



RAILWAYS PENSION TRUSTEE COMPANY LIMITED

&

UNIVERSITIES SUPERANNUATION SCHEME LIMITED

UK CORPORATE GOVERNANCE VOTING AND ENGAGEMENT POLICY

Updated December 2011

Railpen & USS Asset Owners' Voting Alliance

Overview

As two large asset owners with a clear commitment to, and experience in, engagement and long term active ownership, Railways Pension Trustee Company Limited (Railpen) and Universities Superannuation Scheme Ltd (USS) have pooled governance expertise and resources to convene a voting alliance covering companies in the FTSE All Share.

Since February 2010, the two pension funds have jointly agreed a common policy on governance related matters. However, each asset owner casts their vote on an individual basis. The alliance does not provide voting advice on corporate actions, matters relating to a change of control or sensitive proposals at investee companies. The alliance generates letters to investee companies (to advise of the rationale for not voting in alignment with management) as a follow up to voting.

It is hoped the alliance will provide an infrastructure for engaged voting for other pension funds – domestic and overseas – in due course. The alliance may also work together to influence the governance agenda of UK plc by providing a pension fund perspective as an alternative to the messages conveyed by large money managers and investor representative bodies.

Application of the Policy

This is the second iteration of the alliance policy, incorporating the UK Corporate Governance Code (June 2010), the UK Stewardship Code (July 2010) and additional, more recent, UK policy developments.

Whilst this joint policy (and the voting alliance) is directly applicable to companies included in the FTSE All-Share, it should be noted that both Railpen and USS are committed to voting their shares beyond the scope of the alliance, both domestically and internationally. The joint policy is broadly informed by and in alignment with both funds' wider voting and engagement policies and principles. For further information, please see the appendices relating to each fund and their respective websites.

The policy is intended to deal with issues that are either not covered by the UK Corporate Governance Code, require greater emphasis or are specifically left open for shareholders to resolve with company boards. Where helpful, it repeats fundamental issues from the Code for the sake of emphasis. This should assist company directors, investment managers and service providers to understand our views on these issues.

Fundamental principles are set out below and will be applied in the majority of cases. However, both Railpen and USS discourage passive box ticking and aim to take an informed and pragmatic approach to voting. Railpen and USS will give due consideration to the specific circumstances and facts available to each investor before voting. Railpen and USS will cast their votes independent of each other and neither Railpen nor USS will be under any obligation to vote in accordance with the policy or member of the alliance.

Railpen and USS support a "comply or explain" approach to corporate governance and generally endorse the UK Corporate Governance Code. We expect companies to explain and justify any reasons for non-compliance with the UK Corporate Governance Code, and to outline their plans for compliance in future. In the case of non-compliance, Railpen and USS reserve the right to accept or reject the explanation.

Engagement

Railpen and USS welcomed the introduction of the UK Stewardship Code from the Financial Reporting Council (FRC) in July 2010 and issued separate statements of commitment available on the funds' respective websites and the Asset Owners section of the FRC's Stewardship Code site.

Railpen and USS will engage with companies on occasions when it is in members' long-term interests and will endeavour to identify problems at an early stage to minimize any loss of shareholder value.

This approach may be adopted irrespective of whether the company is held in an active or passive fund or whether Railpen or USS is underweight or not.

Instances when Railpen and USS may intervene include when we have concerns about:

- The company's strategy
- The company's operational performance
- The company's acquisition/disposal strategy
- Independent directors failing to hold executive management to account
- Internal controls failing
- Inadequate succession planning
- An unjustifiable failure to comply with the UK Corporate Governance Code¹
- Inappropriate remuneration levels/incentive packages/severance packages
- Poor environmental management, including pollution and climate change
- Poor human capital management
- Poor management and/or disclosure of ESG information

Railpen and USS will seek to engage with companies in a confidential and constructive manner without publicity as we expect good management to reassure investors when faced with shareowners' concerns. As a first step in engagement, where we do not vote in accordance with management's recommendations, we will where practical, write to the company providing them with a rationale for our vote decision in advance of the meeting. However we reserve the right to make public our concerns if the company fails to address adequately the issues which have been raised, and escalate as appropriate.

