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Global corporate governance and responsible investment principles

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Introduction

This document sets out our approach and expectations with respect to topics we believe are essential for an efficient governance framework, and for building a sustainable business model.

We expect all companies in which we invest on a global scale to closely align with our principles, which set out the fundamentals of corporate governance. When developing our policies, we not only look at local market and regulatory expectations, but also broader global guidelines and principles such as those provided by the United Nations Global Compact, OECD guidelines and ILO conventions and recommendations. The extent to which we apply these policies takes into account the governance landscape of each market, allowing some leeway for those markets that are still developing their governance policies.

Most companies have now adapted their business models and policies to deal with the ongoing impacts of the COVID-19 pandemic such as labour and other supply chain shortages. Companies have demonstrated their resilience by balancing their capital allocations, supporting their employees and supply chains. However, globally, we are facing a cost-of-living crisis caused by high inflation, impacting many of the markets that this policy covers. We are therefore asking all companies to ensure that they are giving sufficient attention to the additional strain being placed on their lowest paid employees. Where possible, we ask companies to prioritise pay uplifts to those who need it most. Food producers and retailers should consider how they can limit the increased cost pressures on local staple foods.

Although there is no 'one-size-fits-all' solution to building a sustainable business model, we look for companies we invest in to demonstrate that sustainability is effectively integrated into their long-term strategy and their daily operations. Companies should aim to minimise any negative impact their businesses have on the environment, while innovating to find better solutions. Their strategies should include ways to make a positive impact on society, embrace the value of their workforce and supply chains, while delivering positive long-term returns to shareholders.

We have also developed other region-specific policies for the UK, North American and Japanese markets. They are publicly available on our website here.

We publicly disclose our voting decisions, including the rationale for votes against management. This data is now accessible one day after the shareholder meeting here.

Company board

The board of directors is responsible for the management and long-term success of the company, taking into account the best interests of the company and its stakeholders. It should act as a steward of stakeholders' interests, which is the role that is delegated to it by its shareholders.

The board has the important task of setting the strategy and direction of the business, while ensuring that the necessary resources are available to enable its implementation, and that appropriate risk management and internal controls are in place. It establishes the philosophy for the company, ensuring that stakeholder views are considered and embedded in its culture. The board is expected to take into account environmental, social and governance (ESG) considerations, and to report on company performance in these areas. It is also responsible for ensuring the integrity of a company's accounting and reporting, and the effectiveness of internal control systems. Lastly, the board is ultimately accountable to investors and other stakeholders and should make sure its decisions are effectively communicated to them.

We acknowledge that the structure of the board may vary between companies and countries. However, we believe that the key elements of an effective board are universal.

Board leadership

We believe that having the right composition at the top of a company is an essential element of its success. We expect each director on the board to fully exercise their duties and promote the long-term success of the company.

We expect a board's decisions and actions to demonstrate leadership in managing the company's responsibilities to all of its stakeholders and to limit any negative impact of its operations on the environment.

As such, LGIM will usually hold the board chair accountable for failing to meet our minimum expectations under key policies to protect our planet and to safeguard society as a whole. For more information on key environmental and social focus areas please see below and our website.

The board chair and chief executive officer (CEO)

The responsibilities of the chair include leading the board, setting the agenda for board meetings, and ensuring directors receive accurate and timely meeting information. Under his or her direction, there should be a good flow of information between the board and its committees. The chair is also responsible for leading the appointment process of the CEO.

The chair should be able to challenge the executive directors and encourage the non-executive directors to actively participate in board discussions. It is the chair's role to regularly assess whether board members have the adequate skills, commitment, and whether they are sufficiently diverse to make a positive contribution.

By contrast, the CEO has responsibility for executing the strategy agreed by the board and leading the business.

Given the importance of the role, we expect the chair to be independent.

We would therefore not expect a retiring CEO to take on the role of board chair. As these two roles involve different responsibilities and a different approach to board relations and the company, we have concerns that a hands-on CEO may find it difficult to become a hands-off chair.

Where a company would find the presence of the former CEO on the board beneficial in times of transition, we encourage the company to allow the former CEO to be consulted by the board, rather than as a formal board member, and we would stipulate for this to be for a maximum period of one year.

There are also some instances where a company may, for a short period, be governed by an executive chair. This tends to be when the company is undergoing a shift in its structure or management or is under severe stress. In such circumstances, we would expect companies to commit to re-split the roles within a short, pre-set timetable.

In addition, we expect that a deputy chair be appointed to ensure that no person has unfettered powers of decision-making.

For more details, please refer to our board guide on the nomination of the board chair, available here.

The case of the combined chair and CEO

The roles of chair and CEO are substantially different, and require distinctly different skills and experience. Therefore, we expect the two roles to be separated. This division of responsibilities ensures that a single individual does not have unfettered powers of decision-making at the head of the company, thereby securing a proper balance of authority and responsibility on the board.

Since 2020, we have been taking a stronger stance on combined roles and now vote against the election or re-election of any individual holding such a combined role. We believe that a separation of the roles of board chair and CEO is positive for culture, board discussions, remuneration policy and shareholder rights.

Where a company currently separates the roles of chair and CEO, we strongly discourage the company from re-combining the two roles. This decision should also be put to a shareholder vote for approval, given that these are key board risk functions.

We expect companies that decide to maintain a combined role structure to appoint a strong senior or lead independent director, or deputy chair as well as provide a meaningful explanation and justification in their annual disclosures.

For more details, please refer to our board guide on the topic, available here.

Senior or lead independent director

We believe that the presence of a senior or lead independent director (LID) should not be limited to cases where there is a combined chair and CEO on the board.

The lead independent director plays an essential role on the board and should lead the succession process for the chair and appraise the chair's performance. Additionally, they should meet investors regularly in order to stay well informed of key concerns.

They can also be a key contact for investors, especially when the normal channels of the chair, CEO or chief financial officer have failed to address concerns or are not the appropriate avenues.

We expect the senior or lead independent director to be a fully independent non-executive director. This is of particular importance for those companies that have chosen to maintain a combined chair and CEO.

Our thought piece on the role of the lead independent director is available here.

Non-executive directors/outside directors

We expect non-executive directors to use their skills and experience to constructively contribute to board discussions and help develop proposals on strategy. They are expected to oversee management performance and challenge the executive directors.

Given the responsibility the role involves, non-executive directors must make sure they have sufficient time to perform their duties. We expect non-executive directors to take this into account when they take on any additional board roles. Please refer to our section on board mandates, below.

In their role, non-executive directors should continually update their skills and knowledge and agree on their specific training and developmental needs, which should include all aspects of social, environmental, ethical and reputational risks faced by the business.

Structure and operation

Independence

An independent board is essential in ensuring the board exercises oversight and consistently acts in the best interests of the company and its stakeholders. Its importance for the performance of a company has been shown in several academic studies. Therefore, as a minimum standard, we expect the board of directors of all companies in which we invest to include at least 30% independent directors. Well governed companies should have boards with at least 50% independent directors unless employees comprise 50% of the board; in which case, we would expect the level of independence to be at least one third. In controlled companies (where at least 50% of the economic control is held by one person/entity or a group who are acting together), we expect the level of independence to be at least one third.

We would consider a director to be non-independent if they:

- Have been an employee of the company or group within the past five years;
- Have, or had within the past three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- Have received or receives additional remuneration from the company, apart from a director's fee, such as the company's share option, performance-related pay or pension scheme;
- Have close family ties with any of the company's advisers, directors or senior employees;
- Hold cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- Have served on the board for more than 12 years from the date of first election; or
- Represent a significant shareholder.

However, note that our regional policies take into account local best practice, and therefore we have set stricter criteria and targets in some regions. Please refer to our regional policies available on our website for more details.

We also recognise that non-independent, non-executive directors can offer significant skills and sector knowledge. This can help a company to perform at its best and to maximise value if the board remains balanced. In this instance, we expect the company to fully explain how the non-independent director provides valuable input to the business.

Diversity

We believe a diverse mix of skills, experience and perspectives is essential for a board to function and perform optimally. Several studies have demonstrated that a good level of diversity can improve business decision-making, minimise risks, improve the sustainability of profit growth and therefore maximise long-term returns for investors.

When recruiting members, a board should be looking at diversity in a holistic way and consider the intersectionality of different characteristics. For example, a board should be cognisant of all aspects of diversity that appropriately represent a company's demography of operations and customers, including, for instance, gender, age, nationality, ethnicity, sexual orientation, disability, neurodiversity and socio-economic factors as well as background and experience. Consideration should also be given to the geographies in which the business operates, its future strategic international expansion plans and its consumer base. We would expect a company's diversity and inclusion policy to reflect this information at a minimum for both the board and senior management, and for there to be a broad focus on an inclusive culture, which is a key enabler for greater diversity.

To provide investors with a comprehensive understanding of their diversity strategy, we expect companies to be transparent on the procedures used to find new board members, executives and senior managers, and on how that process ensures a diverse board and senior executive pipeline. We expect all companies to disclose a breakdown of board directors, executive directors, managers and employees, at a minimum by geography, main skill set, gender and ethnicity, and to provide information on the gender pay gap and the initiatives in place and actions the company is taking to close any stated gap. We would encourage companies in those countries that allow the collection of ethnicity data to do so and to report on it.

