

F&C

Corporate Governance: Operational Guidelines

Germany

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F&C
Investments

Expect excellence

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These guidelines set out F&C Management Ltd's (F&C) expectations of companies in terms of good corporate governance and explain how F&C exercises its votes on German companies.¹ They should be read in conjunction with F&C's "Responsible Ownership" policy, which describes F&C's overall philosophy and general approach to voting and engaging with companies.²



The guidelines are structured as follows:

- Preamble
- Overview of key principles and F&C's approach
- Role, structure and operation of boards
- Board committees
- Report and Accounts
- Remuneration
- Shareholder rights
- Voting matters
- Investment institutions.

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 website.³

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 they 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 quarterly 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.

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In the review of these guidelines F&C has noted changes in German corporate given the adoption in 2009 of the Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG Act) and the recent updating and in the updated review of the German Corporate Governance Code that was published in July 2009. F&C expects to update this document annually, to reflect regulatory changes, evolving market practices and any other relevant developments.

1. Overview of key principles and approach

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; and
- A remuneration policy that rewards the creation of long-term shareholder value through the achievement of corporate objectives.

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 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 and discretion to tailor voting. F&C encourages companies to make contact to discuss any areas where they consider divergence from its guidance to be necessary and justified.⁴ When F&C does not vote with directors' recommendations, it writes to the company and explains the reasons why.

1. General Operational Guidelines and Country specific guidelines for France, Germany, Japan, the Netherlands, the UK and the United States are available within the Governance and Sustainable Investment section on the F&C website: <http://fandc.com/governance>

2. <http://fandc.com/governance>

3. <http://fandc.com/governance>

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. 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 testing and setting 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:

- Size and structure;
- Roles and independence;
- Competence, objectivity and renewal;
- Effective functioning of boards; and
- 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 the initiative from companies to draw its attention to specific areas where they believe such departures from its guidance are justified.

In Germany, the German Corporate Governance Code, overseen by the German Corporate Governance Code Commission, is the standard framework guiding German corporate governance practices. It was last updated in June 2009. In the Foreword of the revised Code, a new addition to the text emphasises that companies are to be governed in a context that focuses on sustainability and the broader social dimension of the company: "to ensure the continued existence of the enterprise and its sustainable creation of value in conformity with the principles of the social market economy"⁵.

Board size and structure

Two-tier board

In Germany board structures are typically two-tiered: a supervisory board (Aufsichtsrat) and a management board (Vorstand)⁶. Where these structures exist, companies should maintain an effective mechanism for the various elements of the board to work together, and should explain how this happens. Section Three of the German

Corporate Governance Code⁷ speaks to the importance of robust communication between the management and supervisory boards. The board structure 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.⁸

Co-determination

Legislation in Germany requires companies with over 500 employees to structure their supervisory boards on the basis of co-determination—where employees elect up to half of the supervisory board members. While the inclusion of employee representatives can be positive, F&C applies a more stringent independence standard than that outlined in the German Corporate Governance Code⁹ and does not consider these individuals to be fully independent. Even though fiduciary responsibility for an employee representative is the same as that of a shareholder-elected representative, these employee representatives will have a clear sensitivity to the interests of the workforce. In the case of multinational companies, F&C would encourage broader international employee representation on the supervisory board, so as to provide a more global perspective from the employee representatives. Given the inherent affiliation of employee representatives with the company's workforce F&C would not expect these representatives to be members of key committees, such as the audit and remuneration committees, where independence is required, and would expect that employee-elected representatives to be held to the same standard of fiduciary responsibility to the firm as a whole as that which applies to other board members.

Partly as a result of co-determination legislation in Germany, supervisory boards are typically larger than in other markets, and can often have up to 20 members. Where possible, boards should be smaller than this to allow for more effective communication. Where a smaller board is not possible, given legislative constraints, particular care should be taken to ensure that communication flows between the management board and supervisory board foster appropriate supervisory board accountability.

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. In German companies the supervisory board typically provides a good critical mass of non-executive directors. However, by stating that the supervisory board should have an "adequate" number of independent directors, the German Corporate Governance Code is not as far reaching as other national codes that call for a majority of independent directors. Non-executives should normally be wholly independent of the company, although F&C recognises that, in certain cases, connected non-executives, including employee-elected supervisory board members, 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

5. Deutscher Corporate Governance Kodex, geltende Fassung von 18.06.2009. Regierungskommission Deutscher Corporate Governance Kodex.

