

The UK Stewardship Code - RLAM's approach and disclosure

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Introduction

The UK Stewardship Code was published in July 2010. It aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities by setting out good practice on engagement with investee companies to which the Financial Reporting Council (FRC) believes institutional investors should aspire.

The Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities. Engagement includes pursuing purposeful dialogue on strategy, performance and the management of risk, as well as on issues that are the immediate subject of votes at general meetings.

The Code sets out good practice on engagement with investee companies to which the FRC believes institutional investors should aspire. It provides an opportunity to build a critical mass of UK and overseas investors committed to the high quality dialogue with companies needed to underpin good governance. By creating a sound basis of engagement it should create a much needed stronger link between governance and the investment process, and lend greater substance to the concept of “comply or explain” as applied by listed companies. The FRC therefore sees it as complementary to the UK Corporate Governance Code for listed companies, as revised in June 2010.

The principles of the code

Institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities
2. have a robust policy on managing conflicts of interest in relation to stewardship, which should be publicly disclosed
3. monitor their investee companies
4. establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value
5. be willing to act collectively with other investors where appropriate
6. have a clear policy on voting and the disclosure of voting activity
7. report periodically on their stewardship and voting activities

The Principles of the Code - Detail

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Guidance

The disclosure should include:

- a) how investee companies will be monitored. In order for monitoring to be effective an active dialogue may, where necessary, need to be entered into with the investee company's board;
- b) the strategy on intervention;
- c) internal arrangements, including how stewardship is integrated with the wider investment process;
- d) the policy on voting and the use made of, if any, proxy voting or other voting advisory service, including information on how they are used;
- e) the policy on considering explanations made in relation to the UK Corporate Governance Code.

Principle 2

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

Guidance

An institutional investor's duty is to act in the interests of all clients and/or beneficiaries when considering matters such as engagement and voting.

Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

Institutional investors should put in place and maintain a policy for managing conflicts of interest.

Principle 3

Institutional investors should monitor their investee companies.

Guidance

Investee companies should be monitored to determine when it is necessary to enter into an active dialogue with their boards. This monitoring should be regular, and the process clearly communicable and checked periodically for its effectiveness.

As part of this monitoring, institutional investors should:

- a) seek to satisfy themselves, to the extent possible, that the investee company's board and committee structures are effective, and that independent directors provide adequate oversight, including by meeting the chairman and, where appropriate, other board members;
- b) maintain a clear audit trail, for example, records of private meetings held with companies, of votes cast, and of reasons for voting against the investee company's management, for abstaining, or for voting with management in a contentious situation; and
- c) attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

Institutional investors should consider carefully explanations given for departures from the UK Corporate Governance Code and make reasoned judgements in each case. They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position.

Institutional investors should endeavour to identify problems at an early stage to minimise any loss of shareholder value. If they have concerns they should seek to ensure that the appropriate members of the investee company's board are made aware of them.

Institutional investors may not wish to be made insiders. They will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their agreement.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

Guidance

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include when they have concerns about the company's strategy and performance, its governance or its approach to the risks arising from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if boards do not respond constructively when institutional investors intervene, then institutional investors will consider whether to escalate their action, for example by:

- a) holding additional meetings with management specifically to discuss concerns;
- b) expressing concerns through the company's advisers;
- c) meeting with the chairman, senior independent director, or with all independent directors;
- d) intervening jointly with other institutions on particular issues;
- e) making a public statement in advance of the AGM or an EGM;
- f) submitting resolutions at shareholders' meetings; and
- g) requisitioning an EGM, in some cases proposing to change board membership.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate.

Guidance

At times collaboration with other investors may be the most effective manner in which to engage.

Collaborative engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten the ability of the company to continue.

Institutional investors should disclose their policy on collective engagement.

When participating in collective engagement, institutional investors should have due regard to their policies on conflicts of interest and insider information.

Principle 6

Institutional investors should have a clear policy on voting and the disclosure of voting activity.

Guidance

Institutional investors should seek to vote all shares held. They should not automatically support the board.

If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution.

In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records and if they do not explain why.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities.

Guidance

Those that act as agents should regularly report to their clients details of how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported, including the format in which details of how votes have been cast are presented, should be a matter for agreement between agents and their principals.

Transparency is an important feature of effective stewardship. However, institutional investors should not be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

Those that act as principals, or represent the interests of the end-investor, should report at least annually to those to whom they are accountable on their policy and its execution.

Those that sign up to this Code should consider obtaining an independent audit opinion on their engagement and voting processes having regard to the standards in AAF 01/061 and SAS 702. The existence of such assurance certification should be publicly disclosed.

The UK Stewardship Code and Royal London Asset Management

RLAM is supportive of the Stewardship Code and we intend to comply with the Code and in particular the seven principles contained in the document. This document is intended to outline our overall approach to the stewardship of the securities holdings that we manage on behalf of clients. We will report annually upon our governance activities relating to these principles detailing how we have discharged our responsibilities as an institutional shareholder. This will contain information covering our overall activity levels, some commentary on the environment for stewardship and where appropriate some examples of where we have been involved.