¹ The current version of the UK Corporate Governance Code is the June 2010 edition which applies to accounting periods beginning on or after 29 June 2010. The UK Corporate Governance Code was first issued in 1998 and has been updated at regular intervals since then. In October 2011, the FRC announced its intention to issue a revised code that will apply from October 2012. Railpen and USS will review this policy in light of future revisions to the UK Corporate Governance Code and other best practice and regulatory developments.

Statement of General Principles

Voting is seen as an important aspect of responsible ownership and valuable tool for engaging with companies to encourage better standards of corporate governance and management of environmental and social (ESG) issues.

Accountability: Railpen and USS firmly believe that a company's directors should be accountable primarily to its shareholders as they are the owners of the company and the providers of its risk capital who reasonably expect the board to pursue business strategies to optimise long term shareholder value. However, it recognises that it is very much in the shareholders' own interests that directors should also consider the significance of other stakeholders to the company's long term prosperity. Railpen and USS accept that directors will be unable to pursue the objective of increasing long term shareholder value without developing and sustaining these stakeholder relationships. By the same token, directors must also manage the risks associated with social and environmental issues where appropriate as these may have a material impact on the company's long term performance.

Non-Executive Directors (NEDs) are a vital safeguard of the interests of shareholders. NEDs should work co-operatively with their executive colleagues and demonstrate objective and independent judgement. In line with the current version of the UK Corporate Governance Code on board balance and independence², at least half the board, excluding the chairman, should comprise non-executive independent directors. As a rule of thumb, boards should have at least three independent NEDs, or a minimum of two if the company is small. NEDs considered by the board to be independent should be clearly identified in the annual report.

Independence: We endorse the UK Corporate Governance Code's definition of independence of directors³. According to the definition, a director is assumed not to be independent if he or she:

- is currently or has been an employee of the company within the past five years;
- has or has had within the last three years a material business relationship with the company;
- received or has received remuneration from the company other than director's fees;
- participates in the company's share option or performance-related pay schemes;
- holds cross-directorships;
- represents a significant shareholder; or
- has served on the board for more than nine years.

Railpen and USS take a flexible view, however, on the application of the so-called "nine-year rule" in relation to independence. Long tenure does not necessarily mean a loss of independence, but boards must make a persuasive case in the annual report for a NED's continuing independence in such cases. All NEDs serving more than nine years on the board should be subject to annual re-election.

Companies may, if they wish, pay NEDs partly in shares which should be retained whilst they are in office. NEDs should not participate in performance-related pay or incentive schemes.

Senior Independent Non-Executive Director (SID): the appointment of a SID is encouraged. The individual should be identified in the annual report to provide a communication channel between shareholders and NEDs in addition to existing channels. It is accepted that in many companies this channel need only be used occasionally. However, we consider that the appointment of such an individual is beneficial.

A further role for the SID should be to perform the periodic performance appraisal of the Chairman. Due to the nature of the role, it is important that the SID's independence be *demonstrable*, and Railpen and USS will look closely at how the board has determined his or her independence.

² Provision B.1.2 states: Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.

³ Provision B.1.1

Combined Chairman/Chief Executive: The combination of these roles is actively discouraged.⁴ Any departure (e.g. in a small company) should be fully justified and balanced by the presence of independent and effective NEDs so that no one individual has unfettered powers of decision. Railpen and USS would normally expect a fully independent deputy chairman or senior independent director to be clearly identified when these roles are combined.

Independence of Chairman: A Chairman should be independent on appointment.

CEO Becoming Chairman: The elevation of a company's Chief Executive to Chairman will generally be discouraged⁵, unless it is part of a transitional period at the company or if the company can present a compelling justification for the move. The company should be prepared to explain the measures in place to ensure that the incoming Chief Executive would be able to operate without undue intervention from his predecessor.

Board Appointments: should be both formal and transparent with detailed information on the recruitment process (such as the development of selection criteria, the executive search agencies used), the nominated candidates' background, competencies and skill-sets (Principle B.2) and how they complement the existing Board of Directors.

We encourage the Nominations Committee to widen the pool of talent and professional experience of candidates considered in the appointment of new directors and would refer companies to our section on diversity below. We would welcome disclosure of what individual directors bring to a board and why shareholders should support their election.

Director Disclosures: Full biographical details, including other directorships and/or chairmanships, should be disclosed. In the case of the re-election of a director, the Chairman should confirm the ongoing effectiveness of the director and their commitment to the role, in line with Provision B.7.2.

