

F&C

Responsible Investment: Voting in 2009

February 2010



Summary

Exercising our voting rights is central to encouraging good governance. F&C votes on all companies held in client portfolios, including those managed in-house by F&C Asset Management. We also engage companies both before the vote, to explain our expectations and invite comment, and afterwards, to explain our reasons for any votes against management. Our voting decisions are made on the basis of detailed in-house Voting Guidelines; we have 14 regional variants of these guidelines, reflecting the local specificity of different markets around the world.

In 2009, F&C voted almost 58,000 resolutions at 5,225 companies in 66 countries. This was almost double the amount we voted in 2008, the result of a sharp rise in the number of clients which F&C now represents within its **reo**[®] service. This breadth of coverage gives F&C a unique perspective on governance developments globally.

Over the year as a whole, we voted in line with management recommendations 78% of the time, down from 81% in 2008. In part, this fall reflects F&C taking a harder line on remuneration, with opposition rising from 15% in 2008 to 25% in 2009. Capital structure was another area of controversy, as companies under pressure to rebuild battered balance sheets often overstretched basic rules of good governance.

How we voted in 2009 (2008 in brackets)¹

Description	Number of Resolutions	For Management	Against Management	Abstain	No Vote ²
Board elections ³	26,294	81% (80%)	13% (6%)	3% (11%)	4%
Capital structure	5,901	73% (84%)	18% (9%)	4% (1%)	6%
Remuneration	5,442	70% (79%)	11% (7%)	14% (8%)	5%
Routine & Other Business	19,092	80% (89%)	4% (2%)	4% (3%)	12%
Shareholder proposals ⁴	999	33% (37%)	55% (51%)	9% (12%)	2%
All proposals	57,728	78% (81%)	10% (7%)	4% (7%)	7%

2009 also saw a notable hardening of positions across several regions. In particular, the **UK** has for some years enjoyed relatively cordial relations, thanks largely to a healthy level of company-shareholder dialogue. This year witnessed more confrontation, as our opposition to management doubled overall; pay plans were the area of greatest concern, where we voted against management 19% of the time (up from 10% in 2008). The picture worsened in **Australia**, where our opposition rose from 21% to 27%, as we and other investors objected to companies exhibiting poor disclosure on pay deals. Meanwhile in **Brazil**, our votes against management swelled from 13% to 27%, but this largely reflected a sharp rise in the proportion of small and medium-sized companies, whose standards of disclosure lag their larger compatriots.

Some countries bucked the trend, although for very specific reasons. In **Russia**, there was a significant fall in our opposition to director elections, from 54% to 38%, reflecting a change in our policy position on cumulative voting to make the best of our limited ability to support the election of independent directors⁵.

South Korea also saw a fall in votes against management due to better representation of independent directors – although this apparent sign of improvement masked a growing hostility to the rights of international shareholders, which culminated later in the year in a proposed new law permitting companies to use ‘poison pills’⁶.

1. Totals may not sum to 100% due to rounding.

2. The majority of ‘no votes’ take place in markets which employ shareblocking, where most clients elect not to vote so as not to constrain their investment decisions. The ‘Routine & Other’ category also includes non-voting proposals which is the reason for the relatively high proportion of no votes.