We will continue to monitor our investee companies not only through our own research but also through regular meetings with management where we can discuss a range of issues relating to strategy and governance. We remain supportive of the underlying principle of “comply or explain” and will take careful consideration of the position of management whenever we or other shareholders raise issues with them, particularly in relation to disclosures made under the UK Corporate Governance Code. Our aim from such activity is to satisfy ourselves that we are comfortable with the overall strategy that is being pursued, that the board and its various sub-committees are operating effectively and that the company are aware and are managing appropriately the significant risk factors as they relate to that particular company.

As part of this process if we become concerned that value is being actually or potentially jeopardised we will make our views known to the company through a direct meeting with management and/or writing to the company outlining our concerns. We take the view that good company engagement has a positive cumulative effect and therefore understand that it is through a series of meetings over time that we can build a better understanding of management's intentions, discuss our perspective with them and hopefully build support for a particular course of action or strategy. We will be prepared to pursue meetings with various members of the board dependent upon the nature of the issue that we are looking to address. However we also take the view that there will be occasions where our views are so different from that of management or other shareholders that the best way we can pursue our clients interest will be to dispose of our holding.

Our underlying belief is that management are appointed by the shareholders to manage the business in the best interest of shareholders over time. Therefore our governance activities are not intended to micro manage the company but instead we see that it should be focused upon the more significant issues, for instance on corporate strategy, major acquisitions or management change.

There have been occasions in the past where we have participated in joint meetings involving other institutional investors and management and believe that this can be a legitimate course of action in order to ensure that management are aware of the strength of feeling relating to a particular issue. Collaborative engagement will generally be restricted to occasions of significant corporate or economic stress and we will take due regard to the potential for conflicts of interest and insider information.

The emphasis within the debate around engagement is largely from an equity investor's perspective given that in most instances there is a limited amount of leverage that a bond holder can exercise over the issuing company. However our own experience is that we are becoming more involved in corporate bond restructurings and that these in many instances involve a bondholder vote. We will ensure that we approach such decisions in the same way we would on an equity issue in aiming to support management where appropriate but always seeking to enhance value on behalf of our underlying clients.

We intend to continue publicly disclosing our voting record which covers all of the votes available to us on all our accounts. We subscribe to the IVIS voting service provided by the Association of British Insurers to help us in this process. This provides information, around company meetings, and highlights items of particular interest or where there could potential be an exception to generally agreed principles affecting our shareholder rights. Our voting record can be found on our website at the following location: www.rlam.co.uk. We vote our shares in all UK equities where we have a holding and will vote on our holdings in overseas companies where we determine that there is a significant issue. This reflects the fact that our equity holdings are predominantly in UK equities and therefore we take the view that routine voting of overseas equities cannot be justified on a cost-benefit analysis. In addition we will vote on our

fixed interest holdings where the occasion arises. While we do have a stock lending program in place we will routinely recall the stock when necessary and therefore this activity does not prevent us from exercising our votes.

Our policy on potential conflicts of interest is that if we become aware that there could potentially be an issue, then the senior management will discuss the circumstances in order to ensure that these are appropriately managed so that we always act in the best interests of each individual client.

All enquiries regarding our activities with respect to engagement should be directed in the first instance to the RLAM CIO whose contact details are below.



Robert Talbut
CIO

020 7506 6500

Robert.Talbut@rlam.co.uk

Overall corporate governance guidelines

These guidelines provide the detailed background to how RLAM sees many governance issues, and explains how RLAM exercises votes.

RLAM will normally apply the following guidelines when voting on behalf of client portfolios, unless otherwise instructed by a client. In such cases we will apply client policies as instructed. At the end of the document we reproduce some of the governance papers produced by other bodies which help to frame our practices.

Board Structure & Composition

Initial comments

The structure of boards will vary from company to company. There are variations between larger companies that may have a strategic holding company board and those companies where the board has predominantly operational responsibilities. These differences will be taken into account. Other factors will vary depending on the nature of the business, its size and complexity, the company's stage of development, the ownership structure, the remit of the board and the skills of the individuals on the board. For large companies, RLAM expects at least half the board to be independent directors, have adequate representation of executives (we normally wish to see at least three) and the chairman to be regarded as independent on appointment.

Purpose of the board

The board of a company is responsible for the management of that company. This is mainly achieved through the devolution of powers to the executive management. The board should receive the report of the executive on the conduct of the business, and it should question the executive on these matters. However, certain matters are reserved for the board; it is responsible for testing and setting strategy proposed by the executive, and for planning for succession of both the executive and the board itself.

Quality of the board

The quality of the board is of utmost importance in order to facilitate better informed board decisions. It should have meaningful representation of both executive and non-executive elements. Non-executives should normally be wholly independent of the company.

While diversity of individuals, whether of gender, ethnic origin, nationality, professional background or other factors, can be valid aspects in considering an individual's potential contribution to the board, it is essential that candidates be chosen on the basis of their overall competence and ability to effectively enhance the performance of the company.

