Where engagement is unsuccessful, F&C supports shareholders' right to submit a shareholder proposal for consideration by all investors. In these instances, companies should behave respectfully, by communicating promptly and fully with shareholders and refraining from obstructing the process. The board should provide a full and reasoned response to any shareholder proposal on the ballot. F&C considers all shareholder resolutions put forward and votes in accordance with its understanding of the long-term benefit to shareholders.

Voting on accounts

F&C believes that companies' report and accounts should be put to shareholders for a vote. F&C will generally approve the report and accounts, unless it has significant concerns as to their completeness and accuracy.

F&C expects companies to disclose significant ESG issues in the report and accounts. Where these are not disclosed, and additional information is not forthcoming through dialogue with the company, F&C may not support the report and accounts or ratify management or supervisory board acts.

F&C will withhold support from directors where there is insufficient biographical information to assess their qualifications and independence.

F&C may not support the re-election of audit committee members where it has reason to believe that a company's internal controls are inadequate or where it has other concerns related to financial accounting or the integrity of the auditors.

5. Remuneration

Levels of remuneration and other incentives should be adequate to recruit, incentivise and retain appropriate staff, reflecting the work carried out and the executives' contribution to the company. No director should be involved in setting his own remuneration. F&C expects companies to demonstrate the alignment of their remuneration policy with their overall business strategy and planning. However, given the strong upward trend in total remuneration, F&C expects greater disclosure and justification of benchmarks and performance targets. F&C expects justification of base pay levels awarded, and that a significant proportion of total remuneration should be subject to performance conditions. F&C does not set guidelines for levels of remuneration beyond the principles mentioned below.

Disclosure

F&C seeks appropriately detailed disclosure of board and management remuneration packages (See "*Remuneration committee report*" above). The annual remuneration report should disclose the total amount of remuneration including cash, options, stock and benefits that executives may receive under different performance scenarios. Where consideration of commercial confidentiality may prevent fuller disclosure of specific short-term targets at the start of the performance period, F&C expects companies to disclose the main performance parameters, both corporate and personal, for the previous financial year. Following payment of the bonus, companies should provide a meaningful analysis in the remuneration report of the extent to which the relevant targets were actually met. Pension arrangements for executives and employees should be disclosed in detail, including expected funding and pay-out scenarios. Companies should also include details on how, and in which cases, the remuneration committee might exercise its authority to withhold or reclaim all or part of non-base pay from executives (See "*Clawback policies*" above). The remuneration report should be in plain English and include the tax implications for the company.

At a minimum, the remuneration of all directors, including all non-executive and executive directors, should be disclosed individually. F&C looks for banded disclosure of those individuals at sub-board level who make a significant contribution to the group. This enables shareholders better to understand the company's remuneration strategy and succession planning. As discussed above, boards should have a remuneration committee with at least three directors, all of whom should be independent non-executive directors.

Executive contracts

These should not be for more than 12 months, except in unusual cases, for example where an initial 24-month period is required for recruitment. In such cases, the notice period should reduce month by month until the agreed period of no more than 12 months is attained. F&C also believes that, prior to agreeing employment contracts, companies should actively consider the potential rewards on severance in the event of inadequate performance, and clarify the performance conditions under which such severance benefits are to be payable. F&C encourages companies to seek mitigation in case a director has taken up employment elsewhere and to adjust the length and size of any payments accordingly. F&C regards one year's base pay and pension entitlements as sufficient severance and recommends that companies make larger severance packages the subject of a shareholder vote.

Share schemes

F&C believes that strict guidelines should be observed with regard to the issue, or potential issue, of shares for incentive schemes, both as to the proportion of shares issued and to the rate at which these are issued each year. By way of guidance, F&C would expect no more than a total of 10% of a company's equity to be used for all share schemes within a 10-year period, with no more than 5% being available for discretionary schemes during this period. Treasury shares should be included within these limits. Good practice is to include all shares used, whether market purchase or newly issued, within these limits. F&C will deviate from these limits where it is convinced that the commercial drivers for it outweigh the dilution impacts. If the company is insufficiently transparent regarding the details of such schemes, F&C may abstain or even vote against them.

Equity Incentive Plans

F&C supports the principle of motivating and rewarding executives through the granting of equity incentives. Schemes should be structured to reward long-term growth in shareholder value, and be subject to performance-vesting conditions with a minimum term of three years.

