UK CORPORATE GOVERNANCE AND CORPORATE RESPONSIBILITY VOTING POLICY

2017

AVIVA
INVESTORS

1. Introduction

Aviva Investors is a committed long-term investor. We aim to work with companies towards promoting a profitable, sustainable, long-term future for them, the capital markets and ultimately our clients. This document provides guidance for Board of Directors of UK companies on how we exercise our voting rights.

As a founding signatory to the UK Stewardship Code and the UN Principles for Responsible Investment (PRI), we believe that companies conducting their business in a responsible manner with good corporate governance, high standards of integrity and a sustainable business model deliver better long-term returns to shareholders. Over twenty years, we have developed a deep understanding of the conflicts, barriers and challenges to good governance and we use this insight to identify and address risks and opportunities within our clients' portfolios. Our overriding objective is to improve and protect our clients' returns over time.

We are finding that our clients are increasingly interested in holding us to account in our role as responsible investors and are scrutinising our voting and our approach to environmental and social issues.

On the global front, we have a strong commitment to international standards and principles of good governance such as the International Corporate Governance Network (ICGN) Global Corporate Governance Principles and take our responsibilities as signatories of the UK Stewardship Code seriously. We apply UK standards where these are appropriate but we apply this sensitively, respecting the different cultures and approaches within the country in which we are voting.

Our approach

We wish to support the Boards of the companies in which we invest in the effective management of the company. We see our role as one of partnership with the directors of the companies in which we invest in the creation of long-term value. To that extent, we fully recognise that there is no single answer for every company. We therefore carefully consider best practice guidance and the explanations which companies provide, to ensure that bespoke arrangements provide the necessary checks, balances and protection for shareholders. We look for how companies meet the spirit of good governance, not the letter, and we take into account past practice in forming our opinions. In short, we do not adopt a compliance mentality. We are interested in the principles of good governance and how these are achieved in practice to promote the best long-term prospects for the companies in which we invest.

What is important to us?

To us, the most important aspects of governance are the individuals on the board. Obviously directors need to be of high calibre and the Board sufficiently diverse and independent, but it is just as important that the Board has strong values and is absolutely committed to ensure good culture is a feature evident across the entire organisation. When we are confident that the board is capable of making good decisions in our interests, we are able to spend less time on issues such as remuneration, which continue to have a disproportionate amount of focus.

Where a significant percentage of shareholders vote against or abstain on a resolution, we expect the board to say how it intends to address this. Our interpretation of the Corporate Governance Code means we consider an abstention to be a strong signal to the board that concerns are present. We see an abstention as a useful voting option which should be taken into account.

2. Policy

Our starting point is the latest iteration of the UK Corporate Governance Code. We believe this is a robust code outlining good governance practices. In forming our opinion of the governance of companies we also consider how they meet the spirit of good practice guidelines and also have regard to other best practice documents[1]

The rest of this document highlights areas of focus and priority that may lead to engagement and voting action. This list covers issues that come up most often in our experience and is by no means exhaustive, so it is possible that we may raise concerns on matters not mentioned below.

3. Board leadership and effectiveness

We look for effective boards which safeguard shareholder interests and have the right skills and experience to take the company's strategy forward. This includes setting the company's values and standards. Therefore, we will look to see whether the individuals on boards give us this reassurance.

3.1 Board composition, balance. The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. We look to see that there is an appropriate mix of skills, knowledge experience and diversity required to meet the challenges and opportunities and strategic objectives of the company. In particular we recognise the important role of the chairman and independent non-executive directors in providing appropriate internal challenge to board discussions and decisions to ensure that all directors act in the best interests of the company.

We look for diversity of thought on boards, not just of gender but also of diversity in its broadest sense. Inclusive and diverse boards are more likely to be effective boards, better able to understand their customers and stakeholders and benefit from fresh perspectives, new ideas, vigorous challenge and broad experience. This in turn leads to better decision making. We would welcome disclosure on how this is achieved.

