April 2022

North America Corporate Governance and Responsible Investment Policy

2022

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Introduction

This document sets out Legal & General Investment Management's (LGIM) expectations of investee companies in the North American market in terms of environmental, social and governance issues. This is a region-specific document and is therefore separate to our Global Principles document, which provides a full explanation of LGIM's approach and expectations in respect of topics we believe are essential for an efficient governance framework. When developing our policies, we not only look at local market 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. We expect all companies to closely align with our principles, or to engage with us where circumstances prevent them from doing so.

There continue to be lingering effects from the pandemic, and as a long-term, constructive investor, we will stand by and support the boards of companies in which we invest throughout these difficult times. In doing so, LGIM encourages investee companies to focus not only on shareholders, but on all of their stakeholders. This includes their workforce, supply chain relationships, the environment and the communities in which they operate. On capital-allocation matters, we expect boards to proceed in a manner that will ensure confidence, promote the long-term sustainability of the company and support its stakeholders. Lastly, in relation to executive remuneration, we encourage boards to demonstrate restraint and discretion. We will continue to monitor and take this into account in our voting decisions during 2022.

We publicly disclose our voting decisions, including the rationale when we go against a company's management. This data is now accessible one day after the shareholder meeting here.

Investor Stewardship Group framework

LGIM endorses the framework for US stewardship and governance from the Investor Stewardship Group (ISG), which helps meet the need for investor-led best-practice guidelines for both companies and investors in the US market. Its Principles for US Listed Companies framework includes six principles that are fundamental to good governance at listed companies and reflect many of the beliefs set out in our policies. However, LGIM's principles may be more specific and more robust on certain issues. LGIM sits on the ISG Governance Committee, which oversees the continual development of the principles.

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 delegated to it by stakeholders.

The board has the crucial task of setting the strategy and direction of the business, ensuring that the necessary resources are available to enable their implementation, and that appropriate risk management and internal controls are in place. It sets 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 considerations and to report on company performance in these areas. It is also responsible for ensuring the integrity of the 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.

Board leadership

LGIM believes 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.

The board chair and the chief executive officer (CEO)

The responsibilities of the chair include leading the board, setting the agenda for board meetings, and ensuring that directors receive accurate and timely meeting information. Under his or her direction, there should be a good flow of information within the board and to its committees. The chair is also responsible for leading the appointment process for 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 and commitment, and whether they are sufficiently diverse to make a positive contribution.

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

Given the importance of the role, LGIM expects the chair to be independent at the time of appointment.

LGIM would therefore not expect a retiring CEO to take on the role of chair, as these two positions involve different responsibilities and a different approach to board relations and the company. Additionally, 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 would encourage the company to allow the CEO to be consulted by the board, but not to be a formal board member and 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, LGIM would expect companies to commit to re-split the roles within a short, pre-set timetable. In addition, we would also expect a deputy chair to be appointed to ensure that no person has unfettered decision-making powers.

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, requiring distinctly different skills and experience. Therefore, LGIM expects 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. Therefore, LGIM will vote against the re-election of any director who holds both the chair and CEO positions.

In addition, we expect the company to maintain a strong lead independent director.

Where a company currently separates the roles of chair and CEO, LGIM strongly discourages it 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.

Senior or lead independent director

The senior or lead independent director plays an essential role on the board and should lead the succession process of 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 (CFO) have failed to address concerns or are not the appropriate avenues.

LGIM expects the senior or lead independent director to be a fully independent non-executive director. This is of extra importance when the company has a combined chair and CEO.

Non-executive directors

LGIM expects 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 roles involve, non-executive directors must make sure they have sufficient time to perform their duties. LGIM expects non-executive directors to take this into account when they take on outside board roles.

In their roles, 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 the social, environmental, ethical and reputational risks faced by the business.

North America Corporate Governance and Responsible Investment Policy

Structure and operation

Independence

Independence is essential to ensure that the board exercises efficient oversight and consistently acts in the best interests of the company and its stakeholders. The importance of this for the performance of a company has been shown is several academic studies. Currently our minimum standard, requires 50% of the board to be independent directors. From 2023, this minimum standard is being raised to require two-thirds of the board to be independent directors. With controlled companies, we will maintain a lower threshold of at least 30% of the board members being independent.

LGIM would consider a director to be non-independent if he or she:

• Has been an employee of the company or group within the past five years;

• Has, or has 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;

• Has 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;

• Has close family ties with any of the company's advisers, directors, or senior employees;

• Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;

• Has served on the board for more than 12 years from the date of first election;

• Represents a significant shareholder.

LGIM also recognizes 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 maximize value as long as the board remains balanced. In this instance, LGIM expects the company to fully explain how the non-independent director provides valuable input into the business.

Diversity

LGIM believes a suitably 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, minimize risk, improve the sustainability of profit growth, and therefore maximize long-term returns for investors.

When recruiting members, a board should be looking at diversity in a holistic way and considering the intersectionalities across diversity characteristics. A board should be cognizant of all aspects of diversity that appropriately represent the company's operations, including, for instance, gender, age, nationality, ethnicity, sexual orientation, disability, neuro-diversity and socio-economic background as well as general 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 it to have 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 regarding the procedures used to find new members for the board and at senior management level, and how that process ensures a diverse board and senior executive pipeline. We expect all companies to disclose a breakdown of board directors, named executive officers, managers and employees, at a minimum, by geography, main skill set, gender and ethnicity, along with information on their gender pay gap, and the initiatives in place and action they are taking to close any stated gap.