Companies should ensure that candidates with appropriate skills and qualities are sought through the widest possible means, such as the use of recruitment consultants, public advertisements and the leverage of other relationships in the industry. Companies should also be prepared to look outside the usual pool of candidates to include those from a less traditional 'corporate board' backgrounds. They should be willing to recruit those without previous board experience, as robust induction programmes and incumbent members with sufficient previous board experience in aggregate, will be able to support less experienced directors. This approach will benefit the board's cognitive diversity and will also help to expand the talent pool.

As a minimum we expect all companies in which we invest globally to have at least one woman on the board with the expectation that over time the gender balance will reach one third. In more developed economies, our minimum expectation is that one third of the board comprises women. We expect these companies to continue to improve their gender balance on boards to reach 40% by 2026.

We also expect companies to seek to promote and improve diversity below board level, at executive committee, senior management and workforce level. In the UK and US, we are already placing voting sanctions where we don't see gender diversity at executive leadership level, and we would expect companies in other regions to be similarly focused on this leadership level.

In the autumn of 2020, we extended our diversity campaign to require ethnic representation at board level in developed markets, starting with the US and the UK. We ask the largest companies in these two markets to have at least one board member from an ethnic minority background and this will now result in voting sanctions for those boards that do not have this minimum requirement. While not part of our voting policy at this point for companies in other geographic regions, we encourage companies to consider their ethnic diversity policies and aspirations during the recruitment processes.

For more details on our position, please refer to our publications on the topic, available here.

Succession planning

Succession planning is a vital component of an efficient board. It ensures continuity, and that individuals with the right sets of skills sit on the board.

We expect companies to put in place a formal and transparent procedure for the appointment of new directors. The external board evaluation exercise should assist in this task. We expect the nomination committee, together with the board to consider setting short-, medium-, and long-term plans to ensure there is an orderly replacement of board members and senior executives. The plans should map out potential successors in the short term for unexpected departures, in the medium term to replace directors who reach their tenure limits, and in the longer term to take account of future skill requirements and diversity needs.

We encourage companies to publish as much of this information as possible in their annual disclosures. This includes what skills the company is looking for and why the selected individual is the right fit for the board.

In addition, we would expect to see a skills matrix linked to the strategy of the company, and an explanation of how newly appointed directors would fit into the matrix and the minimum time commitment needed for them to fulfil the role.

Re-election of directors

To ensure the successful composition and functioning of the board, it is essential that shareholders have the ability to effectively exercise their voting rights by holding directors accountable. We are opposed to the practice of bundled proposals that prevent shareholders from approving individual nominees to the board.

We acknowledge that the regulations that govern the frequency of director re-election vary greatly from one country to another. However, we encourage companies to allow shareholders to vote on directors' elections annually.

To allow investors to assess the profile of the board directors proposed for election or re-election and to make sufficiently informed voting decisions, we expect companies to disclose the name of the directors proposed for election or re-election and to provide a detailed biography. We would also encourage the disclosure of the attributes and skills that the director brings to the board and how these fit with the combined skill set of other directors and the long-term strategic direction of the business. In addition, it would be useful to investors if companies provided information regarding the minimum annual time commitment required from each director.

Board effectiveness

Board tenure

The regular refreshment of the board helps ensure that its members remain independent from management and third parties, that different perspectives feed into board discussions, and that skillsets remain relevant. A regularly refreshed board is more likely to be willing and able to question established practices, avoid group think, and exercise more efficient oversight over management to stay ahead of market changes.

Board tenure is assessed in two different ways:

- On an individual director basis: we consider optimum tenure for a director to be between six years and 12 years.
- On an average board tenure basis: average tenure across all board members should not exceed nine years.

Although different regions have different best-practice guidance on this issue, we expect all companies to put in place an individual director term limit of a maximum of 12 years. Please refer to our regional policies for more details on regional expectations on tenure.

Board mandates

We believe it is important for executive directors to seek external board appointments as this will help broaden their skills and knowledge, enabling them to provide more input to board discussions. However, when taking up external appointments, they should be mindful of the time commitment required to exercise their duties on multiple boards.

We would encourage executive directors not to undertake more than one external non-executive directorship of an unrelated listed public company. We also encourage non-executive directors to limit the number of board mandates to a total of five public company board roles. We consider an independent board chair role to count as two mandates due to the extra complexity, oversight and time commitment that it involves.

Shareholders would benefit from an understanding of the time commitments required for each board mandate held by a director.

Board meetings and attendance

Regular board meetings are vital for the board to effectively perform its duties. We believe the chair should hold separate meetings with the non-executive directors to discuss the performance of the executives. In addition, the non-executives should have at least one meeting during the year without the chair present.

Director attendance at board meetings is a vital part of the role to ensure contributions to board decisions and fiduciary duties to investors are fulfilled. We therefore expect companies to allow investors to assess directors' attendance at board and committee meetings by disclosing attendance records in their annual disclosures. We expect directors to have attended no fewer than 75% of the board and committee meetings held during the year. Where a director does not attend a board or committee meeting, the company should report to investors the reason for non-attendance. We would not expect to see a trend of a director's non-attendance at meetings.

Board size

LGIM believes a company should put in place a board that is appropriate for the size of the company and complexity of the business. It is essential that the size of the board does not compromise exchange of thought, challenge and efficient decision-making. It should not be so large as to be unwieldy, which can reduce its effectiveness. In our view, the optimal size of a board is between 10 and 15 directors.

Board effectiveness reviews – internal and external

Board effectiveness reviews have become a more established practice globally as boards increasingly recognise their benefits. The board review can provide investors comfort that the functioning of the board is being regularly assessed to ensure it continues to operate effectively, and that the company is operating in a way that is consistent with its purpose and values.

External reviewers can also bring different perspectives on the functioning of the board as well as experience of how other boards operate. We expect an external evaluation of the board to take place at least every three years. This should be performed by an independent third party to avoid conflicts of interest. The board as a whole should approve the appointment of the reviewer who should not be used for this role for more than six consecutive years. The board should agree the scope of the evaluation at the outset and receive the findings at the conclusion of the review.

In order to safeguard the independence of the external board evaluator, we discourage them being appointed to provide other professional services to the company. Where an external board reviewer is providing other services, we expect these to be disclosed, and a minimum cooling-off period to be adopted and disclosed.

In the interests of transparency, we expect the process and general outcomes of such evaluations to be published in the company's annual disclosures, as well as any progress made on the outcomes of previous board evaluations. For more details on our position on the topic, please refer to our short thought piece on the topic, available on our website here.

Non-executive director induction

The chair is also responsible for ensuring that incoming non-executive directors receive a comprehensive induction to the company on joining the board and that training is available on an ongoing basis. This will allow new directors to contribute to board meetings as soon as possible.

We support the view that companies should hold regular briefings or presentations to the board from divisional directors to ensure that board members are kept informed on all aspects of the business. The corporate secretary can also be an important training resource for non-executive directors.

Directors should be encouraged by the chair to continually update their skills and knowledge and should agree on their specific training and developmental needs, which should include all aspects of social, environmental, ethical and reputational risks faced by the business. One way to remain up to date is to regularly meet with investors, along with other relevant board members, to gain knowledge and to hear various perspectives.

LGIM organises an annual seminar in the fourth quarter for board directors covering key ESG topics. We also regularly publish thought leadership pieces on relevant topics related to corporate governance, stewardship and responsible investment, which can be accessed through our website and the LGIM blog.

Stakeholder engagement

We believe companies should be managed to take account the interests of their stakeholders on material issues. Understanding and taking account of key stakeholders' views allows boards to create better alignment between the company and its stakeholders' interests. We expect companies to report in their annual disclosures how engagement with key stakeholders has fed into board discussions.

Employee voice

We acknowledge that different countries, through regulation or best practice codes, may have different approaches to how boards should consider the views of their employees. We believe investors should be able to hold directors accountable for their consideration of employee views.

Where hard or soft law does not provide any guidance, we encourage companies to set up an appropriate structure. Companies may prefer the appointment of employee representatives on the board or the use of forums or advisory panels.

We do not consider any single model superior to another. All companies should embrace their employees as valued assets and select the method that is most effective for their business model and current circumstances.

For more details on our position on the topic, please refer to our short thought piece on this issue, available on our website here.

Investor dialogue

We believe that engagement is a vital risk-mitigation tool for the board. Engagement with investors should be a two-way discussion. Board directors should aim to use engagement meetings with investors as an opportunity to explain company decisions and to make sure they are well understood by the market. Such meetings should also be an opportunity to listen to investors, use their experience and act on their feedback.

For more details on our position, please refer to our publications on the topic, available here.

Culture

Culture has been an increasingly discussed topic in recent years among businesses, investors and even regulators, and its measurement and assessment are an exercise we expect the board to undertake.

Companies should maintain the highest standards of conduct towards all stakeholders. The board should promote behaviours and values that demonstrate integrity and respect.

