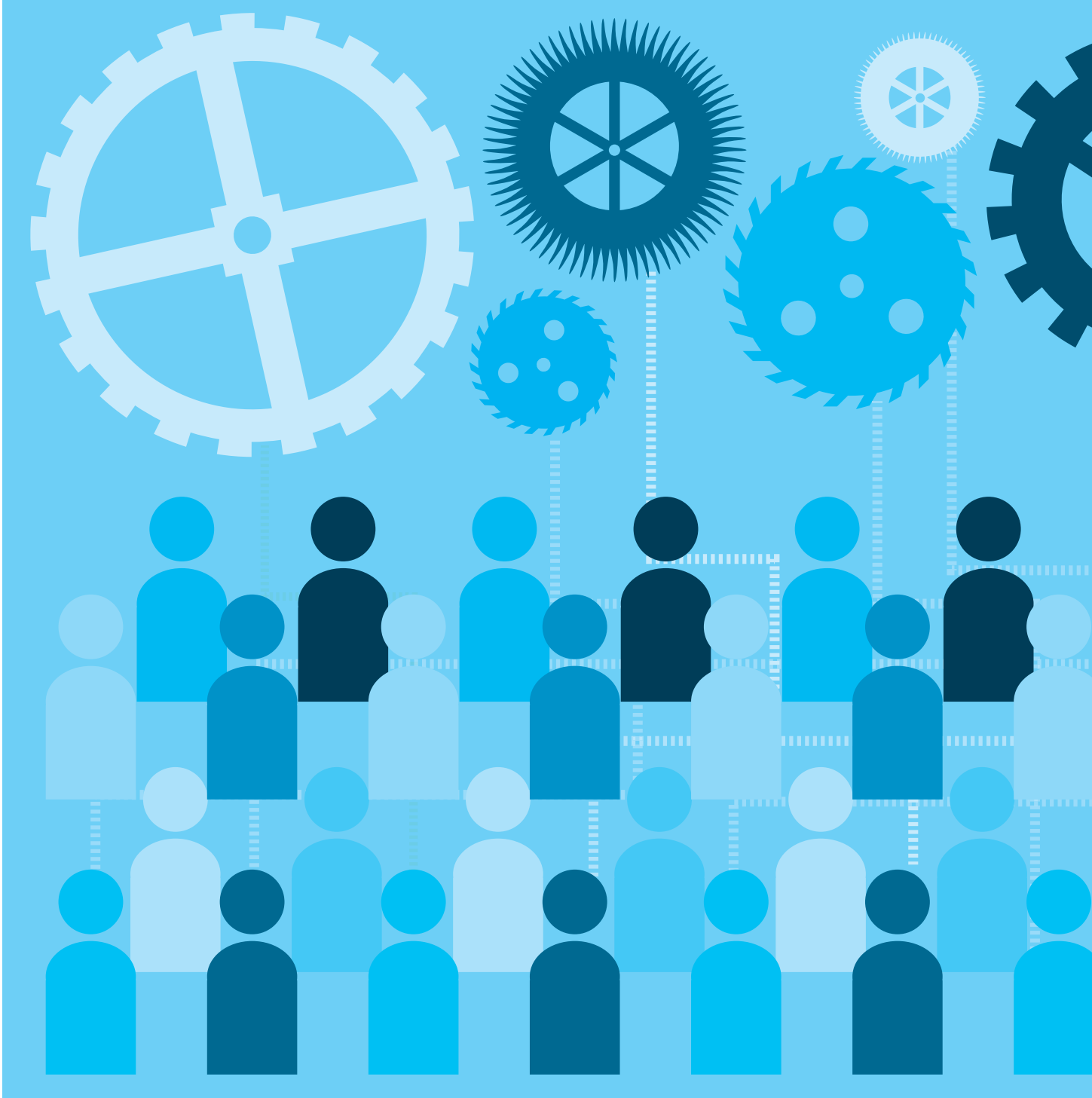




Active ownership

Positive engagement to enhance long-term value



Active ownership means using our scale and influence to bring about real, positive change to create sustainable investor value. Our annual governance report explains how we achieved this in 2015.



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Our vision



Welcome to our fifth annual report. The world of governance continues to evolve rapidly and we are pleased to report on our efforts in this changing world. The team won some prestigious awards in 2015 including 'Best Investor Engagement.' This was voted for by UK company secretaries, highlighting how our work is valued externally as well as internally.

Our role is to help bring positive change to the companies we invest in, and all the work outlined in this report has that overriding aim. The phrase 'long term' can be overused, but in our case I believe it is rightly applied. Our fifth annual report shows many examples and themes continuing from our first one. I hope the specific company examples help highlight our progress and give colour to our work. A great success story this year has been our five-year push for greater diversity. The Lord Davies 2015 target of 25% female representation on FTSE 100 boards was achieved on time (26.1%). Another success this year relates to our push to remove quarterly reporting. A number of companies – including Legal & General – have done just that, showing the increasing support for our philosophy.

The range of topics discussed (in this report and with companies) has increased since our first report. This is largely in response to client demand and feedback around topics such as climate change and cyber security, with which we have been engaging since 2013. On tax, we are collaborating with more investors and regulators on greater disclosure and clarity.

I would like to welcome two new members to our team: Catherine Ogden and Jeannette Andrews. They come to us with considerable experience, have fitted in seamlessly and are making a significant difference already. I thank the whole team for their hard work and we are all excited for 2016 as we feel there is much to do. As always, we are very happy to hear feedback from our clients.

Sacha Sadan
Director of Corporate Governance

Our vision

'Caring for our clients' future by empowering our investments to create long-term sustainable value'

Our mission

To use our influence to ensure that:

Companies integrate **environmental, social and governance (ESG)** factors into their culture and everyday thinking.

Markets and regulators create an **environment** in which **good management** of ESG factors is valued and supported.



Our focus



Creating Sustainable Value:

Ensuring that boards and management are best equipped to create resilient and long-term growth.

We want to safeguard and grow our clients' assets by ensuring that companies are well positioned for sustainable growth.

To be successful in the long term, companies need to have people at the top who are able to deliver sustainable value.

We engage directly and collaboratively with them to highlight key challenges and opportunities in their sector and support strategies that can deliver long-term success.



Influencing the Debate:

Identifying and engaging on key themes and emerging governance topics.



Improving Companies:

Protecting and enhancing our clients' assets by supporting change and holding management accountable for their decisions.

We use our scale to influence markets and the regulatory environment to ensure that issues impacting the value of our clients' investments are recognised and appropriately managed. We identify key themes and emerging governance topics so that we can understand these risks and opportunities and react accordingly. This includes working with governments, regulators and other decision-makers to promote a certain course of action and often collaborating with others to effect change.

As steward of our clients' assets, we believe that real change is best achieved through being an engaged and active owner. In doing so, our investment process includes an assessment of how well companies incorporate relevant environmental, social and governance factors into their everyday thinking. We act on our analysis and engage with companies to improve their performance to protect client assets. Voting is also an important tool, which we use to hold management to account.

Q&A with Sacha Sadan, Director of Corporate Governance



Sacha Sadan
Director of Corporate Governance
Legal & General Investment Management (LGIM)

Q Why is corporate governance important?

A We believe that good corporate governance adds value, and equally poor governance can destroy value. This is value that benefits all asset classes, not just equities. Therefore as the largest pension fund investor in the UK, we put significant effort and resource into this.

We are committed to maximising investment value and protecting our clients by promoting best practice in the companies in which we invest. **The 545 company meetings we had in 2015 show that this is a priority.**

Q What were the key trends in corporate governance in 2015?

A Corporate governance continues to become more integrated into mainstream investing, and our focus is increasingly global. We engaged with companies in the UK, Europe, the US, Japan and Asia to ensure the long-term value of our clients' assets was protected. 45% of our company engagements were ex-UK.

Collaboration between investors has grown for many reasons, such as more resource and the encouragement of stewardship codes. This has helped amplify our work and we listen and cooperate with others who have good constructive ideas.

Cyber security and tax transparency have also risen much higher up the agenda. We have been engaging with companies on cyber security since 2013, making sure that boards have the right skill mix and time to focus on the risks of cyber as well as the digital benefits. On tax, our work with organisations such as the Principles for Responsible Investment (PRI) is helping investors to ask the right questions on transparency. This work has been published.

Climate change is emerging as a key theme and I think it will increasingly impact company valuations. That is already obvious in some sectors such as mining or oil and gas, but you will

start to see an impact in other sectors such as utilities. We are working with companies to understand how it will impact on their business models.

Disclosure will be key – companies will need to make clear how they will operate in a world where the increase in global average temperatures is attempted to be held at 2°C. There is a positive story. There will be many winners and we will explore these R&D opportunities with companies. Encouraging companies to remove quarterly reporting, will we believe, increase management focus on long-term strategies.

Q What is your corporate governance strategy?

A Our strategy is to deliver on our three key themes. These are:

1. Creating sustainable value for our clients by supporting change and ensuring company growth is sustainable
2. Improving companies by ensuring boards and management are the best they can be and aligned for long-term growth
3. Influencing the debate by engaging on key governance themes with industry regulators and governments

I hope it is clear from this report that we are successfully delivering on our strategy. We try to be proactive rather than reactive in driving change. It is all very well to vote against a company, but what happens next? It is much more effective to work with companies on a long-term strategy for change. Also working with regulators and governments to change the whole landscape is vital. Our mantra of **'influence rather than noise'**, means we need this report to show examples of what we are doing in a timely fashion.

Q How do you measure success?

A Corporate governance isn't always easy to measure because many issues are subjective. It is a key reason for this report to show examples of our successes. Here are three instances where our approach has had particular success with data to back it up. We have talked about these topics in previous reports.

1. Pay schemes. We wrote to FTSE 100 companies in 2013 asking them to simplify pay schemes and to have only one long-term remuneration scheme. We forewarned companies that we would vote against multiple and complex schemes, which we have done. The number of companies having more than one remuneration scheme is down from 43% three years ago to 18% today. This will continue to fall

2. Diversity. We have pushed hard on diversity and have been complimented by Lord Davies, who conducted the government review into the representation of women on FTSE boards. Five years ago only 12.5% of companies met the target for a quarter of female board members; today that figure is 26.1%. This is a pleasing result, but more needs to be done on the talent pipeline and we will continue to focus on this topic
3. Auditor rotation. The number of companies changing their auditors has increased significantly, and new EU rules mean mandatory rotation of auditors every 20 years. This has occurred due to LGIM and other investors pushing both companies and regulators. This trend will continue

Q What corporate examples would you highlight from 2015?

A One of our key successes was Syngenta – a Swiss multinational company, highlighting our global focus. It was an underperforming company that was subject to a hostile takeover bid by Monsanto. We collaborated with other investors after the Monsanto bid failed. We continued to engage with the Syngenta board on governance concerns and the company has since been subject to another bid at a materially higher price. This shows how, working behind the scenes, we can help create better outcomes for shareholders.

Betfair is a different example where we supported the company from a hostile takeover in 2013. This was well documented in our last report. Subsequently we have supported the merger with Paddy Power in 2015 and the merged company is now the biggest online gaming company in Europe. Betfair has been one of the best performing companies in the FTSE 350 over the last five years. Our continued support shows our long-term focus.

There are many other examples – some of which we have been working on for multiple years.

Q Where is the corporate governance debate heading?

A I believe corporate governance has evolved from more than just voting on pay issues.

On diversity, the key issue is the proportion of women in the executive pipeline. FTSE 100 companies may be meeting the Davies target of 25%, but most are non-executive directors. Also we're still concerned by how many of the next biggest 250 companies still have all-male boards. We will continue to engage with these companies and we will vote against the chairmen of companies where transparency is an issue.

On tax, there is a lot of confusion around corporate tax policies and the role companies play in contributing to society. We would like to see better public disclosure of tax policies so investors can better assess the potential risks. Best practice includes country by country reporting – our parent company, Legal & General, publishes the amount and type of taxes borne in each territory where it operates. Chairmen should at least be confident in telling their investors about the tax risks and how the board manages its tax affairs and risk appetite so shareholders can make better informed decisions.

Q What could be a key emerging issue in 2016?

A In my view pay ratios, normally defined as CEO pay relative to the average employee, will become a hot topic. The SEC is making reporting of pay ratios mandatory in the US in the future and this is going to put a lot more pressure on companies everywhere. The reason is executive pay has risen faster than the average workforce pay. This is becoming a political and social issue and will creep into the governance world. Frankly we don't know what the

ratio should be, but I think it is going to be an emerging issue and more transparency will occur in this area.

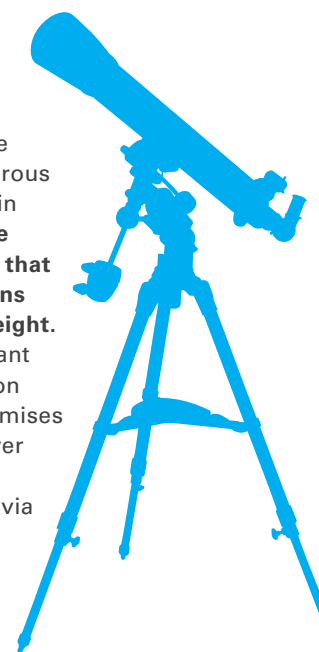
Q Why is your structure unusual in corporate governance?

A We are an independent team, reporting directly to LGIM's CEO and the Corporate Governance Committee, which includes two non-executive directors. The 10 person team is relatively large. We do not report into the equities department, which helps us work on all asset classes and reduce conflicts. This structure ensures that we can act to achieve the best outcome for all our clients.

By having a seat on the board and reporting directly to the CEO, my team and I have authority to do the important work: focusing on protecting clients' interests. This means we can tackle sensitive issues such as tax, remuneration or quarterly reporting relatively early.

Q LGIM has large index tracking assets which cannot be sold. So why would companies listen to you?

A As a large index investor we are unable to sell our holdings. Companies understand that we are long-term shareholders and that our interests are aligned in helping companies become as successful as they can be. Boards and companies are usually very responsive to our concerns, however where this is not the case we have a rigorous escalation process in place. **Being a large shareholder means that our votes and actions carry significant weight.** Voting is an important part of our escalation process. LGIM minimises abstentions to deliver an unequivocal message to boards via our votes.



Our approach to corporate governance

Our clients are important to us. We believe that the management of corporate governance enhances the value of their assets. Therefore we take governance very seriously and devote significant resources to this effort.

'Influence rather than noise'

Our Corporate Governance team is tasked with delivering on our principles. We divide our resources by geography and sector responsibilities. This creates specialist knowledge which enhances our engagement and focus activities.

We execute our strategy by shaping the corporate governance landscape, voting and engaging with companies on your behalf and integrating ESG into the investment process.

Shaping the corporate governance landscape

As one of the largest institutional asset managers globally, we use our scale to bring about change and represent our clients in the most influential way.

Addressing long-term issues such as climate change, evolving regulatory hurdles and shifting societal demands is a key component of our engagement efforts.

The scope of our activities continues to grow, not only in geographical terms but also with the breadth of subjects and policies covered.

During the year, we paid particular attention to improving the performance of companies, by seeking to ensure boards remain relevant and diverse. Also, we have focused on how companies are prepared for the impact of climate change. More information on this can be found in the 'shaping the governance landscape' section on page 10.

Voting and engagement

Ongoing dialogue with companies is a fundamental aspect of LGIM's responsible investment commitment and we undertake this both independently and collaboratively with other investors. We believe that voting and engagement are closely linked and complementary.

Engagement gives us the opportunity to learn about the company's strategy, operations, financial and external challenges and opportunities, all of which are essential for us to exercise our duty effectively. Importantly, ongoing dialogue with companies means that we can express our concerns before votes are cast, which allows an exchange of constructive ideas between us and the company and can often result in change.

	UK			Europe			US and North America			Japan			Asia Pacific			Emerging Markets		
Number of companies voted at	655			330			633			479			332			659		
Annual General Meetings (AGM)	642			325			613			479			321			614		
Extraordinary General Meetings (EGM)	134			34			51			5			63			317		
Total number of votes	10,807			6099			7952			6601			2538			10,826		
	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain	For	Against	Abstain
% of resolutions	98	2	0	86	14	0	91	9	0	87	13	0	86	14	0	84	16	0
% of companies where we did not support at least one resolution	18			65			56			75			44			62		

'LGIM voted against at least one resolution at 18% of UK companies'

Voting statistics represent holdings in flagship pooled pension funds. Please note we vote in a wider universe of global companies.

As one of the largest asset managers globally, we have a responsibility to exercise client voting rights and influence change efficiently and effectively.

LGIM votes in all developed markets and the main emerging market countries. Voting is a significant part of our daily activity where we exercise the rights of shareholders to hold board members to account for the successes and failures of their businesses.

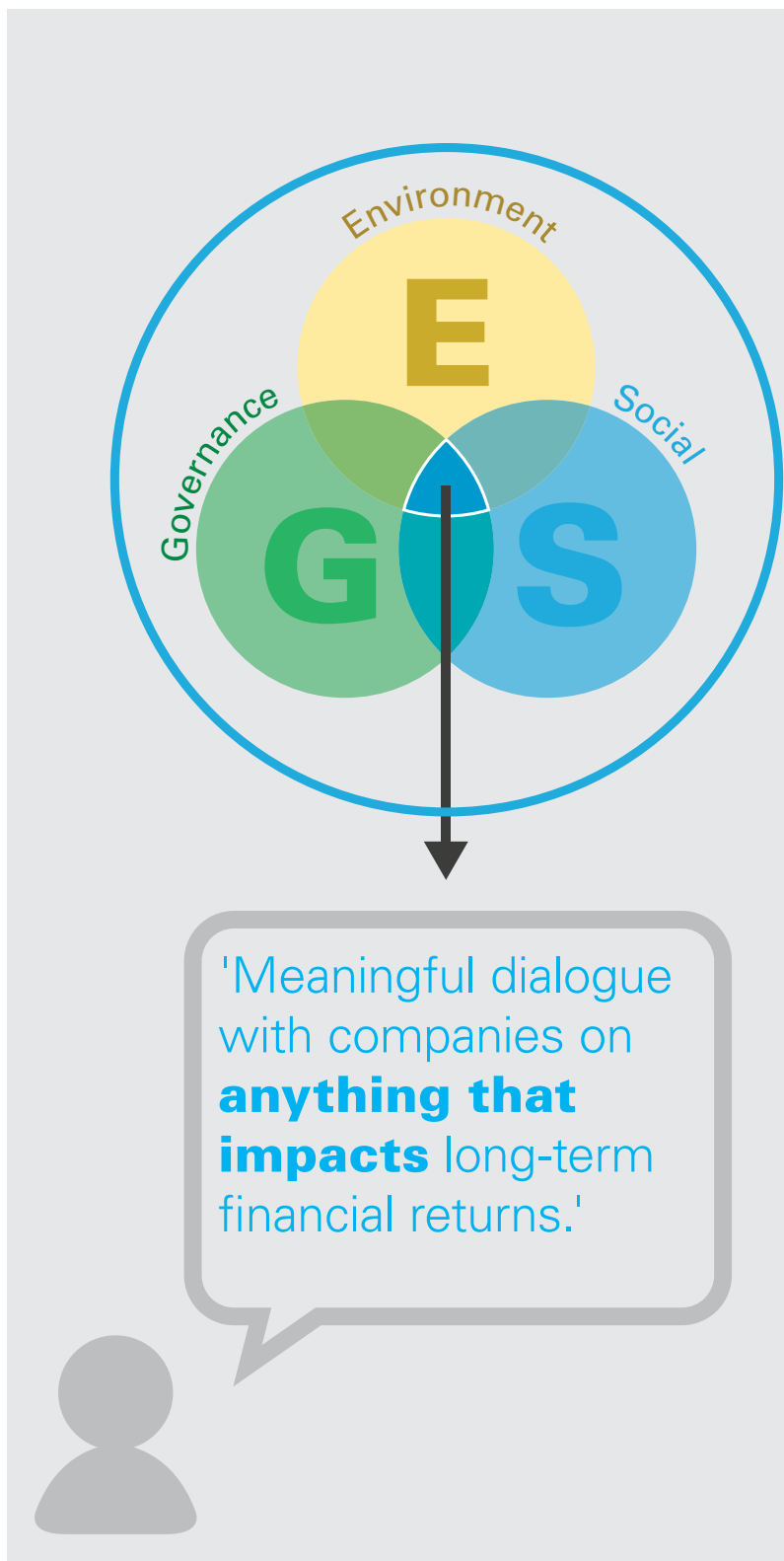
Our voting policies can be found on our website. These policies are continually evolving and reviewed regularly to reflect the changing corporate landscapes. Further information on updated policies is in the Appendix section.

Managing conflicts

A distinction of LGIM is how the Corporate Governance team is structured and supported. Sacha Sadan, Director of Corporate Governance, is a member of the LGIM Board. He reports directly into the CEO and the Corporate Governance Committee which includes two non-executive directors, Lindsay Tomlinson and Simon Fraser. This structure minimises potential conflicts of interest, ensuring the team can act to achieve the best outcome for all our clients.

Integrating into the investment process

ESG factors are increasingly recognised as playing a role in determining asset prices. We therefore integrate our work with the active equity and fixed income teams in order to supplement their fundamental analysis. This means that we identify sector-specific risks and opportunities, and focus our attention on the material impact of ESG on a company's bottom line and creditworthiness. While the team is independent of active fund managers, ongoing communication is maintained to share knowledge and information. Our approach, which combines financial analysis and ESG, is continually evolving in line with best practice; we continue to formalise our processes and improve how we communicate and report our work to internal and external stakeholders. More details can be found on page 52.



Shaping the governance landscape

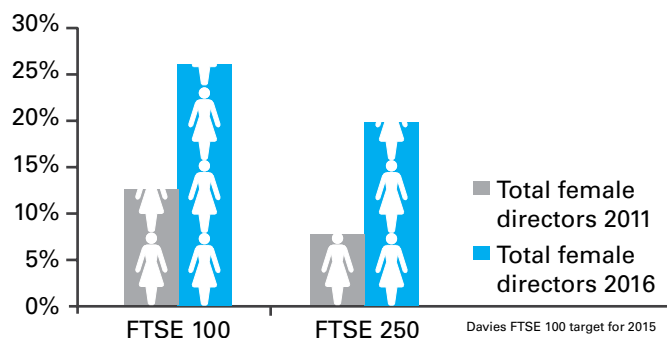
Focus areas

Diversity

The composition of a company's board of directors is critical to the quality of the decisions they make – and therefore inextricably linked to the long-term value of the business.

Having a diverse board helps a board improve its decision-making, manage risk, create opportunities, sustain profit growth and enhancing long-term returns. Since we began our work on promoting gender diversity at board level it is more common now for boards to consider diversity in terms that go beyond gender, encompassing skill sets, experience, nationality and knowledge of different geographies and international markets. This is essential to creating high quality boards who are best equipped to deliver sustainable value. While gender diversity is not the only aspect to diversity by any means, it is an important one.