We expect companies to take targeted action to increase their levels of diversity at board and executive committee levels, which could be supported by establishing an aspirational target to ensure that progress continues. 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 less traditional 'corporate board' backgrounds. They should also be willing to recruit those without previous board experience, as incumbent board members will have sufficient experience in aggregation to support them, and this approach will over time help to expand the candidate pool and be beneficial for the board's cognitive diversity.

For the North American market, by 2023 LGIM expects women to make up at least one-third of board directors and Named Executive Officers. To assist companies in reaching this target, LGIM continues to vote against companies in the S&P500 and the S&P/TSX that have fewer than 25% women on the board. From 2022, we will also apply voting sanctions to the S&P500 companies that do not have at least one woman within their Named Executive Officers, with the expectation that at least one-third of them should be women by 2023. We are targeting the largest companies, as we believe that these should demonstrate leadership on this critical issue.

For smaller companies, we expect them to have at least one woman at board level and for them to reach the 33% target over time.

However, the diversity conversation has broadened beyond gender, and LGIM has been asking companies to collect and report their data on ethnicity at board and senior management levels for a number of years. As a next step, we have established a minimum standard, or 'bright line', for leading global companies. Our expectation is for all S&P500 companies to have at least one ethnically diverse person on their boards by the end of 2021. Therefore, from 2022 we will apply voting sanctions to companies that do not meet this minimum requirement.

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.

LGIM expects 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 encourage companies to publish this information in their annual disclosures. This should include the skills the company is looking for and why the selected individual is the right fit for the board.

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 on an annual basis. LGIM is opposed to the practice of bundled proposals that prevent shareholders from approving individual nominees to the board.

In addition, we acknowledge that the regulations that govern the frequency for director re-election vary greatly from one country to another. However, LGIM encourages companies to allow shareholders to vote on directors' elections annually.

In order to allow investors to be able to assess the profiles 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 a detailed biography. We would also encourage the disclosure of attributes and skills that the directors would bring to the board and how these would fit with the long-term strategic direction of the business.

Board effectiveness

Board tenure

Regular refreshment of the board helps to ensure that its members remain independent from management and third parties, that different perspectives feed into board discussions, and that skill sets remain relevant. A regularly refreshed board is more likely to be willing to question established practices and avoid 'group think', and therefore it exercises more efficient oversight over management and stays ahead of market changes.

Board tenure is assessed in two different ways:

• On an individual director basis: we consider the optimum tenure for a director to be between three and 12 years;

• On an average board tenure basis: average tenure across all board members should be between four years and nine years. LGIM will apply voting sanctions on companies with an average tenure that exceeds 15 years.

The discussion around board tenure has become a key focus in this market, as it directly impacts diversity and skillsets: considerations that have historically been much weaker in this region. Although the majority of board members in this market do not have tenure limits, many companies do apply retirement ages for their directors.

However, LGIM does not consider retirement ages to be an adequate limitation on board tenure as these can be, and often are, easily extended. Instead, LGIM supports an explicit limitation of board tenure, whether this comes through a formal policy or through a more informal approach. Either way, we believe external board evaluations are an important exercise in order to appropriately assess tenure.

LGIM expects the board to be refreshed regularly, and we would be concerned if there had been no new directors appointed to a board in the past five years. We would not expect the tenure in the roles of the lead independent director or chair of key committees to exceed 15 years, as this impacts their impartiality and independence. Therefore, we would vote against the re-election of these directors if their tenure exceeded 15 years.

Board mandates

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

LGIM's limit on the number of board mandates it believes is appropriate is slightly stricter in this market, as we have general concerns around the tenure of directors, and overboarding directly impacts this issue. Therefore, LGIM expects that a full-time CEO at a large public company should not undertake more than one other non-executive directorship at an unrelated listed company. This is especially important in this market, as at many companies the chair and CEO roles remain combined. For non-executive directors, LGIM would expect individuals to hold no more than four public company board

roles. LGIM considers an independent board chair role to count as two roles due to the extra complexity, oversight and time commitment that it involves.

In order to help investors assess how directors with other board mandates are performing their duties, we would like to see disclosure of the time commitment required from directors to enable them to fulfil their duties, and the reasons why their other mandates do not prevent them from effectively exercising their duties.

Skill sets

LGIM expects the company to disclose separate information on the skill sets of board members within the proxy statement, and/or annual disclosures, enabling shareholders to easily understand the composition of the board in terms of skills. This could be provided via a matrix or another illustrative graphic. Some narrative explaining why the specific skill sets identified are important for the company and aligned with its long-term strategy should also be provided.

Board meetings and attendance

Regular board meetings are vital for the board to effectively perform its duties.

LGIM believes an independent 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.

Directors' attendance at board meetings is vital to ensure contributions to board decisions and to fulfil their fiduciary duties to investors. We therefore expect companies to allow investors to assess directors' attendance at board and committee meetings by disclosing attendance records in their annual disclosures.

LGIM expects directors to have attended no fewer than 75% of the board and committee meetings held. Where a director does not attend a board or committee meeting, the company should report to investors the reasons for non-attendance. LGIM does not expect to see a trend in a director's non-attendance at meetings.

Board size

LGIM believes a company should put in place a board of a size that is appropriate for the size of the company and the complexity of the business. It is essential that the size of the board does not compromise the free exchange of thought and efficient decision-making by being too small or too large.

Board effectiveness reviews– internal and external

The evaluation of directors is an essential way of improving board effectiveness and ultimately its performance. It is also a way for investors to determine the quality of debate and interaction between board members.

