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Dear Chris

Financial Reporting Council (FRC) – Revisions to the UK Stewardship Code

Legal & General Investment Management (LGIM) is one of the leading fund management groups in the UK, managing approximately over £370 billion of assets for more than 3000 clients (as at 14th March 2012).

I am writing this letter to you in response to your review of the UK Stewardship Code. LGIM welcomes the opportunity to respond to this review and is fully supportive of the FRC's main aims and objectives.

We support "the FRC's mission to promote high-quality corporate governance and reporting to foster investment." In relation to the Stewardship Code, we agree with the FRC to revise its principles and to clarify its purpose and address any issues since its initial release.

Furthermore, we would like the FRC to continue to promote the Stewardship Code further and increase its signatories. By increasing the critical mass behind the Code, asset managers and owners are further showing support for the culture of corporate governance in the UK. This further enhances the value of the UK market and promotes best practice.

We have provided a response under the main categories highlighted in the review and do not have any objections overall. However, the nature of the Code is increasingly becoming more prescriptive and prudence should be taken on any further amendments.

We would like to draw your attention to a few main areas for consideration:

- **Independent Corporate Governance Function** – The Corporate Governance team at LGIM is able to act independently of fund managers which enable them to perform their stewardship responsibilities with minimal conflict. The Director of Corporate Governance reports directly to the CEO of LGIM.
- **Role of Investment Consultants** – There needs to be more acknowledgement of the stewardship of assets and corporate governance activities of asset managers. Demand needs to be driven by trustees in order to increase focus in this area. Therefore, we propose that investment consultants make it mandatory for corporate governance to be on the agenda during the selection process.

We hope we can contribute effectively to your review and would welcome a meeting to discuss the impact of your proposals once they are published. Please do not hesitate to contact me directly.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'S. Sadan', with a stylized flourish.

Sacha Sadan
Director of Corporate Governance

LGIM RESPONSE – REVISIONS TO THE UK STEWARDSHIP CODE

1. Definition of Stewardship

We welcome the clarification surrounding the definition of the word “Stewardship”. LGIM has found that for different asset managers, it means different things. Our concern in the past has been the existence of free-riders who sign up to the Code but do not effectively engage. The proposed wording in Principle 1 should make it clearer for investors on what their stewardship responsibilities are and what is expected of them.

2. The role of asset owners and asset managers

We do not have any issues surrounding the definitions of asset managers and asset owners. LGIM is an asset manager. However, for L&G Group, this raises a question for how they will need to meet and apply the Principles of the Stewardship Code.

3. Conflicts of interest policies

When considering our fiduciary responsibilities, we always put the interest of our clients first. This is our philosophy.

We do not have any objections to the proposed wording in Principle 2 which has been strengthened and is in line with the section of the FSA Handbook under Senior Management Arrangements, Systems and Controls.

LGIM largely manages passive funds which means we are long only. There is regular communication between the Corporate Governance function and portfolio managers to pool resources on the analysis of companies. However, one of our key strengths in the area of ESG is that the Corporate Governance Department is still able to carry out its stewardship responsibilities without any conflicts. One way in which we do this is by ensuring that the Corporate Governance Department is independent and reports directly to the CEO of LGIM. Furthermore, the Non-Executive Director at LGIM ensures that we are looking after our clients’ interests when contentious decisions are being made. Therefore, this puts LGIM’s Corporate Governance Team in a strong and independent position and minimises conflicts of interest with fund managers.

There are also additional controls in place including Chinese walls, restricted access at Group level, Order Management System for trading activities and all our activities are audited by external auditors.

4. Collective engagement

We welcome the amendment to Principle 5 of the Stewardship Code that requests more information on the sort of circumstances in which investors might participate in collective engagement.

As one of the largest institutional investors in the UK, LGIM heavily participates in collaborative engagement with other investors. The circumstances in which we engage range from remuneration and succession issues to environmental and social matters. We

also have provided evidence of our readiness to engage in the publication of our first publicly available Annual Report, which can be found at:

http://www.lgim.com/library/capabilities/Annual_Report.pdf

During our experience we have found that a minority of shareholders do free ride on other institutions when it comes to engagement. One way of resolving this, in addition to the FRC's amendment to Principle 5, is for investment consultants to develop a ranking system of investors in terms of engagement and how effective it has been in resolving issues with companies. This will also provide a tool for investment consultants when advising asset owners on the level of engagement their investment manager carries out both individually and collectively.

5. The use of proxy voting or other voting advisory services

We do not have any issues with the guidance in Principle 6 that requests institutional investors to disclose the extent to which we follow, rely upon or use recommendations of proxy voting advisors.

We believe that Proxy Advisors provide an important service to the investment community by helping to reduce costs of analysing voting issues and facilitating voting instructions on their electronic platforms. We also take the view that their influence has grown and become more established in the market, which is not going to change in the near future.

LGIM has submitted a response to the ESMA consultation on the Proxy Advisory Industry (see appendix A). Although we note that in the FRC's December 2011 report that companies consider investors are uncritical in following the recommendation of proxy voting advisors, we believe this not be true. In our submission to ESMA, we highlight the use of proxy voting advisors research for informational purposes only and do not blindly follow their recommendations. In addition, LGIM engages with proxy voting agencies on a regular basis to discuss their decisions and have voted differently on a number of occasions, including some high profile cases in the UK.