Performance targets should be clearly disclosed and stretching. F&C believes that the remuneration committee is in the best position to determine the most appropriate performance metrics for driving the long-term business strategy. However, overall remuneration packages should reflect a range of performance targets and should not rely too heavily on the achievement of a single performance metric. Generally,



F&C believes executive pay plans should reflect a balance of financial, operational, and relative performance targets. Where consideration of commercial confidentiality may prevent fuller disclosure of specific short-term targets at the start of the performance period, F&C expects companies to disclose performance against specific targets retrospectively.

F&C opposes fixed caps on pay and strongly believes that exceptional performance over a significant period merits an exceptional level of remuneration. F&C opposes retesting and may withhold support of remuneration plans where the remuneration committee has used its discretion to reduce performance targets previously approved by shareholders.

F&C encourages the inclusion of social, environmental and other non-financial goals for performance bonus payments where these factors have a significant impact on the company's performance. F&C also expects a discussion of the process undertaken by the company to identify such factors and an explanation as to why it considers these factors to be relevant. If the company chooses not to include any such factors in an industry where they are significant contributors to business success, the company should explain the reasons for this.

Employee ownership

Widespread employee ownership can positively contribute to shareholder value, as it further aligns employees' interests with those of shareholders. Such devices should not, however, be instituted as anti-takeover devices, and should be included within company-wide dilution limits. While F&C generally supports broad-based stock option plans, employee discounts should not exceed 20% on a fixed date, the company should not extend loans to purchase options, and options should not be re-priced without shareholder approval. Non-executive directors should not be entitled to options and therefore should not be included in any such schemes.

Voting on remuneration

F&C will consider all votes relating to remuneration on their merits, and vote against a policy or individual scheme where it believes that these are not in the best interest of the company and its shareholders. F&C strongly welcomes dialogue with companies on remuneration issues and looks favourably on any company that puts its remuneration policy to a vote. In markets where this is not mandatory, F&C is unlikely to vote against the remuneration policy in the event of it not meeting best practice standards, though it will send written comments to the board.

F&C will vote against schemes that could lead to excessive dilution, unless there are extenuating circumstances.

Where substantial awards can be made under a scheme, and it is not backed up by appropriate disclosure, F&C will usually vote against.

If F&C considers the overall award package excessive, and not aligned with performance, it will vote against.

F&C will vote against all employee share plans that include excessive discounts, loans to exercise options, or allow for re-pricing or re-testing.

In rare cases, where F&C cannot vote on a remuneration-related matter that is of concern, it may withhold support from any or all members of the remuneration committee or the report & accounts.



6. Shareholder rights

Liaison with shareholders

Companies should be ready, where practicable, to enter into dialogue with institutional shareholders based on an understanding of shared objectives. They should be proactive in making sure important news is imparted, subject to appropriate inside information procedures, and should react helpfully to investor questions. In investment meetings with shareholders, companies should be prepared to address relevant corporate governance, environmental and social issues.

Issuance of shares

F&C respects a company's right to issue shares to raise capital. However, share issuance should be strictly limited to that which is necessary to maintain business operations and drive forward company strategy. F&C will not support requests to increase authorised share capital that exceed one-third of existing capital, unless specific justification has been provided (e.g. to complete an acquisition or undertake a stock split).

Pre-emption rights

F&C believes that pre-emption rights for existing shareholders are absolutely essential. Shares may be issued for cash without pre-emption or for remuneration purposes, subject to shareholder approval and to strict limits as to the proportion of shares issued in relation to the issued share capital, and also subject to flow rates. While practice varies globally, F&C normally considers appropriate limits to be 5% in one year but no more than 7.5% in three years for general purposes, and no more than 10% in 10 years for remuneration. F&C normally will vote against requests to issue shares without pre-emption rights above these limits, unless companies have provided satisfactory justification.

Investment Trusts and similar closed-end companies should not issue new shares or reissue shares at a discount to net asset value (NAV) unless pre-emption is offered.

Share repurchase

F&C expects companies to repurchase shares in the market when it is advantageous for the company and its shareholders. Authority to repurchase shares should be subject to shareholder approval, be limited to about one year, and not exceed 10% of the issued equity. Because of the nature of the business of investment trusts, F&C is prepared to see an authority to repurchase a larger amount – up to 15%. Any share repurchase must benefit all holders on equal terms taking account of options adjustment.

Controlled companies & share classes with differential voting rights

F&C favours a share structure that gives all shares equal voting rights. F&C does not support the issue of shares with impaired or enhanced voting rights. F&C is likely to withhold support for capital-raising by companies with a capital structure that involves unequal voting rights.