LGIM expects an internal board evaluation to take place annually. This evaluation should be led by the most senior independent director on the board, or if managed externally, by an independent third party.

External reviewers can also bring different perspectives on the functioning of the board, as well as experience of how other boards operate. We expect external evaluations of the board to take place at least every three years. These should be performed by an independent third party to avoid conflict, and we do not expect the company's recruitment consultant to be used to perform an effectiveness review.

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 progress on the outcomes of previous board evaluations. Any potential conflict of interest with external reviewers should also be disclosed.

Non-executive director (NED) induction

The chair is also responsible for ensuring that incoming NEDs 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, and it is especially important if the chair is considering a board member who does not have previous corporate board experience. LGIM supports the view that companies should hold regular briefings or presentations to the board from divisional directors to ensure they are kept informed of 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.

We would also encourage new board members to use their investors as a resource to help them perform their duties. LGIM organizes an environmental, social and governance (ESG) seminar, generally in September, for board directors aimed at discussing views on key ESG topics. We also regularly publish worldwide thought leadership pieces on relevant topics related to corporate governance, stewardship and responsible investment.

Stakeholder engagement

LGIM believes companies should be managed to take into account the interests of their stakeholders on material issues. Understanding and taking into account 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. LGIM believes 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 a structure they find appropriate. They may prefer the appointment of employee representatives on the board, the use of forums or advisory panels, or to nominate a current independent NED to seek out employees' views at different levels of the business and to regularly report these back to the board.

Whichever method is adopted, there are factors we have observed that can be conducive to a good process:

• Select a method that builds trust within the company, is valued by all employees and encourages participation;

• Ensure there is a clear mechanism for all staff to feed into the process, regardless of whether that is through a regular meeting with their designated workforce member/non-executive director/employee director or via email;

• Clear action plans for issues that impact employees should be distributed to all staff via newsletter or all-staff email. A dedicated page on the intranet should be created with its existence made aware to all staff. Open and transparent communication is important to get employee buy-in to the process. 'Town halls' should supplement written communication;

• There should be a feedback process for employees to help improve the process;

• Employee engagement and staff turnover should be a score that is tracked over time, disclosed in the annual report and potentially linked to executive pay;

• Exit interviews should be carried out by human resources (HR), the output reviewed by the workforce representative, and any recurring themes should be investigated and reported to the board.

We believe that sharing views internally can lead to innovation, problem solving and greater productivity as studies show that there is positive correlation between employee engagement and performance.

We would like to see companies disclose in their annual report the processes adopted, examples of positive outcomes, improvements in employee engagement scores and staff turnover, as well as the percentage of employees that considers the company to be a great place to work. Greater public disclosure will increase awareness, improve practices, and can lead to greater productivity and long-term performance for all companies in the market.

Although we believe that the board is best placed to determine the appropriate method for engaging with its employees, if there is evidence to suggest that the employee voice is not being heard, e.g. strikes or lawsuits over a three-year period; in addition to engagement with the company, we may take voting action by supporting any shareholder-led resolution calling for action.

Investor dialogue

LGIM believes that engagement constitutes 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.

Culture

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

For investors to understand company culture, it requires disclosure from the board, 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. We are also keen to see how the cultural message filters down to the rest of the organization.

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 of the company and its values are communicated and reinforced;

• Any KPIs that are linked to culture;

• Any relevant data linked to the workforce, such as turnover percentage, attrition analysis and how exit interviews are used.

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

Board committees

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

LGIM expects all listed companies to put in place three separate board committees responsible for the core board functions of audit, nomination and succession, and remuneration.

In order for investors to assess the effectiveness of board committees, LGIM expects the disclosure of the role and composition of all board committees as well as for committees to report on their activities to investors 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, checking their qualifications and independence as well their effectiveness and resource levels. This committee is also responsible for 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, LGIM expects all companies to have an audit committee comprising entirely independent non-executive directors. In

order for the committee to operate effectively it should comprise at least three members, with at least one member who has financial expertise.

We expect the audit committee chair to have served on the board for less than 15 years and to have recent and relevant financial expertise.

Non-independent directors may attend audit committee meetings by invitation, but they should not be members of the committee. The company chair may be a member of the committee if considered independent on appointment, but they should not chair the committee.

Members should have sufficient time to examine company 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 and governance committee

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

The focus of the committee should, however, not be restricted to the board, but must also seek to align with the rest of the workforce in terms of human capital policies. The committee should also 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, LGIM expects it to be entirely composed of independent non-executive directors. The committee should be chaired by the company chair if the individual is considered independent on appointment.

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.

Compensation (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 tenure of chair of the remuneration committee to be less than 15 years.

LGIM expects the committee to consist exclusively of independent non-executive directors. When considering the independence of directors who will serve on the compensation committee, we expect companies listed on the NYSE or NASDAQ to apply the enhanced standards of independence required by section 952 of the Dodd-Frank Act and the 2013, US SEC listing rules. The company chair can be a member of the committee if considered independent on appointment, but they should not chair the

committee. Non-independent directors may attend remuneration committee meetings by invitation but should not be members of the committee.

The remuneration committee should seek independent advice. 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.

Additional board committees

Companies may consider it appropriate to set up additional board committees to assist the board in its discussions. These committees are 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.

For example, we commonly see the implementation of risk, governance, sustainability, health and safety, research and development, and technology committees.

