

F&C

Corporate Governance **Responsible Ownership.**

Policy and Principles for Corporate Governance



What is Responsible Ownership?

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

Corporate governance is the system by which businesses are directed and controlled.

Good practice embodies a number of key principles:

- An **empowered** and **effective** board and management team
- Appropriate **checks** and **balances** in company management structures
- Effective systems of **internal control** and **risk management** covering all significant issues, including SEE issues
- Commitment to promoting a “governance culture” of **transparency** and **accountability** throughout the company that is grounded in sound business ethics
- Remuneration policy that rewards the creation of **long-term shareholder value** and the achievement of corporate objectives.

F&C’s responsible ownership policy is aimed at using both its votes and its voice to encourage companies to achieve these goals. A summary of our specific expectations for companies is set out below (see “*What does F&C expect of companies?*”) and underpinned by detailed operational guidelines and engagement policies available on our website¹.

What does responsible ownership mean in practice?

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

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

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

Pragmatism and consistency

While F&C’s approach is to follow a consistent philosophy worldwide, it also seeks to apply its policy in a pragmatic manner. F&C recognises that businesses are dynamic organisations and that legal or cultural differences may give rise to differing interpretations of best practice. While F&C takes account of a company’s compliance with appropriate rules, regulations and best practice, it seeks to understand the individual circumstances of each company and its “governance culture”, and does not subscribe to a “box-ticking” approach.

Effective use of influence

F&C believes that effectiveness requires a great deal of informal engagement with companies, and not simply the exercise of votes. It seeks to develop dialogues with companies in order to better understand individual practice and, where appropriate, to encourage improvements. Where appropriate, F&C will also co-operate with like-minded investors in order to emphasise shared investor concerns. F&C will, as a general rule, avoid public comment on the details of its discussions in order to enable in-depth, constructive discussions in a climate of trust and confidentiality. However, where discussions have not been satisfactory on an issue of major significance, F&C will consider filing a shareholder resolution.

Transparency and accountability

F&C considers itself accountable to all its customers and investee companies and to any other persons who have a legitimate interest in its approach to responsible ownership. For this reason, F&C provides detailed reports to its clients and to the public, detailing its engagement activities and voting record. It also communicates its policies and the reasons for any votes not in line with directors’ recommendations to investee companies.

Practising what we preach

F&C seeks to achieve best practice within its own business and, as a UK-listed company, supports the provisions and principles of corporate governance as defined by the Combined Code of the London Stock Exchange. It also endeavours to behave in a socially and environmentally responsible manner. It believes these create long-term value.

The F&C board has set up a Corporate Governance Committee chaired by a member of the executive committee of the company. This committee is responsible for reviewing annually F&C’s policies and guidelines on responsible ownership, as well as monitoring the effectiveness of F&C’s voting and engagement procedures. The F&C board has also set up a Corporate Social Responsibility Committee to oversee F&C’s management of SEE issues.

What does F&C expect of companies?

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

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

A summary of F&C's expectations of companies is described below, supported by more detailed operational guidelines and engagement policies available on our website².

Board, structure and composition

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

- **Role of the board.** While most responsibilities can be devolved to executive management, certain matters should be reserved for the board: the testing and setting of strategy proposed by the executive, and the planning for succession of the executive and the board itself.
- **Quality and effectiveness of the board.** Boards should have meaningful representation of both executive and non-executive elements. Non-executives should normally be wholly independent of the company and selected from the widest pool of relevant talent so as to promote a diversity of views and genuine debate. The board should be large enough for meaningful debate, but overlarge boards (over 15 directors) are unwieldy and should be avoided. A process to ensure the "freshness" of the board is desirable, as well as an effective and transparent system for board evaluation.
- **Board meetings.** There should be sufficient meetings for the proper management of the company (six per annum as a minimum).
- **Independence of non-executive directors (NEDs).** To be regarded as independent, NEDs should not: be former executives, have close family ties with the company, hold cross-directorships, be major shareholders or representatives of any special interest group, have commercial involvement with the company or be entitled to performance-related pay, stock options or pensions. Prolonged membership on the board will also jeopardise independence.
- **Two-tier boards and boards without significant executive representation.** Where there is a two tier board or a board comprising primarily non-executive directors, there needs to be an effective mechanism for the various elements of the board and the executive committee to work together.
- **Separation of principal roles.** F&C strongly believes that the roles of Chairman and Chief Executive Officer (CEO) should be separate. This is because they are distinct jobs, and because the challenge of fully leveraging the capabilities of the board requires the concentrated attention of an independent leader who can exercise a beneficial counterweight to the CEO³.
- **Board committees.** Independent audit, nomination and remuneration committees are desirable for all companies, and essential for large companies. Corporate social responsibility (CSR) or sustainability committees are recommended, particularly for companies exposed to significant SEE risks. Audit committees should be fully accountable for the proper identification, management and reporting of all significant financial and non-financial risks, as well as ensuring that an effective mechanism for whistle-blowing is in place.
- **Liaison with shareholders.** The board should positively make itself available for consultation with shareholders on any substantive matter, whether or not it forms the subject of a vote. A board should consider appointing a Senior Independent or Lead Director to fulfil a formal liaison role.

