

Legal & General Investment Management Response

ISS 2018 Benchmark Policy Consultation

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Japan – Director Independence

Request for Comment

- Do you consider the proposed threshold of one-third of the board comprising outside directors appropriate as applicable to companies with three committees or with an audit committee? If not, what percentage of outsiders would your organization consider acceptable when voting on the election of directors at companies with an audit committee and companies with three committees?

Yes, we consider that a one-third requirement is suitable for companies BOTH with a three committee structure AND an audit committee, in addition to being applied to companies with a statutory auditor system (see below).

- Should the proposed policy be applied as well to companies with a statutory auditor system? (Note: if the policy is to be applied to companies with that governance system, adverse recommendations will be made at 73.2 percent of such companies based on ISS data as of August 2017.)

Yes, investors have been publicly calling for one-third independence on Japanese boards for at least 10 years, including engaging with companies and regulators on the issue.

- Do you think that a one-year transition period, i.e. with implementation of the proposed policy from February 2019, is sufficient? If not, please explain why it is not sufficient.

Yes, as mentioned above, this has been a long-standing call by investors and is a well-recognised standard in the market.

- The proposed policy does not require independent directors, but requires outside directors, because of concerns that too much emphasis on independence would prompt companies to recruit individuals with little business background. Notwithstanding such concerns, should the proposed policy still require independent directors?

YES, independent directors are fundamental to good governance, not a conceptual point. Directors must be independent of management, the Chairman and the major shareholders in order to represent the long-term interests of the company, its stakeholders and shareholders.

Outside directors who are not independent do not bring the full benefits of an independent perspective – in fact it may worsen governance on the board by embedding minority views and conflicting policies into corporate culture.

We disagree with ISS' assertion that the pool of potential independent outside candidates is shallow, which results in an over appointment of individuals with accounting and academic careers. We consider that companies ought to be widening their nomination processes in their search for independent outside directors.

Finally, ISS propose to vote against the most senior executive if companies fail to have sufficient independence. In Japan, it is common to vote against the CEO in order to cast dissatisfactory votes. However, LGIM believes that, as the CEO is responsible for running the company, voting the CEO out due to inadequate board structure is not the most prudent course of action. Instead, it is preferable that the chairman be mandated to take responsibility for ensuring that the board structure is robust and competitive.

Japan – Poison Pill Proposals

Request for Comment

- Do you think it is appropriate to add the duration of maintaining a pill since it was first introduced to the "necessary conditions" in the first stage of analysis? If not why?
- If you think it is appropriate to add this criterion, what length of time do you consider acceptable for such duration as a new necessary condition in the first stage of analysis?

We support a three year sunset provision on the shareholder approval of a poison pill. This will provide opportunities for investors to regularly review the suitability of such a structure.

We believe that if well designed, a position pill strengthen the board's negotiating position and allow it to obtain more favourable terms from an acquirer.

However, it is vital that this process is controlled by an independent board that is more concerned with shareholder value than with protecting its own position.

Therefore, we would encourage ISS to add a requirement that the poison pill is overseen by an independent board. Having a third of directors being independent outsiders means there are sufficient numbers of independent directors to oversee the implementation of a poison pill decision.

China – Party Committee

Request for Comment

- Under what conditions or limitations to the power of the Party Committee should ISS make an exception to the proposed policy, and recommend for the establishment of a Party Committee?
- Are there other exceptions to the proposed policy (e.g., any potential risks or concerns) that should be considered? If yes, please specify.

We would not support changes to the inclusion of a formal China Party Committee into the articles of association under any circumstances. As highlighted in ISS' background paper, the requirement to embed a Party Committee into the governance structure of listed companies is driven by government priorities. We do not see there is a benefit for companies to restructure their governance arrangements in such a way.

Overtime we have seen the role of the party committee change in many large companies. Embedding the party committee within the articles of association it cements the relationship and influence and prevents any natural change as the largest SOE's diversify their shareholder base and activities.

This is of particular concern given the relationships between the SOE board and the party committee. We fail to see how such a relationship can be objective given the party committee represents the major shareholder, owns major providers of capital and business opportunities, and may also have appointed or had an important say in the appointment of individual board directors and management.