Advisory committees

In other cases, boards may consider the need for direct access to independent and external advice and expertise from third parties or stakeholders. We are supportive of companies setting up advisory committees. We consider this to be a flexible option to obtain specific and relevant information to assist the board and management in their decision-making without having to impact the size and composition of the board.

Extraordinary situations

Where there may be extraordinary situations, such as impropriety or general misconduct, LGIM expects the board to conduct a thorough evaluation to determine the suitability of the connected directors as continuing members of the board. We will also conduct our own analysis to determine the appropriateness of a given director's continuation at the company.

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. We expect the board to find out why their shareholders may have voted against a resolution at compan'y shareholder meeting where there has been significant dissent. We would consider a significant level to be a vote against of 20% or more of those shareholders who voted. The board should disclose the steps it has taken to address shareholder concerns in the next annual disclosure.

Audit risk and internal control

The board is responsible for determining and disclosing the company's approach to risk, and it should ensure effective risk-management controls are in place and monitor the outcomes of any action taken.

The board is also responsible to its investors for presenting a true and fair view of the company's financial position and for setting out its future capital management plans and near-term financial prospects. Therefore, the established processes and procedures to ensure the independence and robustness of the internal and external audit functions, and the level of oversight from the board, are expected to be demonstrated and explained to investors.

Assessing the resources available for the internal and external audit functions and their effectiveness forms part of the board's responsibilities. We expect the board to report its conclusions to investors, along with a bespoke narrative as to the assessment and any noted areas. These should be reported in the company's annual disclosures.

Compliance with regulations

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

External audit

An external audit provides independent assurance to investors that the financial statements of a company are correct. The role of auditors is to provide reasonable assurance that financial statements give a 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 auditors ought to be fully explained by the board, including how these have been addressed.

The external auditors are also responsible for producing the auditors' 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. LGIM supports the role of the external auditor to be put to tender on a regular basis, at least every 10 years, with the total tenure of the auditor not exceeding 20 years. LGIM will not support the re-election of the external auditor if they have served as auditor for more than 20 consecutive years. Within this timeframe, we expect the lead audit partner to be subject to refreshment at least every five years.

The fees for the external audit should be disclosed in the annual report. Where the external auditor provides non-audit related services, these should be fully explained and disclosed in the appropriate annual disclosures. We expect all non-audit services provided to be incidental to the audit, with the primary purpose being 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 could 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.

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

Recommendations arising from the external audit are to be overseen by the board and the audit committee and 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 will affect its business objectives and identify the level of risk taken. The process and procedures in place to manage such risks should be embedded into the risk-based control system of the company and summarized in the annual reporting to investors. The audit committee should have responsibility and oversight of the internal audit function.

Whistleblowing

LGIM expects companies to establish a whistleblowing policy that is integrated into its Code of Conduct. The policy ought to be publicly disclosed and open to all employees including those within the supply chains. The whistleblowing reporting channels should be easily identified and sufficiently independent from management, with a direct line to the board or audit committee to allow for appropriate oversight and independent escalation where necessary. Companies should ensure their policies safeguard the identity of any whistleblower. They should also report how the risks associated with bribery and other illegal behavior are being monitored and addressed.

Cyber security

The breakdown of a company's cyber security can have a material financial and reputational impact. Therefore, we expect a risk-based approach to be taken to address the issue of cyber security 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 and key intellectual property and therefore accountability should not be delegated. The issue should be a regular board agenda item and where there is an incident, we expect this to be disclosed to the market and customers in a timely manner.

Compensation

LGIM is increasingly concerned about the misalignment of both the structure and the amount of executive pay versus company performance, and the current social sensitivities around income inequality.

To address income inequality, LGIM has explored the topic in two blogs posts.

LGIM expects companies to pay employees a living wage that is sufficient to meet their basic needs. Although most companies continue to set pay for employees based on the minimum wage, we believe this level of hourly pay is outdated and inadequate to meet basic needs. While some states have set their own minimum wage levels well above the legal $7.25 minimum, there are many others that continue to apply the level set by federal law. We encourage all companies to pay no less than the living wage to their lowest-paid employees to keep them out of the poverty trap. North American companies are now encouraged to seek living wage accreditation. Further information on this can be found here.

LGIM also encourages greater disclosure of pay practices of employees, such as pay levels broken down by sex, race and ethnicity as well as gender pay gap reporting.

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. In line with LGIM's long-term investment horizon, we expect executive director pay to reflect financial performance, operational and strategic measures and to be achieved within a long-term, sustainable framework. Where it fails to do so, we expect to be able to hold management to account. Therefore, all companies should allow shareholders an annual vote on executive directors' pay and non-executive directors' fees at their annual shareholder meeting.

In addition, in order for investors to be able to appropriately assess directors' pay, we expect disclosure of the executive remuneration structure, including the total amount and a description of the metrics and targets used under incentive plans where applicable and within the limit of what the company is publicly allowed to disclose.

Although we are cognizant 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 quantum to the executive, employees and investors; and understandable for the recipient, the board and investors;
- Awards should incentivize 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 ultimate flexibility to apply discretion and 'sense-check' the final payments to ensure they are aligned with the underlying long-term performance of the business;
- Companies should be transparent on why rewards have been transferred to the executive, setting out targets that were set, their relevance to meeting long-term goals and which goals were met, and fully justify all adjustments made to accounting measures for remuneration purposes.

Fixed remuneration

We expect the 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 be commensurate with what is offered to the general workforce and its impact on total remuneration should be assessed before approval. Any increase in excess of 10% should be explained in the annual disclosures.

