

Schroders

**Investment and Corporate Governance:
Schroders' Policy**



Schroders

This document outlines the approach taken by Schroder Investment Management Limited and other asset management entities within the Schroders Group to corporate governance, ownership, engagement and the responsible use of voting rights.

This document may be part of a wider policy accommodating additional statements, where necessary, for regulatory purposes or for the benefit of clients in different locations.

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Investment: Our Approach to Corporate Governance

Schroders' Philosophy

Schroders expects the companies in whose securities we invest funds on behalf of clients to achieve returns justifying a company's use of the capital invested. It follows that the boards of companies in which our clients' funds are invested must consider and review the strategy, the operating performance, the quality of leadership and management and the internal controls of the companies they direct, in order to produce the returns required by our clients.

We concentrate on each company's ability to create sustainable value and may question or challenge companies about governance issues that we perceive may affect the value of those companies. Engagement and proxy voting are therefore an integral part of our investment process.

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Corporate Governance: The Role and Objectives of Schroders as an Investment Manager

Schroders as an Investor

The asset management operations within the Schroders group invest in equity securities in order to earn returns for clients over the long term. The sale of shares of a successful company by Schroders is not necessarily a reflection of our view of the quality of the management of a company but may be because of our belief that other companies will offer greater share price growth relative to their current valuation. The purchase and sale of shares will also be affected by the flow of client funds into and out of our control and asset allocation decisions.

Schroders as an Owner

Share interests carry ownership rights. Exercising those rights is an integral part of our investment process and is reflected in the approach we take to engaging with companies, voting and corporate and social responsibility.

The overriding principle is that our objective for all engagement, activism, voting and corporate and social responsibility activity is to enhance returns for clients.

Companies should act in the best interests of their shareholders. We understand and accept that companies should have due regard to other stakeholders – no company can function, for example, without a good workforce and without providing quality services or goods to customers. However, it is the interests of the owners of the business which should be paramount.

All business involves some risk and companies must recognise this risk and manage it. It is in no-one's interest, however, if the process of managing risks unduly restricts businesses. Companies must have freedom to increase returns to shareholders and this requires that companies are sufficiently entrepreneurial. They must not be subject to undue bureaucracy and regulation.

We accept that no one model of governance can apply to all companies and we will consider the circumstances of each company. It is in the best interests of clients for us to be pragmatic in the way we exercise ownership rights. This is particularly the case with smaller companies.

Engagement

Engagement with companies is part of our investment process. In all engagement and intervention, our purpose is to seek additional understanding or, where necessary, seek change that will protect and/or enhance the value of the investments for which we are responsible. Engagement has the added advantage of enhancing communication and understanding between companies and investors.

Issues on any aspect of performance, management, governance and corporate and social responsibility may be raised with companies, including strategy, acquisitions and disposals, board structure and operation, board membership, internal controls and risk management, board and senior executive remuneration, or any other issue of corporate governance. These subjects may be raised in the course of regular meetings held with companies. Other forms of engagement include contact with executive and/or non-executive directors, meetings with executives, voting, communicating via the company's advisers, submitting resolutions at general meetings or requisitioning an extraordinary general meeting.

Voting: Coverage

We must always act in the best interests of clients and therefore, in order to maintain the necessary flexibility to meet client needs, local offices of Schroders may determine a policy regarding the securities which are voted, subject to agreement with clients as appropriate, and/or addressing local market issues.

Where there is insufficient information with which to make a voting decision or where market practices make it onerous or expensive to vote compared with the benefits of doing so (for example, share blocking¹), we will not generally vote.

Voting: Operational Arrangements

We cast our votes along the following lines:

For – we generally support the management of companies.

Oppose – we will oppose resolutions putting forward proposals that appear inconsistent with the interests of shareholders.

Abstentions – we will abstain where mitigating circumstances apply, or the company has taken substantive steps to address shareholder issues but further change is still considered appropriate, or where it is considered that companies will be more responsive to an abstain vote.

All voting is overseen by investment professionals (including portfolio managers) and is undertaken to enhance returns for clients.

¹Share blocking is a practice whereby restrictions are placed on the trading of shares which are to be voted

Client Choice

Corporate governance should be part of the investment management process in order to ensure that the governance policy is operated to enhance the value of funds under management. Accordingly, we believe it is appropriate for clients to give voting discretion to Schroders. However, clients may elect to retain all or some discretion in relation to voting and corporate governance issues. In these cases, we suggest such clients use an external voting service to vote their interests. This would particularly be the case where a client wishes to adopt an engagement approach other than our house policy on the grounds that our approach may differ from a policy operated by another party for that client.