For investors to understand company culture, disclosure from the board is necessary given its role in setting values. Investors need reassurance that the CEO and management are really driving the cultural message and setting the tone from the top, and that this is regularly discussed and challenged by the board. The CEO and management also need to monitor how the cultural message is filtering down to the rest of the organisation. We expect companies to disclose in their annual report aspects such as:

- How culture is measured and how it relates to the business strategy;
- How the mission statement values are communicated and reinforced;
- Any key performance indicators (KPIs) that are linked to culture; and
- Any relevant data linked to the workforce such as turnover percentage, attrition analysis and how exit interviews are used.

For more details on our position, please refer to our publications on the topic, available here.

LGIM may vote against the re-election of directors or the discharge of the supervisory board under certain circumstances where we believe the board has not demonstrated good business conduct. E.g., harassment, fraud, etc.

Board committees

Board committees ensure that specific directors are responsible for key board functions.

As a minimum, we expect all listed companies to put in place three separate board committees: an audit committee, a nominations committee and a remuneration committee. Companies may choose to

include other key committees such as a sustainability committee or advisory committee to assist the board in its discussions. A sustainability committee could be useful where the board could benefit from an increased focus on an issue that is directly linked to its long-term success or where the company operates in a high-risk sector where environmental and social (E&S) risks represent a material part of the business model.

An advisory committee may be considered useful where a board needs direct access to independent external expertise from third parties or stakeholders. We are supportive of companies setting up advisory committees. We consider this a flexible option to obtain specific and relevant information to assist the board and management in their decision-making without having to affect the size and composition of the board.

In order for investors to assess their effectiveness, we expect the role, composition and activities of all board committees to be published in the annual disclosure documents.

Audit committee

The audit committee is responsible for:

- Monitoring the integrity of the financial statements of the company;
- Appointing external auditors, monitoring their qualifications and independence as well their effectiveness and resource levels; and
- The overall risk management of the company to ensure that sound and robust internal controls are in place to appropriately manage the company's financial, operational and reputational risks.

As the audit committee plays a vital role in safeguarding investors' interests, we expect all companies to have an audit committee. Although the requirements in terms of the composition of the audit committee varies by country; LGIM would expect the audit committee to comprise only independent non-executive directors, and in order for the committee to operate effectively it should comprise at least three members. We will not support the inclusion of executive directors as members of the audit committee.

Furthermore, we expect a sufficient number of audit committee members to have financial experience with the chair of the audit committee having recent financial expertise, without which, LGIM will vote against the re-election of the audit chair.

Non-independent directors may attend audit committee meetings by invitation, but we believe that they should not be members of the committee. We note, that in some counties the board chair is not permitted to be a member of the audit committee. LGIM's policy allows the board chair to be a member of the committee, if they are considered independent, but should not chair the committee.

Members should have sufficient time to examine the company's financial statements and to liaise with both internal and external auditors. The chair of the audit committee should be available to answer investors' concerns on specific audit issues.

Nomination committee

The nomination and succession committee is responsible for overseeing all board and senior executive appointments, ensuring an orderly and successful board and executive succession process. The committee should ensure the board has the right composition, taking into account important governance considerations such as skillsets, diversity, tenure and over-boarding.

The focus of the committee should, not be restricted to the board and instead it must also seek to include alignment with the rest of the workforce in terms of human capital policies. The committee should work closely with the remuneration committee to ensure that appropriate service contracts are in place.

Given the key role of this committee in board composition matters, we expect a majority of its members to be independent non-executive directors.

The committee chair should be answerable to investors if it is felt that appropriate succession plans are not in place or where there are concerns over the composition of the board.

Remuneration committee

The remuneration committee is responsible for the setting and operating of the company's remuneration strategy for executive directors and senior executives. It should also have awareness of and an overview of remuneration policies within the rest of the company, below executive management level.

The chair of the remuneration committee should have appropriate knowledge of the business to align the remuneration with its strategy. For this reason, the person appointed to the role of remuneration committee chair should ideally have served as a member of the board for at least a year prior to their appointment as chair of the committee.

We expect the committee to consist exclusively of independent non-executive directors. While in some countries, the board chair is prohibited from serving on the remuneration committee; as a general rule, LGIM will support the board chair being a member of the committee but not as chair of the committee. Non-independent directors may attend remuneration committee meetings by invitation but should not be members of the committee.

Remuneration committees should:

Seek independent advice. External advisers, consultants and internal employees advising the committee should be fully accountable to the committee. It should therefore have the authority to appoint its own independent, external remuneration advisers to assist it by providing external data and other information. The use of such advice, including fees, should be reported in public annual disclosures. The committee should exercise its own independent judgement when considering any advice provided by third parties.
Consider carefully and be able to demonstrate how they have reviewed the pay and related policies of the workforce when setting pay for the executive team and be able to demonstrate how this is aligned with the culture of the company.

Challenge management if the company is paying less than the living wage to its employees and/or is not offering all employees the chance to work a minimum of 15 hours per week. This represents the minimum a company should be doing to reduce income inequality and poverty within its workforce. Give consideration to the views of the company's shareholders. Many institutional investors' policies on executive pay are available on their website.

We will vote against the election of individual board directors where we do not support remuneration for the second consecutive year. We may also vote against individual directors where there are particularly contentious issues.

Board responsiveness

Voting at company meetings is part of a shareholder's escalation strategy to signal concerns with aspects of the governance of the company. Where 20% of more of votes have been cast against a board's recommended resolution, we expect the board to engage with shareholders to determine their reasons. The next annual report should provide information on the steps they have taken to address shareholder concerns.

A vote against a relevant director's re-election may be applied if a company has not provided information regarding the concerns expressed by shareholders that led to the high vote against, and any actions taken by the board to address shareholder concerns.

Audit, risk and internal control

The board is responsible for determining and disclosing the company's approach to risk, its risk appetite, and monitoring the outcome and controls in place for effective risk management.

It is also responsible for presenting a true and fair view of the financial position of the company and it should set out future capital management plans and its near-term financial prospects.

Processes and procedures should be established to ensure the independence and robustness of the internal and external audit functions.

Assessing the effectiveness of and the resources available for the internal and external audit functions forms part of the board's responsibilities. We expect the board to report to investors in its annual disclosures the conclusions of this review along with bespoke narrative as to the assessment and noted areas, along with actions taken to address any concerns.

Compliance with regulations

The audit and risk committee should ensure that all laws and applicable regulations are complied with so as not to expose the company to undue risk of fines, censorship and reputational damage. We will hold the audit committee chair responsible for failing to detect breaches in accounting practices.

Climate risks

We expect companies for whom climate change is a material financial risk, to appropriately reflect these risks in the scenarios, assumptions and estimates used to prepare their financial accounts. Companies should ensure, through transparent disclosure, that there is consistency between their narrative on climate change and their accounting determinations. In addition to our ongoing targeted engagements relating to climate accounting topics, we will develop our work further in this area. This may lead to applying voting sanctions on companies that fall short of minimum expectations from 2024.

External audit

An external audit provides independent assurance of the financial statements of a company to its investors. The role of the auditor is to provide reasonable assurance that the financial statements give a true and fair view of the financial health of the company and that they have been prepared in accordance with appropriate accounting standards. Any significant audit matters raised by the auditor should be fully explained by the board, including how these have been addressed.

The external auditors are also responsible for producing the auditor's report, which is a formal opinion and evaluation of the financial statements. We support and encourage the use of the extended audit report to provide greater insight to investors of the auditor's assessment of the accounts.

The board is responsible for appointing the company's external auditor. The company is expected to clearly disclose the audit firm used, the audit partner who led the audit, the tenure of that firm, and why the board considers the auditor to be independent and how any potential conflicts are being mitigated. We believe the role of the external auditor should be put to tender on a regular basis, at least every 10 years, with the total tenure of the audit firm not exceeding 20 years. Within this timeframe, we expect the lead audit partner to be subject to refreshment at least every five years. We will vote against the election of the external auditor if they have served as external auditor for more than 20 years.

We expect the process of the tender to be disclosed and the rationale for the appointment to be explained.

The fees for the external audit should be disclosed in the annual reporting. Where the external auditor does provide non-audit services, these should be fully explained and disclosed in the appropriate annual disclosures. We expect non audit services provided to be incidental to the audit, with the primary purpose of improving the quality of the financial accounts. We do not expect excessive non-audit work to be conducted by the company's external auditors, as this will bring into question the independence of their judgement. Non-audit related services are not expected to exceed 50% of the value of the audit services in any given year. We expect companies to disclose separately in their annual disclosures, the fees paid to its external auditor for audit as well as non-audit services. LGIM will vote against the election of the auditor or the approval of their fees if this information is not provided.

We believe auditor liability is an important and proportional approach to supporting a high-quality audit. We are not supportive of a fixed auditor liability or restrictions on that liability.

The audit committee should explain how it has assessed the quality of the external audit and recommendations arising from the external audit, and this should be reported to investors when considered material by the board and/or the audit partner.

Internal audit

Companies should have an effective and sufficiently resourced internal audit system in place that is designed to take into account new and emerging risks that may affect its business objectives and identify the level of risk taken. The process and procedures in place to manage such risks should be embedded in the risk-based control system for the company, and summarised in the annual reporting to investors. The audit committee should have responsibility and oversight of the internal audit function.