Incentive arrangements

Annual incentive

Companies may choose to award annual incentives to executive directors. LGIM believes that any annual incentive should be geared to delivering the strategy of the business.

We believe that the annual incentive should be capped as a percentage of salary. A significant portion 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.

We expect companies to provide an explanation for any year-on-year increases in the annual incentive, particularly those exceeding a 20% year-on-year increase. From 2023, LGIM will no longer support increases to the annual incentive where the director's maximum annual incentive opportunity is already at 350% of salary.

Companies that are exposed to high levels of environmental, social or governance (ESG) risk 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, 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 company in the say on pay vote.

In order to more closely align with investors and company performance, we ask companies to pay a portion of the bonus in shares deferred for at least two years. We would expect all bonus payments in excess of 1x salary to be paid in the form of deferred shares.

We also expect companies to put in place contractual and statutory provisions that may allow for a reduction or forfeiture of the annual bonus component in exceptional circumstances (malus or clawback).

Long-term incentive plans (LTIPs)

LGIM believes 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. LGIM therefore strongly encourages all companies to put in place a long-term incentive plan.

In the interests of simplicity, although LGIM advocates the adoption of one long-term plan, we acknowledge that companies typically make use of performance units, restricted stock and share options. We strongly discourage the adoption of any additional incentive plan that would complicate the remuneration structure (e.g. a matching scheme) 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).

To ensure that executives' interests are aligned with their shareholders, we have been calling on companies to increase the use of performance share units in their compensation policy. Historically we expected companies to ensure at least 50% of long-term pay was based on performance share units.Our expectations now require at least 65% of long-term incentives to be subject to performance conditions that are measured over a three-year period.

In addition, we expect any vested long-term awards to be retained for a further two years (holding period) prior to release. These awards should be subject to clawback.

Using too many performance metrics overly complicates executive compensation policy. LGIM does not consider share price appreciation on its own to be a sufficient indicator of sound management decision making, however, we do support the use of relative total shareholder returns as one useful measure of performance. That said, we do not believe that management should be rewarded for underperformance. Therefore, our expectation is that where a relative performance measure is used, e.g. total shareholder return, awards should start to vest at median performance relative to the benchmark group. Companies can expect to receive a negative say on a pay vote if they permit any level of reward for below median performance.

Companies exposed to high levels of environmental, social or governance (ESG) risk 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.

Companies within sectors that can have a significant effect on climate change should link part of their pay to targets set to reduce their impact on climate change. We would expect these targets to be SBTi approved net zero targets with transition plans 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. The use of diversity targets would be relevant for sectors that struggle to recruit women.

Where companies offer share options, we do not support compensation policies that allow the issuance of non-market-priced options or repricing. In addition, we will not support compensation policies that allow the annual release of stock options if that is the only form of long-term incentive in operation.

In addition, all LTIPs should be capped either as a percentage of salary or a fixed number of shares. Where a fixed number of shares is used, LGIM would expect the number of shares being offered to be reviewed every three years to ensure they are offering a commensurate level of reward as when first adopted. Any increase to levels of reward should be subject to shareholder approval.

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. Poor, or no, disclosure of performance conditions will trigger a negative vote on the pay policy.

LGIM does not support retrospective changes to performance conditions that have been pre-set. We also expect companies to put in place contractual and statutory provisions that may allow for a reduction or forfeiture of the long-term incentive component in exceptional circumstances.

Holding periods

LGIM encourages the use of post-vesting holding periods as we find this helps aligning the remuneration structure with long-term performance.

In addition, to encourage the right values and behavior of directors to drive the business for the long-term benefit of investors we would encourage all companies to consider requiring directors to continue to hold at least half of the minimum shareholding requirement for two years post retirement.

Malus and Clawback

LGIM expects all performance-based compensation elements to be subject to malus and clawback.

Equity dilution

LGIM believes 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, LGIM expects 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, approximately 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. LGIM encourages companies to provide transparent explanations regarding the issuance of shares and for share schemes to have performance conditions attached.

Shareholding guidelines

LGIM expects 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 requirement should be linked to the size of the company and the level of annual performance-based compensation that the director receives.

Hedging of stock

LGIM believes the hedging of shares by executives in the shares of the companies where they are employed severs the alignment of interests of the executive with shareholders. We believe companies should adopt strict policies to prohibit executives from hedging the economic risk associated with their share ownership in the company.

Pledging of stock

LGIM believes investors benefit when employees, particularly senior executives, have 'skin in the game'. LGIM therefore recognizes the benefits of measures designed to encourage employees to both buy shares out of their own pocket and to retain shares that they have been granted. Pledging shares can present the risk that an executive with significant pledged shares and limited other assets may have an incentive to avoid a forced sale of shares in the face of rapid stock price decline. To avoid substantial losses from a forced sale to meet the terms of the loan, the executive may have an incentive to boost the stock price in the short term in a way that is unsustainable and so hurts investors in the long term. Concerns regarding pledging may not apply to less senior employees, given the latter group's limited influence on a company's stock price. Therefore, the issue of pledging shares should be reviewed in that context, as should policies that distinguish between the two groups.

Pensions

Pensions 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. LGIM will not support pension enhancement payments at retirement or when a contract is terminated early. Additionally, LGIM will not advocate 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.

LGIM expects 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

Under the Dodd-Frank Act, companies are required to disclose additional compensation arrangements with executive officers in connection with merger transactions, known as 'golden parachutes'. All such agreements should be disclosed, including those between executives at the acquiring and target companies.