Board meetings

There should be an adequate number of meetings for the proper management of the company. We would regard six in any one year as a minimum, and often more frequent meetings are necessary. The board should be large enough for meaningful debate but overlarge boards are unwieldy, and should be avoided. Attendance at board, and board committee, meetings is important and should be publicly reported.

Board evaluation

Whilst individual directors will contribute to the board, the board as a whole and board committees should work as an effective team. To that end, an effective and transparent means of board evaluation should be in place. This should address the effectiveness of the board as a whole, the effectiveness of any board committee and the contributions made by each member and an assessment made of areas that the board does not adequately cover. There is a good case for this evaluation process to be under the supervision and responsibility of the nomination committee and we would encourage companies to employ independent assessment in the overall process. For all companies, external evaluation is very valuable, and for larger companies, RLAM considers it best practice.

Board renewal

RLAM considers it best practice to have a process to ensure the freshness of the board by regular new appointments. However we do not set arbitrary time limits on tenure for board membership. We believe that the process of planning for succession of Board members should be more widely reported upon. Some of the issues surrounding leadership within a business appear to have their roots in insufficiently developed plans for planning for succession of the executive management team.

Smaller companies

For smaller companies the Combined Code requires only two independent nonexecutives. Where the chairman also is independent, RLAM is supportive of this approach and of the chairman sitting on board committees.

Separation of principal roles

Separate people should hold the roles of Chairman and Chief Executive (CEO), because they are different and usually mutually exclusive jobs, and because RLAM judges it preferable to avoid the concentration of power. If for any reason the roles are combined, e.g. over an unexpected transitional period, this should be explained and justified in the Report & Accounts. In all such cases, a notably strong senior independent non-executive director must be nominated. In addition where a Board is considering appointing the CEO as Chairman we would expect to see a high quality of explanation from the non-executive directors as to why they are supportive of such a move and also the evaluation process used to investigate alternative external candidates. We take the view that such a move should only be a relatively temporary arrangement and that the return to the separation of roles should occur as soon as possible.

Retiring directors

RLAM would not normally expect to see a retiring executive director retain a seat on the board as a non-executive director, except in highly unusual circumstances. Particular scrutiny would apply in the case of retiring CEOs and nomination of the Chairman.

Board Committees

RLAM considers independent audit, nomination and remuneration committees to be essential. Ethics, health and safety, governance, and corporate social responsibility (CSR) committees are desirable, and in many cases, such as those large companies exposed to multiple social, ethical and environmental (SEE) risks, they are considered essential. There is currently some debate over the potential for a separate Risk Committee to oversee current and future risks facing the business. We currently retain the view that the assessment of risk should be a matter for the whole board rather than for a subset.

The Chairman

The Chairman sets the agenda of the board in consultation with the company secretary, the executive and the directors. He is the person responsible for the appointment and removal of the Chief Executive (CEO). While we see it as essential that the Chairman provides public support for the CEO we also believe that it is essential that he should not become too closely aligned in order that he can appropriately take account of shareholder views. It is also essential that the Chairman encourages an environment of constructive challenge within the boardroom in order that NEDs feel encouraged to question debate all issues.

Chairman's role on board committees

In large companies where the Chairman is by definition not considered independent, it is advised that he or she neither chair any of the board committees nor be a member of any committee, except the nomination committee. He or she should nonetheless attend all committee meetings. In smaller companies, the role of Chairman may be less arduous and he or she may therefore be regarded as genuinely independent and appropriate to be a member of the committees.

Company Secretary

The company secretary is responsible to the board of the company and not, primarily, to the company's management. The company secretary should be appointed and employed specifically by the board as a whole, rather than by the company.

Executive directors

For properly informed discussion it is important that the appropriate executives are present at board meetings. Not all these executives need to be board members, but the principle ones and those regularly present should be. The company's practice in this regard should be described in the annual report.

Non-executive directors

Non-executive directors have a valuable contribution to make to the development of the quality of management of the company. This is a demanding role. Whilst RLAM does not have hard rules about the number of directorships an individual can undertake, Non-executives must have enough time and energy to discharge the role properly. Non-executive directors also ought to bear in mind that, on occasion, there may be heavy demands made upon their time. We will pay attention to the attendance record of all non-executives to ensure that they are fulfilling their role appropriately.

NED-only meetings

Non-executive directors should hold NED-only meetings on a regular basis, e.g. prior to board meetings, and when circumstances demand. They should also have at least one meeting a year to have an unconstrained discussion away from day to day business matters. A senior independent director (SID) should chair such meetings, although the Chairman may be present. The non-executive directors, and in particular the SID, should also seek where appropriate to establish lines of communication with the principal institutional shareholders, in separate meetings and by joining a few of the regular meetings that executive directors hold with institutional shareholders. In this way they can be better informed on shareholder views of business strategy and performance as well as the current leadership of the company. The SID together with the Chairman should be encouraged to bring any such issues that may arise to the attention of the full board.

