



# Environmental, Social and Governance (ESG)

## Our beliefs

“Capital’s primary role as fiduciary is to find long-term value for our clients. We believe ESG risks are integral to our fundamental analysis of a company and its true worth. We fully integrate ESG into our investment process.”

# Environmental, Social and Governance (ESG)

## The benefits of a fully integrated ESG approach

- Our approach is to fully integrate ESG issues into our investment philosophy and analytical approach, rather than treating them as the responsibility of a separate team.
- Our analysts and portfolio managers treat ESG as an integral part of the investment decision-making process.

### Research

- Our 68 in-house equity analysts produce high quality research covering both financial and non-financial factors, including ESG issues.
- The internal generation of research by our own analysts enables us to adopt a customised approach, rather than simple numerical research screens provided by a third party.
- This enables us to distinguish, within a particular industry or sector, those companies that are better or worse at managing the ESG risks relevant to that industry.
- Good management of ESG risks is an integral part of good governance—which is considered by our analysts when making investment decisions.

### Resources

- Consideration of ESG issues is integral to the entire investment process – resources available for covering ESG issues are not limited to a specialist team.
- We engage with companies directly on material ESG issues.
- Every individual involved in the investment decision-making process is expected to conduct research and engagement on those ESG issues which they judge as material.
- This responsibility is backed up by ESG specific committees and devoted specialist resources to provide support and additional expertise.

### Investment decision-making

- Engagement, research and proxy voting decisions are all channelled through our investment analysts.
- The individuals with the deepest knowledge and understanding of the ESG challenges facing companies are also those with investment responsibilities.
- There is no gap between production of ESG research and engagement which can be the case when engagement is carried out by a separate team.

# Environmental, Social and Governance (ESG)

## Engagement

### Engagement with companies

- Investment analysts are expected to know the companies in which they invest better than anyone else. Approximately 10,000 company visits annually.
- Their involvement in the engagement process is critical.
- Capital's analysts habitually engage with companies to deepen their understanding of the ESG challenges.
- Capital will also engage to bring about change in ESG practices. Although we do not favour confrontation or publicity, and we will not hesitate to make our position clear privately.

### Professional incentive programmes

- We operate a long-term incentive plan with an unusually long horizon; 8 years. This is to encourage analysts and investment professionals to consider the impact of their analysis and decisions on the long term value of companies in which we invest on behalf of our clients.

### Consultation

- Analysts are also increasingly the first point of contact for companies seeking guidance on corporate governance issues.
- Engagement is a way to educate management on Capital's policies and expectations on ESG issues.
- Our analysts are highly respected within their chosen fields of expertise and their views on ESG issues are sought by company Boards and other involved practitioners.

### Involvement in the policy debate

- Although Capital does not seek to be involved in public campaigns or initiatives, privately we engage with regulators, governments and other external groups, particularly on corporate governance issues. Examples of this would include the recent consultation on short selling.

# Environmental, Social and Governance (ESG)

## Proxy Voting

- Capital's voting practices and processes are exceptionally strong, well-resourced and consistent.
- Proxy voting is a key ownership right which we exercise globally.

### Coverage

- Capital makes it a specific objective to vote all shares on a global basis.

### Consistency

- All voting decisions are made in-house, rather than delegating particular markets to a third party. This ensures that our practices are consistent across all markets, whilst also being responsive to regional differences.

### Resources

- All decisions are subject to detailed scrutiny.
- Capital's regional proxy voting committees review all voting policy decisions. All voting decisions are also channelled via the relevant company analyst.
- Our analysts have in-depth knowledge of each company, which enables them to factor in particular the relevant circumstances of each vote rather than a box-ticking approach.

### Integration

- The voting process is folded into the analyst's ongoing interaction with a company enabling them to explain and discuss their voting with company management.
- Analysts and portfolio managers are also kept informed in a timely manner on all votes cast.
- Voting decisions integrate closely with our wider company engagement.