LGIM expects companies to provide a separate shareholder advisory vote to approve 'golden parachute' arrangements in connection with a merger, acquisition, consolidation, proposed sale or other disposition of an asset or a large part of it.

The accelerated vesting of equity due to a change in control does not reward performance and would not be something LGIM would support. Instead, equity should move to the newly merged companies and should vest over a period of time if performance conditions are met. If the board considers accelerated vesting appropriate, then this should only be triggered if a change of control has occurred and the executive loses their job in the company– known as a 'double trigger'. Accelerated vesting should not occur simply on a change of control with the executive remaining employed in the new company – known as a 'single trigger'. Such accelerated vesting of awards made under a change in control situation should be done on a pro-rata basis, so that only awards that have met performance conditions are given.

Tax gross-ups

LGIM does not expect companies to provide tax gross-ups to its executives in severance payments. In agreeing to tax gross-ups on service contracts, the compensation committee may be committing the company to paying excessive amounts in the event of a change in control. LGIM does not support such payments and many companies have phased out such tax gross-ups in new service contracts.

New joiners

When setting the remuneration of a new executive who lacks experience at the company and/or in the role, LGIM encourages 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 period, subject to performance. Where possible, the existing remuneration arrangements should be used to incentivize 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. Executive directors should retain shares in the company for at least two years post exit, at the higher of two times salary or half the minimum shareholding requirement (valued at exit).

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

LGIM expects 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, i.e. loss of life, 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 be lapsed, 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.

Benchmarking

When using benchmark data, the remuneration committee should take into consideration a number of factors: the 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 an outstanding performance.

Discretion

Companies can build trust if they can demonstrate historic restraint, consistency and alignment with investors. Discretion applied on 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.

LGIM expects the company to state:

- The main reasons that might give rise to the application of discretion;
- Whether discretion would be applied upwards as well as downwards;
- The elements of pay to which discretion may be applied.

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 fixed fees being paid in shares is encouraged.

Other disclosures:

Pay ratio

In 2015, the SEC adopted a final rule requiring public companies to disclose the ratio of the compensation of its CEO to the total compensation of the median company employee. The disclosure began in the 2018 proxy season. The company is permitted to select its methodology for identifying its median employee’s compensation every three years. Non-US employees from countries in which data privacy laws or regulations make companies unable to comply with the rule can be excluded.

To identify the median employee, the SEC rule allows companies to select a methodology based on their own facts and circumstances. A company could use its total employee population or a statistical sampling of that population and/or other reasonable methods. A company could, for example, identify the median of its population or sample using:

- Annual total compensation as determined under existing executive compensation rules;
- Any consistently applied compensation measure from compensation amounts reported in its payroll or tax records.

LGIM encourages companies to use their total employee population and to identify the median by using annual total compensation as determined under existing executive compensation rules. We encourage this so that the information provided is consistent and therefore comparable between companies.

Disclosing this information will heighten scrutiny of executive compensation practices, with a specific focus on how CEO compensation compares with the median employee. Depending on the magnitude of pay ratios, the new disclosures may exacerbate existing concerns among investors about executive compensation.

The pay ratio disclosure will provide shareholders with additional company-specific information that can be used when considering a company's executive compensation practices, an important area of corporate governance on which shareholders now have advisory votes. This disclosure illustrates to what extent the dangers of disparity in pay levels are recognized. If used effectively, the data can be applied by compensation committees to better moderate pay packages and reduce the trend of pay disparity. The changes in CEO-to-worker pay ratios will be a useful measure of CEO pay levels and will hopefully reduce CEO pay levels and encourage boards to also consider the relationship of CEO pay to that of other company employees. Companies with high pay ratios will have to explain and justify the ratio to their investors, placing more focus on the reasons behind potentially large CEO remuneration.

LGIM will use the pay ratio information on a relative basis across sectors rather than an absolute basis, allowing us to compare the employee compensation structures of companies over time and against their competitors. Such disclosure will provide valuable information about which companies are investing in their human capital: an increasingly important contributor to investor value and strong business culture. However, LGIM will use this information as only one part of the assessment of overall compensation.

Shareholder and bondholder rights

The provision of shareholder and bondholder rights is a basic entitlement for investors. LGIM expects companies to acknowledge and respect the rights of investors through 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 LGIM as an investor:

Voting rights and share class structures

LGIM supports the 'one share, one vote' philosophy and favors share structures where all shares have equal voting rights and those rights are equal to economic value held.

LGIM does 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, LGIM will review the issuance of shares with enhanced voting rights to understand why these would be necessary. In general, LGIM encourages companies to eliminate differential voting rights over time or at least allow shareholders the opportunity to vote on its continuation on a regular basis. Beginning in 2023, we will vote against the chair of the board when the company has either not provided a plan to sunset unequal voting rights or announced a plan to give shareholders regular opportunities to vote on the matter.

Acting by written consent and calling special meetings

Shareholders should have the right to call special meetings. This allows a shareholder to put resolutions to all shareholders at a specially convened company meeting. Generally, LGIM believes that companies should allow shareholders with a minimum holding of 10% to call special meetings as this allows sufficient access, but prevents abuse of this benefit. However, LGIM will take into account the company shareholding structure when assessing whether the proposed threshold is appropriate. Additionally, there should not be any material restrictions to the ability of shareholders to call this meeting once an acceptable threshold has been set.