Higgs report

RLAM is very supportive of the principles on the role of the non-executive director set out in Derek Higgs's report, published in January 2003.

Independence of non-executive directors

Independence of individual directors is valued, but a good balanced board is valued above all. The following indicators are used as guide in determining the independence of each individual board member, but RLAM will support non-independent directors where it is aware of particular circumstances that justify it. RLAM supports the definition of independence within the Combined Code. RLAM applies the following guidelines when determining independence:

Independent, non-executive directors should:

- not be former executives of the company or group
- not have close family ties with any of the company's advisors, directors or senior employees
- not hold cross-directorships or have significant links with other directors
- not be major shareholders or representatives of any special interest group
- have no commercial involvement with the company as professional advisers or major suppliers or customers
- not be entitled to performance-related pay, stock options, or pensions
- not normally hold other directorships in companies in a closely related industry
- not be known as close associates of any executives

Prolonged membership of a board may jeopardise independence. The Combined Code states that after two three year terms independence needs to be justified, and that after nine years, a director should no longer be regarded as independent. While we would not automatically seek to remove a NED who had been in situ for longer than this period, any non-executive director deemed to be non-independent by reason of tenure should be subject to annual re-election.

Proportion of non-executive directors on the board

RLAM believes that an appropriate mix (a balance of relevant skills) on the board is more important than having a fixed proportion of non-executive directors. It is important to have enough non-executive directors for an adequate

spread of views on the board and for membership of the board committees. For large companies RLAM would expect a majority of non-executive directors on the board, whereas for smaller companies it uses a minimum of three, and preferably a majority, as a rough guide, again considering each breach of this on its merits. The role of chairman in large companies is such that it cannot be regarded as independent, although it is normally non-executive.

Re-election of directors

To ensure it retains an open and critical perspective, the board needs to be continually renewed, therefore all directors should be required to submit themselves for re-election at regular intervals, and for this RLAM considers that every three years is a maximum period of tenure. RLAM is sympathetic to the emerging view that all directors should now be subject to re-election every year.

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, and may, to this end, appoint a SID to fulfil a formal liaison role. Executive management should maintain a good liaison with their principle shareholders covering both developing strategy and current performance so that the owners of the business are properly informed as to the conduct of the business, but avoiding imparting any insider information except when it is essential to do so. Non-executive directors should be involved in this process sufficiently to be aware of how it is carried out and to meet representative shareholders. Directors should consult shareholders, particularly institutional shareholders, prior to seeking approval for resolutions at the AGM and other meetings where any resolution could be considered contentious or consultation is otherwise deemed appropriate. Consulting representative bodies such as the Association of British Insurers (ABI) is recommended in addition. Good quality, open, and regular contact between the company's management and shareholders is the best way of improving support for business strategy and highlighting actual or emerging areas of concern. Shareholders need to devote sufficient time and energy to ensure that management believe that they have had the appropriate opportunity to make their case. Similarly, management need to fully engage with shareholders and be prepared to take account of the views expressed and the strength with which they are held. It is only through such dialogue that the opportunity for public dissent can be minimised. However where shareholders fundamentally disagree with an actual or proposed management action they must be prepared to clearly express that view in order that they can be seen to be discharging their oversight duty with respect to the shareholdings that they manage.

Reporting

RLAM expects companies to report regularly in a manner that allows shareholders to have a clear understanding of the business, its strategy and its conduct. This is discussed further in the section covering the Reports & Accounts, which also calls for reports by the main board committees.

Report & Accounts

This review of a company's operations for the accounting period is an important link in the chain of accountability. The Report & Accounts, or Annual Report, should provide a full review of the achievements of the company and of standards followed during the accounting period. It should also outline strategy for the development of the business. Risk factors should be disclosed and discussed (see Audit Committee). Where it is a significant business matter, it should also discuss company policy for corporate social responsibility. In short, a board should balance the needs of shareholders with the commercial sensitivities of running the business. The company should be as transparent as possible in disclosure within its report & accounts so that investors can obtain a clear understanding of all the important and relevant issues.

Directors

Adequate biographical information should be provided on the directors for shareholders to be able to assess them. This should include their qualifications and experience, age, term of office, date of first appointment, level of independence and other personal and professional commitments that may impact on the quality of their contribution and independence, e.g. other directorships.

Board Committees

RLAM expects adequate reporting as detailed in each section on the principal committees described below.

Code of Corporate Governance

There should be a full and clear statement of all matters relating to the application of the principles, sub-principles and provisions of the relevant code of Corporate Governance.

Qualified audit statement

Any qualification of the audit statement needs the fullest of explanations.