Whistleblowing

We expect companies to establish a whistleblowing policy that is integrated into its code of conduct. The policy should be publicly disclosed and open to all employees including those within the supply chain. The whistleblowing reporting channels should be easily identified and independent from management, with a direct line to the audit committee to allow for appropriate oversight and independent escalation where necessary. Companies should ensure their policy safeguards the identity of any whistleblower and that they are protected from internal harassment. Companies should also report how the risks associated with bribery and other illegal behaviour are being monitored and addressed.

Cybersecurity

The vulnerability of a company's IT systems can lead to a material financial impact and reputational damage. Therefore, we expect a risk-based approach to be taken to address the issue of cybersecurity and data protection. It should be integrated into the control functions of the business and overseen from a strategic perspective by the board. It is the board's role to understand the infrastructure needed in the business to protect valuable information assets, key intellectual property and customer's confidential data. Therefore, accountability should not be delegated. Cybersecurity should be a regular board agenda item. Any data breach incident should be disclosed to customers and the market in a timely manner.

For more information, please refer to our guide on the topic, available here.

Remuneration

We are increasingly concerned about the misalignment of the total opportunity of executive pay versus company performance, and the current social sensitivities around income inequality.

To address the issue of income inequality, LGIM expects the remuneration committee to be mindful of the pay and benefits offered throughout the organisation. LGIM's minimum expectations on employee pay and wellbeing can be found below.

As a long-term and engaged investor, we entrust the board to ensure executive directors' pay is fair, balanced and aligned with the strategy and long-term growth and performance of the business.

Although we appreciate it is not yet standard practice in many countries globally to disclose all of the details of executive remuneration in their annual disclosures, we believe it is important for investors to understand how executive directors (internal directors) are being remunerated and whether the remuneration is aligned to the delivery of sustainable performance.

In several markets globally, shareholders are given a say on pay vote which we consider to be important to hold the remuneration committee members to account for the decisions taken in relation to executive pay policy or its implementation. In some markets, these are advisory votes whereas in others they are binding votes. The amendments made in 2017 to the Shareholder Rights Directive meant that companies within the European Union are required to put their remuneration policy and their remuneration report to a shareholder vote at least every four years. In Australia, their binding vote means that if a company receives a 25% vote against their pay resolutions in two consecutive years, it triggers a "spill vote" which allows shareholders a vote to decide whether board members should stand for re-election.

LGIM encourages more countries globally to mandate a say on pay vote and for all companies to disclose the executive remuneration structure, including the total opportunity under each element of pay together with a description of the metrics and targets used under incentive plans, where applicable that are not considered commercially sensitive.

Although we are cognisant of the variations in executive pay practices globally, we expect companies to consider our principles below when setting pay policies for their executive board.

Key principles

We apply a set of simple pay principles when looking at remuneration structures:

- The structure of remuneration and the payments awarded should be fair, balanced and understandable. This means: fair in terms of what the company has achieved; balanced in terms of total pay opportunity to the executive, versus employees and investors; and understandable for the recipient, the board and investors.
- Awards should incentivise long-term thinking by management and be aligned to and support the achievement of the business strategy and objectives.

- Executives should have meaningful direct equity holdings while employed and thereafter; buying shares is one of the best ways of aligning the interests of management and investors.
- Boards should retain the ultimate flexibility to apply discretion and 'sense-check' the final payments.
- to ensure that they are aligned with the underlying long-term performance of the business.
- Companies should be transparent on why rewards have transferred to the executive, setting out targets, their relevance to meeting long-term goals, which targets were met and justifying all adjustments made to accounting measures for remuneration purposes.

Fixed remuneration

We expect a base salary for executives to be commensurate with the size and complexity of the company. Although salary levels at peer companies may be considered, these should not set a definite benchmark.

Salary increases should not be automatic each year. Any increase to salary levels should not exceed what is offered to the general workforce, and its impact on total remuneration should be assessed before approval.

Addressing the cost-of-living crisis – the remuneration committee of those companies that have decided to give employees on lower salaries a significant pay increase to help them navigate the current crisis should exercise caution if they plan to use the average workforce salary increase rate, when setting executive salaries. Consideration should be given to the impact of a similar increase on the total pay for an executive given the inclusion of incentives that are based on a percentage of base pay.

Incentive arrangements

Annual incentive

Companies may choose to award annual incentives to executive directors. We believe that any annual incentive should be geared to delivering the strategy of the business. A majority of the annual incentive should be linked to the delivery of financial performance. In addition, achieving a threshold level of financial performance should be a pre-requisite for payment of any bonus that is based on personal or strategic objectives.

Companies exposed to high levels of environmental, social or governance (ESG) risks should include relevant and clearly measurable targets that focus management on mitigating these risks. ESG metrics should be meaningful, measurable, aligned to the company's strategy and subject to third-party verification.

For companies in high-risk sectors, where the health and safety of employees is key, we would expect a health and safety modifier to be introduced to the annual bonus to ensure that board members are held accountable for any loss of life within the workplace. Where a company is held responsible for any fatality within the workplace, we expect the remuneration committee to apply downward discretion on any performance- based pay earned. Although we expect any reduction to be material, if it is less than 20%, LGIM will vote against the remuneration report.

We ask companies to pay a portion (at least one-third) of the bonus in shares deferred for at least two years. Additionally, the bonus should be set as an appropriate proportion of base salary and should not be uncapped.).

We expect companies to disclose the maximum level of annual incentive that may be awarded together with the performance conditions that will determine whether an award is justified.

For those companies aiming to follow best practice and highlight the integrity of the target-setting process, we expect the disclosure of weightings for each bonus component and the target ranges, at the very least on a retrospective basis. Targets that are commercially sensitive to the business should be disclosed within a year of payment; if this is not possible, an explanation of why the target continues to be commercially sensitive is expected.

Our expectation is that companies will use financial metrics that are reported in annual disclosures to determine performance. If these are adjusted in any way for example by excluding exceptional items, we expect the company to report how the calculation differs from the reported numbers and why it is considered appropriate to make the adjustment.

Long-term incentives plan (LTIP)

We believe that a company should motivate and reward executives by granting long-term equity incentives that will align their interests with those of long-term investors. Incentives should be structured to motivate management to build a sustainable business that will generate positive returns to investors over the longer term. Therefore, we encourage the adoption of a long-term incentive plan that will deliver the reward in the form of shares. We generally do not support cash based long term incentive plans.

In the interest of simplicity, LGIM advocates the adoption of one long-term plan. We discourage the adoption of any additional incentive plans that would complicate the remuneration structure, e.g., matching schemes, or that would reward executive directors for motives that should already be addressed by the LTIP, e.g. retention plans or transaction-bonus-type schemes.

LTIP awards:

Should be capped either as a percentage of salary or a fixed number of shares. Where a fixed number of shares is used, we would expect the level of award being offered to be reviewed every three years to ensure it is at a level commensurate to when the plan was first adopted. Any increase to levels of reward should be subject to shareholder approval.
Where a company has experienced a significant fall in the value of its shares, resulting in a greater number of shares being awarded under incentive plans for the year, companies are expected to reduce the size of the award to ensure there is no prospect of reward for failure. Where this has not happened, the committee should provide an undertaking to reduce awards when they vest. At the point of vesting, LGIM will expect a detailed explanation of how the remuneration committee has applied discretion to ensure appropriate adjustments were made to avoid windfall gains. LGIM will vote against the remuneration report where we believe that the remuneration committee has not been thorough in its decision making and/or not provided sufficient information to explain its final decision.LTIP performance conditions:

The board should determine the right metrics to deliver the strategy and ensure that the level of stretch in the target is appropriate to deliver the right outcomes for all stakeholders. Metrics should be linked to long-term strategy and should be challenging, but achievable, without encouraging undue risk-taking.

We do not recommend the use of more than four performance conditions as each additional measure will dilute the importance of the performance that it intends to reward and increase complexity. We expect at least one measure to be linked to shareholder returns. Other measures should be linked to the strategy of the business, such as key performance indicators (KPIs) that are selected by the board and reflect the company's ESG risks as well as target opportunities. ESG metrics should be meaningful, measurable, aligned to the company's strategy and subject to third-party verification. Absolute share price measures used in isolation are considered insufficient justification for award vesting.

We support the use of relative total shareholder returns (TSR) subject to an appropriate benchmark group being used. However, we expect median performance to be the minimum performance that may trigger a reward. If used as a performance modifier, we would expect performance below median to trigger a reduction in the financial reward.

We would expect the full award to be subject to performance conditions and measured over at least three years. However, in markets where governance structures are still being developed, we have set a minimum standard of 50% of the award to be performance-based. These should still be assessed over a minimum of three years. We may vote against those companies who fail to provide sufficient transparency into their target setting policy to assure investors that robust performance targets are being set. In addition, except during periods of structural change, we would expect targets set to be higher than the actual performance achieved in the previous year.

In order for investors to assess the appropriateness of long-term incentive arrangements, we expect companies to disclose the metrics and targets used under the plan, within the limits of what they can disclose. We expect the remuneration committee to maintain sufficient authority to exercise discretion when there is not a clear link to performance.