If a threshold of a 10-25% holding (depending on the company structure) to call a special meeting is in place and if other governance practices are strong, as well as the company's open engagement with shareholders, then LGIM will not support the right to act by written consent, as this can disenfranchise some shareholders to the benefit of only a few.

Access to proxy

LGIM considers proxy access to be a standard shareholder right and expects companies to apply a provision to enable shareholders to propose directors to the board. Therefore, LGIM will support proposals that allow access for 20% of the board or a minimum of two seats to be proposed to the proxy if a shareholder group of no more than 20 shareholders owns 3% of the outstanding shares for three years.

LGIM believes:

- Restrictions on re-nominations when a nominee fails to receive a specific percentage of votes are inappropriate;
- Re-submission requirements are not required for management's candidates, and therefore should not apply to candidates proposed by shareholders;
- Securities on loan should be counted towards the ownership threshold, provided the shareholder shows it has the legal right to recall shares for voting purposes and it will vote on them at the shareholder meeting, along with a representation that the shareholder will hold those shares through the date of the meeting;
- A requirement that a nominator provide a statement of intent to continue to hold the required percentage of shares after the annual meeting is unnecessary;
- Nominating shareholders may not know their intent to hold, sell or buy shares until after the election, so the pre-filing holding period of three years, coupled with the requirement to hold the shares through the shareholder meeting, is adequate;
- A prohibition on a nominator from using proxy access for the two annual meetings following an annual meeting at which its nominee is elected to the board (except for the nominee initially elected) is inappropriate;
- A group of funds counts as a single shareholder for the purposes of meeting the 3% ownership threshold with aggregation limits.

Supermajority vote standard

Supermajority provisions on voting go against the principle that a simple majority of voting shares should be sufficient to effect change at a company. The supermajority provision serves to entrench management by preventing amendments that would be in the best interests of investors. LGIM expects companies to eliminate such provisions and, where this requires supermajority support to be enacted, that the company make concerted efforts to gain their shareholder support in order to change its bylaws.

Cumulative voting

Cumulative voting allows shareholders to cumulate their votes for one or more directors on the ballot. Each shareholder is entitled to as many votes as are equal to the number of their shares multiplied by the number of directors to be elected. The shareholder may cast all of such votes for one nominee or may distribute them among two or more nominees at their discretion. LGIM does not support cumulative voting as it does not protect minority shareholder rights and does not support the democratic election of directors.

Amendments to the company's constitution

It is common to see requests from companies seeking approval to update/amend the company's constitution as they impact members' rights.

LGIM expects these changes to be clearly outlined and disclosed in the notice of meeting. We do not support changes to a company's constitution that are introduced to curtail or reduce shareholder rights. Approval at the general meeting should also be sought as separate resolutions, not bundled ones. While LGIM assesses bundled resolutions on a case-by-case basis, we initially view them negatively as they could potentially undermine the value of a shareholder vote and it may be a source of confusion.

Company bylaws

LGIM believes 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. LGIM does not encourage limitations on shareholders' legal recourse including limiting themselves to a single jurisdiction without compelling evidence that it will be of benefit and expects companies to provide a compelling argument on why the provision would directly benefit shareholders.

LGIM also expects companies to put bylaw amendments that have the potential to reduce or negatively impact shareholder rights to a shareholder vote.

Virtual/electronic general meetings

LGIM believes that general meetings 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 its 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 use this mechanism as part of their stewardship activities. For example, it could be utilized as an escalation tool that enables shareholders to make statements and ask questions to the whole board.

On virtual shareholder meetings, investors are cognizant that companies are keen to make sure that their shareholder communications keep pace with developing technology and for those conducting shareholder meetings electronically it is an area of particular focus. We also agree that using technology, such as webcasting the meeting, 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 of its shareholders. The attendance of the board at such a 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 is also important to allow LGIM to bring matters to the board's attention. Removing this tool impairs our ability to hold boards to account on behalf of our clients. Companies that adopt a 'virtual-only' approach may also risk giving the impression that they are attempting to filter questions or limit the participation of shareholders.

Therefore, LGIM is not supportive of 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.

Capital management

The board has a key responsibility in ensuring a company has sufficient capital; overseeing the capital management of the company; ensuring an efficient capital allocation; and, when additional capital is required, making sure 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 to manage 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 that capital is being raised in the long-term interests of investors.

Share issuance

LGIM supports 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 holding in the company's shares.

The existence of pre-emption rights is fundamental to protect shareholders from excessive dilution. It gives the right to shareholders to be offered any new shares, pro-rata to their existing holdings, ahead of these being offered to non-shareholders.

Share repurchases or buybacks

Share repurchases or buybacks can be a flexible way of returning 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 external by merger & acquisition).

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

When utilizing this authority, LGIM expects companies to take into account its impact on other areas. For example, on remuneration, as performance conditions governing incentive schemes may be impacted as a consequence of exercising a buyback authority. Furthermore, given the reduction in the number of shares in the market, the holdings of large shareholders will also increase giving them more control. We would expect greater detail on the 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 the issuance of bonds is important for debt investors. In its reporting, LGIM expects a company to include a:

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

Mergers & acquisitions (M&A)

LGIM supports proposals that are expected to create value for investors over the long term.

In order 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 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.

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

In addition, LGIM believes 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 skill set of the board must also be reviewed, including past M&A experience, to ensure it is appropriately equipped to successfully lead the transaction and manage its impact on the company. The board may also consider putting in place a separate ad-hoc committee of independent non-executive directors.

Takeover defense 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 favorable terms from an acquirer.