Davies FTSE 100 target for 2015



Source: boardsforum.co.uk/boardwatch.html

This year the UK hit the target and major milestone set out by the government in 2010 for 25% female representation on FTSE 100 company boards by 2015. Each month the number of women serving on FTSE boards has steadily increased and while we would perhaps wish for faster progress, the sustained rise in the number of women provides clear evidence that the UK's business-led approach is working.

Some of the key drivers of success have been the setting of realistic and achievable, yet stretching targets, and the voluntary business-led approach which joined stakeholders together in action. As an investor and a key stakeholder, we continued to work hard with companies and other market participants during 2015 on this issue, as we consider this an important input into board effectiveness.

Following our targeted engagement efforts in 2014 with the remaining all-male boards in the FTSE 250, we escalated our action by taking the decision to vote against several board chairs. We wrote to the chairs of the remaining 26 companies in the FTSE 250 with all-male boards to request a meeting to specifically discuss diversity at board level. Of those 26, twelve companies responded to us to set up a meeting. The quality of these meetings varied. Some chairs were very engaged and committed, telling us they that were in the process of appointing a female director, and were keen to have the opportunity to tell their stories, while in other meetings the chair was more defensive and less open to understanding the business imperative of this issue.

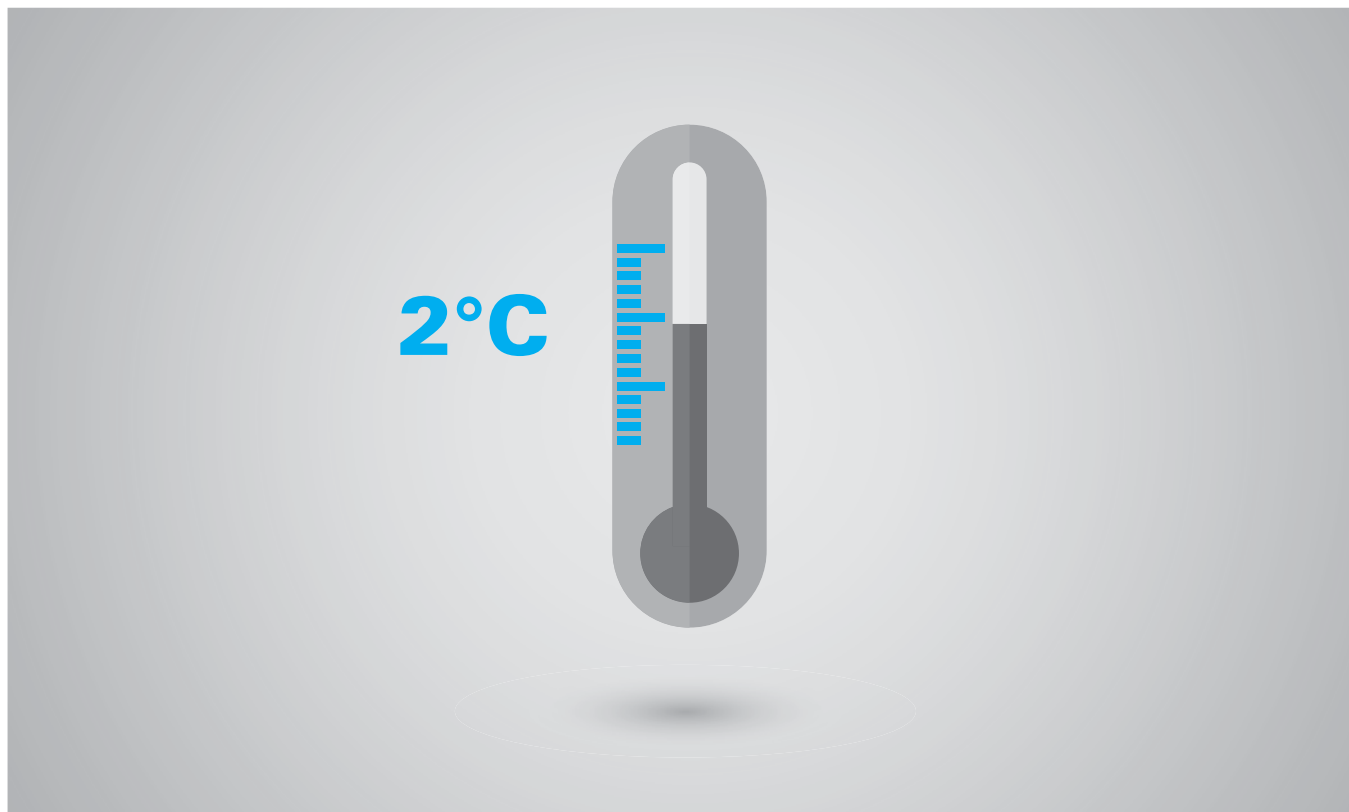
Following this engagement project, we voted against a number of company board chairs for a lack of response and a continued absence of a robust diversity policy or female talent on the board. One company followed up on our vote action which resulted in an engagement meeting with the senior independent director (SID) to discuss what the company is doing to improve its diversity focus. The remaining companies with all-male boards appointed a woman before or at their AGM or have committed to doing so. Therefore we did not take any voting action against these companies. We shall follow up with all these companies in 2016 to ensure that progress in the FTSE 250 continues to be made.

At the end of 2015, **58 companies in the FTSE 100 have 25% or more women directors**, and 29 companies have 30% or more women directors. In average percentage terms, the Davies target was met towards the end of 2015. However, it is **interesting to note that 42 FTSE 100 companies still have less than 25% women directors.***

The FTSE 350 has more women than ever serving on its boards. In 2011 there were 152 all-male boards in the FTSE 350, while at the end of 2015 there were only 17 companies with all-male boards. Steady progress has been made but we need to retain our focus and widen it to include below board level to ensure that companies are making efforts to create a sustainable pipeline of talent. Although we can celebrate this first achievement we cannot get complacent and must recognise that there remains substantial work to be done to create a real and sustainable shift. In this vein we will continue to make this a topic of focused engagement both in the UK and overseas.

We wrote to the chairs of the remaining 26 companies in the FTSE 250 with all-male boards to request a meeting to specifically discuss diversity at board level

*Source: Professional Boards Forum Boardwatch 2016.



The Paris climate conference (COP 21)

Climate change is happening and its significant impacts are felt globally every year. 2015 was the warmest year on record and 15 of the 16 hottest years on record have occurred this century (source: World Meteorological Organization). Research commissioned by 20 global governments found that climate change is already costing USD12tn a year, or 1.5% of GDP. As outlined by the Bank of England's Mark Carney, climate change poses risks to long-term financial stability through physical risks, liability risks and transition risks.

The current trajectory of greenhouse gas emissions is in line with a global warming scenario of 3-4°C above pre-industrial levels. Scientists have overwhelmingly agreed that we need to limit global warming to 2°C in order to avoid further catastrophic consequences. At the Paris climate conference (COP 21) in December 2015, 195 countries adopted the first ever universal, legally-binding global climate deal, which aims to limit the increase in global temperatures to well below 2°C above pre-industrial levels.

LGIM attended COP 21, where we participated in a number of events and discussions around how to finance a transition to a low-carbon economy, and what the role of investors should be in achieving this. Our conversations were wide ranging and engaged a

diverse group of stakeholders, from policy makers and civil servants, to stock exchanges, ratings agencies, banks and development finance institutions. Meryam Omi presented on the UN Global Compact's Caring for Climate Business panel, and Catherine Ogden investigated the merits of emerging solutions for climate finance. The Green Infrastructure Coalition, to which LGIM is a signatory, was launched during the conference.

We are pleased with the outcome of COP 21. In order to meaningfully direct capital to finance a low-carbon transition, it was imperative that we establish some policy certainty and a commitment to limiting global greenhouse gas emissions. The agreement gives a clear direction of travel and provides a solid base on which to assess the role of companies and their investors in providing climate and energy solutions.

Policy support, together with technological advances, will be key to achieving our global climate goal. Individual companies' medium to long-term strategies should also be aligned to that goal, given the overwhelming agreement among all countries. While some risks may be recognised as a result of changing demand for energy, we expect enormous opportunities to emerge as we shift our way of generating, storing and consuming energy in the coming decades.

The Paris Pledge

As a non-party stakeholder who has joined the Paris Pledge, LGIM has clearly stated that we are ready to play our part in supporting the objectives of the agreement. This means we are willing to work to support efforts in meeting and **exceeding the ambition of governments** to keep the world on a trajectory that limits the global warming temperature rise to less than 2°C.

Our Climate Change Policy outlines some of the actions we are undertaking to adhere to this pledge. It includes a commitment to:

- **Work with policy makers:** to support their efforts to implement policy measures that meet our emission reduction targets; to encourage large-scale capital deployment in order to finance the transition towards a low-carbon economy and to accelerate investments in climate change adaptation
- **Develop our capacity to assess climate-related risks and opportunities:** to integrate climate risks and low-carbon opportunities in the investment management of relevant portfolios by seeking key indicators, and acting upon financially material data and information
- **Engage with the companies in which we invest:** to ensure the strategies of these companies are aligned to global goals on climate change, and in order to seek assurance that their boards consist of individuals who can drive the business to succeed through the energy transition. Furthermore, we look to ensure that they are disclosing appropriate levels of risk and opportunity presented by the implications of climate change
- **Develop our client reporting procedures:** in order to communicate the actions we have taken on their behalf and to assist them in considering the implications of climate change for their portfolios
- **Develop investment solutions that are in line with low-carbon opportunities:** we are working with clients to provide products that would be aligned to their investment beliefs, and that capture the multitude of investment opportunities which are arising in order to build a low-carbon economy

The Climate Change Policy can be found in full in the appendices and on our website. Below we outline selected case studies of our recent climate engagement activity.





Engaging with companies

Given that the energy sector is responsible for two-thirds of global greenhouse gas emissions, our engagement efforts in relation to climate change have been largely targeted at oil and gas, mining and utilities. The three main areas of focus in our engagements are strategy, governance and disclosure.

At BP's and Royal Dutch Shell's AGMs in 2015, we supported the 'Aiming for A' shareholder resolutions relating to climate change. This was also supported by BP and Shell's management. These resolutions request that both companies provide greater transparency on how they are assessing this long-term risk and how they will be transitioning their portfolios in a low-carbon environment.

Over recent years LGIM has also been engaging with the world's largest mining company BHP Billiton on the issue of climate change, in particular with a request to undertake a portfolio resilience analysis. In Q3 2015, the company presented a Climate Change Portfolio Analysis to investors. The aim was to provide an insight into the scenario planning approach on the issue of climate change, including the potential portfolio implications of a transition to a '2°C world', i.e. a low-carbon future. The company described four scenarios which had been tested against shock events. Its conclusion was that the company's portfolio remains resilient in a 2°C world, with opportunities to mitigate the impact on the portfolio and to invest in many capital-efficient growth projects.



Quarterly reports

The importance of long-term thinking in business planning and executive incentive arrangements has been thoroughly debated, and mostly agreed. However, a system of short-term corporate performance monitoring by investors does not allow this to flourish in reality.

Interim management statements, known as quarterly reports, have long been pinpointed as a catalyst of short-term behaviour.

Most business managers would agree that it takes at least three-to-five years for meaningful change to occur at companies. In some businesses, particularly research and development-led sectors, decisions taken today might only come to fruition in 10-20 years' time.

In response to this long versus short-term conundrum, the European Union altered the Transparency Directive for listed companies in 2013, by removing the mandatory requirement for interim management statements. The UK's Financial Conduct Authority (FCA) subsequently implemented the change and the regulatory requirements were officially amended on 7 November 2014.

Since then, a small number of companies (Diageo, United Utilities, National Grid and G4S) have stated their intention to drop their quarterly reports. Why so few? One of the main reasons is that investors have not jointly said, "We don't need it".

Transparency versus noise

Everyone agrees that transparency is key and regular contact with management adds value for investors. But the exact value that quarterly reports contribute is unclear. The reports are read and absorbed by the market, albeit more as a tick-list exercise to ensure investment convictions are on track. But the market result does not seem to reflect the amount of effort put into their creation. Even within broker research houses, analysts talk about the distracting nature of quarterly reports, citing their preference for in-depth corporate coverage.

Of course, when it comes to material changes, the regulation still stipulates that companies are obliged to publish them. Quarterly or not, investors would hear about them.

79%

of board and executive managers felt especially pressured to demonstrate strong returns in two years or less.

Management cost

Quarterly reports do provide an opportunity for management to update their broader investor base and manage their expectations, but they come at a cost in terms of resources and can also potentially impact strategic decisions.

Finance and investor relation teams work hard to make sure that the 'numbers' and 'stories' are positive. Management time is spent explaining to the market why and how things happened during the previous three months. That time might be better spent running the business.

A survey by McKinsey of more than 1,000 global board and executive members found that 79% felt especially pressured to demonstrate strong returns in two years or less, while 73% noted that it should be more than three years. Having a longer time horizon, 86% declared, would positively affect corporate performance with strengthening longer-term financial returns and increasing innovation.

Building a house view

Removing quarterly reports and moving to semi-annual updates is not a panacea in creating a long-term investment environment. But asking companies for long-term business growth and expecting them to meet consensus targets every quarter is contradictory and possibly counter-productive.

As a long-term investor, managing assets on behalf of nearly 3,000 institutional clients as well as retail clients, it was imperative that we develop a company view on this. Discussions with heads of investments for equity and fixed income highlighted that cyclical, global competition and a foreign shareholder base all contribute to the necessity to produce frequent reports for some companies. Nonetheless, the same heads agreed that quarterly reports are of limited value to many companies and, consequently, to our investments.

We therefore decided to lend our support to companies considering discontinuing their quarterly reports by writing directly to the chairs of all the FTSE 350 companies. We reiterated that the decision on reporting frequency lies with the board, which should base its decision on the nature of its business and its investor base. Our preference, however, is less communication on short-term achievements and more articulation of business strategies, market dynamics and innovation drivers.

Call for joint support

One reason more companies haven't followed suit appears to be a perception that companies changing

their reporting frequencies could lose investor confidence as a result.

However, European countries will follow the UK in removing the mandatory burden for listed companies to publish quarterly reports by the end of this year. The SEC's 10K requirements are a harder hurdle to overcome, but investors seeking to tackle short-termism in the US are also vocal.

Building on this regulatory support and broad market frustration, we are asking investors to have similar conversations internally and join our effort to support companies reviewing their reporting frequency. Speaking in unison is pivotal for building a healthier, more beneficial relationship between companies and investors. We should strive to achieve that goal for the benefit of our clients.

Cyber security

2015 saw another year of high-profile cyber-attacks against companies globally and the area continues to grow as a major risk. According to the 2015 PwC survey, "90% of large organisations reported that they had suffered a security breach, up from 81% in 2014."¹ Therefore, it is essential that companies manage this issue with a strategy that is developed alongside policies and processes to protect assets and shareholder value.

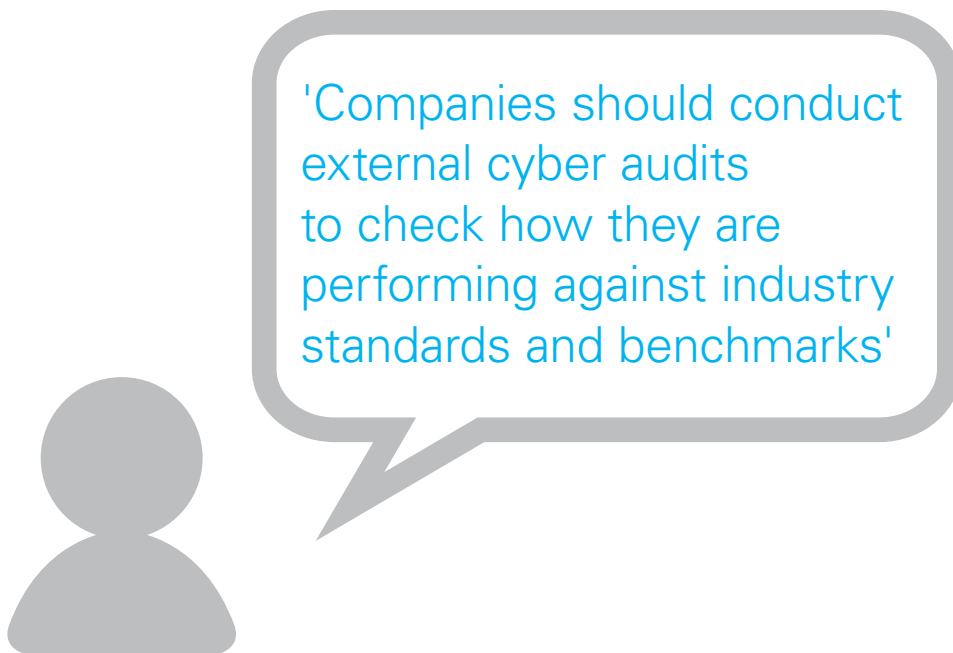
The board and management are responsible for setting the culture at an organisation through training and education.

Although we understand that directors themselves ultimately have no control over the capabilities and motivations of every single employee, any company can make it harder for attackers by taking some basic steps to reduce vulnerabilities.

Most recently, we published an article in the Financial Times called: "Cyber Security is not just the IT department's problem."² Our objective is to promote cyber security awareness beyond the normal function of an IT department to top-level boards because that is where strategy is set and resources are allocated.

We want companies to be the best they can be in using technology to create value but also to protect their business against emerging threats in the digital world. This involves board directors equipping themselves with the education and knowledge needed to build confidence in asking the right questions in the boardroom or appointing new members with technology expertise. Furthermore, we have called for compulsory external cyber audits to be conducted by companies to identify areas of weaknesses that need to be strengthened.

Much work still needs to be done in this area. The complexity and severity of this risk should not be underestimated by the market. In the coming year, we will push for greater awareness and education in the boardroom through our engagement and questioning of directors as well as working with others to promote a holistic integrated approach to examining cyber security in companies.



'Companies should conduct external cyber audits to check how they are performing against industry standards and benchmarks'

1. PwC Information Security Breaches Survey 2015, technical report ([page 6](#))

2. FinancialTimes, Cyber Security is not just the IT department's problem

Promoting good corporate reporting

From the outside, it is often hard for shareholders to understand how management are efficiently utilising the capital provided by the market to create value. This includes understanding how a company is investing in its future through innovation, how it makes key decisions to adapt to changes in the macroeconomic environment and how they seek to mitigate long-term risks to the company.

Corporate reporting is an important tool in getting these messages across to stakeholders. We believe good transparency by a company improves accountability and promotes effective communication with stakeholders.

Good transparency improves accountability

During our engagement with companies, we gathered intelligence on companies that we consider to provide good corporate reporting in certain areas of environmental, social and governance issues.

Therefore, in partnership with the global recruitment firm **Heidrick & Struggles**, we have put together a report which includes examples of best practice disclosures.

The objective is to deliver guidance to companies on what we consider to be important features of good corporate reporting for investors. This ranges from giving an update on the board's activities during the year to articulating the company's vision on how they intend to create

sustainable value for shareholders in the long term. The examples also provide illustrations on how the information could be presented in a clear and concise manner to have the maximum impact on the reader. In producing this guidance, we aim to raise the standard of corporate reporting in the market to support a structure for long-term growth.

Board effectiveness reviews

LGIM strongly believes that board effectiveness reviews are a powerful way to help a company's board improve and evolve. This gives shareholders confidence that the board is striving to be the best it can be.

As a significant investor, we want all companies in the market to undertake board reviews that are rigorous and a value-added exercise. We do not want them to undertake a review 'because they have to' or 'to tick a box'. In 2014, we published our views on board effectiveness reviews in **Fundamentals**. At present, there is a range of practitioners and no minimum standards in place for reviews. This has inevitably resulted in variability of

methodologies and, ultimately, quality of reviews.

We have been a strong advocate for a set of principles to be established. The principles provide a framework that helps to drive a minimum standard of board review as well as providing transparency with regards to the methodology undertaken. Moreover, potential conflicts of interest for evaluators are appropriately managed and disclosed.

During 2015 we helped three of the leading practitioners in the field to establish some 'guiding principles'.

They are designed to standardise best practice for board effectiveness reviews. They are also intended to set professional standards for evaluators, regardless of methodology, and align expectations between shareholders and companies with regard to quality and integrity of process.

There are four guiding principles for evaluators and three for companies that will standardise the quality, credibility and legitimacy of the field, and have relevance across a number of different methodologies. We believe these principles are a positive step forward for board reviews and we will be

discussing them with company chairmen and continue to help best practice and standards evolve.



Four guiding principles for evaluators



Independence

The evaluator must be able to exercise independent and objective judgement. Existing commercial relationships, and other conflicts of interest, should be avoided, and/or disclosed and managed.



Confidentiality

The evaluator must keep all information confidential. The only exception to this is the discovery of unlawful practices or company demands.



Competency

The evaluator will disclose the skills and competences of each individual involved in the evaluation, and provide appropriate references. Expectation between the company and the evaluator must be aligned with regard to quality, value and longevity of service.



Follow-up

The evaluator will discuss progress on agreed outcomes with companies (to include the chairman, senior independent director and/or board) within 6-12 months of the evaluation.

Three guiding principles for companies



Cooperation

There must be full cooperation between the company and the evaluator in order to ensure integrity of process. This will include transparency of, and appropriate access to, board and committee information, participants, and meetings.



Transparency

All disclosures, including the annual report, must identify the evaluator (and any conflicts), the methodology (including the use of interviews and observation), final outcomes (with reference to accepted and rejected recommendations), and the approval process.



Approval

The evaluator should agree and approve any formal disclosures, including the annual report, which describe the evaluation.

Changing external auditor

Since 2011, LGIM has worked with other investors to improve the quality of and trust in audited financial accounts. We were encouraged by the adoption of new regulations in 2014 requiring the regular tendering and rotation of the external auditor across Europe, in addition to restrictions on non-audit services. Across Europe the regulation is now being implemented, coming into effect in mid-June 2016.

The role of the external statutory auditor requires independence, professional scepticism and the need for confidentiality. It is one of the few independent functions of governance that is embedded within an organisation and is looking at the detail of the business. For this reason shareholders and other stakeholders place considerable weight on the assurance provided by an independent external audit.

Given the significance of the external audit, and the potential for a 20-year plus relationship, **it is essential that the audit tender is transparent and robust.** Moreover, the manner in which the tender is conducted will set the tone of the relationship between the company, the board, shareholders and the external auditor.

LGIM considers it important that the audit committee takes responsibility and ownership for the full audit tender process and involves its shareholders early in the process. While it is encouraging that some companies are increasingly seeking shareholder input at the time of the audit tender, we believe that this should become standard practice. During the year we have spoken with chairmen and audit committee chairmen about their tendering plans and this has informed our expectations for best practice audit tenders.