We do not support retrospective changes to performance conditions that have been pre-set.

Use of ESG metrics

Companies within sectors that can have a significant effect on climate change should link part of their pay to delivering on their climate mitigation goals. The performance targets should be linked to SBTi approved/or equivalent transition plans aimed to achieve net zero by 2050 or sooner. Targets should also be set to create new opportunities that not only improve revenue, but also have a positive impact on climate.

By 2025, companies will be five years away from reaching their 2030 climate change transition goals. By this time, we expect a majority of companies to have a clear idea of what must be done to hit these crucial targets. Therefore, from 2025, LGIM will be escalating its policy on climate change. To gain LGIM's support for a new remuneration policy being put to shareholders from January 2025, we will expect to see climate targets within the long-term plan. These targets should be in line with stated transition goals to reaching net zero and across the full value chain (scope 1-3). Ideally, they should be SBTi approved.

This will apply to companies in the following sectors: autos, apparel, aviation, aluminium, banks, cement, chemicals, food, forestry, glass, insurance, logistics, mining, oil and gas, REITs, shipping, steel, technology, telecoms, and multi-utilities.

The weighting for climate targets should represent at least 20% of the overall LTIP award at these companies. For those companies that have adopted a restricted share plan, one of the underpins should be specific to achieving set transitional carbon reduction targets.

The use of diversity targets would be relevant for sectors that struggle to recruit women.

LGIM discourages the use of employee engagement targets, as we believe this is something a well governed company with an inclusive culture should be doing. Financial incentives should not be necessary to drive such a programme. In our view, a better metric for companies, especially for those that have a high level of staff turnover, would be to set targets around employee retention to gauge whether their policies are working.

Oil and gas companies – remuneration should prioritise financial value over fossil fuel production volumes. The use of measures that directly encourage volume growth (such as reserve replacement ratios or production targets) risks incentivising overinvestment at a time when growth in demand seems increasingly uncertain and should therefore be avoided. LGIM prefers financial measures (relating to total shareholder return, balance sheet strength) or other strategic metrics. The use of volume growth targets may result in a negative vote.

Holding periods

We encourage the use of a two-year post-vesting holding period because we find this helps in aligning the remuneration structure with long-term performance. These holding periods should continue to apply even after a director has ceased employment with the company.

Dividends

Accrued dividends on share awards should only be paid on those shares that ultimately vest. LGIM will vote against any share-based incentive plan's operation if it permits the payment of dividends on unvested awards.

Malus and clawback

Employment contracts should be designed to enable the application of malus and clawback, which should apply to all elements of variable remuneration.

To provide clarity for all stakeholders, remuneration committees should set out the circumstances under which malus and clawback will be applied. These circumstances should not be too narrowly defined.

Equity dilution

We believe that strict guidelines should be adhered to in relation to the issuance of shares for incentive schemes, in order to limit potential dilution to shareholders. As a general rule, we expect no more than 10% of a company's equity to be used for all share schemes over a 10-year period and no more than

5% in 10 years for discretionary schemes. The annual run rate or burn rate should also be reasonable; or about 1%.

These limits may vary in certain regions and any variance will be highlighted in the relevant regional policy. Treasury shares should be included within these limits. Such restrictions should apply to all shares whether they are market purchased or newly issued. We encourage companies to provide transparent explanations regarding the issuance of shares.

Shareholding guidelines

We expect companies to encourage their directors and senior executives to build up and retain a meaningful interest in the shares of the company they manage. This is an essential part of aligning directors' interests with those of investors. The level of shareholding should be linked to the size of the company and the level of reward that the director receives under the long-term incentive. Ideally, these shares should continue to be ring-fenced by the company in a trust.

Pensions

Generally, pension contributions are a significant cost and risk for a company as well as an element of remuneration that is not linked to performance. Therefore, the cost of providing a pension should be taken into account when evaluating a remuneration package. We will not support pension-enhancement payments at retirement or when a contract is terminated early. Additionally, we will not accept an individual being compensated for changes in tax. Companies should aim to reduce their pension fund liabilities and costs when recruiting new executives.

Pension provisions should be disclosed in full in the report and accounts and any changes to pension benefits should be fully explained.

We expect companies to set a target to make pension payments to their executive aligned with what is offered to the general workforce.

Service contracts and termination payments

Executive contracts should provide for a maximum notice of 12 months. We do not support provisions within service contracts that enhance contractual terms for loss of office following a change in control.

Contracts of key people should provide the company with the authority to clawback unvested and vested awards.

New joiners

When setting the remuneration package of a new executive who lacks experience in the company and/or the role, we would encourage the remuneration committee to consider placing the individual on a lower salary than their predecessor, with a view to increasing their pay over an extended time period, subject to performance. We encourage the committee to set out their intention to increase their pay over a set period at the time of appointment and in subsequent disclosures to remind investors of this intention. Where possible, the existing remuneration arrangements should be used to incentivise new appointees.

New recruits should be encouraged to purchase shares in the company. Additional benefits in relation to the appointment, such as assistance to relocate, should be time limited.

The use of 'golden hello' payments is not supported. Where a buy-out of existing awards from a previous employer is necessary, it should only cover the expected loss of value, and be awarded predominately in shares and subject to performance.

Departing directors

We expect the company to ensure that there have been no rewards for failure. Therefore, the remuneration committee should take into account poor performance or any exceptional events and consider whether 'good leaver' or 'bad leaver' provisions should apply when determining whether a director should be paid a bonus for the period worked.

With the exception of dismissal for cause and/or poor performance where awards should lapse, any outstanding awards of leavers should be time pro-rated and allowed to run their course, subject to the same vesting conditions that applied at grant.

To promote long-term strategic decisions and shareholder alignment, directors should continue to hold a meaningful number of shares even after departure from the company.

A post-exit shareholding requirement of vested shares should be set that is significant in relation to the in-post shareholding requirement and held for two years. LGIM considers a significant post-exit holding to be no less than 80% of the in-post requirement. As a guide, vested shares, deferred bonus shares and shares subject to a holding period can count towards meeting shareholding guidelines.

Any shares purchased by a director with personal funds are excluded from the post-exit shareholding requirement.

Benchmarking

We discourage over-reliance on frequent benchmarking and would not expect pay to be increased automatically each year. Benchmarking should not be used to justify a substantial increase to pay levels.

When using benchmark data, the remuneration committee should take into consideration a number of factors: size of the company, its geographic spread and performance relative to the benchmark peers. The peer group used should not be too large or too small as both extremes could produce misleading results. Companies should ensure they disclose meaningful information on the benchmarking data used and why it has selected the benchmark group. Directors at underperforming companies should not expect to be remunerated as highly as directors of companies with outstanding performance.

Discretion

Companies can build trust with investors if they can demonstrate restraint, consistency and alignment with the shareholder experience. In exceptional circumstances, discretion applied to any earned award by executives is one way to demonstrate this alignment. We define discretion as anything that alters the monetary outcome of total remuneration.

We expect the company to state:

- The main reasons that might give rise to the application of discretion.
- Whether their discretion policy applies to revising pay upwards as well as downwards.
- The elements of pay to which discretion may be applied.
- The effect that the application of discretion has had on the director’s final pay outcome.

Non-executive directors' fees

Non-executive directors’ fees should reflect the level of responsibility and time commitment of the role. The use of share options or other performance related pay is not supported, but a proportion of the fees may be paid in shares.

Shareholder and bondholder rights

The provision of shareholder and bondholder rights is a basic entitlement for investors. We expect companies to acknowledge and respect the rights of investors by adhering to the highest market standards. This includes providing high-quality disclosures and equal treatment of shareholders. Below, we have outlined guidance on the topical issues that concern us as an investor:

Voting rights and share class structures

We support the ‘one share one vote’ philosophy and favour share structures where all shares have equal voting rights and those rights are commensurate to the economic value held.

We do not support the issue of shares with enhanced or impaired voting rights. In some markets, however, differential voting rights are a long-standing structure, and where this exists the structure should be transparently disclosed. In the case of controlled companies, we will review the issuance of shares with enhanced voting rights to understand why these would be necessary. In general, we encourage companies to eliminate differential voting rights over time.

Amendments to the company's constitution

It is common to see requests from companies seeking approval to update/amend the company’s constitution.

We expect these changes to be clearly outlined and disclosed in the notice of meeting. Companies that fail to provide advance notice of proposed changes run the risk of LGIM voting against these changes. We do not support changes to a company’s constitution that are introduced to curtail or reduce shareholder rights.

We would expect substantially different changes to a company’s constitution to be proposed under separate resolutions and not to be bundled into a single amendment to the constitution. Where such a bundled resolution includes one or more changes that are not deemed supportable, this will lead to a vote against the entire proposal under the resolution.

Executive forum provision

We believe that exclusive forum bylaw provisions limiting a shareholder’s choice of legal venue are not in the best interests of shareholders. Such clauses may effectively discourage the use of shareholder derivative claims by increasing their associated costs and making them more difficult to pursue. We do not encourage limitations on shareholders’ legal recourse including limiting themselves to a single jurisdiction without compelling evidence that it will be of benefit to shareholders and expect companies to provide a compelling argument on why the provision would directly benefit shareholders.