Nevertheless, we recognise that there does need to be guidelines set in the industry on both sides. LGIM is not in favour of rigid regulation but would support the industry developing high standards in order to promote best practice. In addition, as the FRC has highlighted, clear disclosure on how institutional investors use the services of proxy voting advisors would also make it clear and help alleviate pressure for prescriptive legislation.

A summary of our main views we submitted to ESMA on standards for the proxy voting industry are shown below:

- a) **Code of Conduct** – we are supportive of a Code of Conduct, which proxy advisors should adhere to but not established by the proxy advisory companies themselves. Similarly to the Financial Reporting Council (FRC) in the UK, an independent body should develop standards and monitor its effectiveness in line with best practice. For example, the Code of Conduct may require a minimum period for a draft report to be sent to issuers for review prior to publication, which minimises errors in reports.
- b) **Transparency** – the key to proxy advisors working effectively is that there is clear transparency on their procedures for engagement (with companies and investors) and there is meaningful disclosure on conflicts of interest. We are supportive of a 'timeline approach on disclosure' related to engagement with issuers, disclosure in

research reports of other services and fees provided to issuers that may impact the independent analysis and public disclosure of their conflicts of interest policy.

- c) **Votes connected with financial transactions** – we believe proxy advisors should only provide voting advice on corporate governance related issues and not vote on financial transactions such as M&A or Takeovers. These decisions should be referred to investors for consideration.

6. Stock lending

We do not have any objections to the guidance to Principle 6 which requests that institutional investors disclose their approach to stock lending and recalling stock lent.

The passive nature of our holdings in an index fund makes them suitable for securities lending and is a credible source for additional income to funds. However, we believe that it is only beneficial to our clients if the risks involved are mitigated ensuring that collateral is of high quality and provides comfortable cover.

It should be noted that in the UK, LGIM does not lend out stock because the risk/reward trade off is unattractive given the vast supply and demand imbalance, the entitlement to a scrip dividend is lost which reduces the performance of our funds and there remains a risk that stock on loan may not be returned in time for voting.

7. Other asset classes

We believe that the Stewardship Code should apply across all different assets (as they are growing in importance) but for only companies with a premium listing in the UK. For example, on the debt side, the Active Bonds team are invited to meetings with companies to discuss issues surrounding performance. This ranges from issues surrounding the Company's credit rating or rationale for large strategic transactions which may affect the firms' ability to pay back debt-holders.

We do not have any objections to the wording in the introductory section of the Code.

However, we also believe caution should be taken when applying all the principles under the Code as the ability to exercise stewardship responsibilities may be restricted in certain areas. For example, different assets have different properties (e.g. long term fixed assets such as property are more illiquid than equities and the existence of hybrid securities combine elements of debt and equity). Therefore, further thought and consideration needs to be taken in to account on how to apply the Stewardship Code to these assets.

8. Assurance reports

Since the UK Stewardship Code has come in to force, LGIM's external auditors have provided assurance reports on our internal controls. We also make this available to our clients if requested. Therefore, we have no concerns with the proposed wording in Principle 7.

9. Relevance of signatories' statements

We do not have any objections to the requirement that Stewardship statements should be reviewed annually and update them where necessary to reflect changes in actual practice. This is in line with what we do with our own Corporate Governance Policy.

10. Insider information, acquisitions and sub-underwriting

We welcome the changes in Principle 3 that provides more flexibility and clarification regarding institutional investors being made insiders.

Although the FRC comments relate mostly to asset manager participation in equity sub-underwriting, we would like to emphasise that our corporate governance structure is arranged in a certain manner that allows us to become insiders on a broad range of issues including succession planning and remuneration.

As mentioned in section 3 regarding conflicts of interest, our Corporate Governance Department reports directly to the CEO of LGIM and our Non-Executive Director ensures that we take the right course of action when considering all our clients interests'. Therefore, our corporate governance activities are independent of our fund managers and can function efficiently with minimal conflicts. The system and processes the Corporate Governance team has in place allow us to engage with issuers on sensitive matters and act as a sounding board. Furthermore, we can be taken offside for any length of time as this does not influence our fund managers from buying/selling stock on a daily basis.

11. FSA disclosure requirements

We do not have any amendments to the paragraph that highlights the FSA disclosure requirements to 'comply or explain' with the Stewardship Code.

12. The role of service providers

We do not have any additional comments for the introductory sections emphasising that importance of service providers in supporting a role in promoting stewardship on behalf of their institutional investor clients.

We believe that investment consultants play a vital role in raising corporate governance standards. While some encouraging efforts are being made in incorporating Environmental Social and Governance concerns into RFPs and monitoring managers, we are concerned that it is not part of the selection process unless consultants are requested to do this by trustees. As a result, the current demands are mainly limited to public pension schemes. In our view, it should be part of the consultants' role to advise the importance of corporate governance to all clients, especially those with small to medium size assets who lack the resources. As long as corporate governance is seen as an "add-on" and not part of the overall assessment criteria, the take up by the asset owners will continue to be limited.

LGIM believes that trustees should be encouraged to take a more active interest in the companies in which their funds are invested. By driving demand and asking what asset managers are doing on particular companies, this links the beneficiary directly with their investment. LGIM has tried to increase awareness and drive demand by educating our own internal client account managers, giving presentations at trustee meetings, publishing our voting and engagement activities and hosting events such as the trustee education presentation on passive investors in which we invited the FRC to speak in February 2012.