Compliance with ABI Guidelines on Responsible Investing

The ABI has developed a code for Environmental, Social and Governance (ESG) disclosure. RLAM seeks a statement by the company on ABI disclosure guidelines on these issues as outlined in the ABI's document. The guidelines take the form of disclosures that institutions would expect to see included in the annual report of listed companies (this may in fact form part of the Business Review. Specifically they refer to disclosures relating to Board responsibilities and to policies, procedures and verification with respect to the management of ESG risks. In assessing compliance, RLAM seeks information from the annual report (including the Business Review) and the company web site for answers to the following questions:

1. Has the company made any reference to ESG matters? If so, does the board take these regularly into account?
2. Has the company identified and assessed significant risks and opportunities affecting its short and long term value arising from its handling of ESG matters?
3. Does the company state that it has adequate information for identification and assessment?
4. Are systems in place to manage the ESG risks?
5. Does the company disclose significant short and long term risks and opportunities arising from ESG issues? If so, how many different risks/opportunities are identified?
6. Are policies for managing risks to the company's value described?
7. Are procedures for managing risk described? If not, are reasons for non-disclosure given?
8. Are verification procedures described?

Shareholder resolutions

A full and reasoned statement should be provided of management's stance on any shareholder resolution presented on the ballot. RLAM considers all shareholder resolutions put forward and votes in accordance with its understanding of the long-term benefit to shareholders.

Nomination Committee

In line with the provisions of the Combined Code, there should be a nomination committee with at least three members. This should have a majority of independent non-executive directors and the committee chairman should be an independent director or the company chairman.

Nomination of non-executives

In order to promote wide debate within the board, it is valuable to appoint new nonexecutive directors regularly. In seeking new non-executive directors, the nominations committee should consider as wide a range of candidates as possible. The use of specialist recruitment consultants and other appropriate sources, including public advertisement, should normally be considered.

Nomination Committee Report

The report should contain details of the process for identifying and appointing executive and non-executive directors. There should also be a high-level disclosure of the results of any evaluation of the board and its members.

Audit Committee

The audit of a company provides an important safeguard for shareholders and for all those that have dealings with that company with regard to the control and financial status of the company. We believe that a greater degree of dialogue between members of the audit committee and shareholders could well prove useful given the increasing importance that is generally being attached to the work of the Audit Committee.

Composition and principle role

The board should have an audit committee consisting exclusively of non-executive directors, at least three in number, all being independent non-executives. At least one should have recent and relevant financial experience. The report and guidance of the group chaired by Sir Robert Smith on the role of the audit committee, published in January 2003 is seen as best practice. The Report & Accounts should have been examined by external auditors whose independence is to be judged satisfactory to the audit committee, and to the board and external stakeholders. This process of review and issue of the accounts should also be overseen by independent non-executive directors acting as the audit committee.

Appointment of auditors

The auditors' performance and appointment should be periodically reviewed. Where the same firm remains as auditor for a period of time there should be a mechanism within the auditing firm to ensure that the responsibility for the audit changes hands. RLAM does not regard systematic rotation of audit firms as necessarily in the best interests of shareholders. The audit committee should report on its conduct during the year, and in particular, on any specific matters of judgement relating to the application of accounting principles. They should also comment on the process for ensuring independence of the auditors and processes for supervising non-audit work.

System of internal controls

The directors should state that they have reviewed the system of internal controls, including a proper evaluation of all risk factors and their management. The guidance of the Turnbull Committee on these matters should be followed. The audit committee should be fully accountable for the proper identification, management and reporting of all significant financial and non-financial risks. In addition, it is responsible for ensuring that there is an effective mechanism for whistle blowing and may serve as the body to receive reports where no other acceptable body exists.

Environmental, Social and Governance Reporting

As part of the system of internal controls, RLAM believes that companies should assess their wider impacts upon various stakeholders and should comment on any that are material. For larger companies, and/or for those with significant social and environmental impacts, RLAM expects to see full reporting, including evidence of strong management systems for these matters. RLAM will encourage all such companies to demonstrate that they have appropriately identified these matters and have got, or are introducing, effective measures to manage them.

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

Where auditors carry out consultancy work in addition to auditing the company, this should be fully disclosed and the audit committee should consider whether there is a risk that their impartiality may be jeopardised. Where non-audit work is undertaken by the company's auditors, the range and nature of this work and the tendering process following in ordering work should be supervised by the audit committee. Very large non-audit fees or non-audit fees in excess of audit fees can be considered an indicator of risk. Therefore, RLAM looks both at the proportion of fees for non-audit work to audit fees and reviews the absolute quantum of these fees. RLAM recognises that there are certain areas of non-audit work where the company's auditors may provide valuable expertise, without compromising independence.

Remuneration

Levels of remuneration and other incentives should be adequate to recruit, incentivise and retain appropriate staff, reflecting the work carried out and the executives' contribution to the company. RLAM makes use of the guidelines detailed below. RLAM will vote against the remuneration report when it believes policy to be flawed or remuneration to be clearly excessive in relation to performance.

Executive contracts

These should not be for more than 12 months, except in unusual cases where an initial period is required for recruitment. In such cases, the notice period should reduce month by month until the agreed period is attained.