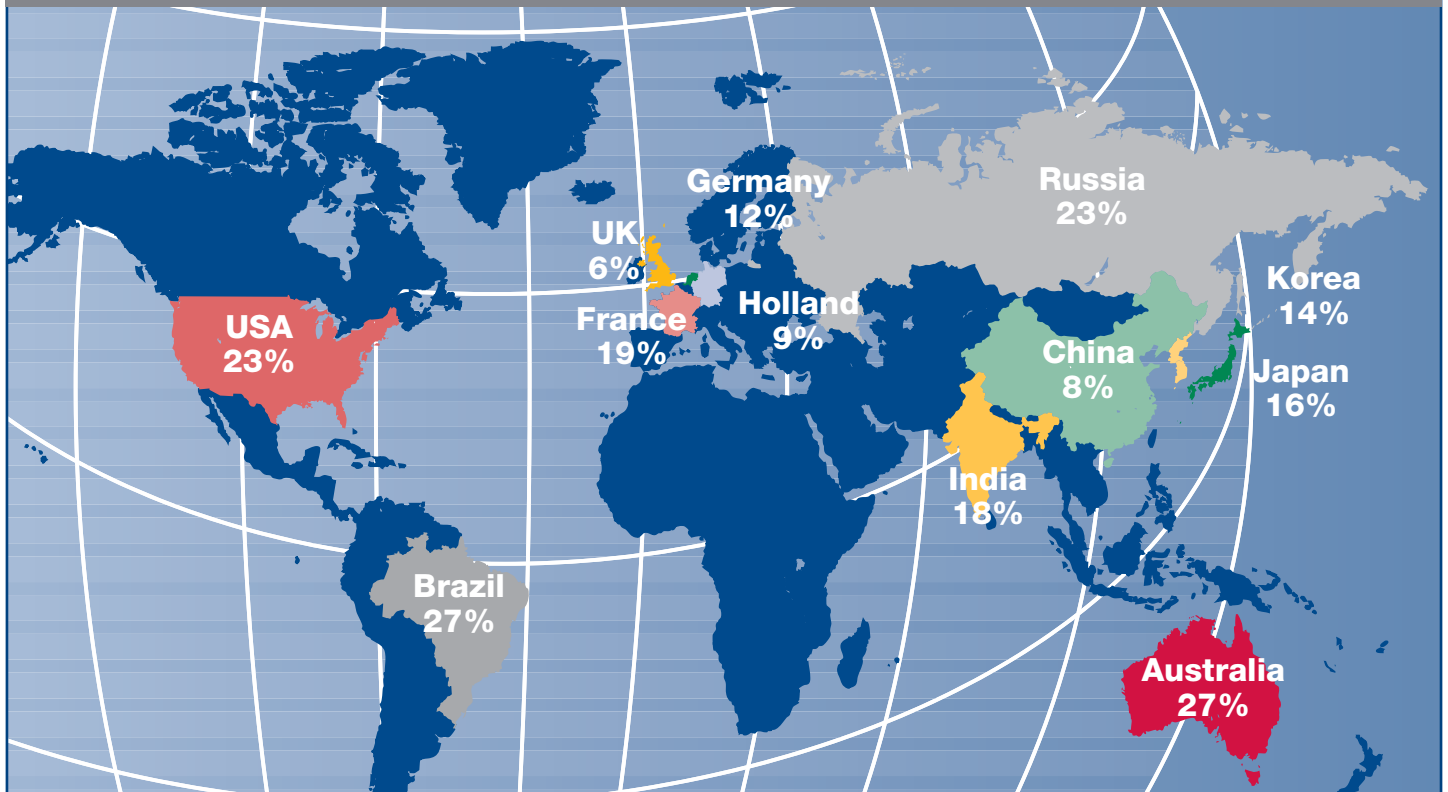
3. The shift from abstentions to votes against partly marks a change in the way F&C classifies ‘Withheld’ votes in the US market. These are now counted as votes against management.

4. Typically companies will advise investors to vote against shareholder resolutions. Hence a vote in favour of a shareholder resolution is counted in our statistics as a vote against management, and vice-versa.

5. F&C has historically opposed cumulative voting on the grounds that it is an opaque system that in practice allows major shareholders to push through their own candidates. We therefore abstained on director nominations when faced with a long list of candidates in excess of the number of seats. However, with the ever-rising pressure on Russian boards to safeguard minority shareholder interests and limited influence of independent directors to perform this function, we elected in 2009 to alter our policy to use our limited votes to send a symbolic signal to boards that greater independence was crucial, and backed this up with detailed follow-up letters.

6. The term ‘poison pill’ refers to a mechanism put in place to prevent a takeover, such as a right for existing shareholders to acquire discounted shares in the event of a potential hostile bidder acquiring a position. F&C’s letter on the subject to the Korean government can be found at www.fandc.com/publicpolicy

Votes against management and abstentions: 2009 in total



Remuneration: Taking the gloves off

Whilst pay at financial institutions dominated the headlines in 2009, missed targets and plunging numbers have affected all sectors, prompting disappointed executives to amend pay plans and reset the goal posts in their favour. It was no surprise, then, that 2009 saw a dramatic rise in F&C's votes against management on remuneration from 15% in 2008 to 25% in 2009. Our opposition to management on pay rose in every major country where ballots on pay were an option. In the UK, votes against and abstentions on pay reached 19% of all votes cast – almost double last year's tally.