3.2 Gender diversity. We have long been strong supporters for more women in senior management. We were one of the first asset managers to factor in gender and diversity in our voting policy. Specifically, we have the option to withhold support from Report & Accounts resolution and/or the re-election of the Chairman of the Nomination Committee should we consider that gender and diversity has been insufficiently addressed. Whilst there is no doubt that there has been progress on this issue, we note that the momentum of new appointments being women has slowed. The government's Hampton-Alexander review of women on boards has set a target of women holding 33% of board positions on the FTSE 350 by 2020. The pace of change needs to speed up significantly if this target stands any chance of being achieved.

We are also concerned that much of the progress made has been due to the appointment of women to non-executive directorships, rather than the more influential executive positions. As such, we continue to encourage companies to develop their talent pipeline and culture to improve the amount of women in senior management positions.

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[1] *Good practice guidelines*

- *The Investment Association Principles of Remuneration (2015)*
- *ABI Report on Board Effectiveness (December 2012)*
- *BIS The Kay Review of UK Equity Markets and Long-Term Decision Making (July 2012)*
- *Hampton-Alexander review of women on boards (July 2016)*
- *Women on Boards Davies Review Annual Report (2015)*
- *FRC's UK Corporate Governance Code (April 2016)*
- *GC100 Directors' Remuneration Reporting Guidance (August 2016)*
- *ICGN Global Corporate Governance Principles*
- *Pensions and Lifetime Savings Association Corporate Governance Policy and Voting Guidelines (November 2015)*
- *The Pre-emption Group Statement of Principles (2015)*
- *Turnbull Guidance on Internal Controls (October 2005)*

We concur with both the Davies Review and the UK Corporate Governance Code i.e. all Chairman of FTSE350 companies should set out the percentage of women they aim to have on their boards. However, to be clear, we expect all companies to consider gender diversity (eg SmallCap companies in addition to FTSE350 constituents). If disclosures and explanations regarding progress (or lack of) are inadequate, we will consider taking the aforementioned voting action.

3.3 Standards, values and culture. We place particular importance on boards setting appropriate standards and values for the company both in terms of corporate responsibility and also on doing the right thing in the way companies make decisions. We believe a responsible culture with clearly expressed values mitigates risks to the long-term sustainability and reputation of companies and can prevent some of the poor practices we have seen from companies over the last few years. We were delighted to see the FRC's comprehensive report on culture and would recommend boards read this carefully and provide feedback to the FRC. We will be increasing the focus of our discussions with boards on how they shape, embed and oversee culture in their organisations and will hold directors accountable if we have material concerns regarding conduct of business and conduct of employees. It would be effective and ideal if the FRC placed more emphasis on culture in the UK Corporate Governance Code to encourage more attention and engagement on culture as part of the stewardship process. Better disclosure in Company R&As would also be helpful.

3.4 Chairman and Chief Executive roles. We have always viewed the separation of the Chairman and CEO roles and in particular, an independent chair as fundamentally important in protecting shareholder value. We will be very reluctant to support non-independent chairs unless there are exceptional circumstances, such as in the case of a brief transitional period. We would also look at the process undertaken to mitigate the risks such as the appointment of a strong senior independent director. Generally, there is a need for much better disclosure in the Report & Accounts (R&As) as to why a non-independent chairman, including a long serving chair, is considered to be in shareholders' best interests.

3.5 Independence. In assessing independence of non-executive directors, we consider directors that have not been appointed through a formal, rigorous and transparent procedure as not independent, in addition to criteria outlined in the UK Corporate Governance Code. Similarly, while pay should be sufficient to attract high-calibre individuals, directors with disproportionately high fees may also be deemed not independent.

3.6 Company Secretary. Executive directors should not also act as company secretary.

3.7 Nomination committees. Nominations committees should not be chaired by an executive director or a non-independent chairman of the company. The majority of the committee should be independent.