The overall objective for the disclosures outlined above should be to provide shareholders with the means to evaluate the individual candidates, their role within the Board as a whole; and the performance of the Nominations Committee.

Board Committees: There should be Audit, Nomination and Remuneration Committees on all but the very smallest boards, with a majority of independent NEDs, and exclusively independent in the case of the Audit and Remuneration Committees. Members of all the committees must be identified in the annual report. The Chairman of the company may be a member of the Nomination Committee, and there are very good arguments for his/her inclusion in its membership. We also accept that permitting the Chairman to sit on the Remuneration Committee as a full member would ensure that performance incentives and other elements of the remuneration policy are properly aligned with the company's strategic objectives. However, the Chairman should not chair the Remuneration Committee.

Audit Committees: should consist of at least three NEDs⁶, all of whom must be independent, and who should be identified in the annual report and accounts. At least one member must have recent and relevant financial experience and this should be clearly set out in the annual report. The Committee should have written terms of reference which are published either in the annual report and accounts or on the company's public website.

Nomination Committees: should consist of at least three NEDs, the majority to be independent. As with the Audit Committee, written terms of reference should be made available. The Chairman of the company can be a member and the SID should be a member.

Remuneration Committees: should consist of at least three members, all of whom must be independent NEDs. No director should be involved in setting his/her own pay. An independent Chairman may be a member of the committee; however, we would not expect the Chairman of the company to chair the Remuneration Committee.

⁴ Provision A.2.1 states: "The roles of chairman and chief executive should not be exercised by the same individual."

⁵ Provision A.3.1 states: "A chief executive should not go on to be chairman of the same company. If, exceptionally, a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report."

⁶ Small companies may have two members.

Director Elections: In line with principle B.7, Railpen and USS consider all directors should be required to submit themselves for re-election at least every three years. There must be no insulation from this requirement.

However, we do not consider it necessary for all directors of FTSE350 companies to be subject to annual elections. In the spirit of “comply or explain”, we will consider carefully explanations as to why a Company does not consider it appropriate to comply with Provision B.7.1. If we agree that the explanation is valid and reasonable, we will support the Company’s position in this area.

Independence: As stated above, Railpen and USS will not apply the “nine-year rule” inflexibly when considering whether to re-elect a NED. However, if there is an insufficient number of independent NEDs on the board, the company will be expected to justify fully the long-serving continuing independence of NEDs and disclose any succession plans for the board.

Education and Evaluation of the Board: The board, its committees and individual directors should be evaluated on an annual basis. In the case of FTSE 350 companies, the evaluation should be externally facilitated at least every three years⁷.

The Board should disclose the methodology⁸ and key outcomes from the annual and triennial board evaluations. We would encourage the Board to discuss any remedial actions taken further to the evaluation process and to place such redress within the context of succession planning for both executive and non-executive directors, talent management and diversity agenda.

We welcome the ABI’s *Report on Board Effectiveness* (September 2011) as well as the Financial Reporting Council’s *Guidance on Board Effectiveness* (March 2011).

There should be a full formal induction for new directors, and regular refresher and updating sessions should be available.

Diversity: This has emerged as a key theme in the debate about the quality and performance of boards, and as a way to improve board effectiveness, in many markets around the world. In our view, diversity amongst board members is a key component of a successful board and we agree with the Financial Reporting Council’s view that ‘diversity, in all its aspects, serves an important purpose in connection with board effectiveness’⁹. However, any consideration on diversity should not be at the expense of appointing the best qualified candidate.

One aspect of diversity relates to gender. We endorse the report from Lord Davies of Abersoch, entitled *Women on Boards*¹⁰ which calls on the chairmen of FTSE 350 companies to disclose their aspirational goals on the percentage of women they aim to have on their boards in 2013 and 2015 and we encourage companies to meet those goals. We also support the amendments to the UK Corporate Governance Code that will require listed companies to report annually on their boardroom diversity policy, including gender, and on any measurable objectives that the board has set for implementing the policy and the progress it had made in achieving the objectives. Whilst the Code amendments will only apply to financial years beginning on or after 1 October 2012¹¹, we would encourage all companies to seek to implement a boardroom diversity policy, as well as a diversity policy across the organisation, and to report on the application and progress of the policy in the forthcoming reporting cycle.

Board Attendance: The number of board, committee and other meetings attended by each director should also be disclosed routinely in the annual report and accounts as a matter of best practice. Instances of poor attendance should be explained.