One of our most frequent concerns in 2009 related to the awarding of discretionary payouts despite missing targets, or retrospectively changing the targets themselves. One of the most egregious examples was the decision by the remuneration committee at Dutch telecoms giant **KPN** to award a 33% increase in long-term incentive pay to the Chairman and 66% to other executives without a shareholder vote, leading F&C and other investors to vote against the Discharge of the Supervisory Board. There was also widespread shareholder rebellion at **Royal Dutch Shell** at the

decision to grant substantial awards under the long-term incentive plan despite the company missing its relative performance target, alongside a generous pay rise for the already highly-paid outgoing CEO. Following rejection by a majority of shareholders at the AGM, the company undertook an extensive consultation exercise, and looks set to put forward significant reforms in 2010.

They said... **“You have to realise: if I had been paid 50% more, I would not have done it better. If I had been paid 50% less, then I would not have done it worse”**

– Jeroen van der Veer, Chief Executive, Royal Dutch Shell, quoted in ‘Shell chief calls for pay reforms’, Financial Times, 8 June 2009

Our opposition to pay deals in **US** companies also rose, from 21% to 36% in 2009, although the picture was complicated by the last-minute decision by the Securities and Exchange Commission (SEC) to put pay to a vote at all recipients of public funds under the Troubled Asset Relief Programme (TARP) scheme. With little time to prepare a measured voting policy, most investors backed management on these resolutions, whereas F&C took a generally firmer line that reflected our long experience of evaluating pay proposals and differentiated starkly between companies. We opposed plans at **Bank of New York**, which lacked forward-looking performance goals, and **US Bancorp**, whose targets for equity awards were too short-term; but at **CapitalOne** we supported a change to the compensation plan, shifting from a purely options-based approach to one which now includes performance-related payouts. Meanwhile, broader momentum for a ‘Say on Pay’ for shareholders in US companies gathered pace, with **Hewlett Packard**, **Occidental**, **Pfizer** and **Goldman Sachs** all introducing an advisory shareholder vote following pressure from F&C and other investors. All eyes are now on policymakers to see if an advisory vote on pay will be made mandatory in 2010.

The financial crisis has prompted fresh thinking on a shareholder vote on pay in other countries as well, in particular **Germany**, where a new law is introducing liability for the entire supervisory board with regard to the remuneration of executive management. However some countries such as France remain resistant, preferring to legislate rather than use shareholders as a component of a broader ‘checks and balances’ approach; in the absence of an item on the ballot, F&C expressed its concerns about remuneration through direct dialogue with companies, or through its vote on the chairman or members of the Remuneration Committee.

Banks at the ballot box

Many of the year’s most contentious votes came in relation to companies in the beleaguered banking industry. Reflecting the complexity of the governance issues involved, we developed a new set of detailed voting guidelines specifically relating to the sector, and entered into substantive one-to-one dialogue with the major banks in our portfolios to better understand their position and put across our views. Where poor risk management and weak governance had seriously impacted performance, yet a company exhibited a willingness to implement tangible reforms, we adopted a more positive voting stance. However, at institutions where reform was less forthcoming or where a company continued to deny its role in addressing systemic sector-wide risks, we came down hard on management.

Notable examples of our votes in 2009⁷ at major UK, European and US banks included:

- n At **Bank of America**, we voted against CEO-Chairman Ken Lewis for poor due diligence of the acquisition of **Merrill Lynch**, and excessive bonuses paid to Merrill Lynch executives. We also objected to his position as joint CEO-Chairman. He has since left the company.
- n For UK bailout recipients **RBS** and **Lloyds Banking Group**, F&C took the unusual symbolic step of opposing the report and accounts, reflecting grave concerns about how the businesses had been managed in 2008.
- n We opposed a large number of pay schemes, including at **Barclays**, **Lloyds Banking Group**, **RBS**, **Standard Chartered** and **Unicredit**, to signal our deep disapproval of poorly disclosed, under-challenging performance conditions that encouraged excessive risk-taking. However, we abstained at **UBS**, **Credit Suisse** and **HSBC**, in recognition of efforts to reform pay structures, including the introduction of ‘clawback’ schemes to recoup bonuses paid on the back of behaviour that might later prove damaging.