# Capital's ESG Coordinating Group

**Members:**

- Rob Beale (Senior Corporate Governance Associate)
- Terry Berkemeier (Portfolio Manager)
- Stephen Gosztony (European Relationship Manager)
- Cheryl Hesse (Senior Counsel – US)
- Suzanne Hutchins (Investment Specialist)
- Ida Levine (Senior Counsel – Europe)
- Tom Lloyd (Research Analyst)
- Frances Waters (Governance & Proxy Voting Manager)

# Environmental, Social and Governance (ESG)

## Capital's resources

London			
Associate	Responsibility	Years of experience	Years with Capital
Suzanne Hutchins	Co-Chair of Proxy Voting Committee	18	4
Ida Levine	Co-Chair of Proxy Voting Committee	29	11
Habib Annous	Co-Chair of Proxy Voting Committee	22	6
Frances Waters	Governance & Proxy Voting Manager	12	12
Rob Beale	Senior Corporate Governance Analyst	7	6
Joana Arin	Corporate Governance Analyst	6	5
Isabelle Dumoutier	Corporate Governance Analyst	6	5
Georges Lambert	Analyst – Proxy Voting Oversight	9	9

Los Angeles			
Associate	Responsibility	Years of experience	Years with Capital
Cheryl Hesse	Co-Chair of Proxy Voting Committee	18	14
Sandra Santana	Governance & Proxy Voting Manager	15	15
Sarah Lang	Corporate Governance Specialist	19	19
Crystal Phung	Senior Corporate Governance Analyst	15	15
Casey Martinez	Corporate Governance Analyst	5	4

# The Governance and Proxy Team ('GAP')

## London



**Frances Waters**  
Governance & Proxy  
Voting Manager



**Rob Beale**  
Senior Corporate  
Governance Analyst



**Joana Arin**  
Corporate  
Governance  
Analyst



**Isabelle  
Dumoutier**  
Corporate  
Governance Analyst

## Los Angeles



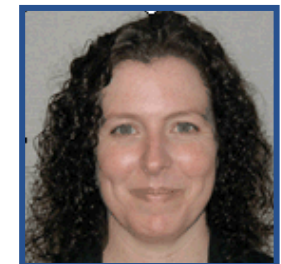
**Sandra Santana**  
Governance & Proxy  
Voting Manager



**Casey Martinez**  
Corporate Governance  
Analyst



**Crystal Phung**  
Senior Corporate  
Governance Analyst



**Sarah Lang**  
Corporate Governance  
Specialist



# Corporate Governance

## Governance & Proxy ('GAP') dedicated expertise

### Objectives

- To vote every share of every company we own at every meeting of that company's shareholders
- To act as a centre of excellence for all corporate governance issues, supporting the Investment Group, Legal and Client Relations
- Own, manage and enhance the proxy voting process for Capital's institutional clients globally
- To apply a consistent set of procedures globally:
  - enable flexibility to cater for specific client requirements
- To apply a consistent set of proxy/corporate governance policies globally (Investment Group to own the policies):
  - enable flexibility to deviate from set policies
- To provide value added support to the Investment Group to aid the voting decision-making process
- Facilitate the efficient reporting of proxy voting decisions to clients

### Benefits

- Increased coordination and effective controls of the proxy process
- Global consistency with regional flexibility and capacity to meet growing demands
- Better use of Investment Group, Client Relations and Legal resources
- Focused management of third-party service providers