Planning the audit tender:

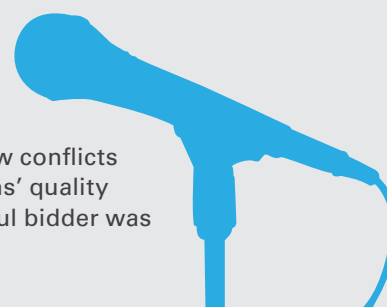
- The audit committee chairman should clearly demonstrate ownership of the tender process to stakeholders externally and internally within the business
- Schedule regular tendering in relation to the company's requirements but do not leave tendering to the last possible year
- If the incumbent firm or a firm with a substantial business relationship with the company is invited to tender, any potential advantages should be anticipated and mitigated
- Define and disclose the selection criteria for the audit tender early in the process
- Identify and map relationships and conflicts of interests between the potential bidders, the company and audit committee

More than a beauty parade:

- The participants from the pitching firms should be the same individuals in the audit team who will be working on the mandate if successful. Global companies may wish to include the audit partners and teams that would lead on the audit of key overseas businesses
- Be efficient with company management's time by setting clear boundaries for when management are involved and a short timetable for the process
- Questions and pitching should be held in front of the audit committee. Consider splitting the tender into two or more parts focusing on different specifics of the process
- Assess the future capacity of the audit firm, for example research and development, expanding capabilities and employee development

Disclosure to shareholders:

- The audit committee's report to shareholders provides an opportunity to communicate the robustness of the audit tender process during the planning stage and following successful appointment
- Pre-tender disclosures should explain: the timetable, restrictions on auditors tendering, whether mid-sized audit firms will be proactively approached (with a clear explanation where this is not the case) and how conflicts with alumni on the committee will be managed and mitigated
- Post-tender disclosures should include: who participated and how conflicts were managed, how pitching firms' quality were assessed, why the successful bidder was chosen and where it excelled





ESG reporting in Asia

There is a tremendous momentum towards strengthening corporate governance standards in Asia, with local stock exchanges leading the dialogue.

There are three key areas where new standards are improving business practice:

1.

The corporate governance code – for companies to follow in terms of best practice

2.

The stewardship code – for investors to undertake their shareholder responsibilities on behalf of their end beneficiaries

3.

Better disclosure on ESG performance for listed companies

During 2015, we engaged with various stock exchanges (see section on Asia Pacific) directly and participated in a consultation facilitated by the Hong Kong Stock Exchange to improve ESG reporting by companies.

The new guidance, set to be applied on a ‘comply or explain’ basis by the companies, lacked clarity around sustainability reporting. We therefore made a strong point in emphasising the importance of the

stock exchange’s role in giving clear guidance in the use of consistent and comparable ESG data, as well as in monitoring and enforcing guidelines to those who claim to be compliant.

Our recommendations, **along with other key ESG investors**, led the Hong Kong Stock Exchange to publish much improved ESG guidelines, which are now incorporated in their listing rules.

David Graham, from Hong Kong’s Chief Regulatory Office and Head of Listing, said: “We are encouraged by the overwhelming support for our proposals to strengthen issuers’ ESG disclosure obligations. Issuers starting to report on their ESG performance may reap the benefits of better risk management, improved access to capital, greater capacity to meet supply chain demands and lower operational costs, to name but a few of the advantages that ESG reporting could bring to issuers’ businesses.” (Source: Responsible Investor)

We believe this is a very positive step, not only for the Hong Kong listed companies, but for the region in general, as they now have the opportunity to learn from each other in terms of best disclosure practices.

Executive remuneration

For many years **LGIM has been requesting that companies simplify their remuneration structures** by only operating one long-term share scheme. We consider that having multiple share schemes risks rewarding executives for the same performance and therefore mis-aligning executive pay with long-term shareholders. This is reflected in our voting policy and we oppose the introduction of multiple

schemes and structures that provide the executives with 'free' matching shares. We have also been encouraging greater alignment with shareholders by calling for executives to hold a substantial number of shares in their company and promoting performance measures that are linked to the long-term sustainability of the company.

Matching shares and multiple share schemes

LGIM has voiced its concern at the use of matching shares and multiple schemes that reward management for delivering the same performance for a number of years through our engagement and voting activities. We were pleased therefore to note that a 2015 PwC survey highlighted that the use of multiple schemes has significantly reduced between 2011 and 2015. In 2011, over 41% of FTSE 100 companies operated at least two schemes and 5% operated three or more schemes. This has fallen to 16% and 2% respectively in 2015 and now 82% of companies only operate one share scheme. LGIM will continue to vote against any new matching schemes or amendments to existing schemes as well as opposing any attempt to introduce multiple schemes unless there is a genuine exceptional case for doing so.

Aligning management interests with those of shareholders is another aspect of executive pay that we consider important.

Executive share ownership

We expect companies to encourage, or mandate, executive share ownership that reflects the opportunity that is delivered from the remuneration package. For example, where an executive is eligible for a share award of 200% of salary, we expect the company's executives to be required to hold shares worth 200% of

their salary. FTSE 100 companies generally have good shareholding requirements with the median around 250% of salary for CEOs and some companies requiring CEOs to maintain a shareholding of 400% of salary or more. CEOs within the FTSE 250 have shareholding requirements of around 200% of salary with some companies demonstrating higher requirements to reflect their remuneration package.

Recruitment and buy-out awards

We continue to see one-off payments on the recruitment of executive directors and the buy-out of existing awards to new management.

We want to encourage executive directors to remain focused on directing the strategy to deliver long-term value creation, therefore we consider that all companies should have a requirement for directors to maintain at least 50% of their executive shareholding requirement for at least two years after they have departed. For example, Barratt Developments has introduced such a requirement but only for good leavers.

Secondly, we would like all outstanding awards to be time pro-rated and allowed to run their course and remain subject to performance. LGIM sees this as a solution to circumvent some of the difficult conversations we have with companies on the level of buy-out awards that are agreed for incoming directors.

A number of companies have sought to introduce one-off plans for incoming directors.

We believe that a newly-appointed director should demonstrate their commitment to the company by buying shares in the market, rather than the company offering free shares.

LGIM voted against 93 resolutions on remuneration in the UK market in 2015. There was just one company that lost its remuneration vote – Intertek – for guaranteeing a bonus for its incoming CEO on top of a salary that was higher than his predecessor. This bonus was

subsequently withdrawn.

'During the year we opposed the re-election of eight remuneration committee chairs due to ongoing concerns with remuneration.'



Corporate tax

The landscape for corporate tax practices is continually changing. More recently how, where or how much corporations pay tax has been an issue of great public interest. The economic downturn means that countries' fiscal incomes are under threat, particularly in an environment where health, pension, education, infrastructure and other social costs are rising at an alarming rate.

The way in which company tax payments can be altered through new tax rules is a significant concern for investors. Similarly, companies' requirement for government to invest in its civil society to create a healthy market economy is another concern.

Lack of transparent corporate tax practices is a material risk to investors. Broadly, there are three main trends that can widely impact company performance over time.

Regulation

Regulatory regimes surrounding tax payments are undergoing major changes due to fiscal constraints and public pressure. What may have been considered legal and within the spirit of the law could be altered suddenly. Companies' policy and practices around tax could potentially disguise earnings that are reliant on tax planning rather than genuine economic activity. Similarly, merger and acquisition activities that rely heavily on benefiting from lower tax regimes could be under increased scrutiny by governments, with terms changing at the last minute.

Reputation and brand

There is growing interest by wider society in the taxes paid by large corporates, with demand for companies to pay their 'fair' share. Various campaigns by NGOs and the media have been of major concern, particularly for consumer-facing companies whose values are highly exposed to customer perception and loyalty. Companies have been put in front of the US Senate Permanent Committee on Investigations, the UK Public Accounts Committee, have been named and shamed in the news or have received customer boycott campaigns that could damage their reputations.

Macroeconomic and societal distortions

As a universal owner of assets globally, what companies do overall and how they benefit from economic growth has enormous consequences for investment returns. The trend of lower corporate tax income for governments, and cash being accumulated instead in tax havens and low-tax jurisdictions, could have a material indirect impact on vital sources of global economic growth, such as public investments in education, healthcare and pension infrastructure.



Companies heavily rely on such public spending to boost consumer spending as well as the availability of a healthy and skilled workforce.

Disclosure

The biggest risk investors face on this issue is the lack of meaningful disclosure by companies on their tax practices. **In recognition of such systemic risk in the market, we started to lead this dialogue in 2013. We convened NGOs, corporates and other investors to consider the increasing risk from lack of tax disclosure by companies and changing regulatory dynamics.**

After hosting roundtable seminars, we launched a collaborative engagement with three other investors (Royal London, Rathbone and Church of England) to investigate this issue in detail. Together we met with heads of tax at leading UK multi national companies to understand current practices and subsequently put together a discussion paper that was disseminated to the wider investor group.

In 2015, as concerns around this topic continued to grow, we asked the PRI (Principles of Responsible Investors) to take a coordination role in consolidating the views of investors. Together, we published a global guidance document which outlines the background on the topic, case studies of best examples and expectation guidance on tax disclosure from companies.

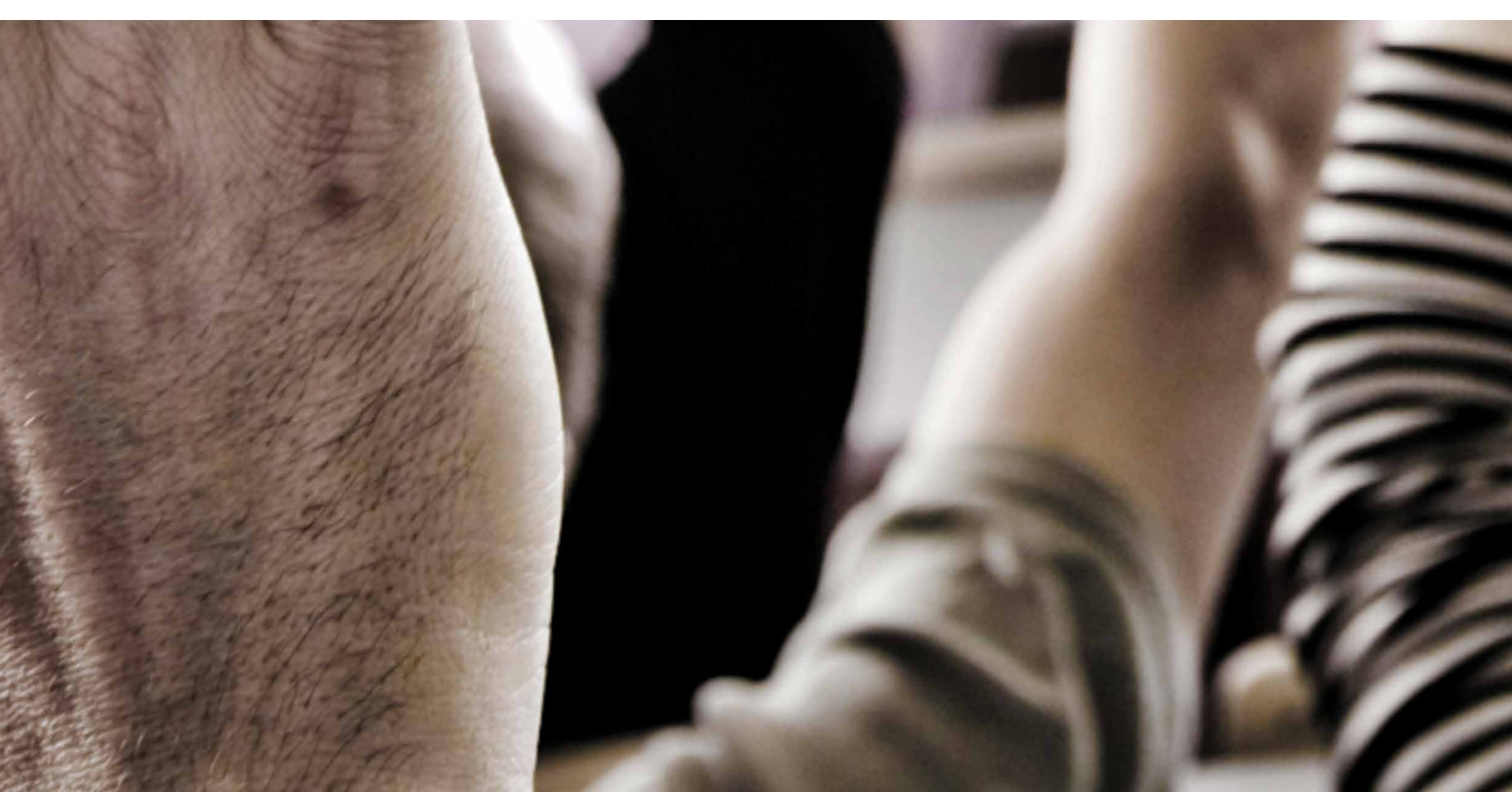


The key message from the engagement is that we want the companies in which we invest to provide their tax policy, an outline of their tax governance and to articulate their key tax-related risks which are unique to the business or sector. This should help investors to make a more accurate assessment of potential risks to the long-term value of their investments.



Company engagement

We believe that real change is best achieved through being an engaged and active owner. Ongoing and proactive dialogue with companies is therefore a fundamental aspect of the Corporate Governance team's activities.





Engaging with companies


allows us to learn about the company's strategy, operations and finances. Moreover, having an open discussion means that we can express any concerns, share best practice and influence outcomes at an early stage of the decision process.


Engagement and voting are interdependent activities for the team. Voting is an important tool for escalating areas which have not been resolved through our engagement activities. Furthermore, voting also allows us to monitor for issues that may then feed into our engagement priorities.

During 2015, the corporate governance team:

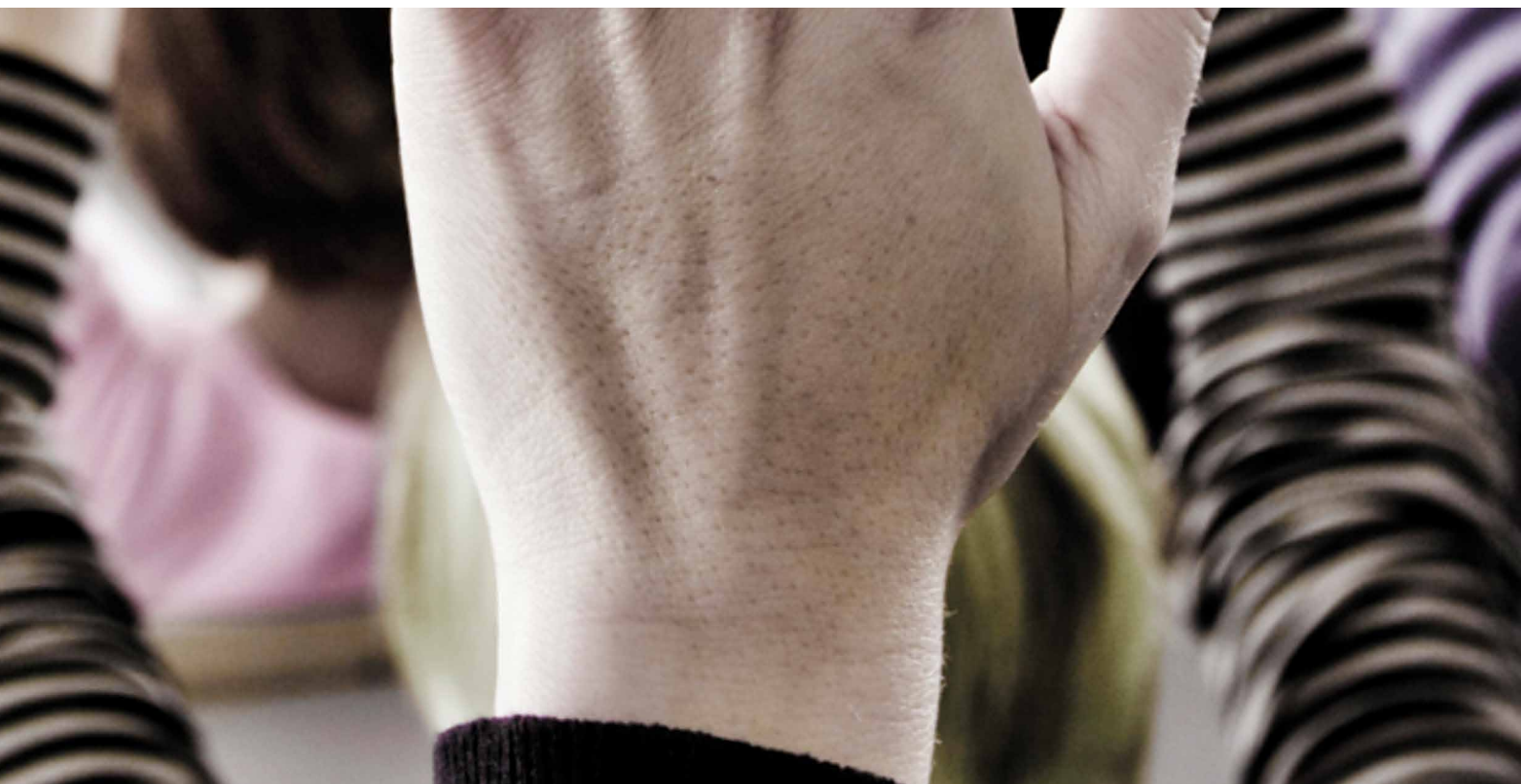
 Held meetings with **337** individual companies

 In many instances we held **multiple meetings** with a company during the year to secure our **desired outcome**

 In total the team held **545** meetings

 Company meetings are undertaken in a number of **different formats**. For example, we meet with company board members and management independently, collaboratively with other investors and alongside LGIM's fixed income and equity teams

We focus on the material issues that are pertinent to the specific company. **Sustainability topics are raised in over 35% of our discussions with companies and financial performance is discussed in most meetings.** Reflecting the increasingly global nature of our discussions, over 45% of our meetings in 2015 were with companies based outside of the UK.



Selected case studies



Syngenta	Mkt. cap: CHF 37.34bn	Chemicals	Switzerland
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Background

Syngenta is a Swiss-based agrochemical company with global operations. For many years it had suffered from sustained share price underperformance. In May 2015 Monsanto, a US based competitor, launched an unsuccessful bid for Syngenta. LGIM engaged with the company and other shareholders to encourage the board to explore options for long-term shareholder value.

Why were we concerned?

Four years prior to the approach by Monsanto, Syngenta had materially underperformed the Swiss market (-31%) and the European chemical sector (-25%). Over this period Syngenta management announced a series of targets, some of which were subsequently missed or downgraded. In addition, we had concerns with the lack of communication between the company and its shareholders. In May 2015, it was reported in the media that Monsanto had approached Syngenta for discussions on a potential consolidation.

What did we do?

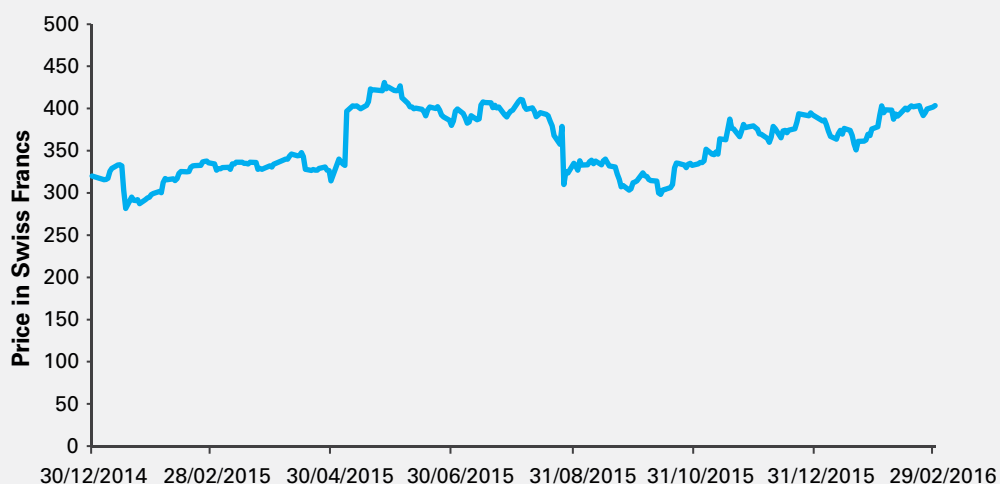
LGIM supported the consolidation with Monsanto, which valued Syngenta at a materially higher amount than recent share price suggested. The Monsanto bid consisted of a mix of Monsanto shares and cash. We contacted the company over the course of the year to inform them of our views and to encourage constructive discussions between Syngenta and Monsanto. In addition to our ongoing discussions with management, we also raised our concerns over the progress being made with other shareholders. Following the failure of the consolidation with Monsanto, LGIM hosted a collective meeting with other shareholders and the chairman to discuss events.

What happened?

Following the failure of the Monsanto bid, the CEO of Syngenta stood down from the board in October 2015. LGIM met the new CEO upon his appointment and had a further meeting with the chairman to encourage the board to continue considering options for creating shareholder value.

In November 2015, ChemChina announced their interest in acquiring Syngenta. The Board accepted an all-cash offer of USD 465 per share (equal to CHF 480 per share) in February 2016.

Syngenta share price 2014 - 2016



Source: Bloomberg L.P.



Sports Direct International	Mkt. cap: £2.37bn	General Retailers	UK
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Background

Sports Direct performed well over a numbers of years. However, significant concerns over corporate governance alongside profit warnings has resulted in the share price falling considerably. Consequently the company was demoted from the FTSE 100 in March 2016. LGIM has had concerns with its governance since 2010.

What did we do?

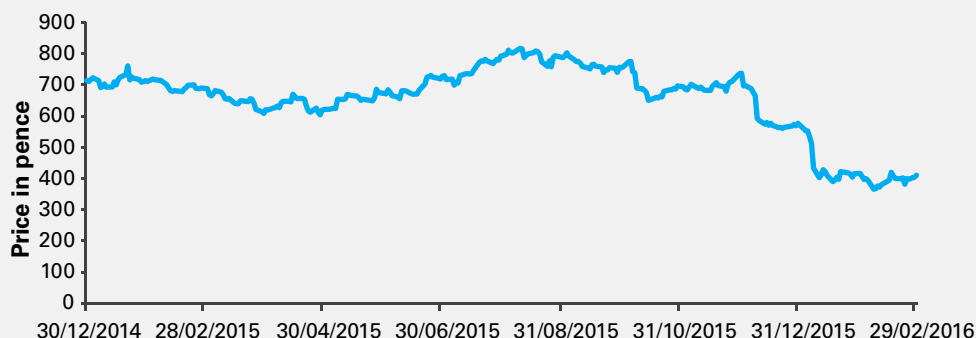
Remuneration: LGIM first voted against its pay policy in 2010 when Sports Direct replaced its bonus and LTIP with a scheme that measured performance over one year and awarded 1m shares. In 2012, the company tried to introduce a plan for the deputy chairman with 8m nil cost options worth £24m (share price 300p). We voted against the plan and it was subsequently withdrawn. The company made a second attempt to introduce the plan in 2013 but it was subsequently withdrawn before the general meeting. Given the ongoing concerns we had with remuneration, in 2014 we voted against the chairman of the remuneration committee.