F&C recognises that in some markets, differential voting structures are long-standing and widespread. Where differential voting structures exist, this structure should be transparently disclosed to the market. In the case of controlled companies, F&C will review any request to issue shares with enhanced voting rights to determine why these are necessary and how they will reflect the interests of minority shareholders. F&C supports the principle of one share, one vote, and encourages companies to take steps to eliminate differential voting structures over time.

Voting caps

F&C opposes voting caps in principle and believes that all shares should be entitled to full voting rights irrespective of the holding period. However, it recognises the widespread use of voting caps in certain markets, and the benefits accruing to shareholders not subject to a cap. Therefore, at a minimum, F&C expects companies to disclose clearly any caps, and encourages them not to introduce new caps and to phase out existing caps over time.

Related-party transactions

Many companies are involved in material related-party transactions, which represent a significant risk for minority shareholders. This risk is mitigated in companies with fully independent audit committees whose responsibility it is to ensure that such transactions are conducted on the basis of arms-length valuations. F&C strongly encourages companies to establish such committees (see “*Board committees*” above) and to secure prior shareholder approval for related-party transactions. In light of continued concerns, F&C recommends that each company disclose any shareholdings that its controlling shareholders may have in other companies or investment vehicles that have a material interest in the company.



Mergers and acquisitions, spin-offs and other corporate restructuring

Bids and corporate restructuring are important as a means to maintain an efficient and competitive environment. However, some bids do not add to shareholder value, so in contested takeover bids, F&C will seek to discuss matters with management and the bidder. F&C expects boards to conduct thorough due diligence prior to pursuing any merger or acquisition and to seek to maximise shareholder value in any deal. F&C will normally support incumbent management, provided the financial terms, synergistic benefits, and management quality are sound.

F&C considers social and environmental risk implications of any corporate activity as part of its assessment, particularly in high-impact industries. It likewise expects the board to evaluate any potential social, environmental or ethical risks or liabilities of any business combination. F&C expects companies to take appropriate consultative measures with employees and communities affected by corporate restructuring.

Poison pills

F&C regards artificial devices to deter bids, known as “poison pills,” as inappropriate and inefficient, unless they are strictly controlled and of very limited duration. In some markets, the use of shares with enhanced voting rights is common, and may be used to block mergers and acquisitions, thereby functioning as *de facto* poison pills. F&C believes that any control-enhancing mechanism or poison pill that entrenches management and insulates the company from market pressures is not in the interests of shareholders. F&C will therefore normally vote against such anti-takeover devices.

Pension and other similar significant corporate liabilities

Companies should be aware of and report to shareholders on significant liabilities such as those arising from unfunded or underfunded pension commitments, or liabilities for medical cover. The extent of the liability should be reported and the plans, if any, that have been put in place to cover the deficit should be reported, including a reasonable time scale for action. The principal assumptions used in calculating amounts should form part of this disclosure.

Shareholder resolutions

F&C considers all shareholder resolutions that appear on the ballot and votes in accordance with its understanding of the long-term benefit to shareholders. Companies should always provide a comprehensive discussion of management’s position on all shareholder resolutions, and be available to respond to reasonable enquiries from shareholders (see “*Liaison with shareholders*” above). In circumstances where F&C has serious concerns about a company’s ESG practices and has been unsuccessful in establishing a fruitful dialogue, it may itself put forward resolutions to invite other shareholders to support calls for the adoption of better practices.

Voting on shareholder rights

F&C votes against any structure that may be used as a poison pill unless companies define strict mandatory limits as to their use.

F&C will vote against the issuance of shares with unequal voting rights unless it is in the long-term interests of all shareholders.

Where F&C is concerned about undue influence of controlling shareholders who directly benefit from related-party transactions to the detriment of minority shareholders, it may not support the report & accounts or the ratification of management or supervisory board acts. It may also vote against members of the Audit Committee if such transactions have not been approved by shareholders.

F&C will vote against the ratification of related party transactions after the event, and firmly believes that shareholders should be consulted prior to such transactions.

Where a company seeks authority to issue shares beyond defined limits, and does not provide a satisfactory justification, F&C will vote against such authority.

F&C votes on any shareholder resolutions in accordance with its understanding of the long-term benefit to shareholders.

F&C will support resolutions seeking approval for the elimination of unequal voting rights, and may file such resolutions if direct dialogue with companies proves unsuccessful.

7. Voting matters

Annual general meetings

There should be an annual physical meeting of the shareholders, and all the directors of the company should attend. F&C encourages the web-based transmission of meetings.