⁷ As per UK Corporate Governance Code Provision B.6.2

⁸ As per UK Corporate Governance Code Provision B.6.1.

⁹ Gender Diversity on Boards”, Financial Reporting Council Consultation, May 2011.

¹⁰ Women on Boards’, Lord Davies of Abersoch, February 2011,

¹¹ An updated version of the Code is to be published in 2012 after other consultations are closed and to coincide with other Government proposed regulations.

Remuneration Philosophy & Design

Railpen and USS set out below their general views on what constitutes an appropriate remuneration policy:

Remuneration Design: Executive remuneration arrangements are often quite complex and need careful scrutiny. In line with Section D.1 of the UK Corporate Governance Code on the design of performance-related remuneration, actual and potential awards should not be excessive and should be directly related to the company's success and aligned to the returns achieved by the shareholders. We would expect to see Executive Directors maintaining a material shareholding in the company. Exceptional rewards can only be justified by exceptional performance. It follows that performance targets should be rigorous. Railpen and USS would look favourably on the inclusion of non-financial performance criteria in both short and long term variable pay, where such factors represent material risks and opportunities as identified by the directors in the Business Review. We support both short and long term variable performance based remuneration being paid in the form of equity. Remuneration systems should genuinely incentivise directors to deliver durable shareholder value and policies should be clearly aligned with business strategy, objectives and key performance indicators (KPIs) which link to long-term value creation.

Pay for Performance: Remuneration should include performance based rewards. Executives should not be compensated merely for market or sector increases in stock prices. Performance metrics should be relevant, linked to strategy and enhance long-term shareholder value. Recipients should have a line of sight between performance and reward. Performance should be assessed relative to relevant peers and over an appropriate time-frame. We do not encourage transaction, recruitment or termination payments.

Disclosure: We expect companies to make full disclosure of the detail of directors' pay and benefits. Key areas where we encourage full disclosure include:

- Rationale behind the selection of the chosen performance metrics.
- Linkage between pay and delivery of strategic objectives.
- Breakdown of total remuneration received during the year.
- Remuneration potential for the following year, including details of bonus.
- Maximum awards available under any LTIP and Option plans.
- Any required explanations and justifications for the decisions and actions taken by the remuneration committee.
- Full justification and explanation for any discretion which the remuneration committee uses, or plans to use.
- Details of the consultation process, including the major shareholders and remuneration advisers that participated.

Remuneration Advisers: Where remuneration consultants provide other services to the company, we would welcome a breakdown of fees and assurance regarding the processes in place for managing conflicts of interest. We would encourage remuneration consultants to adhere to the *Voluntary Code of Conduct in Relation to Executive Remuneration Consulting in the UK* launched in November 2011 by the Remuneration Consultants Group. However, it should be noted that we do not generally accept communication with the remuneration consultants to be a substitute for direct communication with the Board.

Long Term Incentive Plans: should always be put to shareholders for approval as well as any material changes to existing plans. Payment for failure must be avoided, and mitigation arrangements should be applied routinely and robustly on both the appointment of directors and the termination of their contracts. Performance targets should be demonstrably stretching and measured over an appropriate time-frame. We encourage the use of both financial and extra financial performance metrics within the remuneration structure.

Remuneration Report: The inclusion of a remuneration report detailing a company's remuneration policy and directors' pay in a company's annual report and accounts is now a statutory requirement under The Directors' Remuneration Report Regulations 2002.¹²

Where companies do not provide shareholders with an advisory vote on the remuneration report, due to circumstances such as being incorporated outside of the UK, we will consider withholding support for the report and accounts. We see an advisory vote on the remuneration report as an important right of shareholders in companies with a UK listing and overseas domicile.

Where a company provides inadequate disclosure on remuneration, or adopts remuneration policies and practices that are not aligned with shareholder interests, we may consider withholding support for the remuneration report and/or the re-election of Remuneration Committee members.

Railpen and USS are mindful of guidelines of best practice on remuneration set out by other investor groups and industry bodies, such as the International Corporate Governance Network, which are recognised as best practice and we expect companies to follow the guidance on good practice in such policies. There are many other guidelines that provide a practical framework and reference point for both shareholders in reaching voting decisions and for companies in deciding upon their remuneration policy.