3.8 Succession planning. Succession planning continues to be a cause of concern. We look to see that necessary arrangements are in place to manage succession of board members and senior management. Companies with good succession planning arrangements are generally seen to perform better over the long-term. Therefore, we prefer talent to be nurtured from within companies although we recognise that in some situations an external appointment may be appropriate. We may take voting action against chairmen and nomination committees if insufficient attention has been given to the succession arrangements at their companies.

3.9 Over-boarding. Some Directors, including some executives are becoming overstretched given the number of other roles they are taking up. We expect boards and nomination committees to seek greater comfort that new directors (or existing directors taking on additional roles) can devote the time required with consideration given to times of potential stress or during M&A activity. While we are willing to accept good explanations, as a general rule of thumb we see four non-executive appointments of listed companies as the maximum one individual can manage properly. This reduces according to the significance of the posts so, for example, we would not expect one individual to have four chairmanships. Also, executive directors should have no more than one non-executive role. Any material concerns through lack of explanation and justification, will be reflected in our voting on the relevant directors including the nomination committee chair.

3.10 Board evaluation. We are supportive of board evaluations and agree that there should be an external evaluation at least every three years and, to the extent possible, the company should give an indication of the outcomes of the evaluation.

3.11 Annual re-election. We support annual re-election of directors. We would encourage companies outside the FTSE350 to consider putting these arrangements in place.

4. Accountability

We expect companies to make disclosures on risk (to cover all material risks including environmental, social and governance (ESG), reputational, tax and cyber security risks) to help shareholders understand the risk and control issues facing the company and explain the steps taken on risk management and internal controls.

4.1 Internal controls. Building on the long standing credence we place in the Turnbull Code it is important that Boards review their application of the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting and to communicate to their shareholders in a meaningful way on how they manage risk and internal controls. In particular in line with the Guidance, the board should provide clear and concise information that is tailored to the specific circumstances material to the company and should avoid using standardised language which may be long on detail but short on insight. The reporting should be fair, balanced and understandable. From Aviva Investors' point of view we will focus on the very helpful guidance on the responsibility of the Board to set the tone from the top and embed the company's culture throughout the organisation. We would expect companies to be able to describe their culture in some detail.

4.2 Audit committee and auditor reports. We look forward to more meaningful Audit Committee Reports as proposed in the UK Corporate Governance Code which we hope will assist shareholders' understanding of how the Audit Committee has operated in practice and the issues it has addressed.

4.3 Non-audit fees. The integrity of the auditor's relationship with the company is compromised when a firm is paid excessive consulting fees on top of those paid for auditing services. Such arrangements have the potential to open the auditor process to a wide range of conflicts of interest. We often vote against auditors that receive significant non-audit fees unless fees can be explained e.g. by significant M&A activity. The nature of the non-audit fees should be disclosed.

4.4 Concerns over audit practices/ ongoing concerns over high non-audit fees. Where there are concerns over accounting and auditing practices and/or the continuation of high non-audit fees without adequate explanations, we may consider voting against members of the audit committee

4.5 Re-tendering. We expect companies to re-tender for new auditors every 10 years per the CMA Order[2] This process should be explained in the accounts and where changing auditors is not considered to be in the best interests of the company then this should also be clearly explained.

4.6 Going concerns. Per the changes in the latest iteration of the UK Corporate Governance Code we anticipate that most companies will discuss long-term prospects in the strategic report as part of the viability statement, thus coming under the scope of the safe harbour provisions of the Companies Act. These long-term prospects may include liquidity, solvency, and risk management, amongst others. The Code expects a board to include in its assessment of long-term viability a robust identification and assessment of the major risks of the business, and how any such material uncertainties will impact over this increased horizon of assurance. We consider the Environmental, Social and Governance (ESG) risks, covered in section 6, to be included in the scope of this assessment where pertinent. We will assess these statements as part of our process, detailed in section 8 of this voting policy, and engage accordingly, for instance, where there are areas requiring clarification or prompting concerns. The Corporate Governance Code advocates this narrative to cover a period of at least twelve months from the date of approval of the financial statements. Given our long-term outlook we encourage companies to capture the foreseeable business period' rather than the next 12 months and to accompany this with an explanation as to why a certain period was foreseeable in the context of the entity, its operational environment and business cycle.