Governance: The company operated without a finance director for over a year. We expressed our concern and asked that the replacement be an external candidate, but in June 2015 an internal successor was appointed. We had asked for a permanent company secretary to be appointed to assist the board and we were informed the person recruited from their legal team is a full-time secretary now. LGIM wanted refreshment on the board but this is yet to happen. We also asked for clarity about the way in which investments have been made in other retailers and how this forms part of the strategy, as well as clarity around some of the ways deals are funded. We voted against the re-election of the Board Chairman over the past two years to highlight our continuing governance concerns at the company.

Social: We were aware that one of their brands, Republic, sourced garments from Bangladesh and requested the company sign up to the Bangladesh Accord on fire and safety, and asked for details on its supplier-side policies. However, to date we are not aware of any progress towards greater transparency. We wanted clarity about its use of zero-hour contracts and labour policies. We were informed that most employees on zero-hour contracts get pay and benefits including sick pay. They are not entitled to participate in the bonus plan.

In addition to voting against board members, we have held several meetings with the chairman and the senior independent director to push for changes in the company. Although some changes have been made, we remain concerned at the pace of change. In December 2015 LGIM issued a public statement detailing some of our concerns with Sports Direct’s governance. It is an unusual step for LGIM to make a public statement on a live corporate engagement and reflects the severity of our concerns.

Sports Direct share price 2015 - 2016



Source: Bloomberg L.P.



Standard Chartered

Mkt. cap: GBP 14.82bn

Banking

UK

Background

Standard Chartered was one of the few banks to remain in profit during the global financial crisis. However, since the beginning of 2014 Standard Chartered's share price has fallen 70% and the company reported its first full-year loss since 1989. Over the last few years LGIM became increasingly concerned with board oversight, size of the board, internal risk control, strategy and balance sheet strength. We began in-depth engagement with the company on these issues.

What did we do?

Chairman succession: In 2014 there was significant press speculation on succession planning at the top of the Standard Chartered board. LGIM had concerns regarding the chairman's aggregate time commitments and board oversight. During 2014 and 2015 we met on multiple occasions with the senior independent director and other non-executive board members to discuss the timelines for board and chairman succession. In February 2015 Standard Chartered announced that the chairman would stand down in 2016 and we continue to support the board in their chairman search.

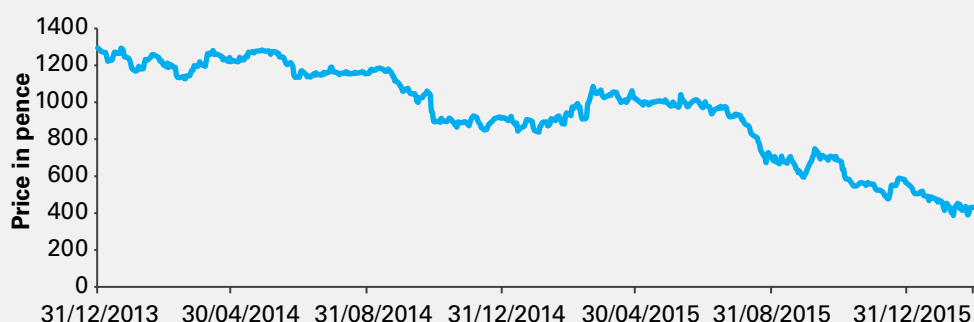
Board and management change: Following our meetings on board succession and capital and risk management in 2014 and early 2015, Standard Chartered undertook substantial changes in board composition, including a reduction in board size, a new senior independent director and the appointment of a new CEO.

Strengthening the balance sheet: Over the course of 2015 we met both the new executive management and the new senior independent director on a number of occasions. The objective of these meetings was to ensure that they are aware of, and addressing, our concerns on the board's revised strategy. The new management also took steps to bolster the balance sheet through a capital raising and the cancellation of the 2015 final dividend.

Remuneration: With a new strategy and strengthened balance sheet, the remuneration committee conducted a review of the compensation structure in Q4 2015. LGIM voted against the remuneration scheme in 2014 and were involved relatively early in the 2015 review. This ensured we were able to express our expectations on quantum and the structure of remuneration to the newly appointed remuneration committee chairman.

Standard Chartered faced a significant amount of speculation during 2015, on its board, performance and potential direction. LGIM continues to undertake sensitive discussions directly with the company, rather than through the press, as we believe this is the best way of influencing change and generating value for our clients. We recognise that there are significant challenges facing Standard Chartered and we will continue to constructively engage with the board and management in the year ahead.

Standard chartered share price 2014 - 2016



Source: Bloomberg L.P.



Darden Restaurants	Mkt. cap: USD 8.67bn	Leisure	US
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Background

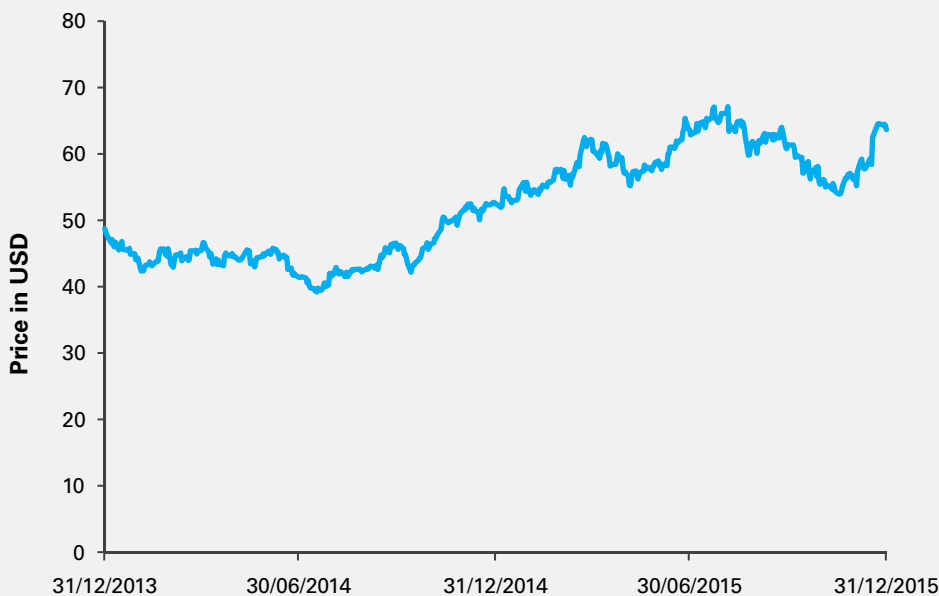
The activist Starboard Value, which held 5.5% of the company’s stock, filed concerns in 2014 over the sale of Red Lobster, believing the company to be significantly undervalued. Despite this, the company continued with the sale.

What did we do?

In reaction, Starboard proposed replacing the entire Darden board due to poor company strategy and concerns that the sale of Red Lobster undervalued it. Starboard reached out to LGIM and we spoke to prospective board members. We also engaged with some of the current board members of Darden to discuss the proposed board changes and ongoing company strategy.

We considered both perspectives and decided to support the new board proposed by Starboard as we felt that this new leadership would establish a better strategy at the company and improve company value over the long term. Starboard were successful and the entire Darden board was replaced at the EGM in 2014. By October 2015 Darden profits were up.

Darden share price 2014 - 2015



Source: Bloomberg L.P.



Betfair	Mkt. cap: GBP 1.35bn	Leisure	UK
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Background

Online sports betting business Betfair floated on the London Stock Exchange at £13 per share in October 2010. However, financial results were below expectations and uncertainty regarding unregulated markets persisted, resulting in the share price falling below £6 by August 2011.

A new CEO joined in August 2012 and set a new strategy focusing on regulated markets, reducing costs and leveraging Betfair’s leading technology to develop a consumer-friendly platform for a wider range of customers.

In mid-2013, the share price rose when private equity group CVC and two major shareholders bid for the company, raising their indicative bid from 880p a share to 920p and then 950p. This final bid represented a 35% premium to the prior share price.

What did we do?

We engaged with the company and gave the chairman and the board our backing to reject the offer and give new management time to pursue its newly outlined strategy. The company rejected the bid and the shares fell on the announcement. In the following years we continued to engage with the board chairman.

The strategy and management team has been a success; transforming Betfair into a technology-focused operator at the forefront of the industry in terms of product development and innovation. In August 2015, Betfair announced it was to merge with Paddy Power to create the listed leader in the global online gambling industry which we supported.

At the point the merger completed, Betfair’s shares were more than 350% higher than the final offer price received for the company in 2013; vindicating our decision to support the board in rejecting the bid. We remain a long-term shareholder in the newly merged business.

Betfair share price 2010 - 2016



Source: Bloomberg L.P.

Thematic company engagements

Food waste

In January 2015, we published an [article](#)³ on food waste, highlighting the scale of the issue where 30% of food produced for human consumption is wasted across the food chain. In the UK, the financial cost of food waste is estimated to be around £12bn. However, the cost of this waste not only affects corporate profits, but has a wider environmental and social cost that LGIM is equally concerned about. In 2010 and 2011 the Food Ethics Council estimated that at least four million people suffer from food poverty.

We believe that food retailers and producers have an important role to play in reducing food waste. Food retailers contribute to the waste by setting demanding aesthetic standards for fresh produce and through poor stock control. Stringent health and safety laws, consumers' over-buying induced by special offers, and throwing away food that is perfectly edible because of the 'use by' date are all major contributors to the level of waste.

LGIM engaged with Tesco, Sainsbury's, WM Morrison and Marks & Spencer to find out what they were doing to tackle food waste and encouraged them to do more.

At that time only Tesco had revealed the extent of the waste in its operations at 55,400 tonnes. Although this was sent for use as animal feed or to anaerobic digestion, the environmental and social impact cannot be ignored. To date, we believe Tesco remains the most transparent retailer on the issue.

During 2015, Tesco signed up with FareShare to divert all surplus fresh food from its distribution centres and online grocery centres. FareShare then uses this food to support charities that offer community services, e.g. helping people with drug addiction. Currently they are helping around 2,290 charities and community groups and providing around 17.7m meals. The offer of a free meal encourages those in need to come forward and receive that help and a free hot meal. LGIM was offered the opportunity to visit its operations in Kent, where we witnessed deliveries from a number of food retailers.



Their biggest hurdle is one of logistics and the lack of resources to transport the food from the source of production to one of its depots. FareShare has its own fleet of vehicles but not enough to cope. We would welcome help from logistics companies.

Working with FareShare only addresses food waste that still has a reasonable shelf-life. In order to tackle store waste, Tesco started working with FoodCloud to trial their app in its stores in Ireland to re-distribute edible store waste. It worked so well in Ireland that the app is being used in 112 of its UK stores with more stores to follow. Tesco has named it the Community Food Connection. When it was piloted in 14 stores, 22 tonnes of food was saved, equivalent to around 50,000 meals.

How it works: the app is installed onto the electronic device used by store staff and connects with local charities. It acts as a two-way communication tool to let charities know what food is available to them. The charity then informs Tesco which items it would like to collect. Tesco invited us to visit one store that was piloting the app to see how it works. We were surprised at how efficient the process is and the amount of food waste that could potentially be diverted to good causes.

Tesco has also announced the launch of a range of imperfectly shaped but perfectly good fruit and vegetables at a lower price under the banner of "Perfectly Imperfect", which we hope will stem the losses in their supply chain and help British farmers to be more sustainable.

Marks & Spencer is also trialling a similar app called the "Neighbourly app". The app connects 500 of its stores with local charities. This is gradually being rolled out across its stores.

3. ESG Spotlight: Food Waste – Are the food retailers acting responsibly?, available at http://www.lgim.com/library/knowledge/thought-leadership-content/esg-spotlight/ESG_Spotlight_food_wasteJAN_15.pdf

During our normal engagement with companies we will encourage other companies to contact Tesco about its app or to contact FoodCloud or Neighbourly directly to get access to this innovative way of distributing their store food waste. Marks & Spencer has given a commitment to disclose how much food is distributed with its app. We would encourage Tesco to do likewise.

Historically Sainsbury has used FareShare and anaerobic digestion as a means of tackling its food waste. In 2015, Sainsbury invested £1m to launch its own initiative to educate the people of Swadlincote, Derbyshire, on ways to reduce household food waste. We look forward to finding out how that money was invested and the improvements that resulted.

Meanwhile Wm Morrison was highlighted in the TV programme “War on Waste”. The programme highlighted the scale of the waste that was created as a result of vegetables not being perfectly shaped. Wm Morrison was singled out for not adopting a value range like Tesco and Sainsbury to sell mis-shaped produce. Since then it has launched a ‘wonky food’ range.

What next: we would like to see food retailers lead the way in curbing food waste and to be more transparent about the level of food waste in their business and demonstrate how this is being reduced over time. We would also like to see more progress by the retailers to help reduce waste within their supply chains.

The role of the senior independent director

In the wake of high profile governance failures such as Marconi and Equitable Life, the role of the **senior independent director (SID)** was established following the Higgs Review of the UK Combined Code in 2003. It stated that: “The senior independent director should be available to shareholders, if they have reason for concern that contact through the normal channels of chairman or chief executive has failed to resolve.”

Thirteen years on, the role of the SID is well established and widely accepted. However, it

“It is a dangerous view to hold that the SID is useful in a crisis, but otherwise it is a quiet role” – FTSE 100 chairman, previously a SID



is not always well understood, even by those asked to undertake it, and expectations are less clear and less codified than in the case of the chairman or committee chairman. During 2015, we worked with the Zygos Partnership to develop a guide on expectations and what best practice for the SID role has become from our different experiences.

The role and importance of the SID has grown hugely. As long-term shareholders, we place great value on this role – both in terms of everyday activities but also under more extreme situations. Of course, at times of stress, such as a takeover or major reputational incident, investors would certainly like the SID to make himself or herself available proactively. However, it should be the case that it is a continuation of a relationship, rather than an initiation of one.

Our thoughts on best practice for SIDs can be summarised as follows:

Setting up for success:

- Clear job description for the role
- Selecting the SID: the nomination committee should play a role in the appointment of the SID, whether internally or externally appointed. If internally appointed, as a minimum, a nomination committee discussion should take place about whether the intended individual is indeed the most suitable, and whether an external search should be undertaken. If there is more than one internal candidate, the whole board should have one vote each on who they believe should become the SID
- SID induction and meetings with shareholders on appointment: when a SID is appointed, they should take the opportunity to meet shareholders alongside the chairman
- SID participation: the SID should sit on all, or at least the majority, of board committees- this enhances their knowledge and understanding of the company

When to change

- Change should be considered once the SID has been on the board for nine years: Independence is at risk around the nine-year guideline. If a SID has been in place for this long, relationships can become too comfortable between the SID and one or both of the CEO and chairman. Renewal of the SID helps bring board refreshment

The right to nominate directors

In the US market, proxy access, a right which allows long-term significant shareholders the ability to nominate directors to boards, was the voting issue of 2015. There is growing consensus among shareholders that proxy access is a key driver of enhanced shareholder value, as board accountability has important implications for long-term shareholder value.

There have been concerns that directors elected through this process will be bound to the interests of those who sponsored them. We note, however, that nominees who appear on the ballot via this proxy access route still have to receive majority support from a wider group of investors.

We consider that this shareholder right is equal to that of a majority vote for the election of directors and encourage every company to implement this as corporate governance best practice.

In 2015, 86 proxy access shareholder proposals came to a vote, 51 of which received majority shareholder support and that support averaged 54%, a clear indication of the importance of this issue. **We supported 93% of these proposals. To date, over 100 of the largest companies in the US have introduced proxy access.**

As we see this issue spanning into 2016, we will continue to support proposals that allow access for 20% of the board, (or a minimum of two seats) to be proposed to the proxy if a shareholder group of no more than 20 shareholders owns 3% of outstanding shares for three years. Although the following list is not exhaustive we will consider:

- Restrictions on re-nominations when a nominee fails to receive a specific percentage of votes: arbitrary hurdles for re-nomination should not be applied to shareholder proposed nominees where they are not required to be met for management's candidates
- Securities on loan should be counted towards the ownership threshold, as long as the shareholder shows it has the legal right to recall shares for voting purposes and will vote at the shareholder meeting, along with representation that the shareholder will hold those shares until the date of the meeting
- A requirement that a nominator provide a statement of intent to continue to hold the required percentage of shares after the annual meeting unnecessary. Nominating shareholders may not know their intent to hold, sell or buy shares until after the election so the pre-filing holding period of three years coupled with requirement to hold the shares through the shareholder meeting is adequate

Despite the success of shareholder support for this provision in 2015, only around 24% of the S&P 500 has adopted or committed to adopt proxy access, so there is still some way to go to ensure this becomes a best practice standard and one that we will continue to advocate and encourage through engagement and voting.

US board refreshment

Board refreshment and director succession planning are key board tasks and the foundations of a well-functioning board. A board should remain relevant and diverse in terms of perspective, experience and skill sets.

This ensures that the board can respond to risks and opportunities in order to sustain profit growth, maximise long-term returns and guide the company successfully into the future.

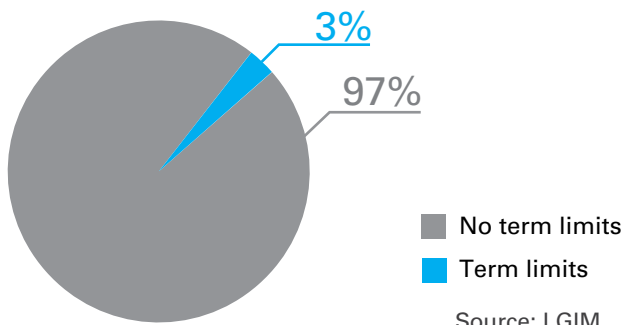
LGIM's expectations

- The lead independent director (LID), along with the chair of the nomination committee, should periodically review the independence, expertise and skills on the board in the context of the company's long-term strategy
- Companies to disclose how board tenure is actively managed and assessed
- Companies to demonstrate a robust succession planning process – including how potential directors are identified and integrated
- Key board committee memberships and the LID role to be held by directors who have not served on the board for an extended number of years
- Companies to declassify their boards to allow for the annual election of directors

A long-tenured board can be an indication of a poorly-managed succession planning process and a lack of refreshment of skills and perspectives, which then calls into question the quality of its members and the effectiveness of the board as a whole.

Only 3% of the S&P 500 specifies a term limit for directors, while the longest term limit is 20 years and the longest tenured director has served 48 years.

Director term limits in S&P 500



The longer tenure of a board director may also indicate a lack of independence from management. In the UK, for example, the independence of a non-executive director is re-assessed once they reach nine years on the board and a company must explain after this period why it believes the director in question remains independent and still able to challenge. Such best practices have helped to lower average board tenure alongside strong independent board chairs.

The mix of tenures and levels of experience on a board is fundamental and we do want long-term experience on the board as corporate memory is vital to help the company navigate through cycles it may have seen before. Longer-tenured directors are not necessarily ineffective board members as experience is important, but LGIM would discourage such directors serving as a LID or as members on key board committees where independence is essential. The independence of longer-tenured directors should also be robustly re-assessed to ensure they remain independent with these assessments being disclosed to shareholders.

A board should be comprised of approximately a third relatively new directors, a third mid-tenured and a third longer-tenured directors.

This balance would allow a company to utilise the experience of the longer-tenured directors while limiting the risk of high director turnover over a short period. Aside from independence potentially being compromised, lengthy board tenure can stifle the board in terms of replacing key skill sets and perspectives,

limiting the board's ability to bring on new directors with relevant expertise. The world is dynamic and fast-moving and boards need to be able to adapt to changes in technology, consumer trends and globalisation: an active refreshment process and mix of tenures will provide newer experience.

The LID or independent chair should closely assess the independence, expertise and skills among the directors in the context of the company's long-term strategy. This is not a personal critique, but rather an honest assessment of what is in the long-term interests of the company. A LID who successfully manages board rotation into the long term should be able to more easily identify skill sets that may need to be replaced in future as he or she will be aware of and able to manage those directors rotating off the board.

Over 100 companies in the S&P 500 have an 'independent' board director who has served for 25 years or more.

The LID should take into account any tenure policies as well as input from board discussions and from the board and committee evaluation processes regarding the specific backgrounds, experiences and skills that will contribute to overall board effectiveness. Also considered should be the future needs of the board and its committees in light of the company's current and future business strategy and the qualifications and skills of directors who are expected to retire and rotate off the board in the future. This simple and thoughtful process will enable the LID to identify director talent with the preferred skills and background required. As a final part of this process a robust director onboarding and training process will allow new directors to contribute quickly.

This process will help recruitment as the potential director knows in advance that they are signing up for a finite period and will also empower the LID or independent chair to ask a board member to not submit for re-election.

Tenure policies

Anticipate future turnover



Board evaluations

Identify skill sets and experience



Director recruitment

Identify talent with preferred skill sets and experience



Director training

Robust training and onboarding allowing fast contribution of new directors

To be able to have regular, open and honest conversations on board composition can aid both the LID and the director when it may be time for an individual to rotate off the board. This is why LGIM is such a strong proponent of a formal external board evaluation process.

LGIM considers the board evaluation process to be a positive exercise to help identify strengths and weaknesses of board composition which should be used to ensure successful board dynamics. This is a process designed not to reveal the shortcomings of board members but rather to help identify skills mismatches, expertise gaps and potential opportunities for succession and director training, to help companies stay ahead of the curve.

Retirement ages are not enough, yet the use of these is increasing

It is common for companies in this market to have retirement age limits for directors. However, a company should have a more active refreshment process, as described here, not least as age limits are often extended once a director is approaching the set limit. Additionally, as demographics and lifestyles change, a director may join a board at a younger age. In today's world of people living longer, where a company has an age limit of 75 an individual could, under such a policy, be able to serve on a board for 25-35 years. There will be significant differences between different directors of the same age. It is often argued that companies do not want to lose the skill sets of a quality director who may be long tenured yet if succession and refreshment is being handled thoughtfully and appropriately, these skill sets and qualities will already have been identified in a replacement. A retirement age is simply a number and does not in fact allow or encourage the continual assessment of the ability, independence, or relevance of skills of a director.

Board refreshment is a key driver of a well-functioning company and it should be undertaken thoughtfully and regularly in order to create the best board and foster the understanding among its members that positions are not indefinite.

Our voting policy will evolve over time as LGIM engages on this topic with companies, we shall begin to vote on this issue in 2017 and beyond:

LGIM will vote against

- The chair of the nomination committee if the average tenure of the board is 15 years or more
- The chair of the nomination committee if there have not been any new board appointments for five years or more
- Key board committee members and/or the LID if they have been serving for 15 years or more



Regional updates

UK

We vote on all UK holdings listed in the FTSE All Share Index as well as some on the AIM Index on an ad hoc basis. We aim to minimise abstentions and over the past four years have not abstained in the UK. Our policy can be found on our website*.

We apply this policy when considering how to vote. Where a company's practices do not meet with our policy, we look to their explanation for any departure. This is done through a combination of further engagement and the request for additional disclosure.

In 2015, we voted against one or more resolution at 18% of companies in the UK. Alongside our engagement activities, our voting activity is an essential tool for us when exercising our stewardship responsibilities.