Therefore, we do not consider there should be any exceptions to the rules.

However, for companies that have now implemented the party committee within the articles we would like to hold them accountable for such systems. Under Hong Kong's Corporate Governance Code and transparency rules, there is no requirement to disclose the workings of the Party Committee as it is not an official Board Committee.

We would like to see ISS include requirements for companies with the Party Committee within the articles, to disclose the membership of the committee, the role of the committee and the division of responsibilities between the board and the party committee.

Where companies fail to provide transparent disclosure of this relationship, we would encourage ISS benchmark policy to vote against.

Singapore – Share Repurchase Price Premium

Request for Comment

- Should the same premium ceiling be applied to off-market repurchases as market repurchases? If no, please explain.

Yes, we support the inclusion of a price premium for off-market share purchases and greater alignment with the on-market purchase policy.

United States – Non-employee Director Pay

Request for Comment

- In your view, what are the circumstances for which large NED pay magnitude would merit support on an exceptional basis (e.g., one-time onboarding grants to new directors)?

No justifying circumstances for exceptional awards.

- If a company's proxy disclosure does not clearly indicate which board committee is responsible for setting and/or approving director pay, which board members should be held accountable?

Chair/LID.

- In calculating average/median pay, should ISS include outsized pay packages provided to NED board chairs, lead directors or other board members who receive outsized boardroom pay?

Yes.

United States – Gender Pay Gap Proposals

Request for Comment

- Are there other factors ISS should consider when assessing proposals requesting disclosure on a company's gender pay gap?

Consider regulation in other countries? For example the UK will have to provide this data and whilst not regulated in the US at this point, it may only be a matter of time. Also best practice in terms of the broader diversity agenda.

United States – Poison Pills

Request for Comment

- Should ISS continue to grandfather the directors whose boards adopted 10-year pills in 2008 and 2009 given that they will expire under their terms over the next few years?

No, these directors should be voted against to ensure policy is consistent.

- Regarding short-term pills (1-year term or less), is the rationale for adoption (e.g. an unsolicited takeover offer) the most important factor for consideration when voting on directors who adopted the pill? If not, please specify other factors.

Other governance factors should also be considered such as proxy access, declassified board, majority voting.

- Should one factor for the consideration of short-term pill adoptions be a commitment that any renewals or extensions of the pill will be put to a shareholder vote?

Yes.

Europe – General Share Issuance Request Proposals

Request for Comment

- For general share issuances without preemptive rights, do you consider a maximum limit of 10 percent of issued share capital appropriate? If not, what limit would you support and why (please specify)?

LGIM would support the proposed reduction to the current guideline of 20% to 10% of the issued share capital for two reasons. It provides harmonisation of policy across Europe. It is important to protect long term shareholders from unnecessary dilution of their investments.

- For general share issuances with preemptive rights, do you consider a maximum limit of 50 percent of issued share capital appropriate? If not, what limit would you support and why (please specify)?

LGIM supports the decision to reduce the general issuance to 50% of the issued share capital.

- Should there be exceptions for certain sectors or industries? If yes, which sectors or industries do you consider would be appropriate and why (please specify)?

These levels provide sufficient flexibility for all companies regardless of sector or industry.

Europe – Board Independence at Non-Widely Held Companies

Request for Comment

- In light of the abovementioned impact, does your organization favor the introduction of a one-third board independence requirement at all non-widely held European companies with effect from February 2019, or do you consider that either some markets or some types of companies may warrant a longer transition period or a lower minimum limit?
- In several European markets, the local corporate governance code contains a specific recommendation for board independence at smaller companies². In some cases, the recommended minimum independence guideline is lower than the one-third independence guideline foreseen in the proposed policy. For example, in France, the Middenext Code³ recommends that small companies have at least two independent directors on their boards. This effectively means that, if the proposed policy were to be implemented, ISS would in some cases apply negative voting recommendations to companies that comply with their local code recommendation on board independence. In light of this possibility, would your organization think it appropriate for ISS to apply voting sanctions based on the local code recommendation in markets where the code recommendation on board independence at small companies is lower than one-third?