6. For purposes of these German Corporate Governance guidelines, when F&C refers to the "board" this should be understood to be the company's supervisory board (Aufsichtsrat) unless otherwise noted.

7. Deutscher Corporate Governance Kodex, geltende Fassung von 18.06.2009. Regierungskommission Deutscher Corporate Governance Kodex.

8. Some German companies are moving away from the two-tiered board structure by using the flexibility of the Societas Europaea, a form of organisation that allows for a unitary board structure. Where German companies have the Societas Europaea structure, they should ensure that the board reflect an appropriate mix of executive and independent



to ensure properly informed board discussions. F&C's more detailed expectations are set out below.

Role of the chairman

The chairman sets the agenda of the board in consultation with the company secretary, the executive and the directors. He¹⁰ is the person responsible for the appointment and removal of the chief executive (CEO). The chairman should not be a retiring chief executive. (See note on Retiring Directors on page 4.)

In large companies, where the Chairman is not considered independent, it is advised that he neither chair any of the board committees nor be a member of any committee, except the nomination committee. He should attend all committee meetings by invitation.

Executive directors

Including executives in board meetings is essential to enhance discussion and allow independent directors to gain the fullest understanding of company operations. When there is a unitary board, 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 rigid rules about the number of directorships an individual can hold, he must have sufficient time and energy to discharge the role properly, particularly during business situations 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 will 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

While F&C generally expects all widely-held companies to have a majority of independent directors, it believes that having an appropriate mix and balance of skills is more important than a fixed proportion of non-executive directors. However, it is essential to have enough independent non-executive directors for an adequate spread of views on the board and for membership of the board committees. F&C encourages companies to have boards that have a majority of independent directors, even for companies with controlling or majority shareholders. However in cases where the controlling or majority shareholder opts to elect a majority of non-independent directors to the board there should be a sufficient number of

independent non-executives on the board so as to allow key committees – audit, remuneration and nomination—to operate with full independence. For this to be achieved, F&C would expect at a minimum for boards to have one-third fully independent directors.

Independence of non-executive directors

Independence of individual directors is valued, but a well-balanced board is valued above all. F&C will support non-independent directors where they bring skills, sector knowledge and other experience 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 International Corporate Governance Network, 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 demonstrate the value that non-independent directors bring to the board.

For public companies, independent non-executive directors on the supervisory board 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 (see ‘Interlocking boards’ below);
- Not be major shareholders or representatives of any special interest group, including government representatives in cases of state ownership or representatives of affiliated companies;
- 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; and
- Not normally hold other directorships in companies in a closely-related industry.

As noted above in the section on co-determination, F&C does not consider employee-elected directors to be fully independent, and discourages such supervisory board members from sitting on committees (most notably audit and remuneration) where full independence is called for.

Interlocking boards

F&C seeks to ensure that directors are not only independent from the company, but also from their fellow directors. F&C expects

non-executive directors (See “Balanced composition” and “Effective functioning of boards” on page 5). F&C does not favour one structure over the other, but believes that achieving an appropriate balance of inside and external perspectives is paramount.

9. See Section 5.4.2

10. 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.

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.¹¹

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 and the strategic direction of the company. 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.

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 so as to enhance the board's and the company'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. Increasing diversity is especially important for German boards where there is often poor gender and international diversity. Particular attention should be paid to improving diversity of employee representatives in international companies where it is important to have a balance of representatives from Germany and other jurisdictions.

Re-election of directors

To ensure that it retains an open and critical perspective, the board needs to be continually renewed. For this reason, F&C encourages the chairman of the board, as well as the chairman of the audit, remuneration and nomination committees to stand for annual re-election. All directors should be required to submit themselves for re-election at regular intervals. This will serve to strengthen accountability on the core functions of the board. F&C also believes that a minimum of one-third of the board as a whole should stand for election annually.

Nomination of directors

F&C strongly believes that a board nomination committee composed by a majority of independent non-executive directors, plus the company chairman, is best placed to identify and put forward suitable candidates for the board for shareholder election. Those director candidates nominated by the employees for the employee election should have a clear understanding of their fiduciary responsibility to the firm as a whole. 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.

Balanced composition

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, or national 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 not serve on key board committees.

Retiring directors

F&C would not normally expect to see a retiring executive director retain a seat on the board as a non-executive director, except in highly unusual circumstances. Particular scrutiny would apply in the case of retiring CEOs if nominated for chairman. 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, going further than the German Corporate Governance Code, F&C would expect that no more than one member of the supervisory board be a retiring executive. F&C would not expect a retiring CEO to assume the role of chairman, as commonly occurs among two-tiered boards in Germany. In such cases, F&C would look for reasoned justification from the company to explain this deviation from good practice.