Clawback and Malus: In line with the 2011 ABI Principles of Executive Remuneration, remuneration committees should retain discretion to reduce or reclaim payments if the performance achievements are subsequently found to have been significantly mis-stated. We consider that there should be specific provision for 'clawback' policies that enable a company to reclaim compensation (bonuses and other incentives) that are awarded based on earnings that were subsequently found to be erroneous, fraudulent or manipulated or through any other such accounting restatement.

Hedging: Railpen and USS consider that companies should strongly discourage hedging by scheme participants of exposure to longer-term incentives, and plan rules should prohibit alienation, however derived.

Service Contracts: We strongly support the Joint Statement on Executive Contracts and Severance published in February 2008 by the ABI and NAPF.

We believe executives of listed companies should be appropriately rewarded for the value they generate. However, we are also concerned to avoid situations where departing executives are rewarded for under-performance. Shareholders have an expectation that boards will consider the risks of negotiating inappropriate executive contracts that can lead to situations where failure is rewarded. Companies should clearly disclose key elements of directors' contracts on their website and summarise them in the Remuneration Report which should fully disclose the constituent parts of any severance payments and justify the total level and elements paid.

Executives should be employed on no longer than one year rolling contracts which should be seen as an upper limit rather than a floor, and we would strongly encourage boards to consider contracts with shorter notice. Compensation for risks run by senior executives is already implicit in the absolute level of remuneration, which mitigates the need for substantial contractual protection. Boards should ensure that contracts do not include any additional financial protection in the event of poor performance leading to termination and also ensure that severance payments arising from poor corporate performance do not extend beyond basic salary.

We do not support contracts that become longer on a change of control of the company, unless it is an initial contract for a fixed period. Changing a contract to a shorter period should not give rise to compensation because the one-year contract term is best practice. We expect companies to look for mitigation of loss if a director leaves and severance payments should be made on a phased basis.

¹² Directors' Remuneration Report Regulations 2002 S.I.2002/1986

Voting at Company Meetings:

- (i) **Report and Accounts resolutions:** A separate resolution proposing the adoption of the annual report and accounts should be tabled at all AGMs. Where we have general and persistent concerns about a company's governance or the actions of the Board as a whole during the year, or where concerns cannot be linked to a particular resolution we may withhold support for the Annual Report & Accounts. The decision to vote against the Annual Report and Accounts at a company will not be taken lightly and will be considered on a case by case basis.
- (ii) **Bundled resolutions:** bundling of matters for consideration that should be put to separate shareholder votes is strongly discouraged.
- (iii) **Electronic voting:** Companies should be encouraged to adopt electronic voting in place of the existing cumbersome proxy voting system and to use all poll voting in place of the show of hands. We reserve the right to demand a poll where the company retains the show of hands.
- (iv) **Proxy voting disclosure:** The total proxy votes should be disclosed for each resolution at the meeting and should be made available on the company's public website or through a regulatory announcement as soon as practicable after the AGM.
- (v) **Companies not incorporated in the UK:** we expect non-UK incorporated FTSE All-Share companies to comply with UK governance best practice.

Donations: Political donations should not normally be made without the prior approval of shareholders, and where such consent is obtained it should not be for an indefinite period. Where the prior approval is not possible, political donations should be the subject of a vote of endorsement at the following AGM. Railpen and USS discourage direct or indirect donations made to political parties and would vote against a specific resolution of this type. We would also consider voting against the report and accounts in the absence of a specific resolution to approve a donation.

However, under the Political Parties, Elections and Referendums Act 2000, EU political expenditure is widely defined to include organisations which carry on activities which are capable of being reasonably regarded as intended to affect public support for a political party in any EU member state or to influence voters in relation to any referendum in any EU member state. Therefore EU Political Organisations might include, for example, bodies concerned with policy review and law reform, with the representation of the business community or sections of it or with the representation of other communities or special interest groups which it may be in the interests of a company and its shareholders to support.

Resolutions which seek authority to make donations to such bodies will normally be supported by Railpen and USS unless the company has a history of making direct contributions to political parties, the authority is for a period of over three years or is for a very large sum, in which event Railpen and USS will review each resolution on a case-by-case basis. We will not generally support resolutions which seek authority for longer than four years in the absence of a clear justification.

Most EU political expenditure would be covered by a specific resolution seeking authority. However, UK company law does not require this for other overseas jurisdictions. We nevertheless expect companies to seek shareholder approval for political expenditure in other jurisdictions and to make full and comprehensive disclosure of such expenditure.

