NAPF Corporate Governance Policy and Voting Guidelines

2011 Amendments

The NAPF has approved a small number of amendments to its Corporate Governance Policy and Voting Guidelines. It is intended these changes should apply during the 2012 voting season.

The attached document sets out which sections of the Guidelines have been amended and which sections remain as they were. The amendments are shown in tracked changes.

A complete and updated version of the updated Corporate Governance Policy and Voting Guidelines can now be accessed via the Corporate Governance page of the NAPF website.

25 November 2011

Introduction

Members of the National Association of Pension Funds (NAPF) have a clear interest in promoting the success of the companies in which they invest. As a consequence of this, the NAPF has long considered that one of its prime functions is to represent these interests on behalf of pension funds and the investment management firms who manage their assets. At the heart of all the NAPF does in representing the interests of its members as shareholders, there are four key themes:

- The NAPF should assist its members in promoting the success of the companies in which they invest.
- The NAPF should help to ensure that the board and management of these companies are held accountable to shareholders.
- The NAPF's efforts should be directed towards maximising the long-term return of its member assets, irrespective of the potential for short-term discomfort.
- The NAPF's policy and guidelines should reflect current market best practice as determined through consultation with its members and other interested parties.

In the Preface to the UK Corporate Governance Code published in June 2010, the Financial Reporting Council noted that its two principle conclusions were: "First, that much more attention needed to be paid to following the spirit of the Code as well as its letter. Secondly, that the impact of shareholders in monitoring the Code could and should be enhanced by better interaction between the boards of listed companies and their shareholders."

These conclusions present shareholders with a challenge in two respects: firstly, it is harder for them to assess compliance with "the spirit of the Code" than it is to apply its Principles in a voting policy; and, secondly, "better interaction" requires a greater understanding of both a company's strategy and shareholders' objectives than has often ben the case in the past. The NAPF sees the Stewardship Code as an important step along the road to improving dialogue and oversight and expects asset managers to disclose the extent to which they comply with its Principles. Pension funds and other asset owners can help raise standards of compliance by themselves committing to the Code and incorporating a review of compliance into their periodic manager monitoring.

~~The NAPF is supportive of these conclusions, while recognising that their implementation presents real challenges to boards and shareholders alike. The changes to o~~Our Policy~~, which~~ remains firmly rooted in the provisions of the Code, ~~have been~~and is drafted with these points in mind. Where the views of boards and their shareholders differ on matters of corporate governance, it is to be hoped that constructive discussion will follow, albeit that ultimately shareholders will exercise their rights as owners to do what they see as necessary to protect their interests.

The main purpose of the NAPF Corporate Governance Policy and Voting Guidelines is to assist investors in their interpretation of the provisions of the UK Corporate Governance Code when assessing a company's compliance with it. While it is particularly focussed on what voting sanctions may be applied at a company meeting, a decision to vote against management can only be taken after proper consideration of the company's explanation for non-compliance and in the light of the particular circumstances at that company.

We hope that in addition the Policy will assist companies and their advisers when they set or review governance practices, by providing guidance as to how shareholders may react to policies which may not comply with the letter of the Code but, in the company's view, are consistent with its spirit.

The NAPF Corporate Governance Policy and Voting Guidelines can be found on the NAPF website (www.napf.co.uk).

Martin Mannion
Chairman, NAPF Investment Council

November 2011

Global Corporate Governance Principles

No changes to Global Corporate Governance Principles

UK Corporate Governance Principles

- **The NAPF supports the UK Corporate Governance Code** in its entirety and wishes to add minimal requirements to that body of work.

- **The Code emphasises the importance of applying the spirit of the Code** and of effective engagement with shareholders. Effective engagement begins with good-quality reporting and a willingness to listen to shareholder concerns. For shareholders and their agents the challenge lies in interpreting companies' application of the Code and developing the skills and resources required for high-quality engagement. The common aim is to raise standards of corporate governance and thus reinforce companies' ability to deliver sustainable performance for their owners.

- **The NAPF and its members will engage with companies** individually and collectively on routine and more serious matters. In addition, the NAPF is prepared to facilitate confidential Case Committees for members who have concerns about particular issues and/or about the strategic direction of companies. Equally, companies should take care to ensure their messages are clearly understood by shareholders and the concerns of the shareholders are clearly understood by the board. The roles of the chairman and the senior independent director in these regards are of the greatest importance.

- **The NAPF expects Boards to support the Code** by observing its provisions wherever appropriate. Non-compliance should be accompanied by clear explanation. Shareholders should not accept "boiler-plate" explanations which provide no insights into the reasons for a board choosing to over-ride the provisions of the Code. Equally, investors should listen to boards that believe it is appropriate not to comply. Good corporate governance is a matter of principle and nuance, not dogma.

- **Prompt and effective communication of changes** in board structures and responsibilities, and remuneration policies, greatly assists in developing good relations between companies and their shareholders and a better understanding of how their governance policies are applied.

- **Shareholder resolutions** can be an effective means of drawing attention to shareholder concerns which have not been addressed adequately through engagement or conventional voting activity. A consequence of increasingly engaged shareholders is likely to be greater use of this device.

- **The Nomination Committee** should anticipate change by ensuring the proper planning of succession. This is part of the process of refreshing the board to which reference is made in the Code.

- **The Remuneration Committee** has a particular responsibility to ensure that executive directors and senior management are appropriately rewarded. This can best be achieved by establishing incentives which are harmonised with the stated long-term objectives of the company. There is increasing concern among shareholders about the asymmetry between remuneration and shareholder returns.