Effective functioning of boards

Drawing on expertise and knowledge of executives

In order to ensure the board has full understanding of the business, there needs to be an effective mechanism for the board to draw upon the expertise and knowledge of executives. This is particularly important in the case of supervisory boards, or other boards without significant executive representation, where it is important for executives to contribute to board discussions where appropriate. Where relevant, appropriate executives should be invited to attend board meetings.

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 interacting between the board and the management of the company in a meaningful fashion 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 utilise professional assistance to facilitate evaluations on a periodic basis.

11. 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



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. While the German Corporate Governance Code stipulates that companies should disclose where directors attend fewer than 50% of board meetings, F&C believes that directors should attend all board meetings, barring exceptional circumstances, and considers attendance of fewer than 75% of board meetings to be unsatisfactory.

NED-only meetings

Non-executive directors (NEDs) should meet without executive board members present, on a regular basis, e.g. prior to board meetings, 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.

Non-executive directors should also meet on a regular basis with the company's auditors, without management present.

Training

All directors should receive appropriate training when appointed, and subsequently on regular occasions. Training needs should be identified during the board evaluation process. F&C encourages companies to develop director training plans that include educating directors on significant environmental, social and governance matters. In particular, we highlight the need for increased training for supervisory board members, given the increasing responsibility afforded to the supervisory board. For employee representatives in particular, there should be clear training as to their fiduciary responsibility to the firm as a whole.

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" on page 7).
- F&C may signal its concern regarding the conduct of business by not supporting ratification of management board acts. F&C will not support ratification of supervisory board acts if it has serious concerns regarding elements of control, or board structure and composition.
- If no directors are standing for election, F&C may not support the approval of the company's report and accounts
- F&C will vote against directors who fail to attend at least 75% of board meetings.
- Where there is more than one candidate proposed for a board position, F&C will vote in favour of the candidate F&C considers most suitable, and will take due note of any recommendation by directors.

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” on page 8).

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 of a company provides an important safeguard for shareholders and for other stakeholders that rely upon the integrity of the report and accounts as a basis for their dealings with the company.

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. We would not expect employee representatives to serve as members of the audit committee. At least one audit committee member should have recent and relevant financial experience, and all should be financially literate. 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.
- If there is no formal risk management committee in place, the audit committee normally should 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 normally is also responsible for reviewing internal business ethics systems, and ensuring that there is an effective mechanism for the confidential internal reporting of wrongdoing, whether within the company itself, or involving other parties, such as suppliers, customers, contractors or business partners. Business ethics control systems should include employee hotlines and other appropriate “whistleblowing” mechanisms related to financial fraud and any other breach of company policies and ethical codes. The audit committee typically may serve as the body to receive whistleblowing 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.

- The audit committee is responsible for publishing the annual audit report, which is essential for investors to evaluate the overall health of the business (see section on “Reporting” on page 8). 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.
- F&C recommends that the independent members of the audit committee meet on a regular basis with the company’s auditors and without company management. This may enable a better flow of information between auditors and the board.

Appointment of auditors

The auditors’ performance and appointment should be reviewed periodically, and an evaluation included within the audit report. Where the same firm remains as auditor for a period of time, there should be policy of regular rotation of the lead auditor. 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 the broadest pool of audit firms wherever these can demonstrably meet the required standard of competence and global coverage.¹² F&C expects that shareholders should be given the opportunity to vote on the appointment and payment of auditors.

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 compromised. 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, very large non-audit fees, or non-audit fees in excess of audit fees, may be an indicator of compromised independence.

Risk management

The board as a whole is responsible for framing a company’s risk tolerance relative to its strategy and operations, and is also responsible for monitoring the company’s performance relative to defined risks. Financial, operational and reputational risks that are relevant to the company’s business should be included in this oversight, including material environmental, social and ethical risks.

Depending on the size and complexity of the company, a standalone risk management committee might be warranted. F&C does not have a specific expectation that a company establish a risk management committee, but does expect that in the absence of such a committee the board can demonstrate that it is alert to, and regularly monitors, company risks on an enterprise-wide basis. A

12. See section 4.2.3



risk management committee is a common feature of large bank boards, for example, but it need not be limited to financial institutions. In some companies risk management is overseen by the audit committee. However, a standalone risk committee may enhance board effectiveness in situations where the audit committee is already very stretched. It is a healthy practice for the board as a whole to review the company's risk management as a standing item of regular board meetings.