Sorting through the debt hangover

Falling share prices, revenues and asset values have placed immense pressure on the balance sheets of even the best-run companies. Consequently, the 2009 voting season was characterised by a wave of rights issues and other forms of capital-raising aimed at putting company finances on a more secure foundation. Despite many of these proposals flouting established standards governing dilution, F&C took a pragmatic view, taking into account factors such as the cost of capital and the long-term viability of the business, and avoiding a box-ticking approach that risked tipping companies into insolvency.

Our discussions with Swedish company **Eniro** were a case in point. The company had seen debt spiral to five times group earnings, and efforts to renegotiate debt terms were thwarted by the high cost of borrowing in credit-constrained markets. Following talks with F&C and other investors, the company decided instead to raise cash through a rights issue, which brought down the debt burden and ultimately led to a share price rally as confidence grew in the viability of the company.

Despite our flexible approach, our votes opposing capital-raising jumped from 10% in 2008 to 22% in 2009 across all regions. The UK saw the sharpest rise – to 8% in 2009, an almost fourfold increase from the year before. New guidance from the Association of British Insurers (ABI) to grant financial institutions greater leeway

7. See F&C’s Q2 2009 public **reo**® report, which sets out these votes in greater detail.

to raise capital without prior shareholder approval was taken by companies outside the sector as a green light to do the same – something that F&C opposed for companies not facing the very unusual circumstances besetting the banking industry.

The financial crisis has also had implications for the balance of power between shareholders and bondholders. As many companies have gone down the route of bond issuance to shore up liquidity, bondholders have gained in influence – yet most elect not to use their voice to call for improvements in the quality of management. F&C has responded to this opportunity by expanding the coverage of its **reo**[®] activities to include corporate bonds as well as equities, in recognition of the importance of adopting responsible ownership principles across all asset classes.

Democracy falls short

Sometimes the challenge of effective company-shareholder engagement lies not so much in the content of what a company puts to a vote, but in the byzantine process of executing the vote. While even getting some items onto the ballot has long been difficult in many markets, there were numerous examples in 2009 of companies employing devices that effectively blocked all but domestic shareholders from voting. In addition, weaknesses in disclosure often left us unable to reach an informed opinion.

At German carmaker **Volkswagen** (VW), an extraordinarily cumbersome process to register votes compounded F&C's misgivings over a resolution to appoint board members and approve capital transactions. We went through the required procedures and registered our opposition to the resolutions. But many other international shareholders simply gave up, leaving VW with a clear field to press through its proposals.

Elsewhere in Europe, the practice of shareblocking⁸ continued to hinder the exercise of shareholder rights. Although shareblocking is gradually being phased out, it is still used in several key markets, such as Italy, Greece and Switzerland. With the majority of shareholders choosing not to vote in order to avoid constraining investment decisions, this effectively insulates companies from shareholder opinion. This year F&C elected to vote a token number of shares at companies employing shareblocking in order to make our views on governance issues heard; examples are included in the table overleaf.

Barriers to shareholder democracy also hindered investors in many emerging markets, although the situation did improve in some countries through 2009. Poor disclosure is a frequent complaint, and we recorded high levels of abstention in many markets, largely reflecting information not being provided in time for us to meet

international voting deadlines. And there are procedural roadblocks as well: Taiwanese giants **Acer** and **TSMC**, for instance, failed to allow investors to vote by poll – a critical facility for foreign investors unable to attend meetings in person.

Shareholder proposals gather pace

Where dialogue fails, filing a shareholder proposal can be an effective way to up the ante and get an important issue onto the table. Ten or even five years ago, proposals often raised matters that F&C did not consider to be material to shareholder value, were poorly worded, or overly prescriptive.