Remuneration

Levels of remuneration, including benefits and other incentives, should be adequate to recruit, incentivise and retain appropriate staff, reflecting the work carried out and the executives' contribution to the creation of long-term shareholder value. Remuneration policy should be set by a fully independent remuneration committee and all significant forms of reward should be disclosed to shareholders, along with the underlying performance conditions. F&C welcomes the opportunity to discuss remuneration issues with companies and to vote on them.

Reporting

Companies should be as transparent as possible within their report and accounts, so that investors can obtain a clear understanding of all important and relevant issues. This includes any significant SEE issues. The report and accounts should provide a full review of the achievements of the company and of the standards followed during the accounting period, as well as a clear description of remuneration levels and the policies that underpin them.

Governance of social, environmental and ethical (SEE) issues

Effective management of the risks and opportunities posed by significant SEE issues is an important component of good governance practice. Companies that ignore such issues risk serious damage to their **reputation** and **brand value**, as well as **litigation** and **operational risks**.⁴ Creating a "governance culture" of transparency and accountability, which goes beyond mere compliance with codes and legislation, is key to addressing these aspects of performance effectively. Well-known scandals illustrate just how important it is to ensure that companies be alert to the business risks inherent in a potentially broad range of issues, such as **fraud, bribery** and **corruption, climate change, human rights, labour standards** in supply chains and the **health impacts** of products.

2. See www.fandc.com/governance within "Publications".

3. For further discussion of this complex point, please see page 2 in F&C's Corporate Governance Operational Guidelines.

4. F&C's more detailed position on specific SEE issues (eg climate change, labour standards, bribery and corruption) can be found at www.fandc.com/governance (see "How we engage" within "Products and Services")

A well-managed company has systematic programs in place to identify, assess and manage these issues. Specifically, good governance in this area requires⁵:

- Board oversight of and accountability for significant SEE issues
- Systems to enable the board to identify and assess SEE risks and opportunities, including, where appropriate, a commitment to open dialogue with stakeholders
- Formal policies on any significant SEE issue
- Management systems for the effective implementation of SEE policies
- Monitoring the achievement of SEE policy objectives
- Disclosure of the above within the company's annual report to shareholders⁶.

Shareholder rights

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

- Enter into dialogue with institutional shareholders, where practical
- Provide pre-emption rights for existing shareholders
- Ensure a share structure that gives all shares equal voting rights by avoiding the issuance of shares with impaired or enhanced voting rights
- Recognise that take-over bids are important as a means of maintaining an efficient and competitive market. F&C regards artificial devices to deter bids, known as "poison pills," as inappropriate and inefficient, unless they are of a strictly controlled and very limited duration. Where national practice or legal structures do not provide suitable protection for minority shareholders, this should be addressed in legislation, and F&C will usually oppose poison pill devices.

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

5. This is consistent with the UK Association of British Insurers' Disclosure Guidelines on Socially Responsible Investment (www.abi.org.uk).

6. This may be supported by more detailed disclosure in a separate Corporate Responsibility or Sustainability report. Where practical, such disclosure should be in line with internationally accepted guidelines such as the Global Reporting Initiative (GRI).

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F&C/4270-01/06



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