Remuneration

The majority of adverse votes cast in the UK last year were against remuneration-related resolutions. This includes the remuneration report, remuneration policy and approval of new incentive schemes. The specific issues vary from company to company but are often related to where the company's remuneration practice and disclosure is not in line with our voting policy. Furthermore, if there continue to be significant concerns around remuneration-related matters and there has been no improvement during the year, we will oppose the re-election of the chairman of the remuneration committee. This is



in line with our escalation policy of holding directors to account for their actions.

Re-election of directors

Another area of focus on voting is the re-election of directors. LGIM supports and encourages companies to recruit board members with a suitably diverse mix of skills, experience and perspectives, and to consider candidates with the technical or industry skills but who may not have previous board experience.

Furthermore, LGIM supports the Davies report and shares his views that women should represent at least 25% of a FTSE 100 board. During the year, we amended our voting policy to vote against the chairman, or the chairman of the nominations committee, of companies that have failed to appoint at least one female to their board. In addition, we have begun to focus on FTSE 250 companies to encourage them to have stronger policies on diversity and to introduce more women on their boards.

'We aim to minimise abstentions and over the past four years have not abstained.'

Minority shareholder protection

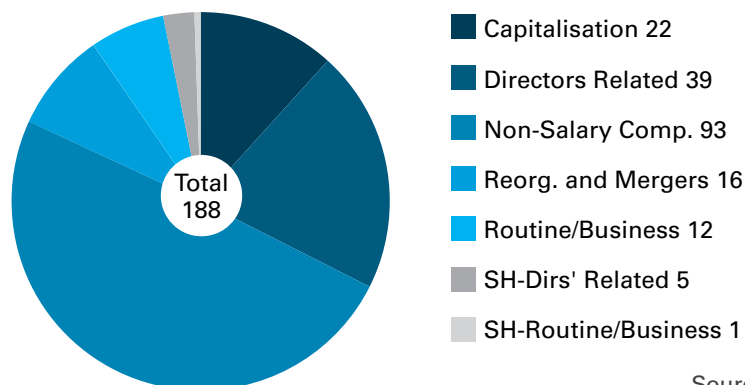
Shareholder rights are enshrined in UK company law. We continue to vote on issues that we believe impede shareholder rights. For example, waiving Rule 9 of the Takeover Code would give majority shareholders the ability to increase control gradually without paying a premium. Furthermore, pre-emption rights are fundamental for shareholders to protect their investment in a company from dilution. In March 2015, the pre-emption group published a revised statement of principles for the disapplication of pre-emption rights.

* http://www.lgim.com/library/capabilities/UK_Corporate_Governance_Policy.pdf

Shareholder resolutions

During the 2015 voting season, there were nine shareholder resolutions put forward for investors to vote on. Collectively, this involved six different companies and the items on the agenda varied from climate change and employee relations to director board nominations. Further detail of these shareholder resolutions can be found below.


UK: vote category breakdown against/abstain









Source: LGIM

Examples of UK voting and engagement activities

Board structure

	Genus	Mkt. cap: GBP 899m	Pharmaceutical and Biotechnology	LGIM wrote to all FTSE 250 companies in October 2014, requesting companies to outline their policies and processes for increasing gender diversity on the board. Genus' board remains 100% male and the recruitment policies detailed in the annual report do not provide information on its policies or timeframes for implementing the Lord Davies recommendations. We therefore voted against the re-election of the chairman at the AGM.
	Glencore	Mkt. cap: GBP 22.40bn	Mining	Following our vote against the re-election of the chairman in 2014, we continued to engage with the company on a number of issues in 2015. This includes regularly meeting management to get an update on the company's financial performance, attending investor group presentations on sustainability and meeting the board chairman. In addition, we held a meeting with the company's recently appointed non-executive director to gain her insight into the board. We will continue to monitor the company's financial performance and approach to ESG issues.
	Ladbrokes	Mkt. cap: GBP 1.22bn	Leisure	Ladbrokes has been a significant underperformer relative to its peers in recent years. We have been pushing for change and met the company on many occasions over the course of the last few years on several issues, including the general management of the business and the poor performance of its digital division. In 2015, it was announced that the Chairman and CEO were to leave the business and a new CEO took over on 1 April 2015. In July 2015, the company announced a proposed merger with the Coral Group, as well as a new strategy. We engaged with both Ladbrokes and Coral regarding the strategic rationale for the deal, the risks around completion (particularly in relation to the Competition and Markets Authority Review) and the governance arrangements for the combined group. It was subsequently announced that the Ladbrokes CFO would leave the company in early 2016. We are continuing to engage with the company to push for a stronger board.
	Rolls Royce	Mkt. cap: GBP 12.70bn	Industrials	<p>During 2014 and 2015, Rolls Royce announced five profit warnings due to a range of issues. Consequently, the company suspended its £1bn share buyback programme halfway through its completion. We engaged with the chairman on several occasions while also meeting the newly appointed CEO to highlight what we believed were the key issues he and the board had to address as part of his operational review (which was delivered to the market in November) to restore confidence in the business.</p> <p>During 2015, three new non-executive directors were appointed to the board in order to strengthen its industrial, operational and financial experience to support the operational transformation the company is going through to deliver its significant order book profitably.</p>

Remuneration

	AstraZeneca	Mkt. cap: GBP 49.13bn	Pharmaceuticals and Biotechnology	<p>As part of its defence against Pfizer's takeover approach in 2014, AstraZeneca set out future revenue targets to be achieved from its current pipeline. As long-term shareholders, we believe incentive arrangements for management should be aligned to the company's new long-term revenue targets and this was discussed during our engagement with the company. However, these targets were not incorporated into the performance conditions under the long-term incentive plan for the AGM in 2015. As a result, we voted against the remuneration report. Nearly 16% of shareholders voted against this item.</p>
	Intermediate Capital Group	Mkt. cap: GBP 1.93bn	Finance	<p>We voted against the remuneration report due to poor disclosure of management's total remuneration package. The resolution received a 34% vote against. We subsequently met with the company's chairman and chairman of the remuneration committee to discuss remuneration as well as other governance topics.</p>
	Man Group	Mkt. cap: GBP 2.54bn	Finance	<p>At the company's AGM, we voted against the remuneration policy and remuneration report due to significant increases to the annual bonus and long-term incentive plan awards. Over 42% of investors voted against the remuneration policy, while 34.4% voted against the remuneration report.</p>
	RSA Insurance Group	Mkt. cap: GBP 4.69bn	Insurance	<p>For the past two years, we have raised remuneration as a concern at the company. In 2015, we voted against the remuneration report due to the remuneration committee awarding the CEO a second 'one-off' LTIP award in two years without sufficient justification. 12.6% of shareholders voted against the resolution, while 21.5% abstained. We also voted against the remuneration committee chairman, who received a 17.3% vote against his re-election.</p>
	Sky Plc	Mkt. cap: GBP 17.15bn	Media	<p>We voted against the remuneration report due to poor transparency in terms of the targets set under the long-term incentive plan; the operation of the share matching plan; and the lack of stretch in the targets set. Furthermore, due to our ongoing concerns with the company's remuneration policy, we escalated our concerns by voting against the chair of the remuneration committee and will continue to engage with the company.</p>
	UK bank remuneration			<p>Remuneration continues to be an area of focus in our engagements with UK banks. During 2015 the UK's Prudential Regulatory Authority and the European Banking Authority released new requirements for remuneration structures within the banking sector. Due to these changes most banks within the UK and Europe will need to revise their executive remuneration policies in 2016. During the year we met with all the UK banks and major European banks to ensure remuneration continues to be weighted towards the long term, is clearly linked to corporate strategy, and appropriately assesses culture and behaviour. We also expressed our expectation that the total size of awards will not increase.</p>

Shareholder protection



Countrywide

Mkt. cap: GBP 813m

Real Estate

Countrywide has a block of shareholders representing 30% of the issued shareholder capital. We voted against the resolution for the company to waive rule nine of the takeover code, due to our concerns that this could be used by the concert party to gain creeping control without paying a bid premium to minority shareholders. The resolution passed but 26% of investors voted against the resolution.



J D Wetherspoon

Mkt. cap: GBP 810.41m

Leisure

We voted against the company's request to amend its articles of association because it deleted an important shareholder protection by removing any limit to its borrowing powers. The resolution was passed but 21.1% of shareholders who voted at the meeting opposed this item. We will meet the company to discuss this subject in 2016.

Shareholder resolutions



Alliance Trust

Mkt. cap: GBP 2.55bn

Finance

LGIM has been engaging with Alliance Trust for a number of years. We had concerns regarding the performance, costs and the large discount of the shares to the net asset value of the assets. Elliott Investors, a US-based hedge fund, held over 10% of Alliance Trust at the beginning of 2015 and proposed three directors to the board. Following engagement with both Alliance Trust and Elliott Advisors we supported Elliott's nominees at the AGM in April 2015. We noted the completion of the strategy review in October and the reduced cost of the fund. The leadership at Alliance Trust changed substantially during the year, with the Chairman, CEO and CFO stepping down and new independent directors appointed. We have met Alliance Trust on several occasions since the AGM and will continue to monitor progress.



Electra Private Equity

Mkt. cap: GBP 1.37bn

Finance

We supported the appointment of two Sherborne Investors (a US-based activist shareholder) nominees to the board of Electra Private Equity plc. in November 2015, including the founder of Sherborne. We agreed with their concerns regarding the clarity of the valuation of Electra's unlisted assets, an issue that was also raised by Electra's external auditor. Sherborne first called an EGM to elect their representatives in June 2014. At that time we considered that the current Electra Board were best positioned to take the necessary action. However, as 2015 progressed LGIM felt further change was required. The Sherborne representatives were elected to the board with the support of 53.5% of shareholders. Following the EGM, the chairman of Electra resigned from the board.



Findel

Mkt. cap: GBP 158.97m

Retail

Sports Direct has a 17.5% stake in the company and tried to appoint one of its own directors to the board as its CEO. This would have created conflicts of interest and undue influence over the board's decision-making process. The Company appointed independent external search consultants to find candidates for the CEO role and also concluded that the proposed director did not have the adequate skills, knowledge or experience for the position. LGIM voted against the proposal to appoint the director at the general meeting due to governance concerns. The resolution was defeated, with 81% of shareholders voting against.

Shareholder resolutions (continued)



National Express

Mkt. cap: GBP 1.65bn

Transportation

We have been engaging with National Express on labour management for several years, particularly in relation to recognising international labour standards such as the International Labour Organisation. At the 2014 AGM, we supported the shareholder resolution to expand the remit of the board's safety and environment committee. At the 2015 meeting, we supported the shareholder resolution for an independent review of employment practices in National Express' US school business since we believed that this proposal was not unduly onerous or overly prescriptive. The resolution received support from 14.7% of shareholders, while 4.3% abstained.

We subsequently engaged with one of the non-executive directors, whose background is in human resources for organisations with large and international workforces, and the Director of Policy and External Affairs on how labour relations and standards in the US are being addressed by the board. We will continue to engage with the company and push for enhanced transparency and data on this topic.

Strategy and financial performance



Basic materials sector

As well as engaging with oil & gas and mining companies on climate change and governance issues, we also discussed operational and financial performance in this low commodity price environment. This macro development has raised a number of questions around balance sheet and spending decisions. This includes mergers and acquisitions activity such as Royal Dutch Shell's acquisition of BG Group Plc and capital management matters including the dividend policy. We will continue to engage with these companies on their strategies as they adapt to a new commodity price environment.



Tesco

Mkt. cap: GBP 15.47bn

Retail

Tesco has been through a turbulent three years that resulted in the replacement of the entire board. Under new leadership, Tesco has been busy implementing its new strategy to improve profitability and the perception of the business. LGIM has held meetings with the new CEO and chairman to get an understanding of how they are changing the culture of the business and their strategy to improve performance. We were made aware of the findings against Tesco on the treatment of suppliers and were given assurance that new policies and procedures were being implemented. LGIM was invited to see what the company was doing to tackle food waste which is covered in more detail in the 'Food waste' section on page 29.

Europe

We vote in the major developed continental European markets including: Austria, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden and Switzerland.

We are seeing increased openness from many European companies, leading to greater engagement with their shareholders. In 2015 we more than doubled the number of meetings held with companies listed in developed European (ex-UK) markets. The increased engagement activity reflects the diverse range of issues impacting companies in Europe.

A major area of engagement during the year was on the introduction of double voting rights in France and Italy and the impact of board diversity quotas. A number of European countries have introduced board gender quotas, or a 'comply or explain' target, including Germany, France, Italy and Spain. We have been engaging with companies on how they will be meeting these quotas and their plans for promoting increased diversity at below board level.

It was also our first year of operating LGIM's Spanish governance and voting policy. The bespoke policy has helped inform our engagement agenda with Spanish companies during the year.

France

The controversial Florange Act was adopted in 2014 and came into force in March 2016. The Act allows for registered shares held for two years to automatically acquire double voting rights.



Double voting rights create a distortion by misaligning ownership control and the equity economic interest in the company.

LGIM is a strong proponent of the principle of one share one vote.

The 2015 AGM provided companies with a window of opportunity to introduce a clause in their by-laws prohibiting the introduction of double voting rights and retaining the principle of one share, one vote.

The Act also introduced an anti-takeover mechanism. LGIM does not support the use of such mechanisms as we consider they can be used to protect underperforming incumbent management and prevent shareholders from having the opportunity to consider the merits of any offer made for the company.

LGIM wrote, in French and English, to the top 90 companies

in the Société des Bourses Françaises 120 Index to express our concerns regarding the protectionist aspects of the Act. We requested that the one-share-one-vote principle be honoured and opined against the introduction of an anti-takeover mechanism.

Following our letter we had a number of discussions. Some companies provided us with assurance that their by-laws would mirror best practice, while other companies, such as those with some element of government control, were unable to accept our request.

LGIM supported resolutions where management or shareholders proposed changing the articles and retaining the principle of one share, one vote. Additionally, LGIM voted against resolutions where companies proposed changes to introduce anti-takeover defences. As can be seen from our voting breakdown, we frequently did not support changes in company by-laws, which is traditionally seen as 'routine' company business.

Italy

In 2015, we visited Italy on several occasions to present to companies at conferences and meet companies in their home market. We discussed our expectations of good governance, including trends and areas of future best practice.

We worked with Assogestioni, the Italian Asset Management Association, to participate in proposing board members to Italian companies through the 'Voto di Lista' process. This enables minority shareholders, such as LGIM, to select candidates for appointment to the board. It is important that we actively use our rights to ensure that boards consist of individuals who are working on behalf of all shareholders.

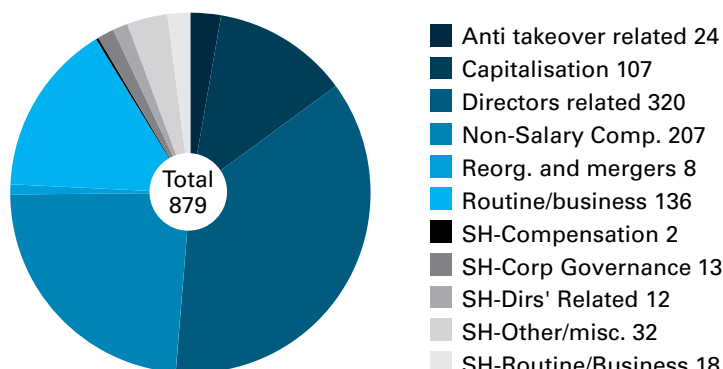
Italy introduced a temporary 'opt-in' right for Italian companies to introduce double-voting votes in 2014. LGIM successfully

collaborated with other domestic and institutional investors, academics and independent directors on Italian boards to persuade the government not to renew this temporary right. In March 2015, LGIM and 11 other institutional investors wrote to the top 100 Italian companies setting out our support for the principle of one share, one vote. Further information can be found here: <http://oneshareonevote.org/>

Voting and engagement activity

Our voting and engagement activities are interdependent on each other by assisting us in identifying concerns and escalating issues. In 2015 LGIM raised concerns through our voting activity at 65% of companies in the FTSE Europe (ex-UK) Index. A sample of how we conducted our voting and engagement activity in the European market is described below.

Europe: vote category breakdown against/abstain



Source: LGIM

Examples of Europe voting and engagement activities

	Compagnie Financier Richemont	Mkt. cap: CHF 33.36bn	Retail	Switzerland
<p>We have concerns regarding the balance of independence on the board at Richemont. We engaged with the company prior to their 2015 AGM and decided to vote against a number of non-independent directors – we believed that their independence was affected by their long-serving tenure and lack of shareholding in the business. In January 2016 we held a further meeting with the senior independent director on our governance concerns.</p>				

	Credit Suisse	Mkt. cap: CHF 27.81bn	Banking	Switzerland
<p>LGIM voted against the consultative resolution to approve the remuneration report proposed at the 2015 AGM. The resolution received significant levels of dissent from shareholders with 30% voting against the resolution. We had concerns regarding the substantial increases in fixed pay for the executive and the structure of the variable compensation awards. Later during the year we met with the chairman of the supervisory board to discuss Credit Suisse's remuneration and the board's reaction to the vote.</p>				

	Electricite de France (EDF)	Mkt. cap: EUR 18.59bn	Utilities	France
<p>Following our letter to EDF expressing our concerns regarding the implementation of the Florange Law, we had two meetings with the company to request the board debate the implementation of the law and to submit a vote to opt-out of the provisions. Our second meeting confirmed that the board did discuss the law and concluded that a vote was unnecessary due to the government's large holding. We expressed our concern with the lack of vote on the law by voting against the approval of the financial statements and statutory accounts at the 2015 AGM.</p>				



Deutsche Bank	Mkt. cap: EUR 23.11bn	Banking	Germany
<p>LGIM voted against the resolution to approve the discharge of the management at the AGM in May 2015, which in Germany is considered a material vote of no confidence. We had concerns regarding the \$2.5bn fine for its participation in the manipulation of the inter-bank offered rates benchmark and ongoing investigations by the US Department of Justice. Over the course of the year the company announced a new strategic plan and appointed a new CEO. LGIM collaborated with other investors and met with the chairman to express concerns regarding the new strategy, culture within Deutsche Bank and remuneration structures. We will continue our dialogue with the board over the course of 2016.</p>			



Enagas SA	Mkt. cap: EUR 6.16bn	Utilities	Spain
<p>LGIM voted against the resolution to approve a non-independent director's re-appointment to the board due to concerns regarding their membership of board committees. LGIM considers that the audit and remuneration board committees should comprise solely of demonstrably independent non-executive directors. During 2015 we met twice with Enagas to discuss their governance structures as well as their health and safety record and energy transition policy.</p>			



Orange SA	Mkt. cap: EUR 41.57bn	Telecommunications	France
<p>LGIM supported the shareholder proposal to 'opt-out' of the Florange Law and retain the one-share-one-vote principle. Although the proposal receives strong support from shareholders, it was not sufficient to meet the super-majority requirements and the proposal was defeated. LGIM also voted against the requests for the authority to increase the capital of Orange, as we consider these could be used as an anti-takeover mechanism. The resolutions received significant levels of dissent from shareholders, with almost 40% voting against. During the year we had several meetings with Orange to discuss governance and voting rights.</p>			



Telecom Italia	Mkt. cap: EUR 18.58bn	Telecommunications	Italy
<p>In November 2015 we voted against the shareholder resolutions proposed by Vivendi, a 20% shareholder in Telecom Italia, to appoint four of Vivendi's management team to the Telecom Italia board. LGIM collaborated with Assogestioni (the Italian Association of Asset Managers) and other investors, to write to both the boards of Telecom Italia and Vivendi raising concerns regarding the proposals. Due to the size of Vivendi's shareholding and the relatively low turnout at the EGM, Vivendi were successful in appointing their representatives to the board. LGIM are continuing to work closely with Assogestioni and other investors to reduce the risk of creeping control to Telecom Italia shareholders.</p>			



Volkswagen AG	Mkt. cap: EUR 61.56bn	Automobiles	Germany
<p>In September 2015, regulators in the US disclosed they were investigating Volkswagen for manipulating diesel emissions testing. Volkswagen is a controlled company, with the voting shares primarily held by Porsche and two other shareholders. We wrote to the company expressing our concerns with the serious operational and governance weaknesses exposed by the scandal. We asked for strengthened board independence and requested a meeting with the chairman. We met with Volkswagen in January 2016 and will continue our dialogue in the year ahead.</p>			



Vonovia SE	Mkt. cap: EUR 14.97bn	Real Estate	Germany
<p>In October 2015, Vonovia, a German real estate company, launched a hostile bid for its competitor Deutsche Wohnen. We spoke to representatives from both Vonovia and Deutsche Wohnen to understand the rationale for the bid. We voted against Vonovia's issuance of new capital in connection with the bid, due to the low premium offered to Deutsche Wohnen shareholders, the capacity of Vonovia to absorb another large acquisition and concerns regarding the strategic rationale. In response to low support from Deutsche Wohnen shareholders, Vonovia extended the tender offer and decreased the percentage of support required. However at the tender offer deadline Vonovia only had the support of 30% of Deutsche Wohnen shareholders.</p>			

US

The pace of engagement with US companies remained consistent in 2015. We held 97 company meetings in 2015 with a significant increase in meetings with board members. This is a trend we continue to encourage and hope to see increasing over time. Our conversations covered board effectiveness and tenure, succession planning, board evaluation process, remuneration disclosures, proxy disclosures and climate change. Clare Payn, our Head of Corporate Governance North America, has been seconded to LGIMA's Chicago office where she will be based for a year. Her presence in the region will build on our growing investor profile and will enable LGIM to gain better access and to meet more companies and market participants.

LGIM attended the Women in Governance event in New York. This was our first attendance at an event that brings together shareholders and board directors in order to establish contacts and have a frank exchange of ideas in the ESG space. Under discussion was shareholder/director engagement; long-term versus short-term corporate strategies; and board effectiveness, tenure and diversity. While in New York we also met with the Lead Independent Directors of Verizon Communications and Pepsico to discuss issues affecting their businesses as well as the management of Johnson & Johnson and Goldman Sachs.

As predicted the 2015 voting season in the US was dominated by the issue of voting access. The New York City Comptroller Office



filed most of these resolutions under the launch of its Boardroom Accountability Project which accounted for 65% of the 120 proxy access shareholder proposal submissions for 2015. Shareholders voted on 86 proxy access shareholder proposals, 51 of which received majority shareholder support and that support averaged 54%, a clear indication that this is important to shareholders. **LGIM supported 93% of these proposals.**

Shareholder proposals related to environmental and social issues surpassed the number of governance related proposals for the second year in a row.

'Climate change dominated the environmental category for the second year where such proposals accounted for **58%** of the environmental category resolutions filed, significantly higher than the **23%** in 2013, illustrating the **increase in importance** of this issue.'

Proponents also expanded the scope of these proposals, adding resolutions on stranded carbon asset risks, capital expenditure strategies, and tying executive compensation to greenhouse gas emissions reductions.

Resolutions raising political spending issues were the second most common shareholder proposal with 118 resolutions, despite this number being down on last year. Other topics from shareholder proposals were sustainable forestry, genetically modified organisms and hydraulic fracturing.