Conflicts of Interest

Occasions may arise where a conflict or perceived conflict of interest exists. This might occur, for example, where an investee company's pension scheme is a client of Schroders. In such situations, if a proposal is specifically addressed by this policy or by another policy operated by or for the client and which Schroders has agreed to operate, Schroders will vote in accordance with that policy unless Schroders considers it is in the best interests of clients to depart from the policy. In that case or if the voting proposal is not addressed by the voting policy and requires a case-by-case determination, Schroders may vote as it determines to be in the best interest of clients, provided that such vote would be against Schroders' own interest in the matter (that is, the interest conflicting with the client's). Otherwise, if Schroders believes it should vote in a way that may also benefit, or be perceived to benefit, its own interest, then Schroders will either (a) vote in accordance with ISS's recommendation; or (b) obtain approval of the decision from the Schroders' Head of Investment: the rationale of such vote will be recorded in writing; or (c) in exceptional cases, inform the client(s) of the conflict of interest and obtain consent to vote as recommended by Schroders.

Reporting

Reports on our use of voting rights and engagement with companies are available to clients.

Stock Lending

Lenders of stock do not generally have voting rights on lent stock. There may be occasions, however, where it is necessary to recall stock in order to vote it. We believe it would be appropriate to recall lent stock when a) the benefits of voting outweigh the benefits of stock lending b) the subject of the vote is material to the value of the company; and c) there is a realistic chance that voting the shares under our control would affect the outcome of the vote.

Corporate Governance and Voting Policy: Our Core Principles

The following pages set out the issues we consider when determining how to vote.

All are subject to the overriding principle that we will vote and act to enhance returns for clients.

We will vote against any proposal or action by a company which would materially reduce shareholder rights or damage shareholder interests.

Strategy,
Performance,
Transparency and
Integrity

Strategic Focus

Companies must produce adequate returns for shareholders. If a company is not making or will not make returns above the cost of capital, it should improve performance or consider returning underperforming capital to shareholders in a tax-efficient manner.

Shareholders' Interests

We will oppose any proposal or action which materially reduces shareholders' rights or damages shareholders' interests.

Major corporate changes or transactions that in substance or effect materially dilute the equity or erode the economic interests or ownership rights of existing shareholders should not be made without the approval of shareholders.

With the exception of those that could reasonably be deemed insignificant, any transactions with related parties should not be made without prior independent shareholder approval.

Shareholders should be given sufficient information about any voting proposal to allow them to make an informed judgement when exercising their voting rights.

Companies should provide secure methods of ownership of shares. Further, there should be no unreasonable restrictions on the transfer of shares.

Boards and Management

Reporting to Shareholders

The annual report and accounts of companies should be properly prepared, in accordance with relevant accounting standards.

Companies must communicate clearly with shareholders. This obligation extends to producing quality accounts and communicating timely and relevant information. Transparency, prudence and integrity in the accounts of companies are factors which are highly valued by investors.

Auditors

Audits provide a valuable protection to shareholders and should ensure the integrity of accounts.

In order to provide objectivity and a robust assessment of the accounts, the auditors should be independent. Where independence is compromised or perceived as being compromised due to a conflict of interest, a firm's suitability as auditor will be called into question. Independence may be compromised, for example, where the level of non-audit work is excessive or inappropriate or where the auditors or relevant individuals have a connection with the company.

Internal Controls

The level of risk a company faces and the way a company manages those risks can have a significant effect on a company's value and may determine whether the company can survive. We understand and recognise that risks must be taken. However, risks must be managed. Linked to this, internal controls should be in place to ensure a company's managers and board are aware of the state of the business.

Status and Role

The boards of the companies in which our clients' monies are invested should consider and review the strategic direction, the quality of leadership and management, the internal controls and the operating performance of those companies.

Board members must be competent and have relevant expertise.

The board of directors, or supervisory board, (as an entity and each of its members as individuals) should be accountable to shareholders.

The discharge or indemnification of a board or management will not normally be supported where we are aware of outstanding issues or have concerns regarding that board or company.

Every member of the board (or supervisory body) should stand for re-election by shareholders no less than every three years.

Companies should disclose sufficient biographical information about directors to enable investors to make a reasonable assessment of the value they add to the company.

Board Structure

Boards should consider the balance of the board:

- The board should be balanced, such that no group dominates the board or supervisory body.
- There should be a material number of genuinely independent non-executives on the board or supervisory body.

Independent non-executives can give shareholders a degree of protection and assurance by ensuring that no individual or non-independent grouping has unfettered powers or dominant authority. However, the issue of independence is not, of itself, a measure of an individual's value or ability to contribute as a board member.

Succession Planning

It is emphasised that the success of a company will be determined by the quality and success of its people. Appointing the right people is an essential part of this process. The process for selecting and retaining board members should therefore be robust and rigorous and ensure that the make up of the board remains appropriate and dynamic.

Performance Assessment

Boards should regularly undertake a review of their performance. A review of performance must not be an academic exercise. Any review should seek to consider the performance of individuals and the board as a whole. Any issues identified should be resolved through, if necessary, operational changes or changes of personnel.

It is an inevitable part of any organisation that there will be changes of staff – people might not have, or no longer have, the right skills, abilities or attitude to properly and successfully fulfil or continue in their role. This applies at all levels in an organisation. Thus, it is a natural and healthy process to have staff turnover, including at senior executive and board level.