It is vital that this process is controlled by a fully independent board that is more concerned with investor value than with protecting its own position. LGIM will not expect a poison pill to entrench management and protect the company from market pressures, which is not in investors’ best interests.

Related-party transactions

Related-party transactions (e.g. between a controlling shareholder and an issuer) are an important issue for minority shareholders as there is a risk that a related party takes advantage of its position.

Adequate safeguards must therefore be put in place to provide protection for the interests of the company and of the shareholders who are not a related party, including minority shareholders.

All transactions must therefore be authorized by the board of directors. LGIM also expects the company to set up a fully independent audit committee, which ensures that such transactions are conducted on the basis of an independent and disinterested valuation.

In addition, LGIM expects companies to disclose sufficient information around the transactions in its annual disclosures to ensure shareholders remain informed to make informed voting decisions.

Shareholder proposals

LGIM considers all shareholder proposals tabled at a company's shareholder meeting in the wider context of the corporate governance practices at the company, and also in relation to the long-term benefits for investors. LGIM expects companies to provide a meaningful discussion of the proposals to enable shareholders to make an informed judgement.

LGIM expects majority-supported shareholder proposals to be adopted. And where there has been significant support (20% or more) then we would expect the company to consider the benefits of the proposal and to discuss this with their shareholders and any outcome in their annual disclosures.

Political donations

LGIM will not support direct donations to political parties or individual political candidates by companies. LGIM believes that companies should fully disclose all political contributions, direct lobbying activity, and political involvement and indirect lobbying via trade associations. There should be increased transparency around 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, think-tanks, and on direct and indirect lobbying activity on policy and legislative proposals etc;

• Clear explanation of how each of the above associations, contributions and actions etc. benefit the causes 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 to be 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. Different stakeholders will also have different views on which 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 businesses 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. However, accountability should sit at the 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 that are 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.

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 operation 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 realizing their strategic E&S objectives, mitigating and managing material E&S risks and impacts, as well as to maximize broader positive stakeholder impacts. While it is important for the targets to be achievable, companies may benefit from setting challenging goals in order to maximize 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 websites. 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 comfort 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
- Remuneration disclosure

Companies not adhering to this will be sanctioned. In line with our increased commitment to greater ESG transparency. LGIM votes against companies that score poorly on transparency within our LGIM ESG and show no improvement after engagement. The list of companies voted against will be published on our website from 2023. For further information on each of these key criteria, please see our public ESG score methodology document available on our website here.

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 in order to internalize the associated costs and benefits. 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 to progress the broader ESG agenda and to 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.

[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

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.

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 and reduction of waste and plastic use are more sector specific.

Below we highlight our expectations in relation to some of these key issues: climate change, biodiversity and deforestation. More information and articles on our position on broader themes can be found on the LGIM website.

Climate change

Climate change has become a defining factor in companies' long-term prospects. We expect companies to disclose how they may be impacted by climate-related risk 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 (SBT's) are decarbonization 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 reflect 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.

Specific 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 recognize 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 companies and/or their directors, to ensure we are using one voice across our holdings.

Biodiversity

Biodiversity loss is currently happening at a rate greater than at 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 $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 direct as well as indirect activities in relation to 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 impact, setting targets and reporting publicly. Our Biodiversity Policy is the first step in formalizing LGIM's approach to delivering on these commitments.

Deforestation

LGIM recognizes 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 Deforestation-Free finance commitment and fully support the call for financial institutions to take ambitious measures within their control to eliminate commodity-driven deforestation within their investments.

LGIM's expectations of investee companies are focused on high impact sectors. Within the Apparel sector, we expect companies to demonstrate how they are improving the circularity of materials and eliminating deforestation from supply chains. In the Food sector, we expect a shifting away from high-impact products and progress on decarbonizing agricultural supply chains. The lack of a comprehensive deforestation policy constitutes one of our 'red lines' when deciding LGIM's priority engagement companies. Our minimum voting standards also consider the presence and application of a deforestation policy and program.

Please see our climate impact pledge (here) for more information on LGIMs sector-based deforestation expectations and examples of our previous engagements with companies on the topic.

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[2] World Economic Forum, 2020

Human capital management

Employees are the greatest asset a company can have. We believe that the value they bring to the long-term sustainability of the company should not be underestimated. LGIM is looking at human capital management using a number of different lenses:

- Diversity & Inclusion – We believe a suitably 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, neurodiversity. This is discussed in greater detail above.
- Employee Voice – The value placed on employees can be measured by the effort a company places on receiving and acting upon employee feedback. This is discussed in more detail above.
- Employee welfare – companies should ensure that their employees have adequate training to equip them with the appropriate skills to carry out their jobs effectively. They should provide a safe working environment and annual training on safety within the workplace. Companies should be mindful of and comply with the principles of the United Nations Global Compact, the International Labour Organization conventions and recommendations; OECD guidelines for multinational enterprises and all local and national laws and regulations relating to the protection of employees.
- Fair Pay – We expect all companies to be paying their direct employees at least a real living wage. This wage is usually higher than any local government/state mandated minimum wages. The 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. In addition, we expect companies to ensure that employees within their supply chain are also being paid at least a living wage.

Modern Slavery – Companies should ensure that they are not permitting modern slavery to take place either within their own operations or within their supply chains. Putting in place a code of conduct is not sufficient to ensuing modern slavery does not exist within the supply chain. We expect companies to carry out due diligence investigations to ensure any such practices are eradicated.

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 prioritization, 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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