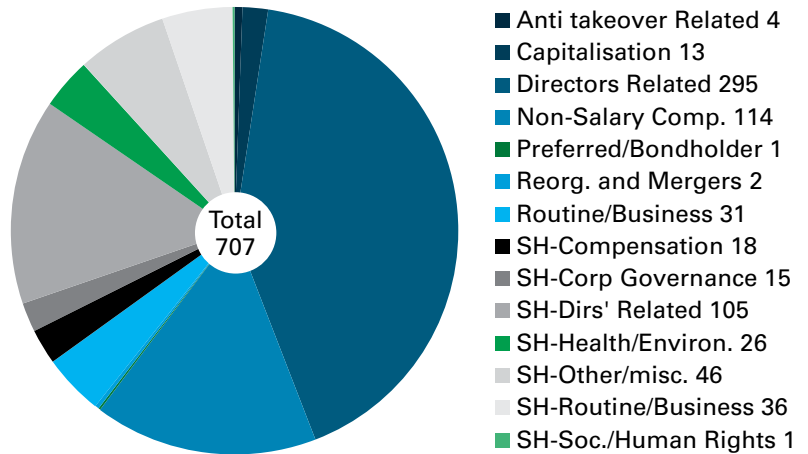
Since 2011, there has been a steady yet slow move toward two different individuals holding the role of CEO and Chair. **In 2015 52% of the S&P 500 had split roles, an increase of 20% in the last 10 years.** Historically in the US, the roles of CEO and chair have been held by one individual, though various market

participants with different perspectives have made enthusiastic arguments both in favour of and against the practice as this standard shifts. Investors, including LGIM, often express a preference for strong, independent leadership of boards through the existence of a separate chair. Although outpaced by proxy access proposals this year, board leadership proposals remain a key shareholder topic. There has been a steady increase in the number of shareholder proposals calling for an independent chair and, although support has decreased in recent years, this trend is likely to continue into 2016 as there is again sharper focus on this issue due to some high-profile board leadership changes in 2015.

Compensation issues receded into the background during the 2015 proxy season as the fifth year of the say on pay vote was uneventful. The trend of shareholders voting overwhelmingly in favour of executive compensation programs continued and the average support was 91.7%. However, where votes against were placed, the principal driver was again pay for performance concerns such as insufficiently robust performance conditions and above-median pay benchmarking. Other common concerns were subjective performance goals or discretionary payments, and a predominance of time-vesting rather than performance-linked equity awards. **The prevalence of problematic pay practices is decreasing, however, as companies are eliminating such practices due to shareholder engagement and pressure.** During 2015 the SEC has taken action on three compensation related requirements mandated under the Dodd-Frank Act, CEO pay ratio, Pay for Performance and claw-back guidelines, all of which will impact executive compensation disclosure and practices going forward.

As we go into 2016, we see many of the issues mentioned above, such as board tenure and effectiveness, proxy access and climate change to be of continuing focus.

US: vote category breakdown against/abstain



Source: LGIM



Examples of US voting and engagement activities



Apple | Mkt. cap: USD 586.62bn | Technology

We continued our long-term engagement with Apple and at its AGM in February 2015 we had concerns around the remuneration awarded to an executive director in connection with her recruitment to the company. We discussed our concerns with the company, expressing that such awards should be linked to the long-term success of the company and that pay structures could potentially cause reputational damage. The vote received only 75% support from shareholders, down from the 97% received last year.



Bank of America Corp | Mkt. cap: USD 138.36bn | Banking

An EGM was called asking for support to re-combine the roles of chairman and CEO. After engaging with the company we voted against this proposal as the company had revoked a majority supported proposal to ensure the company would always have an independent chair. We also had concerns about the balance of power on the board and the robustness of the succession policy for board members. The EGM proposal only received 'yes' votes from 63% of shareholders, meaning that 37% of shareholders did not support the company's proposal, which is a relatively high protest vote in the US.

Following the EGM, which the company deemed a success, the company has stepped up its engagement efforts with shareholders in order to begin to understand shareholder concerns around this issue and to demonstrate the strength of the lead director. LGIM met the lead director to understand more fully his role and to discuss the decisions and company actions in the lead up to the vote. Furthermore, we wanted a greater insight into how the board refreshes its members, maintains oversight of the company and how it is managed in terms of independence. We encouraged the company to commit to engaging with shareholders on a regular basis going forward and will expect to speak to the LID annually.



Chevron Corp | Mkt. cap: USD 182bn | Oil and Gas

LGIM voted against the shareholder proposal to return capital to shareholders as the item concerned capital allocation which is a strategic board and management decision. We supported the shareholder proposals for the company to adopt quantitative greenhouse gas targets, for a report on hydraulic fracturing, and to appoint a director with environmental experience. We have also had a conversation with the company around climate change and how this will affect future business and the need for the company to be more transparent around this issue and to engage with investors.



Freeport-McMoran | Mkt. cap: USD 13.65bn | Mining

We have been engaging with the company over several years with compensation and board structure being the main issues under discussion. We have had a number of concerns with the company, including governance and board structure, concentration of power in the CEO, no lead director, executive compensation practices, and lack of environmental expertise on the board, environmental and safety concerns. Following engagements on the above topics, the company has made the following changes: appointment of a lead independent director; new remuneration structure; new independent executive committee of the board; board reduced by seven directors; executives reduced to one CEO and executive chair; and a new panel to advise the board on environmental, human rights and sustainability matters. This tighter and improved board structure will help the company going forward as it faces strategy challenges.



Microsoft Corp | Mkt. cap: USD 432.32bn | Technology

We spoke to Microsoft regarding its newly designed compensation programmes. We continue to have concerns around the discretionary nature of the short-term plan and encouraged it to move beyond 50% of the total long-term equity award being based on performance in line with emerging market best practice. In light of the compensation committee taking on board our feedback and making positive changes to the compensation plans, we supported the plan this year. However, we have asked the company to make further progress in the future to enable us to support the plans going forward. At the general meeting, 73% of shareholders supported the say on pay proposal.



Oracle Corp

Mkt. cap: USD 170.61bn

Technology

For a fourth consecutive year, the say on pay proposal was voted down, with 51% of shareholders voting against. Dissent on the say on pay structure has been consistent, with 51% against in 2015, 54% against in 2014, 56% against in 2013, and 58% against in 2012. Shareholders this year also signalled their dissatisfaction with the lack of response by the company to this issue year on year by voting against the entire compensation committee who each received approximately 30% votes against. The shareholder proposal to request the company implement the proxy access right was approved by 54.7% of votes. LGIM was included in the votes above and we shall continue to escalate our actions in the absence of constructive engagement.



Japan

Japan continued its impressive reform in corporate governance throughout 2015. The improvement effort was largely led by the Financial Services Agency (FSA) whose timely publication of the corporate governance code required companies to disclose their compliance or reasons for their non-compliance to the code by December 2015. Throughout the process, we actively engaged with the FSA and submitted consultations to ensure that the rules imposed by the code were progressive and meaningful in driving governance changes in Japanese corporates.

The extent of change in Japanese board composition has already been remarkable.

In 2010, 40% of companies in the FTSE Japan index did not have any outsider (not necessarily an independent director) on the board. This year, nearly 90% have one or more.

We expect this trend to continue in line with what the governance code stipulates, which requires at least two independent directors with a third of the board as outsiders for companies to which it applies.

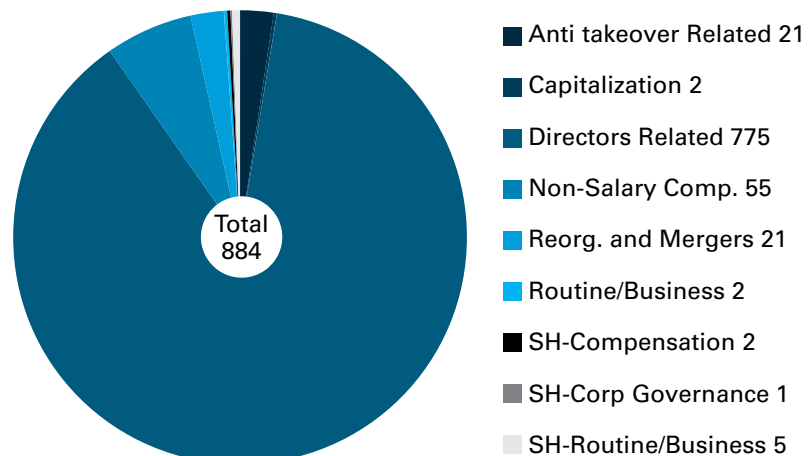
In April 2015, we organised an investor delegation, consisting of eight global investors from USA and Europe, to visit several Japanese companies, the Japanese stock exchange, and various domestic investors. We also took part in various



panels, including the panel at the responsible investment conference in Tokyo, and conducted two key note speeches on the topic of corporate governance in Japan. Our input was very well received by the companies and domestic investors who appreciated our progressive but pragmatic approach to enhancing governance standards.

As a recognised leader in corporate governance reform, we are pleased with the steps that Japanese companies have undertaken on governance so far. However, we believe much work remains to establish a meaningful governance framework that will enhance the value of Japanese corporates and therefore the shareholder returns from investing in Japan.

Japan: vote category breakdown against/abstain



Source: LGIM

Examples of Japan voting and engagement activities



Kyowa Hakko Kirin Co | Mkt. cap: JPY 979.45bn | Pharmaceuticals and Biotechnology

We voted against the election of four inside directors, as the candidates are affiliated with the controlling shareholder of the company and the board consists of less than one third outside directors.



Kuroda Electric Co | Mkt. cap: JPY 67.30bn | Technology

Shareholder activist Yoshiaki Murakami's private companies requested the nominations of four outside directors (including himself) to the board. Their concern was about the company's substantial cash surpluses that had not been paid out to shareholders. They believed that the appointment of new outside directors would provide valuable insight through their extensive knowledge and experience in finance. We voted against the appointment of the outside directors to the board as we believed their proposed dividend pay-out ratio was too aggressive at 100% and not in line with promoting long-term shareholder value.



Ogaki Kyoritsu Bank | Mkt. cap: JPY 125.78bn | Banking

We examined proposals by Japanese companies to increase authorised capital case-by-case. At the AGM Ogaki Kyoritsu Bank sought shareholder approval to double its authorised common capital from 40m to 800m shares, thereby reducing the percentage of common shares outstanding from 87% to 44%. LGIM opposed the company's proposal, as it failed to provide the rationale behind such a significant increase. Moreover, we were concerned that this move could have served as a takeover defence mechanism to entrench management and to the detriment of shareholders, given the lack of independence at board level.



Toyota Motor Corp | Mkt. cap: JPY 19.65bn | Automobiles

We opposed the creation of preference AA shares, as the new class shares not only have a fixed dividend, making them a debt-like security, but also voting rights similar to common shares. By creating such a hybrid financial instrument, only available to domestic retail investors, the one-share-one-vote principle with equal rights and risks among all shareholders is distorted, creating potential conflict of interest among investors. In addition we voted against the re-election of the chairman, as the board of the company is composed of less than a third of outside directors.



Asia Pacific

Australia

In Australia, the commodity price decline has served to weaken the Australian economy and prompted the departure of approximately 20% of CEOs of the S&P ASX200. The CEO exodus highlights where executive remuneration structures have not been successful in retaining CEOs in their roles beyond the short term. This leaves shareholders to pick up the costs of any departure packages and new CEO recruitment. Investors have acted against excess pay by issuing 'strikes' or substantial votes against company remuneration reports, indicating a sentiment that there is a lack of alignment between remuneration and companies' financial performance and shareholder outcomes.

Ironically, despite press statements that 'executives do not value long-term incentive plans', the bigger issue in excessive remuneration is emerging as the divergence between reported remuneration.

This is resulting from shares issued at deep discounts from 'fair value' in executive's long-term incentive plans. This gives potential for more realised remuneration if share prices increase above current levels.



Singapore

Board independence in Singapore has continuously improved in 2015. This was in part due to the five-year transition period for Monetary Authority of Singapore's corporate governance code being set to expire in 2016. The code recommends that at least one-third of the board be independent directors, and where there is CEO/Chairman duality, immediate family members on the board, or a non-independent chairman, independent directors should make up at least half of the board. As of July 2015, all in our voting universe had boards with at least one third independent directors and 33% had independent chairmen.

Singapore Exchange (SGX) also implemented a minimum trading price (MTP) requirement of SUSD 0.2 per share for companies listed on the SGX mainboard. The introduction of the MTP aims to improve the overall quality of the Singapore stock market. More

than 80% have announced their intention to consolidate their shares.

South Korea

In South Korea, the shadow voting system, which allows companies to request uninstructed shares registered with Korea Securities Depository to vote in line with instructed shares, was extended to 2017.

The system, originally introduced in 1991 to help meet the required minimum affirmative votes, allows major shareholders and their affiliates to exercise disproportionate influence. Major shareholders use this system to pass resolutions, entrench management control and to bypass limitations on voting rights imposed to guarantee independence of internal auditors and audit committees. However, due to heavy opposition from companies and trade organisations, the grace period for shadow voting abolition has been extended contingent upon whether companies have adopted

electronic voting, and whether companies have solicited proxies from all shareholders.

Hong Kong





In Hong Kong, new rules set by the Stock Exchange of Hong Kong served to upgrade certain recommendations from the corporate governance code to a mandatory requirement. Subsequently, more than 90% of

companies now have at least one-third independent directors. Issuers that fail to comply with the new independent director requirements must appoint a sufficient number of independent non-executive directors within three months.

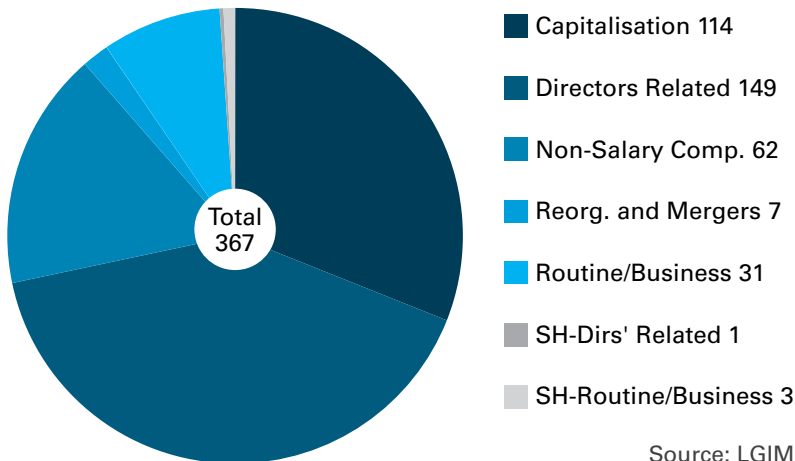
On a more undesirable note, numerous alleged misconduct, corruptions and scandals have

continued to plague companies in Hong Kong. Anonymous Analytics, a group loosely linked to hacker group Anonymous, targeted various companies for misrepresentations and fraud.

Examples of Asia Pacific voting and engagement activities

	AGL Energy Ltd	Mkt. cap: AUD 12.33bn	Utilities	Australia	We supported the shareholder resolution to amend the company's constitution to require the board to develop a business model that incorporates climate change mitigation efforts. Despite having some commitments to address climate change, such as decommissioning all coal-fired power plants by 2050, the company did not have quantitative emissions reduction targets or emissions intensity reduction targets. Since AGL is Australia's largest emitter of greenhouse gases, we believed that the company needed to take a more ambitious approach towards mitigating climate change.
	CITIC Limited	Mkt. cap: HKD 347.92bn	Industrials	Hong Kong	We opposed the election of five non-executive non-independent directors because of lack of independence at board level. Even though one-third of independent directors featured on the board – in line with listing rules – one of the five independent directors had served for 21 consecutive years on the board of CITIC Limited. His extremely long tenure compromises his ability to make independent and objective judgements, and hence cannot be considered independent. We voted against five non-executive non-independent directors, as the independent director was not on the ballot.
	Guangzhou Baiyunshan Pharmaceutical	Mkt. cap: CNY 27.92bn	Pharmaceuticals and Biotechnology	China	We opposed management's proposals to issue A shares which represented 24.5% of total issued shares at a significant discount. The issuance of A shares was non-public and exclusively targeted the controlling shareholder and its connected companies which would have increased their stake in the company from 45.2% to 57.4%. Moreover, the share issuance would have had a considerable dilutive impact on our holdings.
	Samsung C&T	Mkt. cap: KRW 28.07tn	Industrials	South Korea	We voted against the takeover deal by Cheil Industries Inc. Samsung C&T was facing tough economic conditions due to competition in the construction sector and falling commodity prices in its trading business. The company argued that the deal would bring about synergies, but we did not believe this would compensate for both the significant undervaluation and dilution of shares. Instead, it appeared the interests of the founding family were put above shareholders as Samsung Group and the affiliates' stake in the company increased significantly from 14% to 40%. The merger passed in a landmark proxy, with 69.5% of shares in favour, just 3.5% above the required amount. This was a big protest vote in South Korea.

Asia Pacific: vote category breakdown against/abstain



Source: LGIM



South-East Asia developments

We attended the OECD roundtable on corporate governance in Bangkok and the Asian Corporate Governance Association (ACGA) conference in Kuala Lumpur in November.

Both were very well attended and provided a unique opportunity to meet and exchange ideas with key stakeholders in South-East Asia, namely stock exchanges, and the institute of directors and corporates.

On reflection, overall there is tremendous momentum for change and progressing corporate governance standards, largely driven by the following key trends:

- ASEAN scorecard, ACGA CG watch and OECD guidelines
- The development of stewardship codes in local markets
- Sustainability and transparency promotion by stock exchanges
- Recognised value of female representation on boards

Local exchanges are now competing with each other to improve ESG standards and we've seen many 'roadmaps' and plans of how they intend to enhance governance practices for the benefit of their local businesses.

However, three key market dictating components remain that must be addressed in order to bring about meaningful changes. These are controlled companies (either state-owned or family-owned), related party transactions and director nomination processes.

We have been working together with local participants to address these common issues and aim to achieve what we can as foreign investors to promote better governance practices further.

Company visits in Malaysia

In Malaysia, we visited the local stock exchange, Bursa Malaysia, which is driving the governance and sustainability agenda in the region. We also visited the Sime Darby palm plantation, the biggest palm oil producer in the world, and also met representatives from the Malaysia International Shipping Corporation and the shipping division of Petronas.

'From our visit, it is clear that there has been significant progress in Malaysia and increasing appetite in local markets to address and improve corporate governance and sustainability practices.'

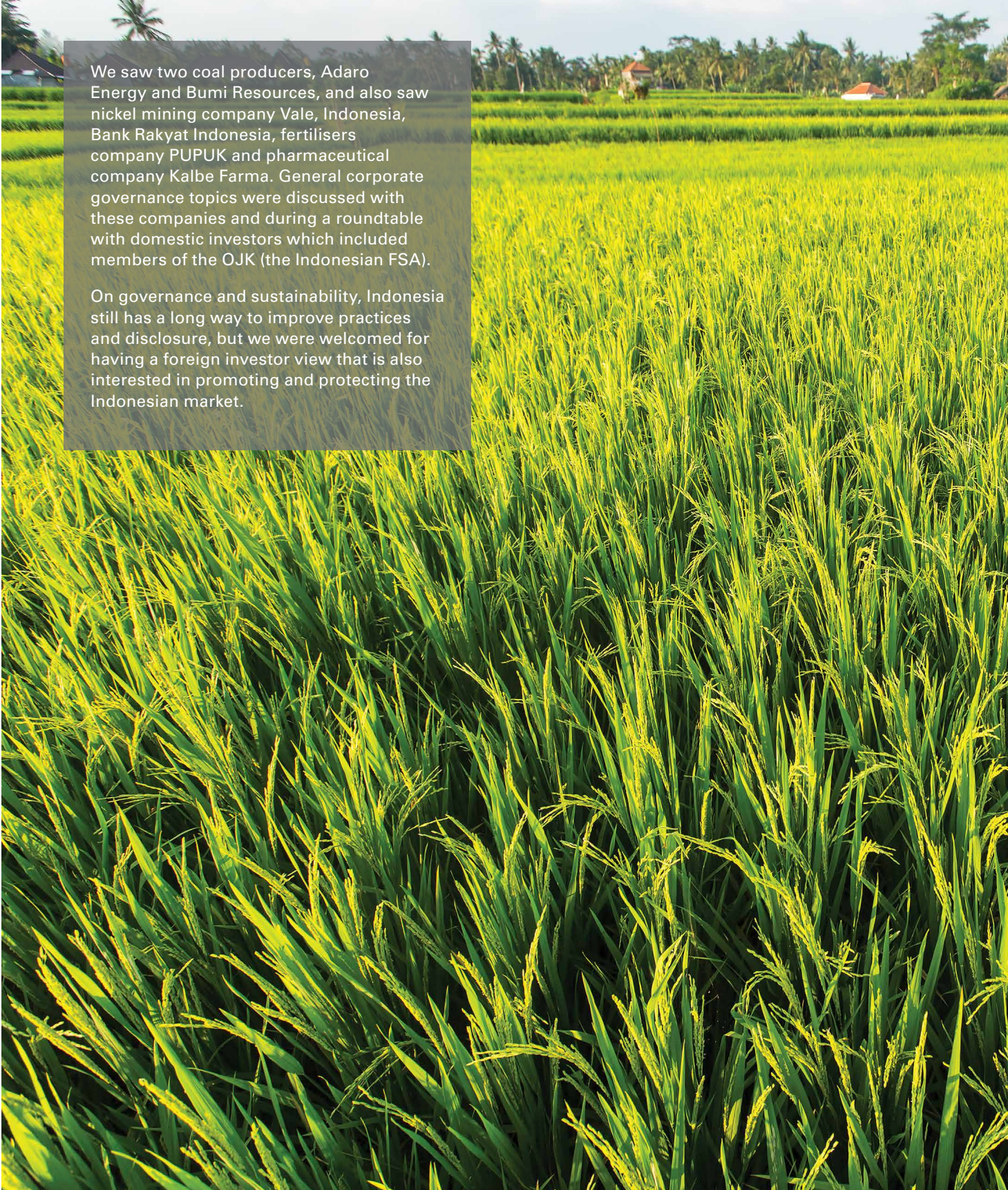
Due to the lower oil price, conversations were driven by how the economy needs to thrive without relying on oil revenues and through promoting local business.

We saw some of the best standards of palm oil plantations process at Sime Darby which sets a high bar for the rest of the participants.

Company visits in Indonesia

Haze that covers much of Indonesia's rural regions is caused partly by small-scale palm oil growers. Tracing and managing such supply chain issues was a major topic on our agenda and in conversations in Indonesia. On palm oil, we saw representatives from Golden Agri, Astra Agro Lestari and IPOP (collaboration among palm oil companies).

So far, the drop in oil price has had a positive impact for Indonesia which had recently dropped the level of subsidy for fuel consumption. As a producer of coal, however, the current status and the market outlook is gloomy for the coal producers who rely on exports to China and other markets for revenue.



We saw two coal producers, Adaro Energy and Bumi Resources, and also saw nickel mining company Vale, Indonesia, Bank Rakyat Indonesia, fertilisers company PUPUK and pharmaceutical company Kalbe Farma. General corporate governance topics were discussed with these companies and during a roundtable with domestic investors which included members of the OJK (the Indonesian FSA).