LGIM believes that board independence is key for a well-functioning board. We welcome the strengthening of ISS' board independence policy for non-widely held European companies as we believe your influence as a proxy advisor will contribute to raise market standards.

The case of negative voting recommendations to companies that comply with their local code

Whilst ISS' proposal of 1/3 independence may in some cases exceed local requirements, we support the introduction of stronger requirements. We believe that proxy advisors together with institutional investors have an important role to play to raise governance standards.

ISS transition period guidelines

LGIM believes that the composition of a company's board is critical. Whilst we welcome ISS' efforts to strengthen independence requirements, we believe that the short transition period proposed may potentially be too disruptive for companies in the following specific instances:

- **where no local code requirements are in place**
- **where ISS recommendations exceed local code recommendations**

In these two cases, we would encourage ISS to consider **introducing a more lenient transition period of 2 years**. As we acknowledge that change takes time and to allow an appropriate succession planning process to take place, an extended transition period would allow companies to appropriately transition towards greater board independence.

For other all 'non-widely held' European companies where local codes require a 1/3 board independence threshold, we believe that **a one year transition period is appropriate**.

In addition, we would like ISS to ensure that this policy change is effectively communicated to all "non-widely held" European companies to ensure they are informed of this strengthening of requirements.

UK/Ireland and Europe – Virtual/Hybrid Meeting Proposals

Request for Comment

- Some investors have indicated that they would be willing to support the practice of "virtual-only" shareholder meetings if they provide the same shareholder rights as a physical meeting. If your organization supports this view: what rationale or assurances would be required in order for your organization to support changes to the articles of association allowing for "virtual-only" shareholder meetings?
- Should ISS provide additional disclosure or alter its voting policies in markets (such as the US) where shareholder approval is not required for companies to switch to virtual-only meetings?

LGIM believes that shareholder meetings are an important forum for dialogue between shareholders and board directors. Whilst we support the use of hybrid meetings, we strongly oppose the practice of virtual-only shareholder meetings.

Physical shareholder meetings allow for all shareholders, and especially for those who cannot engage with the company during the year, a fair and direct access to the company. These meetings also play an important part in reinforcing directors' personal accountability both individually and for the board as a whole. They allow unfiltered dialogue with shareholders and therefore require significant preparation from board directors who can be asked any question in a public forum.

Whilst LGIM meets company boards outside of the AGM process, our right to physically attend and directly ask questions to the board during an annual or special meeting of shareholders remains an important tool for escalating concerns.

LGIM believe that the right to attend an AGM is a fundamental shareholder right. Therefore, where a company seeks to introduce virtual-only shareholder meetings, we believe that shareholders ought to be consulted on the matter.

We welcome ISS' proposal to generally recommend a vote against proposals that allow the convening of virtual-only shareholder meetings. Whilst the law of the state of incorporation may not necessarily allow shareholders to express their opinion on the matter, we believe it is essential that shareholders' disagreement is expressed at the shareholders meeting.

LGIM would expect ISS to remain consistent in its approach to virtual-only shareholder meetings in cases where shareholders cannot express disagreement through a vote against the proposal. We would therefore expect ISS to:

- **Flag the issue to shareholders**
- **Recommend a vote against the chairman of the company**

We expect the chairman to ensure the protection of shareholder rights. Where the company chooses not to consult shareholders on the removal of such a fundamental shareholder right, we expect ISS to take a clear position on the subject through a vote against the director with the most senior responsibility for ensuring the protection of shareholders.

Europe – Director Overboarding – Nordics Region

Request for Comment

- Do you agree that the scope of the overboarding policy in the Nordics should only cover main market indexes or should the policy be applied for more companies in these markets?

LGIM would support the extension of the over-boarding policy to the main Nordic indexes. These will tend to include larger and more complex businesses and therefore require greater scrutiny to safeguard shareholder interests.

- Do you agree with the proposed change to include Finland in the over boarding policy, despite all Finnish board elections being bundled?

The main way to ensure director accountability lies in shareholders' ability to vote on a director's re-election. In countries such as Finland where board elections are bundled, voting against the entire slate could be one way of putting pressure for the voluntary adoption of separate director elections. It would also ensure companies place greater importance to the existing time commitments of potential directors when considering their suitability to serve on the Company's board.

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