Charitable donations are generally acceptable within reason and should be fully disclosed.

Investment Trust Companies: It is now widely accepted that boards of investment trust companies should be composed entirely of independent non-executives who must not be employees or former employees of the fund manager and its subsidiaries and associates. In practice, up to one non-independent director, who should not also act as Chairman, can be permitted. The Chairman must also be demonstrably independent. The fund manager's contract should not be longer than one year. Railpen and USS generally support the Association of Investment Trust Companies' Code of Corporate Governance (published 2003) as best practice for the sector.

Audit and Auditor Fees: Railpen and USS support the guidance given to Audit Committees by the *Smith Report on Audit Committees* (now incorporated into the revised UK Corporate Governance Code) and the *Turnbull Guidance*, as amended in 2005. The Audit Committee should publish an explanatory report of its own in the annual report and accounts which should state its policy on the appointment, remuneration and rotation of external auditors, as well as how the independence of external auditors is maintained and assured. The committee should also make clear the nature of its relationship with the company's internal audit function. It should also conduct an annual review of internal controls and state that it has done so in the annual report.¹³ We encourage audit committees to take account of the global disclosure guidelines¹⁴ on Audit Committee Reports published by the *Enhanced Disclosure Working Group* which provides helpful guidance on the scope and content of audit committee reports.

Companies should disclose clearly in their annual report and accounts a breakdown of audit and non-audit related fees paid to their external auditors during the year. Non-audit related fees should not be combined into one sum but should be broken down into separate activities and if necessary explained in the Audit Committee's own report. The nature of any non-audit work undertaken by the external auditor should be made in the notes to the accounts with additional supporting explanations in the Audit Committee's own report and an indication as to whether non-audit work is put out to competitive tender. There is no set ratio of audit to non-audit fees that the Railpen and USS find acceptable, but in general very large non-audit fees without adequate explanation will be resisted. Conversely, very small non-audit fees which are greater than audit-related fees may be looked upon more favourably than if the quantum was substantially higher.

We are not supportive of the indemnification of the external auditors as this could undermine the integrity of the audit. We note that UK company law currently permits companies to reach auditor liability limitation agreements with their auditors, subject to formal approval by shareholders. It should not be taken for granted that shareholder consent will be obtained.

We will not support liability limitations with a fixed cap liability of whatever form. We may support proportional liability limitation agreements on a case by case basis. However, we expect directors seeking approval for such a liability limitation agreement to explain why it is in the company's interest to reach this agreement. We will also expect companies to take account of any guidance provided by the FRC and, in seeking shareholder approval, to state where and why they derogate from the standard form agreements and guidance.

Contested Takeovers: Railpen and USS reserve their positions in the event of a hostile takeover. Support might not be extended to the existing management in circumstances of poor performance or if a very full price is offered. Such voting decisions will be taken by each individual institution with regard to the views of the investment/fund manager(s) and in the light of the individual circumstances.

Dilution of Equity: Like most major institutional investors, Railpen and USS endorses the Pre-Emption Group's guidelines on dilution which permit up to 5% of share capital to be offered for cash rather than on a rights basis. Existing shareholders should be offered the right of first refusal when a company issues shares exceeding 5% of the existing shares in issue or exceeding a 7.5% threshold in any three-year rolling period, as set out in the Pre-Emption Group's document "Disapplying Pre-Emption Rights: A Statement of Principles", issued in 2006.

We also strongly support the basic principle in the ABI's "Guidelines for Share Incentive Schemes" in its Principles and Guidelines on Remuneration (revised December 2005) that overall dilution under all schemes should not exceed 10% in any 10-year period with the further limitations of 5% in any rolling 10-year period on discretionary schemes.

We consider pre-emption to be a basic shareholder right that should not be eroded and will only agree in very exceptional circumstances to waive pre-emption rights. A wide variety of financing options are now available to companies. Companies should explain why a non-pre-emptive issue of shares is the most appropriate means of raising capital, and why other financing methods have been rejected. They

¹³ As per UK Corporate Governance Code Provision C.2.1, which states further: "The review [of internal controls] should cover all material controls, including financial, operational and compliance controls and risk management systems."