[2] The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

4.7 **Cyber security.** This is an increasing area of importance to us, as whilst most companies have been investing significantly in this area, we are concerned a number have had serious security breaches. In our discussions with companies on cyber security, one of our key concerns will be where there is an apparent absence of a crisis management protocol. Indeed, we will be holding the chair of the audit and risk committees accountable where we think not enough is being done to combat the risks or there is a lack of contingency in place.

4.8 **Share Buybacks**. Whilst buybacks may be a sensible strategy, we have become concerned that in many cases it is to the detriment of the longer-term prospects of businesses. As such, when voting on share buy-back proposals we will be expecting better disclosure, as follows:

1. Stronger rationale for share buybacks being sought. We would expect more than just buybacks will increase EPS. Explanations should include how share buy-backs would be positive for the long term future of the company and specifically, how the board assesses the buybacks against other investment opportunities

2. Better disclosure on share buy-backs that have been made in the year under review. We believe there should be more specific disclosure requirements that add to the guidance by the Investment Association. We would need to know the prices at which the shares were bought and how it has created long term value for the company.

3. More detail on the effect of share buybacks on remuneration arrangements for executive directors and senior management.

5. Remuneration

A large proportion of this policy deals with remuneration. The binding vote on remuneration policy and the annual advisory vote on the remuneration report take up a considerable proportion of our resources. We are keen to maximise the time we have available for broader discussions around, for example, the calibre and appropriateness of the individuals on the board, rather than only on their pay. To complement this approach, we have chosen to go into a little detail here and **further detail in Appendix 1.**

In 2016, there were two significant events in respect of executive remuneration. The first being Theresa May's Corporate Governance Proposals specifically (a) shareholder votes on Executive pay should now be binding, not advisory; (b) to ensure executive pay reflects performance, and is aligned with average employee pay (i.e. the introduction of pay ratios) and (c) better retrospective disclosure of bonus targets. Secondly, in July 2016 the Executive Remuneration Working group published their recommendations. Interestingly, recommendation 9 supports pay ratios and the Working Group suggests focusing binding votes on those companies that have failed to receive support from 75% of the shareholders on the remuneration report in the previous year. Our current thinking is supportive of pay ratios and binding votes although of course there are many variants and approaches to addressing the issues. As such, we intend to update our guidelines on these issues in our 2018 policy.

However, our approach to remuneration remains the same. In summary, we look for arrangements that are aligned with strategy and shareholder interests, hold management to account and only reward value creation. We also look for remuneration arrangements that are, well-structured, understandable and not excessive. Pay arrangements should have a sufficient focus on the long-term and have adequately challenging performance conditions that align the directors' interests with those of shareholders. If the outcomes are particularly inappropriate, in extreme cases, we may vote against executive directors and the chairman in addition to members of the remuneration committee.

6. Corporate responsibility

We believe companies that consider material environmental, social and governance (ESG) as part of their business strategy generate enhanced shareholder value over the long-term. We therefore support integrated disclosure of ESG issues within the Annual Report and Accounts and believe this should reflect an informed and considered deliberation of these issues by the board. We very much welcome Integrated Reporting (<IR>) and encourage our investee companies to adopt this wherever practical. We welcome the amendments to the Companies Act as outlined in the Strategic Report requirements and will indicate within our voting the extent to which we consider the company has met these requirements.

6.1 CR risks. We expect all large and listed companies to disclose information on their exposure to and management of key corporate responsibility risks. These may include, but are not limited to, issues associated with the environment and climate change, bribery and corruption, health and safety, human rights, modern day slavery and labour standards.