Remuneration committee

The remuneration committee is responsible for setting the remuneration of executive directors and senior executives and should co-ordinate with the Group Human Resources function to develop a coherent and effective remuneration strategy throughout the company. In Germany this committee is sometimes referred to as a personnel committee. This committee 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. F&C does not expect employee representatives to serve as members of the remuneration committee.

Following the introduction of the Vorst AG Act in August 2009, the supervisory board as a whole has become accountable for the company's remuneration structure, including details on individual executive compensation. The law makes it clear that determining an appropriate level of remuneration is one of the most important duties of the supervisory board and establishes liability for all supervisory board members for any violations of its obligations. However a remuneration or personnel committee will remain a feature of supervisory boards, providing a support role for the board as a whole.

In this context, the remuneration committee must consult with other board functions to ensure that pay mechanisms are well-aligned with strategic goals and the corporation's appetite for risk. Finally, the committee should be attentive to compensation across the corporation to assure itself that management is driving risk and strategy properly and addressing other important issues linked to pay such as discrimination and glass ceilings.

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.
- F&C will vote against or abstain on employee representatives sitting on key committees, such as the audit and remuneration committees.
- F&C will vote against audit committee members who are standing for re-election where it has reason to believe that a company's internal controls are inadequate or has other concerns related to the financial reports. This may include concerns over the independence of the auditor.
- 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.
- F&C may vote against board directors who sit on committees that oversee anticorruption if company officials are charged with violations of anticorruption legislation, or if there are strong indicators that the company's internal controls relating to anticorruption have broken down.

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, German companies should comply with the EU Accounts Modernisation Directive and related German regulations.

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 favourable and unfavourable 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 to be able to assess them. This should include their information about their qualifications and experience, term of office, date of first appointment, level of independence, board committee membership 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 senior executives, including long term succession planning. It should also

discuss 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 members where this might be questioned. 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 processes for supervising non-audit work, and how it considers the interests of minority shareholders with regard to material related-party transactions. 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 and risk management

F&C expects companies to have in place robust systems for evaluating internal controls, including strong internal reporting and employee hotline or whistleblower systems. The audit or risk committee is responsible for receiving the results of these systems wherever necessary. If the audit committee's purview includes risk management, the audit committee report should also address the board's oversight of enterprise-wide risks. The directors should state, in the annual report, that they have reviewed the system of internal controls, including a proper evaluation of all risk factors and their management.

Either as part of the audit committee report or a standalone report, the company should explain the results of the board'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

All German companies are required to publish an annual remuneration report. 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.

In line with the recent adoption of the Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG Act), F&C encourages companies to put their remuneration report to an annual advisory shareholder vote. F&C also recommends that companies actively consult their major shareholders regarding remuneration issues prior to the general meeting. F&C's experience of voting on remuneration reports has shown that this is a valuable mechanism that improves dialogue



and understanding between the board and international shareholders. F&C would expect to see a breakdown of remuneration by individual director.

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

There should be a full and clear statement of all matters relating to the application of the principles, sub-principles and provisions of the German Corporate Governance Codex. The way the provisions are put into effect should be clearly discussed. F&C recommends that, in line with the German Codex, any deviations from the Codex should be explained and put to a vote at the general meeting. Companies who have a listing on a US exchange must detail how they comply with the provisions of the Sarbanes-Oxley Act.

Shareholder resolutions and access to the proxy statement

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. F&C supports shareholder resolutions relating to the right to nominate or remove directors and relating to an advisory shareholder vote on pay.

Voting on reporting and 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 may vote against the company's report and accounts or against the company's auditors in cases where auditor's fees are not reported or in cases where there have been material misstatements.
- 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. Given the worldwide upward trend in total remuneration, F&C also expects justification of base pay levels awarded, and that a significant proportion of total remuneration should be variable and subject to performance conditions. F&C does not set guidelines for levels of remuneration beyond the principles mentioned below.

Relationship to strategy and risk

F&C expects companies to demonstrate the alignment of their remuneration policy with their overall business strategy and planning. Performance metrics should relate to the company's articulated strategy and risk tolerance. Targets should be constructed to align executive incentives to the interests of long-term shareholders, and should not create incentives for executives to undertake short-term risks that might imperil longer-term performance.

