

FIL LIMITED



## Principles of Ownership

September 2009



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## A. Introduction

Shareholders are the ultimate owners of companies and the basic goal of the board of directors is to ensure the long term success of companies in the collective best interests of shareholders. In addition to maximising shareholder wealth, directors should also have regard to the fostering of fruitful relationships with employees, suppliers, clients and fund shareholders, the maintenance of a sound business reputation and consideration of the company's impact on the community and the environment. We believe that high standards of corporate responsibility make good business sense and have the potential to protect and enhance investment returns. Consequently, our investment process takes social, environmental and ethical issues into account when, in our view, these have a material impact on either investment risk or return.

## B. Stewardship

FIL Limited and those of its subsidiaries engaged in fund management activities around the world (notably based in London, Hong Kong and Tokyo, together referred to throughout as "FIL") pursue an active investment policy through portfolio management decisions, voting on resolutions at general meetings and maintaining a continuing dialogue with management. This involves holding regular meetings with companies to discuss specific results or events as well as a more informal dialogue incorporating site visits and other research initiatives. Regular access to executive management is a key part of FIL's investment process and we encourage management to provide regular trading updates to the market in order to facilitate this dialogue as much as possible.

As a general policy we are supportive of the management of the companies in which we invest but we will nonetheless form our own views on the strategy and governance of a business. This forms part of our dialogue with companies. On occasion our views will differ from those of management and where this is accompanied by a failure to achieve our reasonable expectations for shareholder return we will consider promoting change. Our specific response will be determined on a case by case basis and we will weigh up the relative merit of intervention or a sale of the shares. Typically we will choose to intervene to promote change when the expected benefits of intervention (through increased returns to our investors) outweigh the anticipated cost.

Where there is disagreement we will initially promote our views through discussions with the company's advisors and/or independent directors although we may also speak to other shareholders and third parties. Wherever possible we seek to achieve our objectives in a consensual and confidential manner but in extremis we will consider requisitioning an Extraordinary General Meeting to enable shareholders as a whole to vote on matters in dispute.

In instances where our clients own shares in more than one party to a transaction or where there are potential conflicts of interest, we will always act in the interests of the specific funds/clients holding the investment in question.

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FIL is able to accept price sensitive information through its corporate finance group. The corporate finance group operates separately from the dealing and fund management activities and is able to discuss proposals with companies without compromising the fund managers' ability to deal. This facilitates a full and open dialogue with the companies in which we are invested and we encourage companies to consult with us at an early stage when they are contemplating major strategic or corporate initiatives. The corporate finance group also supports the investment team if intervention is deemed necessary.

With regard to UK-Listed companies, FIL supports the recommendations of the Combined Code on Corporate Governance; we also support the September 2005 Statement of Principles drawn up by the Institutional Shareholders' Committee setting out the responsibilities of institutional shareholders and agents. In addition, we support the Statement of Principles Disapplying Pre-Emption Rights issued by the Pre-Emption Group.

### C. Voting Policy

It is FIL's policy to submit voting instructions for General Meetings unless the loss of liquidity as a result of attendant share blocking is deemed to outweigh the expected benefits to be gained from exercising the votes. However, even in markets subject to share-blocking FIL will seek to vote at least 50% of its shareholding provided the investment exceeds our minimum size criteria. We have a set of proxy voting guidelines which generally direct our voting behaviour although we do also take account of the particular circumstances of the company concerned, and of prevailing local market best practices. Our voting guidelines are reviewed on a regular basis.

Subject to these guidelines we usually vote in favour of company proposals reflecting our broadly supportive investment philosophy although this does not preclude us from voting against management on specific occasions. In instances where we vote against a board's recommendation we seek to ensure that management understand the reasons for our opposition. Although it is not our usual policy to attend General Meetings we will on occasion vote in person and may additionally make a statement explaining our position. We may also decide to abstain where we have insufficient information or where we wish to give a cautionary message to a company – in the latter case, we will advise the company of the reasons for our abstention.

We encourage boards to consult with shareholders in advance rather than risk putting forward resolutions at General Meetings which may be voted down. In our view confrontation with companies at General Meetings represents a failure of corporate governance.

We oppose anti-takeover proposals as well as any moves which adversely affect the voting rights of existing shareholders. We generally oppose the transfer of authority from shareholders to directors and we do not favour shares with restricted or differential voting rights. We will also generally oppose unusual or excessive authorities to increase issued share capital, particularly in respect of proposed increases for companies in jurisdictions without assured pre-emptive rights.

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## D. Remuneration Policy

It is in the interest of shareholders that boards should have the ability to attract and retain the highest quality of executive directors. In our view setting appropriate remuneration levels is the responsibility of the remuneration committee of the board and will be a market-based judgment although all remuneration arrangements should be aligned with the interests of the shareholders and be proportionate to the contribution of the individuals concerned.

We support the concept of variable remuneration and believe that properly crafted incentive schemes play a role in aligning the interests of management and owners. We encourage management ownership of shares and over time we expect executive directors to build a shareholding in the company which is material in the context of their remuneration.

The remuneration committee should play a key role in ensuring the correct balance between the potential rewards for management and the dilution of shareholders' interests. Incentive schemes should be voted on by shareholders and should be designed to ensure that the rewards reflect genuine outperformance and the creation of additional shareholder wealth by the executives. All relevant information should be disclosed to enable shareholders to reach an informed decision on the likely costs and benefits of a proposal and unnecessary complexity should be avoided. Once a scheme has been approved by shareholders and brought into operation, there should be continuing disclosure of how it is working in practice relative to its original benchmarks.