¹⁴ Audit Committee Reports Global Disclosure Guidelines published by the Enhanced Disclosure Working Group, December 2011

should also disclose the level of dilution of value and control for existing shareholders on both a proposed and rolling three-year measure, and make clear the process they would follow if approval for a non-emptive issue were to be granted, for example how dialogue with shareholders would be carried out in the period leading up to the announcement of an issue. Furthermore, we would expect companies seeking authority from shareholders to waive pre-emption rights to do so on an annual basis, rather than every five years as stated in s.80 Companies Act 1985.

In line with current ABI guidance on share issues, which was updated in January 2009¹⁵, we accept that companies may wish to request a general authority to issue new shares worth up to two-thirds of their existing capital without holding an extraordinary general meeting. However, we would expect a clear justification of the request, particularly where a capital raising has been undertaken within the previous year. Where the Board is not subject to annual re-election, we endorse the ABI guidance that all directors of a company requesting such an authority should stand for re-election at the following AGM.

Share Buybacks: We would encourage companies to provide explicit assurance that share buyback authorities will only be exercised where it is in the best interests of all shareholders and will result in an increase in earnings per share (EPS). Further, where remuneration schemes are based on EPS performance, we would encourage companies to provide additional assurance to demonstrate the alignment of pay with performance.

Cash Boxes: We discourage companies from raising money by use of an off-shore Cash Box system where it is highly dilutive to institutional investors or has been used as a vehicle to avoid pre-emption rights.

Operating and Financial Review (“OFR”) / Business Review: The Companies Act 2006 requires quoted companies to publish an enhanced business review to allow shareholders to make an informed assessment of the performance and prospects of the company. This extends to, but is by no means limited to environmental, employment, social and community issues.

Railpen and USS strongly encourage companies to publish a forward-looking review as a best practice requirement and to go well beyond bare compliance or boilerplate disclosure. The Review should describe the company’s strategy, and associated risks and opportunities, and explain the board’s role in assessing and overseeing strategy and the management of risks and opportunities. We wish to see a balanced and comprehensive analysis of the company’s performance and prospects; an informative description of principal risks and uncertainties facing the business; and analysis using appropriate financial and non-financial key performance indicators. In the UK, such a statement would take account of the guidance contained in the Accounting Standard Board’s Reporting Statement on the Operating and Financial Review.¹⁶

Environmental, Social and Governance (ESG): Railpen and USS have clear voting guidelines on governance issues as laid out in this policy but do not take a specific voting stance on other environmental and social resolutions at company meetings. Most of these resolutions would be addressed in a case-by-case manner to reflect the company’s own practices, as well as the specific requirements of the resolution and in line with Railpen and USS’s fiduciary duty to their members.

As stated earlier, Railpen and USS consider that the board is accountable primarily to its shareholders, but recognise that the board should consider the significance of other stakeholders. Railpen and USS support the ABI Guidelines on Responsible Investment Disclosure, and would expect to see disclosure in a company’s annual report regarding how it takes account of the significance of these matters to the business of the company and the materiality of any environmental, social and governance risks that impact their operations. The publication of a Corporate Social Responsibility Report, whether incorporated in the annual accounts or as a standalone document, is encouraged. However, key risks should be covered in the Business Review of the main annual report and accounts.

¹⁵ ABI Guidance on “Directors’ Powers to allot share capital and disapply shareholder’ pre-emption rights”, January 2009.

¹⁶ “Reporting Statement: Operating and Financial Review (OFR)” published by ASB, London, January 2006.

In this regard, the Companies Act 2006 now has requirements with respect to the information to be contained in the business review section of the Directors' Report. Section 417 states that, for quoted companies, the enhanced business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, contain information about:

- (i) environmental matters (including the impact of the company's business on the environment),
- (ii) the company's employees, and
- (iii) social and community issues,

including information about any policies of the company in relation to those matters and the effectiveness of those policies.

Furthermore, Railpen and USS expects its fund managers – internal and external - to take into account ESG considerations in selecting and retaining investments, where these factors are likely, in the fund manager's view, to have a material impact on the performance of the portfolio. Both Railpen and USS have incorporated such expectations into their Statements of Investment Principles.

December 2011

Appendices: About Railpen & USS

Railways Pension Trustee Company Limited

The Railways Pension Trustee Company first adopted a corporate governance policy in 1992. Our investment managers have been instructed to vote our shares at all UK meetings in accordance with our voting policy since 1992. The policy is monitored on behalf of the Trustee Company by RAILPEN Investments. The policy is reviewed periodically and was last updated in February 2008 to reflect amendments to the Combined Code on Corporate Governance (the “Combined Code”), and other developments in UK corporate governance. This joint version of the document incorporates our general approach to corporate governance in the UK and our more detailed voting policy in the context of the Railpen & USS Asset Owners’ Voting Alliance.