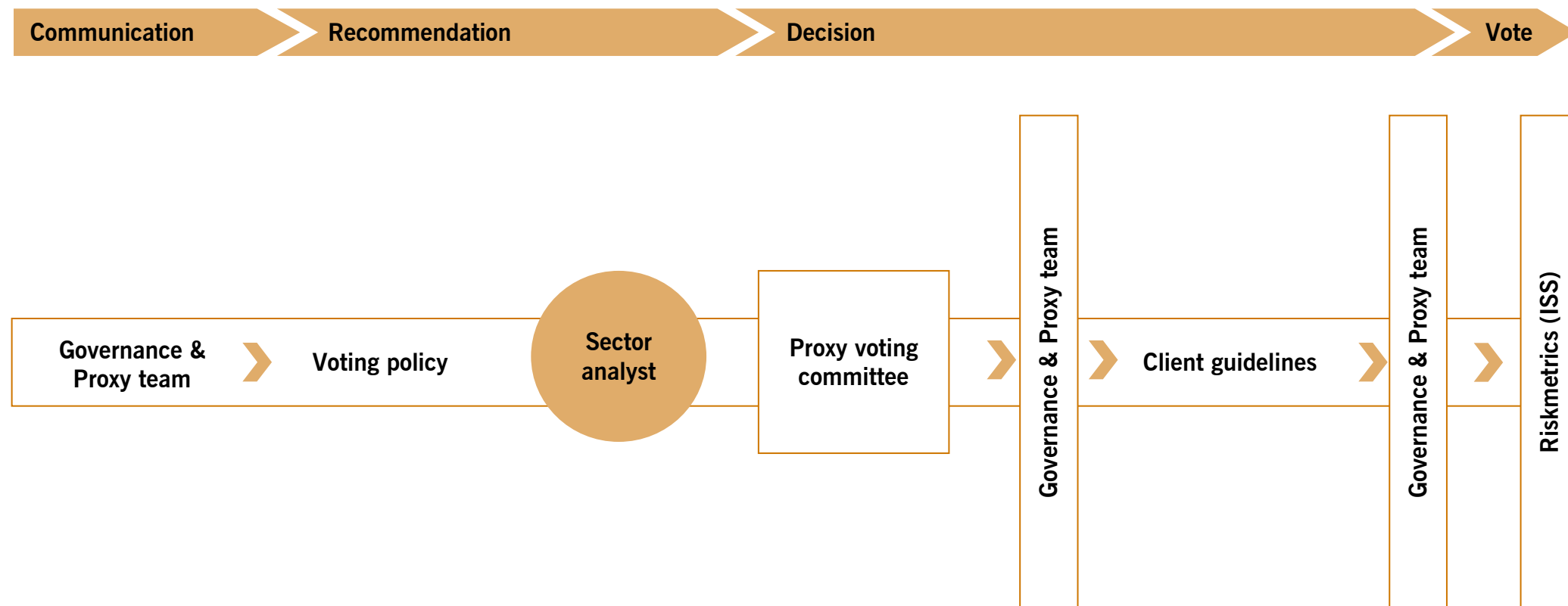
# Corporate Governance – Recent changes

## Governance & Proxy ('GAP')

- The Governance and Proxy team re-joined our Portfolio Control Department ("PC") in September 2008. PC is a global department that completes the link between the Investment Group decisions and the Client Portfolios.
- The core GAP team remains largely unchanged, their growth in experience displays a broader knowledge base of all markets.
- Changes to the Corporate Governance structure brings the GAP team closer to the engagement/ investment process, bridging the gap between the Investment Specialists/Proxy Committees and the analysts.
- More direct relationship and closer proximity has improved integration with the investment process and team.
- Knowledge transfer between the different PC disciplines has enabled the GAP team to get closer to the life cycle of the investment process and has promoted a greater understanding of the investment process for all involved e.g. corporate actions crossover - rights issues, DRIPS.
- 2009 proxy season has seen a successful collaboration with GAP and the investment group and in many cases the companies, enriching their ability to understand the impact of the voting process.

# Corporate Governance overview

How do we decide how to vote?



# Proxy Voting Committees

## UK

### Chairs

	Years at Capital
<b>Habib Annous</b> – Portfolio Manager: European small-cap Equities	6
<b>Ida Levine</b> – Senior Counsel	11

### Members

<b>Suzanne Hutchins</b> – Investment Specialist	4
<b>Terry Berkemeier</b> – Portfolio Manager: Global Equity	17
<b>Martyn Hole</b> – Investment Specialist	6
<b>Brian Kennedy</b> – Investment Analyst: European healthcare	3
<b>Georges Lambert</b> – Investment Analyst/Proxy Voting Oversight	9
<b>Philip Winston</b> – Portfolio Manager: European Equities	12

## Europe

### Chairs

	Years at Capital
<b>Suzanne Hutchins</b> – Investment Specialist	4
<b>Ida Levine</b> – Senior Counsel	11

### Members

<b>Habib Annous</b> – Portfolio Manager: European small-cap Equities	6
<b>Terry Berkemeier</b> – Portfolio Manager: Global Equity	17
<b>Keith Dicker</b> – Investment Analyst: European chemicals and healthcare	16
<b>Gerald Du Manoir</b> – Portfolio Manager: European Equities	19
<b>Arthur Gromadzki</b> – Portfolio Manager: European Equities	22
<b>Georges Lambert</b> – Investment Analyst/Proxy Voting Oversight	9
<b>Rudolf Staehelin</b> – Portfolio Manager: Global Equities	27