Committees

Boards should appoint an audit committee and a remuneration committee, each consisting of independent non-executive board members.

Capital

Efficient Use of Capital

The objective of a company should be to earn a return on capital that at least exceeds the company's weighted average cost of capital.

Companies should have efficient balance sheets that minimise the cost of capital, with an appropriate level of gearing. A shareholder-approved maximum limit should be placed on debt.

Where companies cannot or will not use capital efficiently, they should consider returning the capital to shareholders: the capital may then be allocated to investments earning an appropriate return.

Surplus capital should not be used for value-destroying acquisitions.

Share Buybacks

Companies repurchasing equity share capital should only exercise such authorities when it would be in the best interests of shareholders as a whole.

Issuing Shares

Companies should not propose general authorities to allow unlimited or substantial capital authorisations or blank cheque preferred stock. The creation of different classes of equity share capital must be fully justified.

Pre-emption Rights

Pre-emption rights are an important investor protection measure. We recognise that it is appropriate for companies to have a certain amount of flexibility to issue shares for cash without offering them first to shareholders on a pre-emptive basis.

Accordingly, authorities to issue shares non-pre-emptively should not exceed recognised market guidelines or practice or, in the absence of guidelines or a recognised practice, an overall limit of 10%.

We will consider powers to issue shares on a non-pre-emptive basis in excess of these limits, where a company can provide a reasoned case that the issue of shares on a non-pre-emptive basis (whether directly or, for example, through the issue of convertible bonds or warrants or for vendor placings) would be in the best interests of existing shareholders.

Share Voting Rights

Companies should provide strong arguments to justify the introduction or maintenance of equity shares with special voting rights, golden shares or other split capital structures.

Executive Remuneration

High calibre individuals are a vital component of success for any organisation. Remuneration policies should allow the recruitment and retention of these individuals and provide appropriate incentive arrangements which reward returns for shareholders.

In considering the pay arrangements of senior executives at companies, we are concerned with the structure of total compensation and to ensure that potential rewards are aligned with shareholder interests.

We recognise the value of high-calibre executives and note that it is likely that pay for these individuals will increase if companies are to retain them. Individuals in market economies have choice. If senior executives determine that it is in their financial best interests to work in other fields, for example private equity, the benefit of those individuals' experience and abilities will be lost to quoted companies. Therefore, in order to hire the best individuals, it is necessary for companies to pay at levels which allow them to compete in the market to recruit successful executives. This market is a different market to that for the workforce generally and may cause increases in executive pay beyond the rate of increase of returns to shareholders and pay increases for the workforce generally. However, the existence of this effect does not justify unwarranted transfers of value to executives.

In formulating proposals remuneration committees and boards should, in particular:

- avoid creating arrangements or policies that could result in excessive dilution of shareholders' interests or create excessive or unwarranted costs. It is expected that average dilution through the commitment to issue shares to directors, executives and employees would not exceed 1% per year;
- link significant elements of total remuneration to real performance and in particular focused on the achievement of above average performance (preferably evidenced through total shareholder return exceeding that of a suitable comparator group) and earning an economic profit;
- avoid arrangements that would encourage the destruction of shareholder value;
- achieve an appropriate balance between long- and short-term elements of pay;
- avoid service contracts and provisions providing compensatory arrangements in excess of one year, except following appointment where for a limited time a longer period may be acceptable;
- appoint remuneration committees consisting only of independent non-executive directors. These committees should be responsible for determining and recommending to the board the pay policies in respect of executive directors and senior managers;
- not reprice, adjust, or otherwise amend stock options and awards.

Other Issues

Takeover Bids

Takeovers are an important part of an efficient market. However, we recognise that takeovers do not always create value for shareholders. Each case will be judged on its merits. Factors considered will include the quality of a company's management, the prospects for the company's share price and investors and, ultimately, whether the price offered should be accepted in the best interests of our clients.

Waivers, for which shareholder approval may be required, of any requirements to make a general offer will also be considered on their merits in each case.

Poison Pills and Takeover Defences

Poison pill arrangements, takeover defences or other equivalent arrangements have as their purpose the benefit of management rather than the owners of the company and are frequently contrary to shareholder interests. Such arrangements should not be introduced and existing arrangements that have been put in place should be removed.

Memorandum and Articles of Association/Regulations/Constitutions

The documents defining the constitution of a company are key documents providing protection to the interests of shareowners. Any changes to these documents should be clearly justified.

SRI & Corporate Social Responsibility

Companies should adopt appropriate, transparent policies on environmental and social responsibility and disclose these policies. As with our stance on governance issues, we will consider all social and corporate responsibility issues in the context of the value of a company. A separate document covering our policy in this area is available.

Fixed Income and Other Securities

The guidance in this paper summarises our position in respect of managing equity investments. Where necessary, we exercise voting and other rights in respect of bonds and other securities.