The Trustee Company strongly supports the Financial Reporting Council’s UK Stewardship Code and has published a stewardship compliance statement on its website at www.rpmi.co.uk. Other corporate governance policies and disclosure of UK voting decisions can also be found on the website. The Trustee is also supportive of industry guidelines issued by the National Association of Pension Funds and the Association of British Insurers, such as their joint statement on ‘Best Practice on Executive Contracts and Severance’ and the ABI’s ‘Guidelines on Responsible Investment Disclosure’.

In addition to the monitoring and engagement performed by its fund managers and voting overlay managers, the Trustee Company will take further action in relation to individual companies, whether independently or with other parties, where it considers it in the best interests of beneficiaries to do so.

The Railways Pension Scheme is an industry wide scheme with over 100 designated and participating employers. The Trustee Company’s governance and voting policies are applicable to all listed companies, including without exception those that participate as employers in railway industry pension schemes. The Trustee Company is firmly committed to voting on all resolutions at every meeting of the UK companies in which it holds an interest. Although the Trustee Company’s external fund managers are expected to advise and report on governance issues and to engage proactively with companies in line with the UK Stewardship Code, full voting authority ultimately rests with the Trustee Company.

The Trustee Company has started to introduce active voting in overseas markets, and supports the ICGN Statement on Global Corporate Governance Principles, updated in 2009. This document has served as the starting point for the Trustee Company’s approved voting policies for the USA, Japan, Australia, Singapore and Hong Kong and will continue to be a reference point for policies in other markets, whilst also taking into account local governance codes, where they exist. It is hoped that best practice in corporate governance will develop worldwide and, in future, separate policies may be developed for countries or regions where the Trustee Company actively votes.

Universities Superannuation Scheme (USS) Ltd

Universities Superannuation Scheme Ltd (USS) is the corporate trustee of Universities Superannuation Scheme, which is one of the largest pension funds in the UK. USS was established in 1974 to administer the principal pension scheme for academic and senior administrative staff in UK universities and other higher education and research institutions.

As part of the funds' commitment to being a long-term, active and responsible shareowner, USS votes its shares in most of the markets in which it invests and views voting as an important tool for engaging with companies to encourage better standards of corporate governance. Where we have voted against management or abstained on a resolution we will, where practical, write to the company providing them with the reasons for our voting decision.

USS' voting is informed in the UK by the joint voting policy agreed by Railpen and USS for stocks covered by the voting alliance. In addition, USS has its own internal guidance notes and utilises independent proxy research. USS' intention is to cast proxy votes in consideration of the facts and issues on an individual company by company basis. Outside the UK and for companies quoted off the main market (e.g. AIM), we seek to take into account local market standards and best practice.

The policy includes guidance on environmental and social issues to a moderate extent. However, USS has not developed a specific policy on extra-financial issues, particularly environmental and social matters, as they are often very company specific. Resolutions covering such issues are reviewed on a case by case basis taking into account advice from a variety of sources (e.g. the company, other shareholders and/or resolution filer, other investor bodies, proxy agencies, unions, NGO's) where appropriate.

The fund uses locally informed research providers where possible and participates in regional corporate governance fora. Through working with domestic market investors and other pension funds investing in the local market, USS seeks to better understand overseas market best practice and undertake more effective engagement with companies and market regulators. The fund participates in initiatives with other shareholders to remove impediments and protect minority and foreign shareholder interests in overseas markets.

In accordance with best practice, the fund is committed to disclosure of its voting records. The fund posts reports on responsible investment and details of voting activity on our website, providing commentary on the rationale behind the vote where possible.

USS also publishes a list of its global equity holdings across internal (LIO) and externally managed portfolios for each quarter.

USS has an active securities lending programme. To ensure that the fund is able to vote all its shares at important meetings or where USS is a significant shareholder, the fund has established procedures to restrict lending for sensitive stocks and recall shares in advance of the record date where appropriate.

Further details of USS' responsible investment activities, policies and reports are available on the Responsible Investment section of the USS website at www.uss.co.uk.