6.2 Organisation for Economic Co-operation and Development (OECD) National Contact Point (NCP). All companies operating in OECD countries are subject to the OECD guidelines for multinational enterprises which cover a range of principles for responsible business practice including on human rights, employment, the environment, anti-bribery and corruption, consumer interests, science and technology, competition and taxation. Where appropriate, we monitor the outcomes of the NCP mediation process. We expect transparency and due consideration by the companies in which we invest as to the recommendations to be covered in an appropriate public document, including but not limited to the next iteration of the Annual Report and Accounts or a separate regulatory news release. Where we consider the response has been insufficient we may capture this in our voting stance on the annual report and accounts and/or the re-election of the director with responsibility for such matters.

6.3 How we implement this policy. Where companies do not publish this information or where we see poor corporate responsibility performance o**r** management practices, we may vote against or abstain from the resolution to adopt the Report and Accounts. In addition, where we consider this is warranted, we may also withhold support from the Remuneration Report (where ESG performance measure have not been appropriately integrated) or individual directors with responsibility (such as chair of a board sustainability committee or equivalent). This is applied to constituents of the MSCI World Index and FTSE 350. We are also likely to support shareholder resolutions that reflect our general views on issues such as climate change and the governance and disclosure of climate risk, as set out by the Financial Stability Board's Task Force on Climate Related Financial Disclosure (TCFD).

7. Investment trusts

In the main, we support the principles in the AIC Code. However, there are two areas that we wish to bring to your attention.

7.1 Definition of Independence. The AIC's code does not recommend that long serving directors should be prevented from being considered independent but we believe that lengthy service can compromise independence. In addition, investments trusts should ideally comprise solely independent directors but we will support one exception. As such, we may vote against long serving non-executive directors although we would consider appropriate board refreshment as a mitigating factor.

7.2 Re-issue of treasury shares. In line with the IA guidelines, we are unlikely to support proposed share issues if the company has failed to provide a commitment that shares will not be issued at a discount to Net Asset Value (NAV). We note that the IA have changed their policy regarding the re-issue of Treasury shares where they are now comfortable with Treasury shares being re-issued at a discount as long as this is lower than the average discount at which all shares held in Treasury have been repurchased, and if the Investment Trust has provided a sufficient explanation for this. We are less likely to support this arrangement, and would need to be convinced that any re-issuing of shares at a discount is in the best interests of shareholders.

8. Our process

At Aviva Investors, we've always believed that companies conducting their business in responsible and sustainable manner are more likely to succeed, benefiting our customers and society as a whole. For more information please see our Responsible Investment microsite:
http://uk.avivainvestors.com/gb/en/individual/about-us/responsible-investment.html

How we vote and engage with companies is becoming increasingly important to our clients. As investors we are being held accountable for our stewardship of the companies we are invested in and have disclosure requirements under the UK Stewardship Code. In order for our stakeholders to understand the way we work, we have set out our broad process as follows:

8.1 Oversight. Primary responsibility for oversight of our policy lies with the Executive Team at Aviva Investors. The ESG and corporate responsibility elements of the voting and engagement strategy are overseen by an external Advisory Committee.

8.2 Integration with fund managers. Issues in respect of our active holdings are decided in conjunction with our fund managers to ensure that all special circumstances and the company's strategy is taken into account.

8.3 Proxy agencies. We use proxy voting agencies for information but will make our own decisions.

8.4 Engagement with companies. As we own a large number of securities we cannot promise to inform all companies ahead of their shareholder meetings if we are intending to vote against (or abstain on) resolutions. We will endeavour to do so where we hold at least 2% of the stock or where we are a top 10 shareholder. Similarly, with remuneration consultations or offers of meetings on corporate governance issues, we will prioritise by the size and value of our holding, and the materiality of any concerns. In addition, we write to companies on an annual basis to advise of any changes to our voting policy and where our voting records and rationale can be found on our website.

8.5 Collaboration. We collaborate with other shareholders where we have a significant interest in a company and on developing points of principle. However, we are careful to stay well within the concert party regulations.

8.6 Inside Information. The decision as to whether we should become insiders (i.e. to be in receipt of non-public price-sensitive information on a company and hence unable to trade in the company's shares during that time) is taken on a case-by-case basis. As a general rule we are willing to be made insiders. However, we prefer to have a clear idea of when we will be released from being insiders and the information made public. Our preference is to be insiders for as short a time as possible, for example, for days rather than weeks. There are no Chinese walls regarding trading restrictions so when a security is added to our Stoplist, no fund manager is able to buy or sell the stock. This will also apply to personal dealing.