# Role of Proxy Voting Committees

- Structured by investment region and covering the globe. Five proxy voting committees: North America, UK, Europe, Asia, Emerging Markets. Our guidelines are global and there is exchange of ideas among committees.
- Members are from the investment group and other business areas: research analysts, portfolio managers, investment specialists and legal.
- GAP go to the research analyst responsible for a stock to establish the vote recommendation. This is the analyst that has the expertise and knowledge on each company.
- Committee reviews proxy decisions on substantive issues such as remuneration and when the analyst recommends a vote against guidelines.
- Communication for proxy votes is by e-mail and coordinated by the GAP team. All votes are recorded. Where there are differences of view, this will be communicated via e-mail, phone call or face to face.
- Meet pre and post proxy season to review existing voting policy guidelines to identify trends, update current thinking, recurring issues and make changes if necessary.

# Proxy Voting Statistics – Capital Group International, Inc.

Calendar year 2008

2008	Q1 Jan – Mar	Q2 Apr – Jun	Q3 Jul – Sep	Q4 Oct – Dec
<b>Total meetings (Capital Group International, Inc.)</b>	<b>245</b>	<b>1,347</b>	<b>222</b>	<b>189</b>
Number of proposals	1,908	15,473	1,696	1,382
% Proposals With Management	94.5	94.7	94.4	93.7
% Proposals Against Management	5.0	4.2	5.0	5.7
% Proposals Abstained	0.5	1.1	0.6	0.6

# Major issues this voting season

- Failure to consult shareholders on major transactions
- Remuneration
- Rights issues
- Role of institutional shareholders
- Engagement on social and environmental issues
- US developments

# Telenor's failure to consult shareholders

- **Original investment thesis mainly driven by:**
  - Potential for significant cash flow increase as the growth phase enters a harvesting period
  - Respect for the high quality operational management
- **Engagement prior to the announcement of the investment in India assured us that management would not go ahead with the deal:**
  - Frank exchange of views on the Indian Telcom market
  - We did our own field research
  - We leveraged off our emerging market analysts' expertise
- **We reviewed the deal after the announcement to ensure we had all the facts and to confirm our view that it was not in shareholders' interests:**
  - We engaged with management and expressed strongly our concern to management
  - We studied all our options
- **We identified and engaged other shareholders:**
  - Board: Chairman, Vice Chair, Corporate Assembly
  - Government: Ownership Department, Deputy Minister, Secretary of State
  - Lawmakers: Head of Trade & Industry Committee, various other committees
  - Civil Society: Oslo Stock Exchange
  - Other shareholders within the limitations imposed by law (concert party rules)
  - Banking Advisors: UBS, Goldman



# Telenor's failure to consult shareholders (continued)

- **What have we achieved:**

- Not as much as we would have liked, the deal went ahead
- We helped change the shape of the deal and made our views heard

- **Long-term we haven't given up! We are continuing to try to make changes:**

- Ongoing discussions with the Oslo Stock Exchange to protect minority rights
- Engagement with the Nomination Committee for Board Membership Election

# Remuneration – CGII policy and guidelines (an extract)

- The analyst and committee will review all proposals regarding executive compensation and stock option plans
- In the UK however, the analyst will review all remuneration reports for the AGM and the committee review is only necessary if any of the following apply:
  - Analyst recommends to vote against / abstain
  - The analyst recommendation has changed from the previous year
  - New long-term incentive schemes are being proposed
  - There are significant changes to any aspect of remuneration (e.g. salary; bonus potential; overall quantum; amendments to long term incentive schemes)
- Policy guideline is to consider on a **case by case** basis
- In principle, the following factors are also considered: (analysts should take account of different market criteria and disclosure requirements)

## Stock Option Plans

- Questions are raised when the allocation of shares for a new plan exceeds 10% of share capital or increases the number of shares reserved under an existing plan by over 5% of share capital
- The plan should not have an evergreen provision
- Questions are raised when the annual dilution for the plan's term exceed 1%
- 3 year historical dilution of awards should not exceed 1% annually
- Options should be issued with an exercise price at fair value on grant date
- The plan should prohibit option re-pricing
- Performance criteria should be reasonable and challenging
- Plan should prohibit a re-test of the performance criteria
- (Japan) Deep Discount option plans should be considered as a component of compensation and the plan terms should not be excessive

## Incentive Share Schemes

- Performance targets should correspond to an increase in shareholder value, measured over a number of years to ensure that management's long term interests are aligned with shareholders. The analyst should confirm that the performance targets are challenging
- Restricted Share Schemes should have an appropriate lock up period and size of award