On governance and sustainability, Indonesia still has a long way to improve practices and disclosure, but we were welcomed for having a foreign investor view that is also interested in promoting and protecting the Indonesian market.



ESG integration

What is ESG integration?

The Global Sustainable Investment Association (GSIA) estimates the assets managed against ESG criteria at USD 21 trillion (2014), or equal to 30% of professionally managed assets.



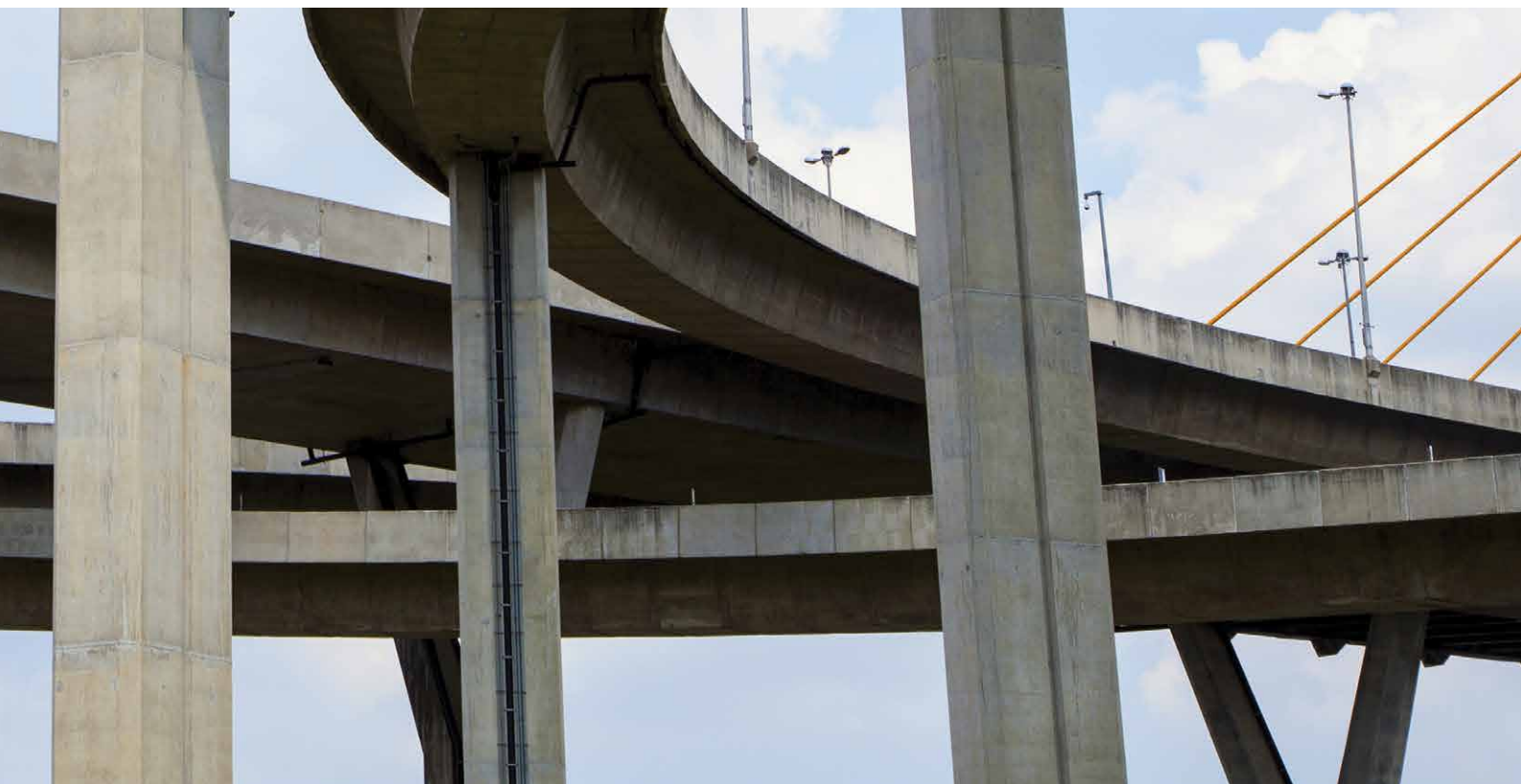
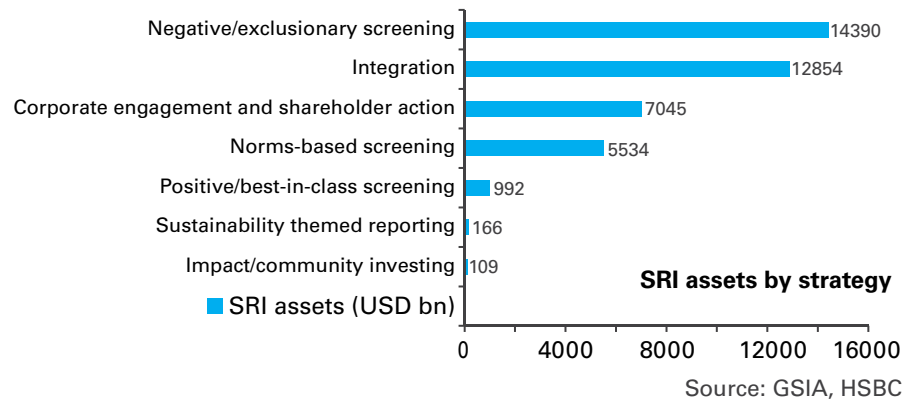


Europe is estimated to be the largest market at 64% of total assets, followed by the US at 31%. There are a variety of ESG investment strategies employed in managing this money. These vary from negative screening, whereby certain sectors, companies or practices based on ESG criteria are excluded from portfolios, to corporate engagement, shareholder action and ESG integration.

LGIM’s responsible investment strategy has been focused on active ownership and integrated ESG analysis across equities and fixed income, within mainstream funds. ESG refers to the management of extra-financial performance of companies which can have a financial impact on a short, medium and long-term horizon. Integration is about the systematic inclusion by managers/investors of these issues into investment research and decision-making. This may involve

considering ESG as part of top-down or bottom-up stock selection or in asset allocation. Integrated analysis involves the proactive consideration of ESG factors in traditional financial analysis. The aim is not to dictate portfolio compositions, but to enrich the research process of issuers, sectors and the macro outlook. It can result, for example, in investments being over-weighted, under-weighted or avoided altogether in the portfolio. According to GSIA,

there is an estimated USD 13 trillion of global assets managed against ESG integration criteria. Some, or many, aspects of the analysis are already incorporated informally into company valuations (view on management, and impact of environmental regulation etc.) or sector attractiveness. However, ESG makes a formal assessment using a range of quantitative and qualitative criteria, in order to distinguish those aspects within fundamental analysis.



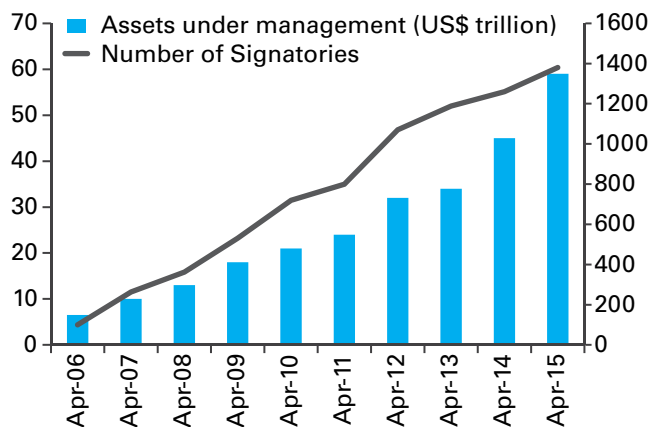
Why ESG integration?

As a signatory to the United Nations Principles of Responsible Investment Initiative (UNPRI), LGIM is committed to incorporate ESG issues into investment analysis and decision-making processes.⁴

Since its establishment in 2006, the number of PRI signatories has grown to over 1,300, representing more than USD 59 trillion under management. This growth and that of the ESG movement are clearly linked, with a dramatic rise over the last decade (see chart below)⁵.

A 2014 PwC survey looked at what’s driving this trend; why are investors increasingly looking at sustainability issues in their investment process? The results showed risk mitigation, avoidance of unethical conduct, and enhancing performance to be the driving forces behind the trend (see chart right). This raises a couple of interesting and important points for discussion.

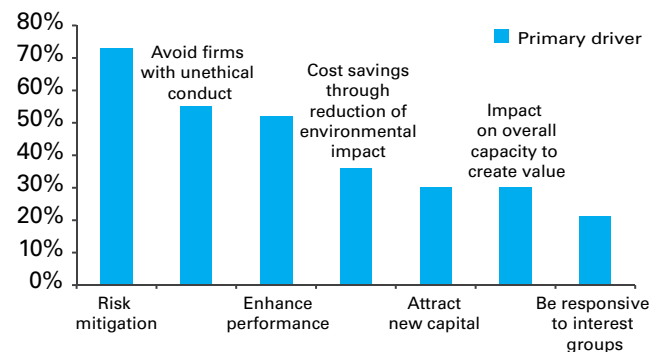
PRI signatories and assets under management



Source: PRI Fact Sheet

Firstly, on fiduciary duty: institutional asset owners “are legally bound to a duty of care and loyalty and must place the needs of their beneficiaries above all other considerations... they seek to minimise negative externalities and reward positive ones.”⁶ The UNPRI, among others, has for some time claimed that failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty. It is a topic that has been much debated, as others have viewed the obligation to ‘maximise investment returns’⁷ as incompatible with consideration of ESG issues. The recent clarifications given by the Law Commission in the UK and US Department of Labor made it clear that ESG is firmly within our fiduciary duty.

Primary drivers of investors considering sustainability issues (% of investors surveyed)



Source: HSBC, PwC

Secondly, on investment performance: the business case for considering ESG dynamics has strengthened over recent times, both in debt and equity markets. ESG can assist the identification of risks well before traditional financial analysis and can improve an analyst’s examination of company performance and credit quality.

A 2015 meta-study review⁸ of more than 200 studies on ESG factors and resulting company performance found that 80% of studies showed that prudent sustainability practices have a positive impact on investment performance.⁹ For corporate bonds, research by Barclays suggests bonds with high ESG ratings have modestly outperformed their lower-rating peers when controlled for various risk exposures. Engagement on ESG is also important for returns. A US study of 2000+ ESG-related engagements between 1999-2009 found that successful engagements were followed by cumulative excess returns of +4.4%, most of which occurred in the 12 months following the engagement. Further evidence suggests that funds from companies that are not involved in ESG engagement activities perform significantly worse, indicating the materiality of ESG engagement in investments.

Against this backdrop, the expectations and demands of clients in relation to sustainable investment practices and ESG are rising. Incidents such as the BP Gulf of Mexico oil spill, the recent emissions scandal at Volkswagen, or the dam collapses at BHP Billiton/Vale’s joint venture in Brazil¹⁰ have provided some of the most overt examples of the relationship between the management of ESG issues and investment performance. At the Paris climate conference (COP21) in December 2015, 195 countries adopted the first-ever universal, legally binding global climate deal. As governments globally begin to meaningfully curb greenhouse gas emissions, investors will be presented with new and evolving risks and opportunities; client awareness of this is rising.

What is LGIM doing?

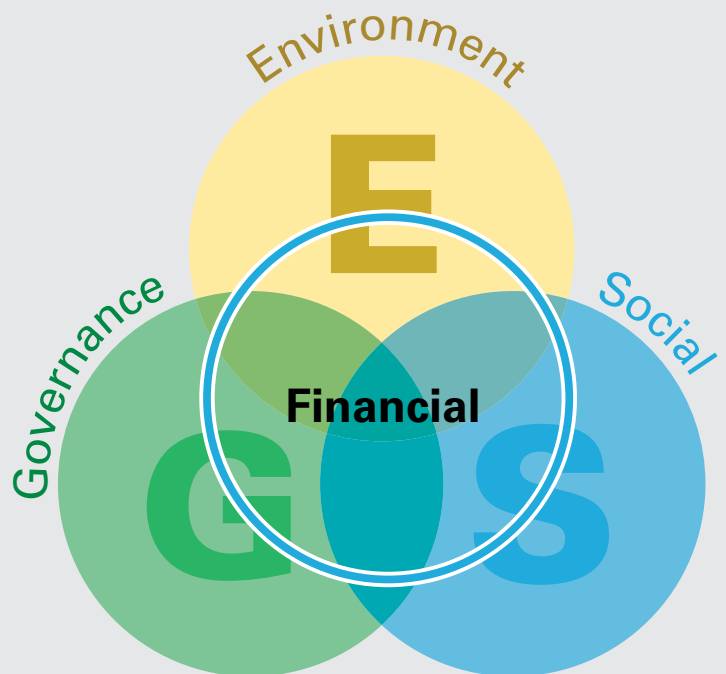
LGIM's Corporate Governance and Responsible Investment Team work with investment analysts and portfolio managers to assess whether company governance is robust enough to withstand forthcoming challenges and exploit opportunities.

This means that we identify sector-specific risks and opportunities and focus our attention on the material impact of ESG on a company's bottom line and credit worthiness.

This approach, which combines financial analysis with ESG, is applied across active funds.

Our proprietary ESG scorecard is used to flag company-specific ESG concerns, or performance issues; the scores are internally available to all within the investment and corporate governance teams. The Corporate Governance Team provides specialist insight on ESG considerations to credit and equity analysts, who have the responsibility of incorporating them into fundamental analysis. Fund managers are responsible for monitoring the portfolio-level exposure to ESG risks and opportunities. The process is complemented by our active engagement at a company, sector and policy level. We have for example been working to encourage greater clarity from ratings agencies on how ESG factors are considered in credit analysis. It is crucial to achieve alignment of key stakeholders in formalising ESG across the investment process.

At LGIM we continue to evolve our approach to ESG integration in line with best practice, formalising our processes and improving how we communicate and report our work to both internal and external stakeholders.



4. Principle 1: we will incorporate ESG issues into investment analysis and decision-making processes

5. HSBC Global Equity Strategy, December 2015

6. John Rogers, CFA. May/June 2014 issue of the Financial Analysts Journal

7. "In many jurisdictions, fiduciary duty is widely considered as imposing obligations on trustees or other fiduciaries to maximise investment returns"; PRI, Responsible investment and fiduciary duty.

8. "From the stockholder to the stakeholder: how sustainability can drive financial outperformance";

9. HSBC, Equity Strategy Global; ESG drives performance

10. Samarco Mineração S.A. is a Brazilian mining company owned in a JV by BHP Billiton and Vale

Keeping you informed

We believe that transparency – both with clients and the wider market – is an integral part of the corporate governance process.

We use a variety of channels to explain why we think that corporate governance matters and what we do to bring this to the attention of companies and investors. On some company-specific issues, communicating our views to the public in a timely manner is not always possible due to the sensitive nature of the discussions. However, we endeavour to report on such examples after the event.

During 2015 we featured in many national and international newspapers on various governance topics. We do not normally comment on specific companies in the press, but will present our point of view on an issue more generally. We also regularly participate in seminars, conferences and educational sessions on environmental, social and governance issues. Information on our press exposure and external presentations undertaken during the year can be found in this section.

External presentations

Ernst & Young – annual reporting

In September 2015, Ernst and Young published a report on annual reports. Our Director of Corporate Governance was featured in a Q&A section where LGIM's perspective as a shareholder was given on the importance of the document. A link to the report can be found [here](#)¹¹.

Global Law Summit - Shareholder activism panel

LGIM was specifically asked to talk at the summit on shareholder activism. Lawyers globally attended

on different approaches to active ownership. It is pleasing to see LGIM as a major active investor.

Guardian Live - Climate Change Panel

Meryam Omi was on a live panel at the Guardian's divestment campaign, "keep it in the ground". The panel which was chaired by the Guardian's editor-in-chief and joined by Lord Stern and corporate leaders, discussed the merits of divesting and/or engaging with fossil fuel based companies. The discussion can be viewed [here](#)¹².

ICGN panel in Boston

We were invited to be a panellist at the ICGN Conference in Boston in September where we took part in a discussion on ESG integration. We shared how we are integrating our ESG work into the investment process and the obstacles and successes around this. Following the presentation there was a lively discussion as to the various approaches and questions raised.

ICGN Conference – Madrid

Sacha Sadan spoke at the ICGN conference in Madrid on the importance of the role of company secretaries in promoting good governance. Over 120 European investors and corporates attended.

Investor Engagement Panel – US

Clare Payn, Head of Corporate Governance North America, has been relocated to our Chicago office for a minimum of a year. Her presence in the region will build on our growing profile and will enable LGIM to gain better access and to meet many more companies and market participants.

Master Trust Annual Forum

For the second year running, LGIM presented to the Master Trust Annual Forum on corporate governance. The purpose of the presentation is to educate the trustees on the topic of corporate governance as well as discuss recent trends and issues. The feedback has been positive on understanding corporate governance.

PRI Conference - Corporate tax

We attended the annual Principles of Responsible Investment (PRI) conference in September where 800 global delegates attended. We presented our work on corporate tax on a panel and attended events on a variety of topics including: climate change, Japanese FSA and CEO-level discussion on the future of responsible investment.

Retail Conference and Audit Quality Forum

At LGIM's conference for the retail business, we presented to over 170 leading financial wealth managers on the importance of ESG issues and the responsibility that comes with being one of the world's largest asset managers. Furthermore, we presented at the Audit Quality Forum in front of 300 people on the importance of corporate culture and the ability to provide assurance.

Women in Governance

LGIM attended the Women in Governance event in New York. This was our first time at the event, and we presented a key discussion topic on remuneration to begin a wider debate among attendees. The event brought together female shareholders, corporate governance experts and board directors in order to establish contacts and have a frank exchange of ideas in the ESG space. Under discussion was shareholder/director engagement; long-term versus short-term corporate strategies and board effectiveness, tenure and diversity.

Fundamentals – Climate Change

Fundamentals is one of LGIM's flagship client publications. The October 2015 edition had a corporate governance focus, with Meryam Omi discussing the impact of climate change and energy transition. We outlined some of the biggest changes that are taking place in the policy and energy space and the role of investors, like us, to engage on the topic and provide solutions. The report is available in the 'Knowledge' section of www.lgim.com.

11. http://www.ey.com/Publication/vwLUAssets/EY_-_Annual_reporting_in_2014_reflections_on_the_past_direction_for_the_future/USD_FILE/EY-Annual-reporting-in-2014.pdf

12. <https://www.youtube.com/watch?v=LnJasWFdswg>

Press and publications

Voting rights in France (FTFM)

LGIM provided quotes and commentary to the press on our concerns regarding the introduction of double-voting rights in the French market, which we considered to be a form of government protectionism.

Shareholder rights in Italy (Financial Times)

LGIM provided quotes and commentary to the press on the international investor response to Italy's introduction of double-voting rights. This included speaking to the Financial Times on behalf of the group of international investors who signed an open letter to the Italian government.

Interview in 'The Asset' (Dutch Investment Publication)

Passive investing, active ownership.

Board Diversity - Davies Report

As an active supporter of the government's 25% gender target for boards, we were invited to contribute a case study to the updated 2015 Women on Boards Davies Report to reflect our work and focus in this area.

Spencer Stuart – diversity

Spencer Stuart, the global head-hunter, asked LGIM to contribute an essay to its UK Board Index on a shareholder's perspective on diversity. The report released in November 2015 is available on the Spencer Stuart website*.



Cyber security (Financial Times)

In November we published an article in the Financial Times: "Cyber Security is not just the IT department's problem." Our objective was to point out that cyber security awareness is more than a normal function of an IT department, but a matter for boards to consider given

that this is where strategy is set and resources allocated.

LGIM's Corporate Governance team wins inaugural industry award

LGIM's 9-strong Corporate Governance Team received the Institute of Chartered Secretaries and Administrators (ICSA) inaugural award of 'Best Investor Engagement' for 2015. The award ceremony took place at the Park Lane Hilton Hotel, London on Tuesday 1 December.

The award was voted for by the company secretaries of all FTSE 350 companies who were asked to nominate the investor or investment manager who has been responsible for the most constructive stewardship engagement with their company in 2015. Each company secretary had one vote.

The award was introduced by ICSA to assess the difference that the Stewardship Code had made to the quality and quantity of investor engagement by its signatories and identify investors that do this well.

Meryam Omi lauded as a Rising Star of Corporate Governance by Millstein Center

Meryam Omi, Head of Sustainability at LGIM, was named as a 'Rising Star of Corporate Governance' by the eminent Ira M. Millstein Center for Global Markets and Corporate Ownership at the Columbia Law School, South Carolina.

The award, presented at the 10th annual Millstein Governance Forum, recognises global corporate governance professionals under the age of 40 who are making their mark as outstanding analysts, experts, directors, managers or advocates. The selection process was based on criteria such as past accomplishments and thought leadership, future projects and endeavours, leadership and character, and potential to influence the industry.

In total there were four recipients of the Rising Star of Corporate Governance Award; it was the seventh year the award has been made.

The individuals, hailing from three continents, were nominated by their peers and selected by a committee of global leaders who are previous awardees.

* https://www.spencerstuart.com/~/media/pdf%20files/research%20and%20insight%20pdfs/ukbi2015_web.pdf?la=en



Appendix

Associations and collaboration

We recognise that working with others can be a powerful tool which can quickly influence change. Collective work is an extremely effective method of engagement, but one that requires enormous amounts of resources and organisation. In order to facilitate this process, we are members of industry-wide associations and networks. There are various ways of collaborating including group meetings and co-signed letters. Below are a few examples of our activities during the year.

A full list of the organisations and bodies of which we are members and with whom we work can be found on our [website](#)¹³.

Investor forum

LGIM signed up on the inauguration of the UK Investor Forum. Sacha Sadan is a board member and we are encouraged with the progress to date. 39 members have signed up and the Forum has refined its template on company engagements. In 2015 the forum engaged with nine large UK companies on behalf of shareholders (typically 10+ involved). LGIM was involved in eight of these sub-groups. Positive changes, including changes to directors, were made to some of the companies and discussions are still taking place with others. Encouragingly, Chairmen have been supportive and seen the forum as an additional tool in understanding a variety of shareholder views. We look forward to many more engagements in 2016.

Principles for Responsible Investment (PRI)

The United Nations-supported PRI Initiative: an international network of investors working together to put the six principles for responsible investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices.

Climate change letter: a co-signed letter, alongside institutions representing over USD 4.6 trillion in assets under management, in support of the Government of Alberta in its stated intention to update and strengthen its climate policy. We feel such steps are necessary to ensure the long-term success of Alberta as a favourable investment jurisdiction.

Tax: together with other global investors, we published a guidance note on the risks from certain companies' tax practices and an engagement toolkit in November.

Credit ratings

LGIM has been working through the PRI to encourage greater incorporation of ESG considerations in credit ratings; this is in addition to direct engagement with

ratings agencies. We recognise that environmental, social and governance factors can affect borrowers' cashflows and the likelihood that they will default on their debt obligations. We therefore consider ESG as a critical element in assessing the creditworthiness of a borrower.