For a fuller description of how we operate, please see our Stewardship Code Statement on our website.

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Appendix 1: remuneration principles

These are the principles we would apply to the binding policy vote and the advisory vote on the remuneration report (also called the implementation report):

Policy vote:

5.1 Identifiable limits. We would expect an identifiable limit for each of the different components within the policy. This need not necessarily be in monetary terms but expressed in a way that will allow shareholders to understand the potential maximums. For example, we would be unlikely to support disclosure that indicates there is no maximum limit.

5.2 Discretion. While we expect companies to request a certain amount of discretion to deal with exceptional circumstances, we would be unlikely to accept discretion that gives companies freedom to exceed policy without any context or explanations of the extent to which the company would use that discretion.

5.3 Performance conditions. The Policy Statement for the Annual Bonus and long-term plans should disclose the likely performance metrics and weightings, with fuller details disclosed in the annual Remuneration Report.

5.4 Recruitment. We understand the need for flexibility in the event of external recruitments. However, our preference is that:

a) Any breach of normal limits should still be within the maximum limits set for payments for exceptional circumstances. If the policy allows for payments to go beyond the limits in the disclosed policy we will be unlikely to support the policy. We do not include buyout awards in our assessment as we recognise that there may be occasions when it is necessary to exceed the maxima quoted in the policy.

b) Where there is compensation for loss from the previous employer, we would like an explanation on whether the payment is on a like-for-like basis and if not, what other issues have been taken into account. In essence, we would want to know if new recruits are being paid more than they are giving up and why. We also take into account quantum for buy-out awards. Even if the payment is on a like-for-like basis, there may be occasions where we consider the payment as simply too generous.

Annual Remuneration Report:

We look at the total package and outcomes and form an overall view of the arrangements. We also look at a company's track record both on pay and governance. We expect companies to explain and justify their pay arrangements in a meaningful way that is specific to the business and its strategy rather than statements that are boilerplate and generic.

5.5 Annual Disclosure. Although not required by the Reporting Regulations, it will be helpful to shareholders if the Policy Table is disclosed in the Remuneration Report on an annual basis.

5.6 Abstentions. When disclosing in the Report & Accounts the levels of shareholder support for past remuneration reports, companies should not exclude abstentions from the total number of votes cast. Taking into account the abstentions will provide a true reflection of the percentage of shareholders supporting the remuneration report.

5.7 Remuneration committee. We would expect remuneration committees to be fully independent.

5.8 Shareholding requirements. We are very supportive of management holding a meaningful amount of shares in their company. We expect them to hold the shares in their own right and preferably not be gifted by share schemes. Unvested shares in incentive arrangements should not count towards the total.

5.9 Holding periods upon executives retiring from the business. To ensure management are thinking about the long term health of the business, including succession arrangements in the period before they retire, we consider it to be good practice that any bonuses that are subject to deferral in shares, should remain deferred upon their retirement, until the end of the holding period. The same should apply for LTIP performance and holding periods. Therefore, they will effectively be rewarded for leaving the business on a fine footing. We also consider that shareholding guidelines should continue for a period after executives have retired from the business.

5.10 Pensions. Ideally, pension entitlements should be the same as for the rest of the workforce. However, we recognise that industry practices are currently some way from this ideal and that it will take time to transition. Consequently, we look for differences in pension arrangements for executive directors and the rest of the workforce to be disclosed and justified.

5.11 Simplicity. We prefer pay arrangements that are clear and understandable. Cutting down on numerous plans would be one way of producing clarity. A number of companies have already done this. Care needs to be taken to ensure that performance conditions are not convoluted or overly complex.

5.12 Balance of pay. The right balance between fixed and variable pay will depend on the company. However, in general we prefer to keep fixed pay lower with higher pay for exceptional performance, subject to not incentivising inappropriate risk taking. Companies should justify why the balance is appropriate.