F&C supports the *VorstAG Act's* introduction of a minimum 4 year vesting period for options as this strengthens the alignment of management with long-term shareholder interests. F&C also notes that the *VorstAG* allows for German companies to put their remuneration to an advisory shareholder vote, and F&C encourages German companies to adopt a "say on pay".

Disclosure

F&C seeks appropriately detailed disclosure of board and management remuneration packages (See "Remuneration committee report" on page 8). The purpose of the remuneration report should be to enlighten and enhance understanding; it should not be used simply as a compliance document. The annual remuneration report should reflect total remuneration including cash, options, stock and benefits that executives may receive under different performance scenarios.

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. Reports should be in plain language and include an explanation of the tax implications for the company.

The company should enable shareholders to understand its remuneration strategy, and assure themselves that it is properly aligned with their long-term interests. As such, in line with the German Corporate Governance Codex, F&C expects the remuneration of all directors, including all non-executive and executive directors, to be disclosed individually. We would not expect companies to seek any delay in the disclosure of this information. F&C looks for banded disclosure of those individuals at sub-board level who make a significant contribution to the group.

Executive contracts

Executive contracts 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. Although the German Corporate Governance Code stipulates that severance pay should not exceed the value of two years' compensation,¹³ F&C regards one year's base pay and pension entitlements as sufficient severance. Where this is not the case, F&C would expect a clear explanation for severance packages in excess of this amount.

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.

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. In cases where a relative performance measure, such as total shareholder return, is employed, use of an absolute performance metric can serve as an underpin to ensure that rewards are scaled back when the company's overall performance suffers. Generally, F&C believes executive pay plans should reflect a balance of financial, operational, and relative performance targets.

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 will consider one-off equity awards on a case-by-case basis in light of justification provided by the company. However, frequent use of exceptional awards raises questions over the adequacy of the overall remuneration strategy and effectiveness of succession planning. F&C will take particular care when reviewing equity awards granted for the purposes of retention when such awards are not linked to stretching performance targets. Barring exceptional circumstances, F&C will not support the award of free shares to executives that were overlooked for the position of chief executive.

F&C encourages the inclusion of social, environmental and other non-traditional 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.

Whilst the German Corporate Governance Code stipulates that Supervisory Board members should receive performance-related pay,¹⁴ F&C does not support this practice, and believes that this may compromise the independence of directors. F&C is, however, supportive of directors receiving a portion of their remuneration in shares.

Holding periods, vesting and "Clawback" policies

Bonus payment and long-term incentive schemes should be structured to reward long-term growth in shareholder value, and be subject to performance-vesting conditions. F&C encourages a portion of the short-term bonus to be satisfied in deferred shares. Longer-term incentive plans should be share-based, and vesting periods should extend from four to five years.

The remuneration committee should maintain authority to withhold or reclaim (i.e. 'claw back') all or part of performance-based pay

13. See section 5.4.6

14. Available on <http://www.fandc.com/governance>



from executives in cases where it deems it appropriate. This might occur following a significant restatement of accounts, where previously granted awards were paid on the basis of inaccurate figures or where the long-term outcomes of a specific strategy result in significant value destruction for shareholders.

In particular, where representations that executives made to the audit committee about the integrity of controls have been revealed to be inaccurate, or where executives have failed to exercise due caution in the discharge of their duties, the company should consider seeking the reclamation of performance awards.

Clawback policies may also be supplemented with extended deferral periods for share and bonus plans. The potential liability in a clawback arrangement may be scaled back over time to reflect evidence of sustained performance. The applications of a clawback policy should also not be abused; for example, for public companies that have gone private, clawbacks should not be manipulated by private equity firms solely as a means to transfer wealth from former executives back to the private company.

Employee ownership

Widespread employee ownership can positively contribute to shareholder value as it further aligns employees' interests with those of shareholders. Employee share ownership schemes 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.