Within LGIM we have already begun the process of more systematic inclusion of ESG into investment analysis and decision-making for fixed income. Individual investors cannot however stand alone on integrating ESG; we need ratings agencies on board in order to achieve greater market alignment, reduce security re-rating risks and to increase investor confidence in the quality and utility of ratings. Alignment on integration does not need to be at the expense of differentiation and alpha generation.

LGIM therefore participates in dialogue and engages in collaborative initiatives with other investors and credit rating agencies to further efforts to integrate ESG.

Investment Association (IA)

The IA represents UK investment managers and its members manage more than £5.5 trillion for clients around the world. We are on the IA's corporate governance and engagement and remuneration committees, while LGIM's CEO is on the IA's board of directors.

Asian Corporate Governance Association (ACGA)

ACGA engages in constructive dialogue with financial regulators, stock exchanges, institutional investors and companies on practical issues affecting the regulatory environment and the implementation of better corporate governance practices across 11 markets in Asia.

In 2015, as part of an ACGA delegation, we visited three ASEAN countries (Thailand, Malaysia and Indonesia) where several meaningful corporate governance changes are taking place.

Institutional Investors Group on Climate Change (IIGCC)

The IIGCC is a forum for collaboration on climate change for European investors. Our membership of the IIGCC helps to push for global, European and UK policy changes to help build a low-carbon economy.

Council of Institutional Investors (CII)

The CII is a leading voice in the US for good corporate governance and strong shareowner rights. The CII is an important forum for us to engage with US investors and continue to build our networks and reputation in the US.

CERES

Ceres is a non-profit organisation that uses its global network of investors and companies to advocate on sustainability issues. In April 2015 we signed the collaborative letter organised by CERES to the US Securities and Exchange Commission asking for



13. <http://www.lgim.com/uk/en/capabilities/corporate-governance/associations/>

improved disclosure of carbon asset risks by oil and gas companies. The letter discussed the carbon asset risks to these companies and investor efforts to improve disclosure through letters, dialogues, resolutions and 'disclosure expectation' documents.

International Corporate Governance Network (ICGN)

The ICGN is a global membership organisation of leaders in corporate governance from 50 countries. It promotes best practice guidance, encourages leadership development and keeps its members informed on emerging issues in corporate governance.

During the year we were a panellist at the ICGN conference in Boston on the topic of ESG integration where we shared how to integrate ESG into the investment process, the obstacles and successes around this. Additionally, we were a speaker at the ICGN conference in Madrid on the importance of the role of company secretaries in promoting good governance. Over 120 European investors and corporates were in attendance.

Industry consultations

During 2015, we submitted detailed responses to the following consultations:

Tokyo Stock Exchange (TSE) listing rules – March 2015

We provided comments directly to the TSE with regards to the development of listing rules to implement the Corporate Governance Code in Japan. As a long-term investor in Japanese equities, we are aligned with the enhancement of corporate value driven by meaningful changes such as corporates having rigorous corporate governance structures in place. We outlined three main points for consideration: the importance of outside independent director appointments, corporate reporting in English and the necessity for all companies to be subject to the Corporate Governance Code under a 'comply or explain' framework to protect its integrity.

Law Commission on fiduciary duties – April 2015

In this consultation, we directly responded to the Department of Work and Pensions on changes to investment regulations following the Law Commission's report on fiduciary duties. Its purpose was to discuss the difference between financial and non-financial factors and the role that stewardship can play when taking decisions about investments. Our response centred on the argument that factors related to ESG are financially material and should be discussed when making investment decisions. Therefore, law should not make these issues difficult to analyse and should provide flexibility in order for them to be examined in a consistent and transparent manner

European Securities and Markets Association (ESMA) – Impact of the best practice principles for providers of shareholder voting research and Analysis – July 2015

Through the Investment Association, we responded to the ESMA consultation on proxy voting advisors. The consultation wanted feedback on the practical application of the principles which guide a number of proxy voting advisors on their activities. In our contribution, we highlighted concerns with governance structure and lack of independence of the Best Practice Principles Group which is composed of members of the industry as it is standard practice for codes and principles to be monitored and administered by independent parties.

Singapore Stock Exchange – Questionnaire on Sustainability – July 2015

We completed an online survey developed by the Singapore Stock Exchange on sustainability. The questionnaire sought to better understand our approach to ESG as a global investor. This will provide guidance to the Singapore Stock Exchange on how it develops its own policies and guidance on this topic in the future.

Financial Reporting Council (FRC) – Audit Firm Governance Code – August 2015

We responded to the FRC's mandate to review the Audit Firm Governance Code (AFGC). This is in order to protect the integrity of the quality of audits conducted by audit firms. We also provided views on the clarification of terms such as 'public interest' in order to assist Independent Non-Executives (INEs) in understanding the full remit of their role. We reaffirmed our support for the appointment of INEs to provide fresh insight and challenge to the operation of audit firms

Hong Kong Stock Exchange (HKSE) – consultation on ESG guidelines – September 2015

In this consultation, we responded directly to the HKSE on its proposed ESG reporting guide to companies. We believe that reporting on non-financial issues is important as this provides investors with a more comprehensive view of a company's performance. Good transparency is also an important element in the management of our investments, providing a basis for engagements with companies to influence better practices. We highlighted six main areas of focus: materiality, timing of releasing the report, integrated reporting, comply or explain framework, disclosures to be upgraded and use of global reporting standards.

TUC fund manager voting survey – September 2015

This annual survey is intended to provide its members, including trustees, with information on how various fund managers exercise their voting rights, and to offer an insight into voting and engagement processes. We responded to this survey by providing our voting statistics, engagement activity and rationale for our decisions.

Financial Reporting Lab – dividend distributions – November 2015

We were active participants in the Financial Reporting Lab's project on dividend distributions. This project incorporates best practice disclosure on distributable reserves, a key disclosure requirement to assist investors in monitoring a company's underlying share capital position. A link to the report can be found [here](#)¹⁴.

Financial Services Authority (FSA) Japan – Japan Corporate Governance and Stewardship Codes – January and December 2015

In the consultation in January 2015, we provided comments on the exposure draft of the Japan Corporate Governance Code by the FSA and TSE. Subsequent to its release later on during the year, in December 2015 we provided follow-up comments to the FSA on the Corporate Governance Code and the Stewardship Code in Japan. We emphasised the importance of these two codes in enhancing the value of Japanese companies in the long term. On the Corporate Governance Code, we asked the FSA to pay particular attention to issues that could improve the effectiveness of the board such as a regular board evaluation being conducted. Furthermore, in relation to the Stewardship Code, we highlighted conflicts of interest as a key area of focus, particularly the integrity of 'Chinese walls' in communication.

Policy updates

General Corporate Governance & Responsible Investment policy

In January 2016 we updated our general corporate governance and responsible investment policy. This policy is applied globally across all our asset classes. It sets out our approach for monitoring and engaging with companies and our minimum expectations for governance and sustainability. The updated policy includes new sections on integration, political donations and board tenure.

New voting policy for Brazil

We have developed a policy for Brazil for the first time. This will then be used to produce a customised voting policy.

The Brazilian market is one where a majority of companies are controlled and therefore the issuers have a big influence on the governance regulations to which they are required to comply.

Most of the director elections are bundled and knowing the details of any new nominees in sufficient time for international shareholders to make an informed decision remains difficult. However, new regulations become mandatory from 2018 that will require 30 days' notice of new nominees.

The level of independence on the board is also very low with only 20% independence being a requirement. Board committees are non-existent except for financial institutions that are required to have a remuneration committee.

Remuneration votes are problematic due to a resistance to disclosing individual pay details.

Voting policies – Spain

In 2015 we added to our collection of policies and set out a voting policy for Spain. The country has undergone some significant developments in corporate governance recently due to key legislative reforms affecting governance as the financial crises revealed weaknesses in the legal framework of corporate governance and remuneration practices. This new policy is on our website and is also translated into Spanish.

UK – customising

This year we have not made significant changes to the UK policy on responsible investment. There have been minor changes to reflect:

- The ABI's Investment Affairs department merged with the Investment Management Association in June 2014 and was renamed the Investment Association. Our UK policy was amended to take account of this change and the associated changes to the various Committees which LGIM is a member
- The change to guidance on internal audit issued by the FRC and to take account of the new regulations on audit tendering
- Shareholder rights amended to reflect the changes to the pre-emption guidelines

The main area of change was to the structure and operation of the board where we have strengthened our stance on gender diversity, which will affect our voting decisions.

As the new remuneration reporting regulations are fully operational, we revised this section. There are no material changes to our policy, but we have re-emphasised our expectations of companies to provide retrospective disclosure of bonus targets and to adopt a policy that requires directors to maintain a shareholding for at least two years following retirement from the business.

We are introducing a customised policy to assist with UK voting, with the flexibility to override this policy in exceptional circumstances. The way in which we monitor companies will not be affected by this decision, but will reduce the administrative burden and free up time for engagement and analysis.

14. <https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Lab-Project-Report-Disclosure-of-dividends-%E2%80%93-poli.pdf>



Climate change policy

Investing through times of changing climates

As a global investor, Legal & General Investment Management is committed to addressing the issue of climate change. We believe that recognising the potential risks and providing solutions to mitigate downside risks is firmly part of our fiduciary duty of managing our clients' assets.



Climates are changing globally. Scientists are now 'unequivocal' in their opinion that greenhouse gases emitted as a result of human activities are causing global warming. The global temperature increase we will experience in the coming decades will profoundly impact people's lives and, therefore, our economies.

In order to minimise the most damaging consequences, global leaders have agreed to limit the temperature increase to 1.5 – 2°C above the pre-industrial levels. It is an ambitious but achievable target if we can meaningfully shift our methods of generating and consuming energy globally.

Climate change, and its direct and indirect impact, poses a significant systemic risk for long-term investors. Due to the unpredictable and inconsistent nature of weather patterns, it is difficult to assess the exact level of its impact. The magnitude and likelihood of risks and the scope and scale for solutions are also highly dependent on the policy support for mitigating excess emission levels and adapting to more extreme and changing weather patterns. The table

Policy changes	Weather impact	Resource availability
Subsidies/taxes	Floods/droughts/storms/bushfires/acidification	Water
Emission controls	Agriculture	Food
Technology support	Property/infrastructure damage	Energy
Infrastructure investments	Supply chain disruptions	

below broadly summarises three areas which could impact our investments as a result of climate change.

LGIM IS COMMITTED TO:

- **Work with policy makers**

To support their efforts to implement policy measures that meet our emission reduction targets. To encourage capital deployment at scale, in order to finance the transition towards a low-carbon economy. To accelerate investments in climate change adaptation

- **Develop our capacity to assess climate change related risks and opportunities**

To integrate climate risks and low-carbon opportunities in the investment management of relevant portfolios by seeking key indicators and acting upon financially material data and information

- **Engage with the companies in which we invest**

To ensure investee companies' strategies are aligned with global climate goals, to seek assurance that boards consist of individuals who can drive the business to succeed through the energy transition, and to ensure they are disclosing appropriate levels of risks and opportunities presented by the implications of climate change

- **Report to clients**

To communicate the actions we have taken on their behalf and assist them in considering the implications for their own portfolios

- **Provide investment solutions that are in line with low-carbon opportunities**

To work with clients to provide products that are aligned with their investment beliefs and that capture the multitude of investment opportunities that are arising in order to build a low-carbon economy

HOW LGIM ENGAGES

Policy engagements

We recognise that a rise in global temperatures above the recommended 1.5 – 2°C degrees can have an adverse impact on many of the long-term assets in which our clients are invested.

For this reason we have emphasised the need for policy changes and for a global agreement on the matter. We have done this by engaging collaboratively with other investors and civil society, as well as directly with policy makers in the UK and EU through our membership of IIGCC (Institutional Investor Group on Climate Change). We work together for the following purposes:

- Providing stable, reliable and economically meaningful carbon pricing that helps redirect investment commensurate with the scale of the climate change challenge

- Strengthening regulatory support for energy efficiency and renewable energy, where this is needed to facilitate deployment
- Supporting innovation in and the deployment of low-carbon technologies, including financing clean energy research and development
- Developing plans to phase out subsidies for fossil fuels
- Ensuring that national adaptation strategies are structured to deliver investment
- Considering the effect of unintended constraints from financial regulations on investments in low-carbon technologies and climate resilience

Integration

The varying timeframes within which the effects of climate change materialise means that the risk implications are often sector and region-specific, and ultimately dependent on the type of the portfolio we manage.

For index-tracking funds, we address climate risks through direct engagement with investee companies and policy makers. For actively-managed funds in equities and bonds, we assess it as part of our fundamental analysis. To assist both processes, key indicators such as energy intensity trends, policy on addressing climate change, energy efficiency, energy and reserve mix and water use are incorporated into LGIM's proprietary ESG (environmental, social and governance) toolkit. Each company in a sector exposed to climate change risks is assessed against its peers in addressing climate risks and opportunities. The overall score allocated to the companies allow our ESG system to flag those with sub-standard performance, thus stimulating discussion internally as well as leading to direct company engagement.

We are, however, cognisant of the lack of comparable and reliable disclosure in the public domain to assess the appropriate level of exposure companies have to the effects of climate change. As such, we are committed to enhance the level of disclosure by companies through participating in various collective initiatives as well as requesting data and information directly from companies.

Company engagements

Our engagements with company boards and executive directors are key to advancing this dialogue and in helping companies build strategies that will enable them to adapt to and thrive within the changing political, technological and environmental backdrop.

The three main areas of focus in our engagements are: strategy, governance, disclosure.

Given that the energy sector is responsible for two thirds of global greenhouse emissions, our engagement efforts in relation to climate change are focused on these three main sectors: oil and gas, mining and utilities. This is because much of the revenue from these sectors is related to either extracting or burning fossil fuels i.e. oil, gas and coal. With companies in these sectors we discuss how their business strategies are aligned with the global climate goals and the rationale for their capital spending. We also look for assurance in the board members' skillset and experience to overcome policy and technology challenges in the future.

Regarding disclosure, investors are increasingly demanding clarity on companies' internal energy scenario models, assessments of the impact of future carbon prices and reasons for participating in public policy debates on energy through trade associations. Where material risks are identified, we would expect them to be outlined in the annual report, alongside an appropriate strategy with which to address them. We also recognise that these sectors hold as much opportunity in the energy transition as potential risks. To assess this, we encourage companies to articulate their medium to long-term plans in which their business models will become solutions to the low-carbon transition globally.

There are many other industries which are highly exposed to climate change. For example the high energy use in real estate, cement, steel, manufacturing and transport sectors exposes companies to potential energy-related risks. We therefore ask companies for their plans to reduce energy use and avoid future carbon taxes.

Furthermore, the indirect impact associated with climate change can also be significant in sectors such as finance. Banks' lending exposure to fossil fuel-based exploration or energy generation projects can pose a risk if the industry faces increasing policy and increasing expenditure risks. Banks are also asked to play a leading role in financing low-carbon asset financing, such as green bonds. For insurance companies, the insurance risks from adverse weather can impact their ability to pay out.

There are, of course, industries that will drive the change for energy transition. Namely, industrials' investments into battery storage which could transform the way energy is generated and consumed. Ongoing research and development by the auto industry and commercialisation of alternative transport models at scale will revolutionise the

transport sector and potentially decrease oil demand trends globally. Moreover, innovation by the technology sector will allow us to be more efficient, and smarter in the way we generate, store and consume energy.

In each company meeting our engagement topics will be tailored to the company and their unique perspective of future changes. The overall goal is to help them build a sustainable business model that will thrive in the changing business dynamics.

Reporting

We are committed to communicating our effort to our clients. Climate change will form a part of the regular ESG reporting channels, which are quarterly for clients and annually for the general public. Additionally, we look to host seminars, attend conferences and publish our thought pieces on a range of sustainability themes. Please refer to our latest publication on climate change and energy transition as an example [here](#)¹⁵.

Product development

With increased scrutiny over the role of fossil fuels and raising carbon emissions, some of our clients are evaluating their own carbon footprint and exposure to fossil fuel reserves in their portfolios. At the same time, there is a wider discussion in the market as to how we can jointly finance the energy transition in a manner that is conducive to meeting global climate goals, but also fulfils our financial obligations.

A wide range of indices and investment products that address these two aspects is starting to be developed in the market: carbon reduction and green finance opportunities. We have a few investment options that address these, but are looking to expand our range of solutions by working closely with our clients to understand their investment requirements.

15. http://www.legalandgeneralgroup.com/assets/portal/files/Fundamentals_Oct_2015.pdf

The Corporate Governance Team

LGIM's Corporate Governance and Responsible Investment team is led by the Director of Corporate Governance, Sacha Sadan. The team of nine collectively has an average of over 13 years' investment experience.



Sacha Sadan
Director of Corporate
Governance

Sacha is Director of Corporate Governance at LGIM and has overall responsibility for the corporate governance investment team which includes Environment Social Governance (ESG). The team performs a highly active role in engaging with the companies in which LGIM invests, particularly FTSE companies, seeking to deliver the best possible long term value for shareholders. The team also collaborates with other investors, the Government and FCA. Sacha is a member of the Investment Association Governance and Engagement Committee. Sacha also helped in the formation of the new UK Investor Forum and is a founding member of their Board. Prior to joining LGIM, Sacha worked for Gartmore where he was a Senior UK Equity Fund Manager and co-managed a range of UK equity hedge, retail and institutional funds. Sacha was the top-rated Pan European Fund Manager in the Thomson Reuters Extel Awards in 2010 and rated third in 2009 as voted by UK companies and key sell-side participants. Prior to Gartmore, Sacha was the lead UK Equity Fund Manager of a £4bn pension fund for the Universities Superannuation Scheme PLC. Sacha is a member of the CFA Institute and holds a BA in Accounting and Finance from Manchester University.



David Patt
Senior Corporate
Governance Analyst

David has overall responsibility for LGIM's UK corporate governance activity including proxy voting, company engagement and client reporting. David is also responsible for responding to government/industry consultations in order to position LGIM as thought leaders in corporate governance. David joined LGIM in 2006 from ISS where he was a research analyst. In this role, his day-to-day responsibilities included analysing corporate governance structures in UK listed companies and providing voting recommendations for investors at general meetings. David graduated from Salford Greater Manchester University with a degree in business economics. In addition, he holds a diploma in economics from the University of Manchester and has completed Unit 1 of the Investment Management Certificate.



Jeannette Andrews
Corporate Governance
Manager

Jeanette is a Corporate Governance Manager with responsibility for implementing LGIM's corporate governance strategy. Jeannette is responsible for engaging with companies in which LGIM invests on governance issues and has a particular focus on the European pharmaceutical and banking sectors. She joined LGIM in September 2015 from USS Investment Management Ltd where she held the title of Senior Analyst, Responsible Investment. Jeannette joined USS in 2008 and split her time between developing and implementing USS's stewardship, integration and engagement policies and working as an equity analyst. She was responsible for researching and making stock recommendations for a £420m global equity income portfolio. Prior to that, she worked for five years as a Governance Analyst at Manifest Information Services, a proxy voting service provider. Jeannette graduated from Anglia Ruskin University in 2008 and holds the CFA and CAIA charterships. In 2014 Jeannette was recognised by Financial News as one of the 40 under 40 Rising Stars of Asset Management.



Clare Payn
Head of Corporate
Governance North
America

Clare is Head of Corporate Governance North America and has overall responsibility for LGIM's ESG engagement, voting activities and policy setting in the North American region. She communicates with companies, investors, and other market participants in striving for best practice in this market. Clare also leads the governance team's work on improving gender diversity on corporate boards. She sits on L&G Group Plc's Equality, Diversity and Inclusion Committee, co-heading the gender stream, which works towards creating an inclusive and diverse culture. She also sits on the FemaleTalent Forum, a committee focused on strengthening the Group's female representation below Board and Executive level. Clare joined LGIM in March 2010 from Aberdeen Asset Management where she was responsible for establishing, managing and accelerating the company's UK and European corporate governance strategy and proxy voting capabilities. Prior to that, she was a corporate governance analyst at Deutsche Asset Management for five years. Clare graduated from Loughborough University and holds a BA (Hons) degree in English literature and has 15 years' experience in corporate governance.



Meryam Omi
Head of Sustainability

Meryam is responsible for engaging on sustainability themes globally. She leads on the project to integrate environmental, social and governance (ESG) aspects into the fundamental research of mainstream funds and to carry out sector/theme specific engagements on key sustainability topics, such as climate change, water and corporate tax policy. Meryam has over 11 years of investment experience in asset management companies, starting her career as a business proposal writer for fixed income funds. She joined LGIM in 2008 to set up a business proposal team and project managed various marketing and sales initiatives across a wide range of products and capabilities. After completing an MSc in Environmental Decision Making, she joined the Corporate Governance team in 2010 to establish the engagement programme on environmental and social topics as LGIM signed up to the UN Principles of Responsible Investment and the UK Stewardship Code.



Catherine Ogden
ESG Analyst

Catherine joined LGIM's Corporate Governance team in 2015, in a new role created to help drive forward LGIM's ESG integration into mainstream fund research, and to strengthen sustainability engagements. Catherine joined LGIM from Adam Smith International, an international development consultancy, where she worked for four years with governments in Africa on the sustainable policy, planning and management of the oil, gas and mining sectors. Prior to this, Catherine spent five years as a French small and mid-cap Equity Analyst, with a particular focus on the oil and gas sector. Catherine graduated from Durham University in 2005 with a BA in Economics and modern languages, and in 2011 from the School of Oriental and African Studies, with an MA in Globalisation and Multinational Corporations.



Angeli Benham
Corporate Governance
Manager

Angeli is Corporate Governance Manager with responsibility for LGIM's voting and engagement on ESG issues with UK, European and Brazilian companies. She is responsible for developing LGIM's policies in these regions and specialises in executive remuneration. Angeli represents LGIM at the IA Remuneration Committee. Angeli joined LGIM in 2005 from the Association of British Insurers where she was a Corporate Governance Analyst for five years. Prior to this she worked for Prudential as a corporate finance assistant for three years. Angeli holds a BSc (Hons) Financial Economics, PGDip Law, Legal Practice Certificate in Law, Investment Management Certificate and part qualified ICASA.



Tom McGarrity
Corporate Governance
Analyst

Tom undertakes analysis and research for engagement and voting activities with investee companies, as well as assists with client reports and presentations. Tom joined LGIM in 2011 as a graduate trainee. Tom holds a BA (Hons) degree in management studies and an MSc in corporate strategy and governance from the University of Nottingham. In addition, he holds the Investment Management Certificate and has passed all three levels of the CFA programme. He holds the Investment Management Certificate and is a CFA Charterholder.



Maxine McMahon
PA to Sacha Sadan

Maxine has 30 years PA experience including events, HR and Office Management, Sales and Marketing within various sectors and teams.

CONTACT US

For further information on anything you have read in this report or to provide feedback, please contact us at corporategovernance@lgim.com. Please visit our website www.lgim.com/corporategovernance where you will also find more information including frequently asked questions.

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