Virtual/electronic general meetings

We believe that a company's general meetings for shareholders are fundamentally important to the exercise of shareholder rights and integral to a good corporate governance system. Furthermore, we view physical shareholder meetings as providing an important mechanism by which a board is held publicly accountable to all their shareholders, both institutional and retail.

Shareholder meetings provide an invaluable opportunity to raise concerns with a board in a public forum and investors are able to use this mechanism as part of their stewardship activities. For example, they could be utilised as an escalation tool that enables shareholders to make statements and ask questions to the whole board.

We are cognisant that companies are keen to make sure that their shareholder communications keep pace with developing technology and conducting shareholder meetings electronically is an area of focus. We also agree that using technology, such as webcasts, to complement the physical shareholder meeting could be beneficial and could increase investor participation.

However, we believe that such technology should be used in parallel with the in-person meeting and should not lead to companies adopting a virtual-only approach. The shareholder meeting is the only time that the whole board must be publicly accountable to all its shareholders. The attendance of the board to such meeting is a demonstration of its commitment to hear and understand the views of shareholders.

Virtual-only shareholder meetings remove this accountability due to the remoteness of participants. The public nature of AGMs and full attendance of the board are also important to allow us to bring matters to the board's attention. Removing this tool impairs a shareholder's ability to hold boards to account.

In certain countries, e.g., Germany, the law allows a company to amend its articles to hold virtual-only AGMs if this change is supported by its shareholders. This change in the law has resulted in the AGMs of many German companies being held on the same day, e.g., on 17 May 2023 there will be 35 meetings held. This impacts a shareholder's ability to attend the meeting in person or virtually, which removes one of the important fundamental shareholder rights. This is particularly an issue for retail investors who do not have access to management during the year.

Therefore, despite changes in local laws that now permit virtual shareholder meetings, LGIM will not support the move towards fully virtual-only shareholder meetings. Any amendments to a company's constitution in relation to electronic meetings should confirm that a physical meeting will continue to be held unless it is prohibited by law to hold a physical meeting.

Capital management

The board has key responsibility to ensure a company has sufficient capital; overseeing the capital management of the company; ensuring efficient capital allocation; and, when additional capital is required, ensuring it is raised in an appropriate way.

Balancing the long-term investment needs of the company with shorter-term returns to investors is a critical role of the board.

Therefore, we support the right of shareholders to have a separate vote on the tools and authorities provided to the board in managing its capital structures. Such rights protect shareholder interests while balancing the need for board flexibility. For example, making sure share issuances are not dilutive and capital is being raised in the long-term interests of investors.

Share issuance

We support a company's entitlement to issue shares to raise capital. However, such issuances should be limited to what is necessary to maintain business operations and should not expose minority shareholders to excessive dilution of their holdings in the company's shares. In general, we would not support an authority to issue more than 100% of the issued share capital.

The existence of pre-emption rights is fundamental in protecting shareholders from excessive dilution. It gives the right conveyed to shareholders to be offered any new shares, pro-rata to their existing holdings, ahead of these being offered to non-shareholders. Our thresholds for approval of share issuance authorities are generally in line with established best practice in each market. In general, we would only support an authority to issues shares on a non pre-emptive basis if the authority is for between 10% and 20% of the issued share capital. More information on specific guidance on limits can be found in our regional policies which take into account the different local business practices and laws.

We expect companies to be transparent on whether any new authority sought will cancel any outstanding authority or whether any unused portion of the current authority will continue to be valid. If the authorities will be amalgamated, we expect companies to set a cap on the maximum potential issuances with and without pre-emption rights that applies across current and proposed authorities. Companies should provide a clear strategic rationale for any share issuance authority.

Share repurchases or buybacks

Share repurchases or buybacks can be a flexible way to return cash to shareholders. We expect the board to be transparent in how the share buyback authority will be used in relation to other uses of capital (such as dividends, internal investment or externally for mergers and acquisitions).

However, the benefits of using this approach depend on a number of factors including the price at which shares are bought back, the company's individual financial circumstances and wider market conditions at the time.

When utilising this authority, we expect companies to take into account the impact on other issues. For example, on remuneration, performance conditions governing incentive schemes may be impacted as a result of a company undertaking a buyback. Furthermore, given the reduction in the number of shares in the market, the holdings of large shareholders will also increase, giving them more control.

Some markets may have an annual limit on the number of shares that can be bought back in any year, which is discussed in the relevant regional policy. We would expect a detailed rationale for any buyback authority that is greater than 10% of the issued share capital.

Debt issuance

Good transparency and disclosure by the company on bond issuances is important for debt investors. In its reporting, we expect a company to include:

- The timely release of publicly available prospectuses both before the new issue and while the bonds remain outstanding;
- Commitment to provide public access to ongoing financials and disclosures; and
- Five-year financial history of the company.

Mergers and acquisitions (M&A)

We support proposals that create value for investors over the long term.

To make an informed assessment, we expect management to be transparent on the terms of the merger, and its financial and cultural integration implications on the long-term business strategy. We also expect all companies to explain how the transaction is expected to yield significant long-term benefits for the company and its stakeholders, including its investors.

We encourage the company chair and non-executive directors to hold separate meetings with investors without management present, and to have an honest conversation about the risks and opportunities of the transaction. In a contested takeover, we will aim to meet with both parties before making a final decision.

In addition, we believe that a strong governance framework is essential during any M&A activity. Companies should therefore make sure the independent non-executive directors are informed at an early stage and can obtain independent advice at the cost of the company, with advisers remunerated on a fixed-fee basis. A strong process should be in place to ensure there are no conflicts of interest. The skillset of the board must also be reviewed, including past M&A experience, to ensure the board is appropriately equipped to successfully lead the transaction and its impacts on the company. The board may also consider putting in place a separate ad hoc committee of independent non-executive directors to consider any M&A activity.

Takeover defence plans – poison pills

‘Poison pill’ is the term given to an artificial device implemented by a company to deter takeover bids. Well-designed poison pills may strengthen the board’s negotiating position and allow it to obtain more favourable terms from an acquirer.

It is vital that this process is controlled by the independent members of the board that are more concerned with investor value than with protecting its own position. We do not expect a poison pill to entrench management and protect the company from market pressures, which is not in investors’ best interests. Any poison pill should only be used for a finite period.

For more details on our approach on M&A and takeover defences, please refer to our thought piece on the topic, available here.

Related-party transactions

Related-party transactions are a concern for minority shareholders as there is a risk that a related party may take advantage of their position. We are therefore not generally supportive of related party transactions.

In those cases when related-party transactions are undertaken, we expect adequate safeguards to be put in place to provide protection for the interests of the company and its shareholders who are not a related party, including minority shareholders.

All transactions must therefore be authorised by the board of directors. We also expect the company's audit committee to ensure that such transactions are conducted on the basis of an independent assessment and valuation.

For material related party transactions, we expect companies to provide additional information to shareholders in their annual report. This should include information on whether board approval was unanimous or received majority support.

In addition, shareholders should be given the opportunity to approve material related-party transactions, including any transactions undertaken with directors. We expect companies to disclose sufficient information about such transactions in their annual disclosures to enable informed voting decisions to be made.

Shareholder proposals

We consider all shareholder proposals tabled at a company's shareholder meeting in the wider context of the corporate governance practices at the company, our thematic policies and the long-term benefits for stakeholders. We expect companies to provide a meaningful discussion of the proposals to enable shareholders to make an informed judgement.

We expect majority-supported shareholder proposals to be adopted. Where there is significant support (20% or more) we expect the company to consider the benefits of the proposal and to discuss this with its shareholders and to include any outcome in its annual disclosures.

Political donations and lobbying activity

We will not support direct donations by companies to political parties or individual political candidates. We believe that companies should fully disclose all political contributions, direct lobbying activity, political involvement and indirect lobbying via trade associations. There should be full transparency regarding the memberships of and monies paid to trade associations and lobbying groups including:

- A breakdown of payments to political parties, candidates and associations, trade associations, and think-tanks, and of direct and indirect lobbying activity on policy and legislative proposals, etc.

- A clear explanation of how each of the above associations, contributions and actions benefit the causes the company supports and align with the strategy of the company.
- A public statement from the company outlining where it disagrees with the associations of which it is a member on a particular issue, and the reasons why it believes it is beneficial to remain a member.
- Disclosure of where responsibility sits within the company for the oversight of such relationships.

Sustainability

As a major global investor, we have a fundamental interest in ensuring that shareholder and bondholder value is not eroded by a company's failure to manage the risks associated with its natural and social environment. We believe that, if companies take advantage of the need to move towards a more sustainable economy, investors can benefit through protection from future risks and the potential of better long-term financial outcomes.

Sustainability governance, process and operations

With this in mind, we expect our investee companies to meet minimum standards in how they identify, assess, manage and disclose sustainability-related risks and opportunities across their business operations. Our key expectations are laid out below.

Risk identification and management

Material environmental and social (E&S) risks will vary between sectors and from company to company, depending on a range of factors. Stakeholders will also have different views on what issues are material for them. Despite this complexity, it is important that all companies across different sectors undertake an analysis of E&S issues that could be material to their business over varying timeframes.