We strongly support the use of performance driven vesting criteria and believe that these should incorporate a combination of absolute and relative return targets and a direct linkage with share price performance. There should also be a further period of mandatory retention once a share award has vested.

Boards should not sanction rewards for failure and should seek to mitigate termination costs. Ex-gratia payments to directors should always be the subject of a specific vote of approval from shareholders and as a generality we do not support rolling service contracts for executive directors of more than twelve months' duration. For additional detail on our approach to incentive schemes for the senior executives at UK-listed companies, please refer to the Appendix.

## E. Take-over Bids

As stated above, our general policy is to support incumbent management in good standing but we reserve the right to support hostile bids when either the management has consistently failed to achieve our reasonable expectations for shareholder return or where, in our judgment, the level of a bid fully recognises the future prospects of the company in question. We will always try to give a fair hearing to the arguments of both sides before determining a course of action. As a general rule we will not sign irrevocable undertakings to accept an offer.

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We regard corporate acquisitions as amongst the most risky but potentially rewarding steps that a management can take and in these instances we will expect companies to have investigated both the operational and financial consequences of any acquisition in exhaustive detail. Where we are a significant shareholder and where the transaction is material in the context of our investment we encourage direct consultation (with our corporate finance group if necessary) at an early stage. In mergers between two companies we encourage the non-executive directors of both companies to meet together at an early stage and to have a meaningful role in determining the composition of the management of the combined group.

Management buy-outs can be an effective means of delivering value to shareholders but they also give rise to serious conflicts of interest. In these instances we look to the independent directors on a board to take control of the process at an early stage and to ensure that it is as transparent and non-exclusive as possible. Specifically, we recommend a competitive tender process before any particular financial backer is granted exclusivity and where possible we encourage boards to validate any proposal by seeking competing offers from third parties. In instances where we are a significant shareholder we once again encourage direct consultation at an early stage.

## **F. Returns to Investors**

In circumstances where risk adjusted returns exceed a company's cost of capital we encourage companies to invest, subject to maintaining appropriate controls and capital structure. The potential returns from investment in the business should also be tested against dividends or share re-purchases to determine the optimum return for shareholders. We regard dividends as an integral part of shareholders' reward for investing in a business and we therefore also encourage the payment of a dividend as a validation of the cash flow of the business, even where companies are sustaining high growth rates and/or high internal rates of return on projects.

When a company cannot find projects generating a return which exceeds the cost of capital we favour a capital distribution either by enhanced dividend payments or by share re-purchase. In our view this does not imply any lack of strategic vision but rather reflects what is best for shareholders at a given moment in time. The taxation position of both the company and shareholders should be taken into account when determining the precise course of action in this regard.

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## G. Corporate Social Responsibility

FIL believes that high standards of corporate social responsibility (“CSR”) will generally make good business sense and have the potential to protect and enhance investment returns. Consequently, our investment process takes social, environmental and ethical issues into account when, in our view, these have a material impact on either investment risk or return. Social, environmental and ethical best practice should be encouraged provided they enhance long term financial return.

We do not screen out companies from our investment universe purely on the grounds of poor social, environmental or ethical performance but rather adopt a positive engagement approach whereby we discuss these issues with the management of the companies in which we invest or consider investing on behalf of our clients. We use the information gathered during these meetings both to inform our investment decisions and also to encourage company management to improve procedures and policies. We strongly believe that this is the most effective way to improve the attitude of business towards CSR.

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*If you would like to learn more about FIL's approach to corporate governance, please contact either Don Cassidy on (44) 207 961 4925 or Trelawny Williams on (44) 207 961 4873.*

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## Appendix

### Guidelines on remuneration plans for senior executives at UK listed companies

#### A. Terms and provisions of share incentive plans and share option plans:

1. The dilution effect of the new shares authorised under the plan plus the shares reserved to be issued under all other stock option plans should not be greater than 10% in any rolling 10-year period.
2. The Board should not be able materially to alter the plan without shareholder approval.
3. There should not be a performance retesting period for grants of new shares. If performance targets for a given year are not met then awards for that year should be foregone.
4. The period for performance measurement and vesting should be at least three years in duration. Ideally the period used for performance measurement and vesting should be a minimum of five years with a further holding period between vesting and sale.
5. The offering price of options must be at least 100% of fair market value at the date of grant.
6. The terms of share plans should not permit the re-pricing of options.

#### B. The use of performance criteria:

1. For plans that grant awards whose vesting conditions are based in whole or in part upon the company's performance relative to a comparator group, FIL will generally vote against such plans if they allow for any portion of the award to vest for below-median performance. We also encourage the use of a comparator group comprised of a reasonable number of constituent companies whose business profiles are broadly similar to that of the subject company.
2. For plans that grant awards whose vesting conditions are based in whole or in part upon attainment of internal measures of performance such as earnings per share:
  - a) FIL will have regard to consensus expectations in evaluating whether the proposed targets are sufficiently challenging; and
  - b) To the extent such internal measures are intended to encourage a company's organic growth, the performance hurdles should be adjusted to account for the impact of subsequent corporate actions such as mergers and/or acquisitions.
3. We encourage the use of sliding scales which correlate the reward potential with a performance scale. In the event of a change of control, performance conditions should not be waived and awards should also be determined in a time pro-rated basis.

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