6. Shareholder rights

Disclosure of economic stakes by controlling shareholders

F&C encourages companies to disclose economic stakes in other listed companies exceeding 5%, even when these are not direct stakes but are accumulated by derivative contracts. The practice of 'creeping takeovers' should be actively avoided—even if technically legal—and minority shareholders should be made aware when a single investor holds a stake in excess of 5%, whether through a direct holding or indirectly through derivative contracts. F&C would expect the audit committee to report on the steps that the board is taking to protect minority 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

Voting on remuneration

- F&C will consider all votes relating to remuneration on their merits, and vote against a policy or individual schemes where it believes that these are in the best interests of the company and its shareholders.
- F&C will vote against schemes that could lead to excessive dilution unless there are extenuating circumstances
- F&C will vote against any resolutions that seek to delay disclosure of individual directors' remuneration
- Where substantial awards can be made under a scheme, and it is not backed up by appropriate disclosure, F&C will usually vote against.
- Where Supervisory Board members are given performance-related pay, F&C will 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.
- F&C may oppose the re-election of the chairman or members of the remuneration committee if the company lacks a far-reaching clawback policy despite recent material restatements.
- 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.

information procedures, and should react helpfully to investor questions. In investment meetings with companies, 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. While practice varies globally, F&C normally considers appropriate limits to be 5% in one year, 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.

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, limited to one year, and not exceed 15% of the issued equity. Any share repurchase must benefit all holders on equal terms taking account of options adjustment.

Related-party transactions

Many companies are involved in material related-party transactions that can 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” on page 6) 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.

Poison Pills

In most cases, F&C regards poison pills as inappropriate and inefficient, unless they are of a strictly controlled and very limited duration. Where poison pills are deployed, companies should seek prior shareholder approval.

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. Other significant liabilities could include specific operational, environmental or social risks that the company faces. The company should provide some indication of how these risks can result in contingent liabilities.

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” on page 11). In circumstances where F&C has serious concerns about a company’s governance, including social, environmental and ethical matters, 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 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 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 co-file such resolutions if direct dialogue with companies proves unsuccessful.
- When voting F&C will consider how the company reports on the protection of minority interests when deciding whether to discharge the acts of the Supervisory Board. In cases where the company has concealed economic ownership stakes through the use of derivative contracts, F&C will typically not discharge the acts of the Supervisory Board.



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.

Vote disclosure

F&C expects companies to disclose the voting results of their general meetings both at the meetings 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.¹⁵

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.

Stocklending

Stocklending is a widespread market practice involving the sale and contractually pre-agreed repurchase of a stock, collateralized by a basket of securities. Insofar as title to the stock passes from the "lender" to the "borrower", this transaction is not, in fact, a loan, and therefore means that the voting right that attaches to the underlying stock cannot be readily detached and retained by the lender. Stocklending is an important factor in preserving the liquidity of markets and in facilitating hedging strategies; it also provides investors with a significant additional return on their investments because the sale-repurchase transaction includes a profit margin. Importantly, however, if the term of the "loan" coincides with an annual or extraordinary general meeting, the transfer of the voting right impairs the ability of the underlying shareowner to exercise his voting rights. In rare instances, this has led to abuse, where borrowers have deliberately entered into transactions to sway the outcome of a shareholder vote without any intention of owning the stock long-term.

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.¹⁶

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

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.

Some companies have their shares held by a trust office that, in turn, issues depository receipts representing the economic ownership of the company. In these cases, the trust must solicit proxies from the holders of depository receipts without any limitations to voting rights. Where the holders of the receipts do not provide proxies, the trust office should abstain from voting. Where trusts direct votes based on various different authorities such as direct instruction or discretion, then the proportion of votes so exercised must be published. F&C believes that the authority to delegate discretion to the trust to execute voting rights should only follow an active instruction from the underlying security holder to do so, rather than be held as a default position established by the company.

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

15. This applies to funds directly managed by F&C. For clients of F&C's responsible engagement overlay service (*reo*[®]) service in cases where F&C does not manage the fund - clients will need to coordinate with their fund managers with regard to stocklending policies and practices.

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

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.

Appendix: 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

Winning gold with F&C

Delivering highly effective investment strategies is just one part of the service we provide. As principled asset managers, we are determined to lead our industry in all aspects of our business.

In 2009 F&C were voted winners of the 'Gold Standard' in the Fund Management category for the fourth year in succession. Only a few companies have been privileged enough to win a Gold Standard award, and as such, this is an exceptional achievement. The Gold Standard Awards aim to identify financial services companies that excel not just in service but in five key areas important to consumers of financial products and services:

Financial strength

Ability to meet and exceed customer expectations

Capability

Outstanding expertise and aptitude as a fund manager

Service

Ability to maintain and grow an effective post-sales relationship

Fair value

Assessing whether customers receive great value for money

Trust

Ability to instil confidence in consumers

As a result, the Gold Standards are one of the hardest, most sought after awards in the financial market place.



WINNER



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

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Important information. All data is as at 31 December 2009, unless otherwise stated.

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