Voting disclosure

F&C expects companies to disclose the voting results of their general meetings, both at the meeting and on their websites, with a detailed breakdown of votes for and against, as well as abstentions.

F&C believes that companies have a right to know how their shareholders have voted, and therefore writes to all companies to explain any cases of votes against management, abstentions, or votes in favour that nevertheless were the subject of concerns.

In the spirit of transparency, F&C also makes available to both its institutional and retail fund customers a comprehensive record of its voting by publishing its aggregated voting record on its website on a monthly basis. Companies held in all F&C retail or institutional funds may also check their results on this web page. A summary of F&C's voting record can be found in its quarterly Responsible Engagement Overlay (**reo**[®]) report, its annual corporate governance report and its annual Corporate Responsibility report.¹⁰

Shareblocking

F&C believes that shareblocking, i.e. the practice of preventing shares from being transferred for a fixed period prior to the vote at a company meeting, acts to discourage shareholder participation and should be replaced with a record date. Where shareblocking exists, F&C will follow client policy and may be prevented from voting because of concerns about failed trade settlement and extraordinary cost to clients. F&C systematically writes to all companies involved in shareblocking to encourage them to discontinue the practice and to engage with their custodians to do the same. Through its engagement with regulatory authorities and custodians, F&C continues to press for elimination of this practice.

Record dates

F&C recommends that a record date be set five working days prior to company general meetings for custodians and registrars to establish clearly those shareholders eligible to vote. This will give time for all relevant formalities to be completed and serves the same purpose as shareblocking without the disruptions noted above.

Voting systems

All companies should conduct voting by poll, rather than relying on a show of hands.

F&C believes that shareholders have the right to appoint any reasonable person as proxy to vote their shares, either in person or electronically.

F&C encourages the introduction of electronic voting systems that are accurate and provide an effective audit trail of votes cast.

Bundled resolutions

Resolutions put to company meetings should cover single issues, or issues that are clearly interdependent. Any other practice potentially reduces the value of votes, and can lead to opposition to otherwise acceptable proposals. F&C will normally oppose resolutions that contain such inappropriately bundled provisions.

Any other business

F&C expects to vote on resolutions the contents of which have been made clear to shareholders and are in the interests of the company and its shareholders. Where a resolution invites shareholders to vote on an "any other business" resolution, F&C will systematically vote against it.

Political and charitable donations

F&C welcomes the opportunity to vote on company donations, if material. F&C supports charitable acts at an appropriate level, especially where an active donations policy supports the company's engagement with its local or wider community. With respect to donations to political parties or to organisations closely associated with political parties, F&C considers that these are inappropriate and should be strictly avoided. However, in countries where the practice is widespread and deeply rooted, companies should at the very least submit their political donations policy and the past year's donations record to a shareholder vote.¹¹

10. Available on <http://www.fandc.com/new/aboutus/Default.aspx?id=63889>

11. For further details on F&C's policy with regard to political lobbying and donations, click on Public Policy at www.fandc.com/governance.



Appendix 1: Sustainability reporting and disclosure

F&C expects high standards of transparency from the companies in which it invests. This should include a narrative account within the annual report about the trends and factors affecting the performance and future development of the business. So-called “narrative reporting” is an important mechanism for improving the quality of dialogue between companies and their owners, covering the full range of factors underpinning long-term profitability. This includes areas that have not been traditionally covered in annual reports such as material environmental, social and governance

(ESG) issues. In high-impact sectors, we also expect companies to publish a comprehensive sustainability or corporate social responsibility report that provides more detailed information for a wider group of stakeholders such as employees, local communities, non-profit organisations, and government representatives. While F&C recognises that ESG reporting will vary across geography and sector, F&C has identified some overarching best practice guidelines, set out below.

F&C's 12 steps to best practice ESG reporting

Basic

- Identify significant ESG risks and opportunities for the business
- Establish and explain board accountability for ESG issues
- Set out policies for significant ESG issues and explain how they are implemented and monitored
- Establish and disclose targets and Key Performance Indicators for significant ESG issues covering global operations
- Describe systems for training board members and staff on ESG issues
- Report on performance against policies.

Best practice

- Explain how ESG policies link to key operational and financial drivers
- Describe procedures for consulting key stakeholders and provide feedback on the range of views
- Discuss challenges and set-backs as well as success stories
- Describe procedures for verifying data including external verification
- Take account of widely-accepted reporting standards such as the Global Reporting Initiative
- Describe how ESG objectives are embedded into the corporate culture, including how they are reflected in remuneration policies and other performance management tools.



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