A dynamic risk-mapping exercise should identify the degree to which a company is exposed to each risk element. It should also be used to identify business opportunities such as new products and services, and potential efficiency gains as a result of changing policy, technology and business environments.

Robust E&S risk management processes should be integrated into company Enterprise Risk Management (ERM) systems. The approach should be holistic and implemented across all business operations that either can be considered exposed to environmental and social-related risks, and/or that may produce negative externalities. Where possible, such systems and processes should be externally verified.

Where risks have been identified for the business, comprehensive policy statements should be disclosed to all stakeholders in order to demonstrate the company's commitment to managing these risks.

Governance and accountability

Responsibility for managing a company's societal and environmental impact and the related risks to the business is shared across all business functions. Ultimately, accountability sits at board level. We expect the fulfilment of sustainability targets and commitments to be the responsibility of the CEO and the board. We expect companies to disclose the governance processes they have in place to oversee

and manage these risks. Where material to the business, we encourage companies to link executive remuneration to the delivery of these commitments.

Where specific material issues, such as climate change, are identified, – whether over the short, medium or long term, we expect companies to have sufficient expertise and experience on the board to ensure effective strategic and operational oversight. More information can be found here.

Sustainability strategies

Building a sustainable business model that enhances performance and builds resilience should be at the core of business strategies. E&S issues should not be viewed as peripheral components of business operations or simply ethical and compliance obligations. Where material risks and opportunities have been identified, there should be a clear link to a company's overall strategic priorities. Plans to mitigate risks and realise opportunities should be disclosed clearly.

Reporting and disclosure

Target-setting

Companies should set targets to focus their efforts on realising their strategic E&S objectives, mitigating and managing material E&S risks and impacts, as well as to maximise broader positive stakeholder impacts. While it is important for the targets to be achievable, companies may benefit from setting challenging goals to maximise their overall impact. We expect companies to report suitable metrics that allow progress against these targets to be tracked effectively.

Public disclosure and transparency expectations

Transparency and disclosure are key tools that enable investors to undertake a robust analysis of investment risks and opportunities, and allocate capital accordingly. We expect companies to demonstrate their commitment to the disclosure of sustainability information and data, through publication in key company reporting; this includes the annual report and accounts, with supplementary information in sustainability reports and on their corporate website. We encourage companies to align their sustainability reporting to best-practice frameworks (such as GRI and SASB) and where relevant to relate the Sustainable Development Goals (SDGs) to their strategic priorities and operations. Disclosing in a clear and consistent manner is important in facilitating the analysis of trends in this area.

We encourage our investee companies to be proactive and undertake where possible the verification of their ESG data externally by a reputable independent assurance provider, based on recognised standards. This can be evidenced by making the assurance statement public. This verification exercise should provide reassurance to stakeholders, including investors, around the ESG data disclosed, and should strengthen the credibility of companies' ESG data.

We encourage companies to disclose to key third-party sustainability agencies, and in line with best-practice international guidelines.

We expect the following public disclosures at a minimum:

- ESG reporting standards;

- Verification of ESG reporting;
- Scope of Greenhouse gas (GHG) emissions;
- Tax disclosure;
- Director disclosure; and
- Remuneration disclosure.

We will vote against the board chair at companies that score poorly on transparency within our LGIM ESG score and show no improvement after engagement. The list of companies voted against is published on our website. For further information on each of these key criteria, please see our public ESG score methodology document available on our website.

Please refer to the ESG Transparency section of this document for additional details about our expectations on company disclosures.

Financial impact quantification

Quantification of sustainability risks and potential impacts can help investors make more informed capital allocation decisions, according to their risk, return and impact objectives. Quantification practices can also support companies in better understanding their risk exposure and achieving a net benefit by managing sustainability impacts effectively.

We encourage companies to demonstrate a commitment to best sustainability practices and, where possible, seek to quantify the impact in financial terms to internalise the associated costs and benefits. For example, to the extent that they are material,[1] companies should explain how climate-related matters are considered in preparing their financial statements.

Industry collaboration

Companies may benefit greatly from sharing knowledge and experience with their peers by joining and contributing to industry-wide associations. We encourage collaboration between companies where appropriate to progress the broader ESG agenda and broach cross-sectoral and inter-sectoral ESG challenges. Where relevant, we expect companies to engage with regulatory bodies to promote best practices and policies to achieve sustainability targets.

Lobbying transparency

Whether companies perform individual engagement with regulators or policy makers, or collaborative engagement as part of an industry association, we expect them to be transparent and to comprehensively disclose their public policy engagement activities, including trade association memberships (See section above on political donations and lobbying).

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[1] In accordance with IAS 1.7, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements

Sustainability themes

LGIM focuses on the material issues that can impact a company's long-term sustainability, both financially and reputationally. Some of these issues apply across multiple sectors such as climate change, biodiversity, health (e.g., antimicrobial resistance (AMR) and nutrition) and human capital management issues such as income inequality and modern slavery. Meanwhile, other issues such as food waste, reduction of waste and plastic use are more sector specific.

Below we highlight our expectations in relation to some of our key themes. More information and articles on our position on broader themes can be found here.

Climate change

Climate change is a defining factor in companies' long-term prospects. We expect companies to disclose how they may be impacted by climate-related risks and opportunities, and how these factors are considered within their strategy. We expect to see companies developing their climate disclosures against the Taskforce on Climate Related Financial Disclosures (TCFD) framework. Specifically, companies should be looking to improve approaches to scenario analysis and the quantification of financial impacts that result from climate risks. In addition to TCFD, we expect companies to report using the CDP climate questionnaire, which is aligned with the TCFD framework and crucially provides investors with climate data on a large universe of companies in a comparable format. For sectors where it is material, we strongly encourage companies to report via the CDP Water and Forest questionnaires.

Science Based Targets (SBTs) are decarbonisation targets aligned with the objective of the Paris Agreement. We therefore encourage all companies we invest in to commit to and work towards approved SBT's aligned with the Science Based Target initiative's recent net-zero standard. Alongside this, we expect companies to articulate how their business models reflects a Paris aligned transition.

As part of our Climate Impact Pledge, we expect companies to not only have greenhouse gas (GHG) reduction targets in place, but also to disclose board oversight of climate change and other sector-specific policies. More information on our expectations of different sectors, and the metrics we use to assess companies can be found here.

In relation to climate change, we would expect companies to publicly disclose any concerns they may have with current or evolving legislation and to publicly report on any lobbying activity that is undertaken as a result of such concerns. We recognise that achieving the Paris Agreement requires policy action in a wide range of areas. Therefore, we expect companies to engage with policymakers and regulators to encourage the introduction of policies to enable a net-zero transition for their respective sectors.

Companies that fail to meet our minimum standards with regards to climate disclosure will be removed from select funds, including our Future World funds, subject to tracking error constraints. In all other funds where we cannot divest, we will vote against the chair or other directors, to ensure we are using one voice across our holdings.

Please see more on LGIM's policy on climate change here, and our climate impact pledge here.

Nature

Biodiversity

Biodiversity loss is currently happening at a rate greater than any other time in human history. This matters to investors as biodiversity loss presents a major global systemic risk, with more than half of the world's gross domestic product (GDP) – around US$44 trillion – dependent on nature.[2]

We expect companies to assess their impact and dependencies on biodiversity with a view to managing risk, as well as mitigating and, over time, reversing negative impacts. We encourage companies to commit to having an overall positive impact on biodiversity and to consider the direct as well as indirect activities of their supply chains. We will be seeking greater disclosure from investee companies in line with the Taskforce on Nature-related Financial Disclosures (TNFD) framework and SASB standards.

As a signatory to the Finance for Biodiversity Pledge, we have committed to collaborating and knowledge sharing, engaging with companies, assessing impacts, setting targets and reporting publicly. Our Biodiversity Policy is the first step in formalising LGIM's approach to delivering on these commitments. Please see more information on LGIMs policy on biodiversity here.

Deforestation

LGIM recognises the importance of ending commodity-driven deforestation to tackle climate change, reduce biodiversity loss, and support food security. We are proud to be a signatory to the COP26 Commitment on Eliminating Agricultural Commodity Driven Deforestation from Investment Portfolios. We fully support the call for financial institutions to take ambitious measures to eliminate commodity-driven deforestation within their investments.

In 2022, LGIM launched its deforestation policy. In line with our COP26 commitment, the policy commits LGIM to assessing commodity-driven deforestation risk in investment portfolios. This has been done, and where identified, we have contacted such companies in high-risk sectors with little or no deforestation policies of their own. LGIM is likely to vote against the board chair or other board directors of these companies. LGIM is also encouraging companies and data providers to improve the quality and availability of data on deforestation risk. You can read more about our deforestation policy here.

Although our policy was published in 2022, LGIM has been engaging with key companies in high impact sectors on the topic of deforestation since 2017 as part of its climate impact pledge commitment. For example, LGIM's expectations of investee companies within the apparel sector, require these companies to demonstrate how they are improving the circularity of materials and eliminating deforestation from supply chains. In the food sector, we expect a transition away from high- impact products and progress on decarbonising agricultural supply chains. The lack of a comprehensive deforestation policy constitutes one of our 'red lines' under our climate impact pledge.