The quality of resolutions has been improving, however, and for the past two years, F&C has supported the majority of them. The volume of such resolutions has also shot up, reflecting both a more sympathetic Obama-era SEC that has allowed more resolutions onto US company ballots, and their growing use by trade unions and other activists in markets that have traditionally had few of them, such as the UK. In 2009, F&C voted almost 1,000 shareholder resolutions, up from 708 in 2008 and only 256 in 2003.

In the US – still the largest market for these proposals – resolutions calling for a 'say on pay' dominated the mix. There were also proposals on responsible lending at some of the major retail banks, which F&C supported. Some environmental resolutions did not meet the required standards to get onto the ballot – but with the SEC likely to take a more lenient line in 2010, we expect to see a range of resolutions on issues such as oil sands and climate change strategies.

Key F&C votes in 2009

F&C publishes its voting record in full on its website⁹, including explanations for all decisions to vote against management. These decisions are also communicated directly to companies. The following table summarises F&C's stance on a small number of key votes that took place during the year, including some of the most controversial shareholder resolutions.

**For****Abstention****Against****Examples of F&C voting on shareholder proposals worldwide.**

Company	Country	Resolution ¹⁰	Vote	Explanation
Apple	US	Director elections		We withheld from members of the nominating and governance committee because the board has disclosed almost no information regarding its succession plan, which was particularly pressing given the uncertainties regarding the health of the CEO.
Barclays	UK	Election of directors		We opposed the election of the Senior Independent Director over treatment of shareholders during the Middle Eastern capital raising.
Barrick Gold	Canada	Commission independent review of sustainability *		We supported the proposal (voting against management's recommendation) because we believe that the company still faces significant risks around community engagement and sustainability, despite some improvement in recent years.
Bellway	UK	Remuneration		We opposed management because of the payment of bonuses despite targets being missed.
Chesapeake Energy	US	Election of directors		We withheld support from all directors in protest at poor corporate governance and remuneration practices – including the decision to ignore a shareholder vote calling for the annual election of all directors, and a lack of performance conditions for pay.
Credit Suisse	Switzerland	Remuneration		We welcomed the introduction of a 'clawback' mechanism to reclaim bonuses based on decisions that turn out to be damaging in the long term.
EADS NV	Netherlands	Discharge from liability		With the company facing insider dealing charges, we abstained on the resolution to discharge the company's directors from liability.
Hong Kong Electric	Hong Kong	Acquisition of new assets		A special meeting was called to ask shareholders to approve the acquisition of coal-fired power stations in China. We held a conference call with the company to find out whether the company had factored climate change risks into its decision. Satisfied that the company had factored the shift in government policy into the valuation of these assets, we supported the resolution.
Kungsliden AB	Sweden	Option plan		We opposed this plan as the company was seeking to allow for a transaction to be booked in the current financial year purely in order to meet the performance conditions for bonus payments.
Lloyds	UK	Various		We opposed the report and accounts, the remuneration scheme, and election of the chairman and other board members, reflecting our grave concerns about mismanagement in 2008.
Novartis	Switzerland	Introduce annual remuneration vote *		We supported the resolution (voting against management) as we believed that an annual vote on pay would serve the long-term interests of shareholders, by improving the board's accountability.
Parmalat	Italy	Report and accounts		We had concerns around recent court cases regarding alleged fraud. Whilst we supported the Report and Accounts, we used the opportunity to contact the company to call for the annual re-election of directors, in order to improve accountability.
RBS	UK	Involvement in Asset Protection Scheme and share issuance		We supported this resolution as the long-term survival of the bank depended on new capital raising. However, we still had concerns that participation in the scheme could place limits on the bank's activities, placing it at a disadvantage.
Tesco	UK	Improve management of labour standards *		We undertook in-depth dialogue with the company regarding allegations of poor labour standards management by the filers of this shareholder resolution. Following this, the company published specific responses. Whilst we still had some concerns, we did not believe the solutions proposed by filers were the right ones.
Wal-Mart de Mexico	Mexico	Election of directors		We voted against the slate of directors due to concerns that only 3 of the 11 board members were independent. We believe that at least one-third should be independent to broaden and diversify board discussion.

10. An asterisk denotes a shareholder resolution. As management invariably recommends voting against shareholder resolutions, a vote in favour of such resolutions is recorded here as a vote against management.

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

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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



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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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