Share schemes

RLAM does believe that strict guidelines should be observed with regard to the issue, or potential issue, of shares for incentive schemes both as to the proportion of shares issued and to rate at which these are issued each year. Normally RLAM would expect no more than a total of 10% of a company's equity to be used for such schemes within a ten-year period covering all schemes, with no more than 5% being available for discretionary schemes during this period. Treasury shares should be included within these limits. Best practice is to include all shares used, whether

market purchase or newly issued within these limits. Schemes should be structured to reward long-term business performance. RLAM strongly believes that exceptional performance over a significant period merits an exceptional level of remuneration. RLAM welcomes employee-wide schemes in the belief that it helps all employees understand the concept of shareholder value. RLAM also believes that companies should actively consider the potential rewards on severance following inadequate performance prior to agreeing employment contracts, and clarify the performance conditions under which such severance benefits are to be payable. The joint statement by the NAPF and the ABI in this regard, given below, is considered best practice.

Remuneration Committee

Boards should have a remuneration committee with at least three directors, all of whom should be independent non-executive directors, per the definition of director independence detailed above. RLAM supports the ABI Principles for Executive Remuneration and their periodic updates.

Remuneration Report

It is important that the remuneration report details policy and practices, and be clear and explicit, in order to be able to receive shareholder approval. Where a report contains significant elements that are against the RLAM remuneration policy and particularly where RLAM opposed the adoption of an incentive scheme, RLAM would expect to vote against the report. We are becoming more concerned at the use of increasingly complex schemes and the use of benchmarks in the setting of remuneration as these appear to be encouraging a ratcheting up of reward which does not always reflect performance achieved.

Ethics, Health & Safety, Governance and other important Committees

It is desirable for the board to have committees for issues related to business ethics, health, safety and environment, corporate responsibility, sustainable development and corporate governance, where these are particularly pertinent to the company's business. Such a committee would both serve as a source of external perspectives on emerging business and broader societal concerns, and ensure that the company has proper internal control systems to identify and manage any risks that such issues may pose to the business.

Shareholder Rights

Liaison with Shareholders

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

Pre-emption

RLAM believes that pre-emption rights for existing shareholders are important. Shares may be issued for cash without pre-emption or for remuneration purposes, subject to limits as to the proportion of shares issued in relation to the issued share capital, and also subject to flow rates. This is normally, for general purposes, 5% in one year but no more than 7.5% in three years, and, in addition, no more than 10% in ten years for remuneration. (More detail on these can be found in the attached copy of the statement from the Pre-Emption Group).

Voting rights

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

Takeover Bids

Bids are important as a means to maintain an efficient and competitive environment. Some bids do not add to shareholder value, so in contested take-over bids RLAM will seek to discuss matters with management and the bidder. Subject to the circumstances, RLAM will normally support the incumbent management unless we have lost confidence in its abilities or there are clear strategic or synergistic benefits to a transaction.

Shareholder resolutions

RLAM considers any shareholder resolutions put forward and votes in accordance with its understanding of the long-term benefit to shareholders. Companies should always provide a comprehensive discussion of management's position on all shareholder resolutions, and be available to respond to reasonable enquiries from shareholders.

Voting matters

Record Dates

RLAM recommends that a record date be set five working days prior to company general meetings for custodians and registrars to establish clearly those shareholders eligible to vote. This will give time for all relevant formalities to be completed.

Voting Record

The fundamental right to a secret ballot applies to the proxies cast with corporations. Except in those limited circumstances when the law requires disclosure, this right should be respected. Clients may wish for the sake of transparency to have their record of voting instructions in the public domain. RLAM can make this information available to clients on request. We publish regularly on our web site a document which shows how we have voted at all meetings and in particular where we have withheld support or voted against.

Voting Systems

RLAM sees voting systems that are accurate and provide an effective audit trail of votes cast (such as electronic voting) as most desirable and increasingly as best practice. Furthermore, RLAM encourages companies to disclose a record of how votes have been cast at shareholder meetings at and subsequent to these meetings.

Attendance at annual and other company general meetings

RLAM believes that voting at company meetings forms an important part of our constructive engagement process with management. These votes will usually be by proxy except where specific circumstances make attendance by a representative of RLAM desirable.

Certain Other Voting items

Bundled resolutions

Resolutions put to company meetings should cover single issues, or issues that are clearly interdependent. Any other practice potentially reduces the value of votes, and can lead to opposition to otherwise acceptable proposals.

Any Other Business

RLAM expects to vote on resolutions, the contents of which have been made clear to shareholders and are in the interests of the company and its shareholders. Where the contents of a resolution are unclear, such as one that invites shareholders to vote on an 'any other business' resolution, RLAM will systematically vote against it.

Political and Charitable Donations

RLAM welcomes the opportunity to vote on company donations, if material. RLAM supports charitable acts at an appropriate level, but sees donations to political parties or to organisations closely associated with political parties as inappropriate. RLAM believes that there should always be a vote on policy for political donations. RLAM will support certain limited donations that may, in the widest sense, be considered to be political, provided that donations to political parties are specifically excluded. It will vote against any donations to political parties and in the sense mentioned above, vote against authorisations above £250,000.