Circular economy

Our current globalised economic model can be described as 'linear.' Many of our production processes follow the same route, extraction of raw materials, manufacture, use and disposal ('take-make-waste').

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[2] World Economic Forum, 2020

The system does not put a value on the materials that are at the 'end-of-life' stage, or the environmental and social implications.

This traditional linear system can be reformed, accelerating our 'just' transition to net zero and nature-positive economies, with ecosystems restored. The economic model that can reform our system at scale is the introduction of the 'circular economy'. It is a key component of LGIM's approach to nature. It is based on three principles, driven by design: eliminate waste and pollution, circulate products and materials (at their highest value), and regenerate nature. LGIM will focus its engagement on supporting a transition from a 'linear' economic model to a 'circular economy' model. LGIM's expectation of companies will be increasingly expanded but will include: strengthening disclosures on approach to circular economy and reduction of waste and pollution; whether a circular economy commitment, strategy, business model and policy are in place across the value chain; proportion of raw, re-used, recycled and compostable materials; explanation of how the strategy is embedded, targets and progress; board-level oversight; protection and regeneration of nature and ecosystems; and lobbying activities.

Water

Globally, we need a 'Just Transition' to economies that are both net zero and nature-positive, and in which ecosystems are restored. Water is a key element of this, as it is the very essence of life on this planet. It permeates our lives and has an impact on all of us, reaching across all sectors, businesses and economies. Water can have a diversified impact along a company's value chain, directly impacting operating risks and financial performance.

In its current form, the water system presents a long-term systemic market risk that will impact LGIM, the markets that we invest in and our investment returns, and ultimately our clients. The challenges are significant and there is insufficient global scale action being taken to protect our most precious resource. LGIM will focus engagement on key areas of the water system, i.e., water scarcity and security, and water quality. LGIM's expectation of companies will be expanded and will include: strengthening disclosures on approach to impact on water quantity and quality; whether a commitment, strategy and policy is in place across the value chain; explanation of how the strategy is embedded, targets and progress; board level oversight; protection and regeneration of nature and ecosystems; and lobbying activities.

Health

Antimicrobial Resistance (AMR)

The importance of tackling AMR should not be underestimated. It can have a material financial impact on investments. In 2017, the World Bank estimated that the world will lose 3.8% of its annual GDP by 2050, if action to stem the spread of anti-microbial resistance (AMR) is not taken. That is equivalent to the economic damage caused in the 2008 financial crisis. The Bank further estimated that global output losses could amount to more than US$1 trillion by 2030 and up to US$2 trillion by 2050. In a worst-case scenario the World Bank estimated that additional healthcare expenditures globally could amount to US$1.2 trillion on an annual basis. Moreover, the World Health Organisation (WHO) describes AMR as

one of the top 10 global public health threats facing humanity today. A study published in January 2022 confirmed that 1.27 million deaths globally in 2019 were directly attributable to bacterial AMR.[3]
We ask pharmaceutical companies involved in antimicrobial manufacturing to manage their effluent waste to reduce the risks of AMR, and we ask animal pharmaceutical companies to transparently disclose their AMR stewardship efforts. We also ask companies in for example the Food sector to apply the WHO guidelines on antibiotic use in food-producing animals, including in their supply chain. Further, we expect all water utility companies to be aware of the possible risks of AMR from contaminated water. For more information on our concerns please read our blogs the scale of the AMR problem, why the issue matters to investors, and how we're engaging water utility companies on AMR.

Nutrition

Poor nutrition can have a negative health impact on individuals, workforces and broader societies. This can create a financial burden on economies from increased healthcare costs, both private and public, and on companies from absenteeism. For consumers to make informed decisions about the food they consume and to promote healthier diets, we encourage companies to be transparent on their nutrition strategies; demonstrate progress on these strategies; commit to disclose the share of the company's portfolio and sales associated with healthy food and drink products (using government-endorsed nutrient-profiling models such as the Health Star Rating or NutriScore); and set targets to increase the proportion of these sales.

People

Employees are one of the greatest assets a company can have. We believe that the value they bring to the long-term sustainability of the company should not be underestimated.

Human capital

Human capital – As an investor, it is important for us to understand the culture of the companies in which we invest our clients' money and how that culture impacts the people working within its operations. We expect companies to disclose information that will provide a holistic view of their culture. We would ask companies to disclose metrics such as: workforce turnover and how that compares with the sector average, skills and development training, compensation, benefits, workforce demographics including diversity and health and safety.

Human rights

We expect companies to respect workers' human rights as set out in the Universal Declaration of Human Rights and the main instruments through which it is codified, such as the International Labour Organization's eight core conventions. In addition, we expect companies to be mindful of and comply with the principles of the United Nations Global Compact, OECD guidelines for multinational enterprises and all local and national laws and regulations relating to the protection of employees. LGIM votes against the chair or other directors of any company that is on the UNGC violator list for three consecutive years.

Employee fulfilment/wellbeing

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[3] The World Bank, 2017

Employee voice
The value placed on employees can be measured by the effort a company makes to receive and act upon employee feedback. Therefore, in addition to what is discussed in more detail above, companies should support workers' rights by allowing freedom of association and collective bargaining.

Employee welfare
Companies should ensure that their workforce has received adequate training to equip them with the appropriate skills to carry out their jobs effectively. Workers should be protected from harassment, discrimination and all forms of forced or compulsory labour. Their working environment should be safe, and annual training on health and safety within the workplace should be compulsory. All workers should receive benefits such as paid sick leave, maternity and paternity leave. Where possible, companies should provide access to services to help workers with any medical issues, such as mental health, private health etc.

Income inequality
Living wage: As a minimum, we expect all companies to pay their workers the minimum wages as mandated by local law. However, we believe that to ensure employees avoid the poverty trap, which can create hardship, stress and health problems that together can have an impact on the operational performance of the company, it is important that employers pay a living wage.

A living wage should be sufficient to afford a decent standard of living for the worker and their family. Elements of a decent standard of living include food, water, housing, education, health care, transportation, clothing and other essential needs including provision for unexpected events. Our expectation that workers receive a living wage extends to all contractors that operate on their premises. Procurement practices should ensure that workers' pay is ring-fenced from negotiations on price to ensure they receive a living wage.

To better inform investors about the culture of the company that they are investing in and to further develop our policy on this topic, we are calling for greater transparency on employee practices. We expect companies to publish in their annual disclosures whether they are paying a living wage to their employees. We also want to understand what steps are being taken to ensure their suppliers are paying or working towards paying their workers a living wage. Additionally, we want to understand whether companies are offering all employees the opportunity to work for a minimum of 15 hours a week and what other benefits are in place to alleviate financial hardship, such as paid sick leave, free meals, interest free loans etc. LGIM may take voting action against companies that fail to provide greater transparency on these policies by 2025.

Financial wellbeing training: It is not only important to ensure that all workers are receiving a living wage, but it is equally important that they receive guidance on issues such as money management, where to get financial help etc. We encourage all companies to provide their employees with training on this important topic.

Pensions: We would ask companies to consider the long-term health and wealth of their employees and where possible, to increase the non-contributory element of pension provisions.

Equity ownership: We encourage all companies to offer employees the opportunity to participate in equity ownership. We believe that this is a good performance motivator and retention tool. To ensure

sufficient take-up, we encourage companies to offer free shares to all employees or to those earning below the national median pay level. The offer of shares should be linked to continued service.

Gender pensions gap/ethnicity pay gaps – we expect companies to make themselves aware of these inequalities that exist in their organisation and to take positive steps to reduce them.

Modern slavery

Can take a number of forms, such as child labour, forced labour and human trafficking. Companies should ensure that they are not permitting modern slavery to take place either within their own operations or within their supply chains. As such, we expect companies to adhere to all applicable laws pertaining to modern slavery, which can result in financial and reputational risks to the company as well as potentially causing distress to those workers involved. Therefore, putting in place a code of conduct is not sufficient for ensuring modern slavery does not exist within the supply chain. We expect a more rigorous process to be in place, which includes and is not limited to due diligence audits, local workforce interviews and technology to provide full traceability of all components of goods or merchandise sourced.

Diversity and inclusion

We believe a diverse mix of skills, experience and perspectives is essential for a board to function and perform optimally. We expect boards to embrace different forms of diversity: gender, ethnicity and neurodiversity. Our expectations on diversity and inclusion not only extend to the executive level but run throughout the company. This is discussed in greater detail above.

Why adherence to these principles is important for LGIM

We believe that integrating environmental, social and governance considerations into investment processes can help mitigate risks and improve long-term financial outcomes. For this reason, we embed both top-down and bottom-up ESG analysis into our investment processes. In addition, positive and negative externalities generated by companies can have consequences for the economy and society at large. We believe that investors have a responsibility to a broad set of stakeholders and the market as a whole. We need and expect companies to play their part. Our sustainability principles set out our minimum expectations of companies with regard to the prioritisation, management and disclosure of sustainability issues. These principles naturally feed into our voting and investment decisions, and for certain themes we have very structured processes in place.

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