- **The Audit Committee** has arguably the most complex and demanding brief of any of the board committees. It is important therefore that it is staffed solely by independent directors and that there is sufficient relevant experience on it to carry out its responsibilities to a high standard.

- **The NAPF supports the principle underlying pre-emption rights** except where a clear case is made for these not being applied in the context of the best interests of the owners of the company concerned. For the same reason, protecting the rights of existing shareholders and reinforcing the accountability of management to the company's owners, the NAPF will generally oppose the creation of any "poison pill" provisions.

- **The NAPF supports the Stewardship Code** which sets out important principles for the role of investors in monitoring and improving standards of corporate governance in the UK. Pension funds as well asset managers are encouraged to publicly state their support for the Code.

Responsible Investment

No changes to Responsible Investment

UK Voting Guidelines

No changes to UK Voting Guidelines

PART 1: Companies

SECTION A: Leadership

No changes to Part 1 Section A

SECTION B: Effectiveness

Guidance

Shareholders have a reasonable expectation that boards should be effective in delivering results, over time, which are consistent with the company's stated strategy. Where results are below expectations they should assess the extent to which any shortfall can be attributed to poor management judgements, weaknesses in corporate governance or external factors over which the board has limited control. The annual report should be used to set out the ways in which the board has sought to ensure its effectiveness.

Of particular concern to shareholders will be the following: independence of non-executive directors; succession and refreshment policies; evaluation; and re-election.
The NAPF sees the nine-year "rule" as a milestone rather than a cut-off. Thereafter directors will be subject to increasing scrutiny as to their effectiveness and independence. Boards are encouraged to set out their succession and refreshment policies in detail when they propose the re-election of a long-serving non-executive director.

Shareholders will look for evidence of implementation of a succession policy. Any statement on succession should also include a reference to diversity. The disclosure should set out clearly the board's approach to succession planning, any changes anticipated in the next year and how it will approach diversity, bearing in mind the need to develop the right skills and experience on the board.
The importance of gender diversity has been emphasised in the past year and investors now expect boards to set out an explicit policy for achieving a greater degree of diversity than has been the practice in the past. They should also track the implementation of that policy.

The NAPF views board evaluation as an important tool for all boards. Companies are encouraged to disclose details of the process and as far as possible the outcomes from the evaluation.
Given the recognition of the importance of board effectiveness and the widespread acceptance of annual re-election, the NAPF encourages companies to state more fully the skills and experience

which a director brings to his/her role. Such a statement should also include other current appointments which might affect his/her ability to make a full contribution to the work of the board (eg an executive role or a potential conflict of interest). In this way shareholders can make a better informed voting decision.

No further changes to Part 1 Section B

SECTION C: Accountability

No changes to Part 1 Section C

SECTION D: Remuneration

D.1. Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

D.2. There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Guidance

The Principles set out above are clear and yet remuneration remains one of the key points of dispute between boards and shareholders. This is ~~primarily~~ often due to the absence of demonstrable links between strategy, performance and pay, coupled to the multi-year trend of executive remuneration rising at a faster rate than pay more generally and, in recent times at least, poor returns to shareholders, as measured by share prices and dividends. Many investors are also concerned that remuneration has become too complex and question its effectiveness in motivating management.

No further changes to Part 1 Section D

SECTION E: Relations with shareholders

No changes to Part 1 Section E

Appendix 1: Detailed Voting Guidelines

Introduction

No changes to Appendix 1 Introduction

SECTION A: Leadership

No changes to Appendix 1 Section A

SECTION B: Effectiveness

B.7 Re-election

Provisions: annual elections of directors/biographical details/board's rationale for election

Discussion

B.7.1. The NAPF accepts that annual elections for all directors could lead to better accountability and supports this provision of the Code. However, we recognise there are risks associated with annual elections, particularly with respect to continuity and stability. In the instance where a company chooses not to comply with the Code, the policy on director elections should be clearly explained in the context of shareholders' interests.

No further changes to Appendix 1 Section B

SECTION C: Accountability

No changes to Appendix 1 Section C

SECTION D: Remuneration

D.1: The level and components of remuneration

Provisions: performance-related pay/NED pay/early termination/notice periods

Discussion

D.1.1. The NAPF has suggested that in general, for executive directors:

- **Base pay** increases should be capped at inflation, unless there are sound and compelling reasons for a different approach;
- **Bonuses** should be aligned with profits - thus if profits fall then bonuses also fall;

- In **share plans**, where performance targets are reduced, thus making the target easier to reach, the scale of awards should also be reduced.

D.1.2. In the UK, good practice in remuneration has been set out by the Association of British Insurers (ABI) in its "~~Executive Remuneration – ~~ABI ~~Guidelines on Policies and Practice~~Principles of Remuneration". These can be found at http://www.ivis.co.uk/. The NAPF anticipates that most institutional investors and issuers will use the ABI ~~Guidelines ~~Principles as a guide to remuneration policies and has therefore chosen not to re-interpret them in detail here. However it is important that companies tailor their policies to their own particular circumstances and do not slavishly follow established guidelines.

No further changes to Appendix 1 Section D

SECTION E: Relations with shareholders

No changes to Appendix 1 Section E

SECTION F: Other voting issues

No changes to Appendix 1 Section F

APPENDIX 2: List of relevant websites

ABI Remuneration ~~Guidelines~~Principles:
www.ivis.co.uk/ExecutiveRemuneration.aspx

No additional changes to Appendix 2