Auditor Liability

We remain supportive of moves to introduce a system of proportionate liability for the company's auditor. However we believe that resolutions to severely limit auditor liability to a pre-determined nominal amount are not appropriate and we will vote against such resolutions.

Implementation of the Stewardship Code in 2010

We believe that the Stewardship Code provides a good template for how we should view the process of oversight that we apply to the investments that we hold on behalf of our clients. As a leading asset manager we take our responsibilities very seriously in terms of providing a competitive return to our clients but also in terms of demonstrating a commitment to understanding how this return is being achieved, including risks that are being taken and how they are managed and mitigated. Overall we are looking for evidence that there is consistency through the corporate strategy, the company specific risks, the remuneration policy in support of the strategy and the financial returns that are provide to us as shareholders.

RLAM believes that it is important we remain active members of various industry bodies in order that we can help to shape the way in which best practice within the industry is developed. Therefore we are members of and contribute to the future direction of the Association of British Insurers, the Investment Management Association and the National Association of Pension Funds. A proportion of our time with these bodies will also involve contributing to evolving best practice in areas of environmental, social and governance (ESG) issues. In addition we take our commitment to these issues further through being a signatory for a number of years to both the UN Principles of Responsible Investment, which sets the standard for how ESG type issues should be incorporated into the investment process, and also being a signatory to the Forest Footprint Disclosure which is involved with the development and sustainability of forests worldwide.

Identification of issues

Issues where some form of engagement may make sense can arise from one of three different sources:

1. Routine analytical work of a financial nature by a member of our investment team
2. Analytical research that highlights an issue of a non-financial nature
3. Issues that are brought to our attention through our extensive network of market contacts, industry bodies and other organisations.

We adopt a proportionate response to our engagement activity where we concentrate the vast majority of our efforts either where we consider the issue to be more significant, either in terms of potential reputational damage to the company and/or to RLAM's standing, or where we have the most financial exposure to the situation. We also try to evaluate the likelihood of change and also the potential time frame over which the engagement activity will need to be employed. We fully appreciate that much engagement activity can be very time consuming and the outcomes achieved are uncertain. When we start any process we will have some idea of what we are trying to achieve and over what time period and try to evaluate progress against these objectives, again appreciating that priorities can change through the process.

During the last 12 months we have had engagements, either individually or collectively on the following topics:

- Listing venues and proposed changes
- Dividend payments, timing and size
- Capital structures
- Management change and succession
- Financial performance
- Future funding options
- M&A
- Remuneration practices
- Issues around reporting and transparency
- Crisis management
- Health & safety issues
- Board structure and governance
- Environmental issues

- Strategy and risk management

Escalation of Issues

Much of our engagement activity takes place in private as we attempt to engage with management. This process should involve our preparedness to set out our views on various matters and also a willingness to listen to the views of management. We will then decide whether we are comfortable with the views that have been expressed to us or whether we need to continue the process. This can take a number of forms:

- We may decide that further individual meetings with management are necessary
- We may decide that a meeting needs to take place with other members of the board, for instance the Chairman, the senior independent director. Or with other independent directors.
- We could decide that we should be collaborating with other shareholders who may share similar views over next steps to be taken.
- We may discuss our concerns with the company's advisors.
- We may decide to voice our concerns publicly if we believe that this may help in the shifting of positions or highlighting the degree of concern.

Voting

We believe that exercising our voting rights is one of the most important elements of our stewardship activity. Where we are unable to support management, and where we have more than a negligible holding, we believe it is important that we write to the company to explain our reasoning and also to open the door to ongoing engagement regarding the issue. During the year we voted at 718 meetings with a total of 7747 resolutions. In all we voted in favour of approximately 93.5% of all resolutions, while we either withheld our support or voted in favour with the balance of the resolutions. It is important to appreciate that a number of the votes that were in favour of resolutions will only have been arrived at after a period of discussion with management and on many occasions after the proposals have been amended in some way.

Examples of Engagement

Below we give some examples of the activity that we undertook during the year to indicate the range of issues with which we have been involved, how we became involved and the outcomes.

Hampson

This involved management changes brought about after very poor performance during the aerospace downturn. Our feedback was given via the company's broker. We had previously been involved in consultation and input to previous management on the nature of the fund raising back in 2009/2010. Unfortunately, the management took a long time to make a decision which we saw as axiomatic of indecisive management. It was our general advice to companies recapitalising in the credit crunch that it was always better to get on with it, as if the finance is really required the more apparent that becomes, the more expensive it gets.

Healthcare Locums

Last year we were very concerned by the connected party transaction that was announced and more alarming was that the acquisition was in direct contrast to the previously stated policy of not re-entering the nursing side of staffing again. This management action followed on from an accounting issue and the scale of the Governance issues that we perceived together with inconsistent strategy were so great as to recommend a sale of the shares rather than further engagement. This ultimately turned out to be the correct course of action given subsequent management change, the highlighting of financial concerns, and the suspension of dealing in the shares. This was an example where long term dialogue with the management was able to contextualise their latter actions and allow us to realise that further dialogue was not a good use of our time and that instead disposal of our interests was in the best interests of our clients.