5.13 Quantum. We take quantum into account when assessing how we should vote. Whilst this is not our primary concern, excessive pay can represent a risk to the company both in terms of encouraging the wrong behaviours within the firm and also for the reputation of the company itself. We will make our assessment on the explanations companies give us for the overall pay levels, the need for pay increases and what else they have considered in coming to their conclusions e.g. wider employee pay, performance and inflation.

5.14 Pay increases and salary positioning. Companies should provide good reasons for any pay increases. We are supportive of rewarding exceptional performance over the long-term but companies should explain pay increases in the context of additional returns for shareholders, how other employees will benefit and why it is deserved. Falling behind the pay benchmark is not a sufficiently adequate reason on its own. Companies are unique and directors' pay should therefore reflect their differences. Care should be taken when using benchmarks as individual roles and companies can be very different.

Also, large salary increases immediately after the Company has made a larger acquisition would not be considered appropriate without good reason. The integration / success of an acquisition needs to have been proved first. If retention and integration challenges are considered to be key issues, then we would prefer to see slightly more performance-related pay potential.

5.15 Salaries / remuneration packages for new joiners. Unless there are exceptional circumstances, salaries / pay packages for new directors should not be more than their predecessors, particularly if predecessors were in post for a significant amount of time and delivered strong performance.

5.16 Living Wage. Aviva plc is a London Living Wage accredited employer. As such, we see the value in paying the Living Wage. We are very supportive of investee companies who are accredited or taking steps towards being accredited albeit this is not yet a factor which directs our voting decisions on its own. For the avoidance of doubt we use the Living Wage Foundation's definition of the Living Wage rather than the Government's definition in its 2015 Budget.

5.17 Disclosure of bonus measures and targets. We expect specific targets to be disclosed for the year that is under review with sufficient transparency for shareholders to decide if any payments have been a fair reflection of performance. We welcome the revised GC100 guidance on what is expected i.e the decision to withhold should not be taken lightly, and only where there are company-specific circumstances that lead the directors to "positively form the opinion that" the information is commercially sensitive. If disclosure for bonus awards is poor, we are unlikely to support the remuneration report.

5.18 Alignment to long-term strategy. We welcome companies using their stated KPIs and targets as their performance conditions under their share plans. This has the advantage of closely linking pay with what investors expect companies to achieve. However, please note, we would expect some element of the conditions to include TSR (see 'performance measures').

5.19 Performance measures. We prefer TSR to be a component of LTIP awards We are aware of the shortfalls of TSR but no performance measure is perfect and many are open to manipulation. Our view is that TSR is least manipulable over the longer term and will take into account operational performance. Importantly, it is the measure that most aligns company performance with shareholder returns and this is ultimately how all companies will be measured. We expect measurements of TSR, share price EPS and other performance measures to be constructed so that measurements are transparent, minimise arbitrariness and do not skew vesting in favour of participants. Where possible, companies should minimise "cliff-edge" vesting. Sliding scales starting from a suitably low level of payment at the point where awards are made is preferred.

5.20 Environmental, social and governance measures. We also expect material ESG (environmental, social and governance) performance measures to be included, particularly for companies in high risk sectors. As with all performance measures these should be material to the business, clear and transparent with specified metrics and targets and measurable. ESG considerations may be introduced via malus mechanisms, for example, if an individual has damaged the company's reputation through unethical behaviour, or if the company has poor health and safety records or customer complaints). ESG considerations may also be incorporated as a form of underpin whereby certain ESG standards need to have been met before payout, even if all the financial targets have been met. We may vote against the remuneration arrangements where we consider the Company has not considered material ESG risks or performance issues in their remuneration arrangements.