Hydrodec

An example of a very long and difficult period of dialogue with management. This is now a very small and illiquid company and our main priority has been to avoid equity holders getting excessively diluted by the convertible bond holders (and other debt providers), while committing as little extra equity as possible until the company can trade out of its difficulties. We successfully negotiated a switch from a planned hugely dilutive debt issue in favour of equity in 2008 and agitated through the advisors for management change. The Chairman, FD and COO have all been replaced and we have regular and constructive dialogue with the new Chairman. There have been some signs of light at the end of the tunnel on the trading front and we hope that the whole company can be properly recapitalised in due course, allowing us to either invest on a more sound footing or exit a repaired investment.

Prudential

We consistently expressed our unease with the proposed acquisition of AIA. We were uncomfortable given the size of the proposal with the quality of the rationale that was presented to shareholders and also with the insufficient explanation of the risks inherent in the deal both in terms of financing and on execution and integration of the purchased business. This view was communicated through the company's advisors, direct to members of the board and finally through speaking to the media. We were also concerned that relations between the Prudential and the UK regulator did not appear to be entirely smooth as they sought approval for the deal. The deal was subsequently withdrawn and shareholders were left with a very significant cost.

UK Banks

Through the second half of last year we met with all the major UK banks as they reviewed their remuneration arrangements. We were encouraging of the fact that each bank was attempting a more tailored approach to the structure more aligned with their individual strategies. In particular we welcomed the approach from HSBC to extend the time horizon over which success was to be judged as well as the lengthening of the holding period. In the case of Barclays we were supportive of the wider range of criteria to be used in the scheme but we expressed severe reservations around the use of contingent capital within the structure. In particular we remain uncomfortable with the use of an untested capital instrument and the carry benefit appeared to be very generous. We were supportive of Lloyds desire to largely defer revisions to their schemes until the new CEO has detailed group strategy which should then be used for a more full review. Through this overall process of reviewing the banks schemes there was agreement that the engagement should continue on a regular basis to ensure that the schemes were working to the satisfaction of shareholders. It is useful to note that many of the meetings with the banks did take place collectively with a group of shareholders.

BP

There was considerable engagement with the company regarding the Gulf of Mexico disaster. This took place at the time and has continued subsequently and we envisage will continue for some time. The initial engagement concerned the attempts to stop the leak, but moved on to issues surrounding the clean up, compensation issues and then the causes of the disaster. Engagement has been with both executive and non-executive members of the board as we covered these issues and also those around management responsibility and the culture within the business. More recently we are starting to shift our attention onto engagement regarding future strategy, the unsuccessful link-up with Rosneft, leadership, together with options on corporate structure. We expect these engagements to continue for an extended period.

Mitchells & Butler

We were engaged in the debate surrounding the significant change in personnel within the board that was proposed by the two largest shareholders. We, together with other institutions, met both the instigators of the change as well as a number of the directors who were in situ. Ultimately our voting decisions were driven by the view that the large shareholders were attempting to exercise undue influence upon the whole board and we were unsure that this would ultimately be in the best interests of all shareholders. In addition we took the view that the existing board members who the significant shareholders were attempting to remove were doing a reasonable job in managing the business. Therefore we voted against the large shareholder proposed resolutions but these were all carried at the shareholder meeting. This was clearly an instance where the engagement process undertaken by us and others proved unsuccessful and does reflect that there are no guarantees of success. However in the months that have followed the shareholder meeting a number of those proposed by the large shareholders have themselves left the board which we take as some vindication that our resistance to the original proposals was appropriate.

Peel Holdings

In early 2010, RLAM were contacted by Peel Holdings, the large private conglomerate, via the ABI, to enter discussions regarding a possibly refinancing of the company's £200m 2011 debenture. RLAM was a significant holder of this bond which benefited from fixed charges on commercial property assets. Due to a combination of an extremely weak property market and shrinking bank balance sheets, the company felt it would be prudent to open discussions with bondholders well in advance of the bonds becoming due in 12 months time.

RLAM, along with two other investors, became heavily involved in confidential negotiations with the company, including an extensive site visit to a number of the charged assets. Ultimately, we agreed to an extension of the maturity of the 2011 bond to 2040, removing the major refinancing risk for the company and, crucially, extracted a significantly improved covenant package and an attractive coupon (8.375%). Given the enhanced terms of the extended bond, we were also prepared to increase our investment in the company, providing Peel with additional liquidity.

It has been a long held tenet of RLAM's philosophy that the market undervalues secured bonds, which generally benefit from better recovery prospects than unsecured bonds due to their permanent seniority in the creditor hierarchy. However, an often overlooked element of this security is the greater control it gives investors over any process. Indeed RLAM's influence in the successful Peel refinancing is starkly different to the typical involvement of an unsecured bond holder in restructuring situations which tend to be dominated by banks.

Source: rlam as at September 2011 unless otherwise stated.

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363/PRO-09/2011-CC