5.21 Payment at median. Companies should be careful not to pay too much for median or threshold performance because we believe significant incentive awards should only vest for exceptional performance. We prefer not to put a limit in place for how much should vest for threshold performance as there are numerous factors to consider (such as the positioning of salaries and pay overall relative to the size of the Company, and how challenging we consider the threshold targets to be). However, when Long Term Incentive Plans were first introduced, it was generally accepted practice that 25% of the award could vest for median (or threshold) performance awards as award levels were typically at 100% of salary, Grant levels over the last few years have increased significantly so when justifying such levels, companies should be mindful of what this means in terms of (% of salary) vesting for threshold performance.

5.22 LTI Performance periods. We are looking to see long-term schemes move beyond performance periods of three years without a corresponding increase in reward value. Where there are mitigating factors that would justify a shorter performance period, these need to be carefully explained to shareholders.

5.23 Deferral of variable pay. We would like to see a significant length of deferral. We are encouraged to see deferral also being applied under long-term incentive plans. Companies should explain any mitigating factors that may justify a lack of deferral in variable pay.

5.24 Share options / share appreciation rights. We are disappointed that the Executive Remuneration Working Group paper (published in July 2016) did not include share options (or other forms of share appreciation rights) as one of the alternative structures for long term incentive arrangements. We have always considered share options to be aligned with shareholder interests (as the share price has to increase before awards are worth anything). Whilst there are issues and past practices that have led to share options falling out of favour such as dilution, large block grants and their impact on accounting, none of these are insurmountable. We think companies should consider share options or Share Appreciation Rights (SARs), which will have the same alignment but with fewer shortfalls.

5.25 Pro-rating for time for departing directors' LTIP awards. In 2016 we saw an increasing number of cases where LTIP awards for departing directors were not pro-rated for time. LTIP awards that are subject to the usual performance conditions and time periods are a positive feature because they allow for executives to be rewarded (or not as the case may be) for their contribution to the business / decisions they have made in the period before they leave the business. For example, if they have left the business in strong shape or made good decisions regarding their successor, then it is feasible that there outstanding LTIP awards are likely to vest subject to meeting the performance conditions. However, our general view is that the award size should be pro-rated to reflect how much time has elapsed between when the LTIP awards were granted and the executive's departure. For example, if LTIP awards have two of three years to run then they should be pro-rated by two-thirds).

5.26 Malus and clawback. We are supportive of malus and clawback. We support the drafting of provisions which enable performance adjustment or post-vesting clawback for executive directors' variable pay and specify the circumstances in which the remuneration committees would consider it appropriate to act.

5.27 Retesting. We do not support the retesting of performance conditions for annual plans.

5.28 Change in control. There should be no automatic waiving of performance conditions on a change in control situation where we expect awards to be pro-rated for performance and time.

5.29 Dilution. Dilution levels should not breach best practice guidelines as stated in the Investment Association's Principles of Remuneration 2015

5.30 Discretionary and retention payments. We do not approve of discretionary payments and, in particular, we do not believe retention payments work. A properly thought out remuneration policy should be sufficiently retentive and reward exceptional performance.

5.31 Recruitment. Where recruitment payments are made we consider the following:

(i) Quantum

(ii) Whether the incentives are subject to performance conditions (only vested incentives from the previous employer should be compensated for without performance conditions)

(iii) Awards that are made in shares and are to be held over a number of years are more aligned with shareholder interest than immediate cash awards.

(iv) Companies should not pay more than a like-for-like replacement of what the appointee is losing.

5.32 Exit payments. Ideally, exit payments should be no more than 12 months base salary and should only be made when deserved.

5.33 Tax arrangements. Tax arrangements should not result in additional costs to the company or an increase in its own tax bill.

5.34 Collateral and hedging. We are not supportive of shareholdings being used as collateral for loans, or any form of hedging against achievement of performance conditions.

5.35 Pay consultations. When consulting on pay, we expect to see the total pay arrangements put into context. For example, base pay (and base pay rise expectations), bonuses (and anticipated maxima), benefits and LTIPs. Importantly, companies should also include pension entitlements as part of the consideration of the overall package. Therefore when consulting on a specific part of pay arrangements e.g. the LTIP, please put this in the context of all other elements of pay.