## Executive Bonus Plans

- Should be reasonable, appropriate and demonstrably linked to performance

## ■ Stock Purchase Plans / SAYE / Employee Saving Scheme

- Plan should be available to all employees and broadly spread
- Holding period required of greater than 1 year

## ■ Approval of Remuneration Report. Voting factors include:

- REMCO should consist entirely of independent directors
- Mix of short/ long term performance based compensation
- TSR is relative to a peer group comparator
- Executive service contracts are one year or less
- A significant proportion of directors' compensation is performance based
- Performance targets are sufficiently challenging

# Examples of remuneration engagement

- Engagement with UK companies year to date include:
  - Vodafone, Smith & Nephew, Yell, HSBC, Cable & Wireless, BHP Billiton, BG Group, Home Retail Group
- UK companies where we voted against remuneration reports include:
  - RBS, BP, Smith & Nephew, Punch Taverns, Enterprise Inns
- Voting against French severance packages.
  - Our guideline is to vote against severance pay which is more than 1x annual cash compensation. Examples where we voted against:
    - Sanofi Aventis, Danone, Axa, Schneider Electric, Vivendi, Carrefour, Vallourec
- Supporting the introduction of a remuneration vote in Switzerland
  - We voted in favour of the Ethos proposal at Nestle and Novartis to introduce an advisory vote for shareholders on remuneration.
  - We reviewed the remuneration policies presented by ABB, Credit Suisse and UBS, and voted in favour

# Role of institutional shareholders

- The role of institutional investors in the financial crisis has been scrutinised by the government and regulators.
- They have been criticised for lacking awareness of what they were buying and their failure to question Boards on companies' governance, strategy, risk management and remuneration practices.
- With others in the industry, we have been reviewing the appropriate role of institutional shareholders, tools available to them, and constraints on their ability to act, including identifying regulatory impediments.
- Our primary focus has been on the role of Boards, Chairs and NEDs, and effective interaction between them and their shareholders individually and collectively.
- Some examples of ideas for improvements that have been discussed are:
  - Safe harbour across EU for shareholder action
  - Increased participation of Chairs/NEDs in investor meetings with management
  - Uniform 'toolkit' for shareholders across EU and other jurisdiction to reflect best practice
  - Greater shareholder emphasis on the composition of Boards

# Engagement on social issues

## Hankook Tire – Labour issues with new plant in Hungary

### The investment case:

Oligopolistic industry with pricing power. Hankook is in a strong, competitive position, the 8th largest tire producer globally. Proven management track record. Significant exposure to growth in China. Recovery in capacity utilisation rates will drive earnings power. The share price discounts most (if not all) of the bad news

- Client's SRI screen recommended exclusion
  - New Hungarian plant had reportedly breached local labour laws
  - Allegations that the company had hindered union activity
- Our analyst responsible for the stock raised these issues with representatives from Korea and Hungary a number of times as well as visiting the Hungarian plant
  - Our concerns were taken seriously
  - They accepted mistakes had been made and that labour practices fell short of local standards
  - And paid a fine levied by the Hungarian National Labour and Labour Safety Inspectorate
  - Training subsidies were withdrawn
- The company took steps to ensure no further violations would occur and this is being monitored
  - OMMF labour inspection bi - monthly
  - Strict register of working hours and breaks
  - Improved relations with the trade union (International Fed of Chemical, Energy, Mine and General Workers' union)
- We have continued to put pressure on Hankook to resolve outstanding issues with the local trade union
  - Our analyst has discussed all the issues with the SRI screen provider.
  - The union agreement with Hankook is drafted and ready to sign - this was confirmed by the SRI provider after talking to the union
- Our engagement has had a positive effect
- The investment remains a high conviction idea



# Engagement on environmental issues

## Freeport McMoran – Environmental risk at its mine in West Papua, Indonesia

### The investment case:

One of the world's largest producers of copper and gold with high quality assets and a well respected management. Operationally one of the best in class. Provides good exposure to an upturn in the global economy and to China as well as an inflation hedge from the gold assets.

#### ■ The issue:

- Allegations were made that the company dumped toxic waste into the local rivers and failed to mitigate the environmental impact of its Grasberg mine in Indonesia.

#### ■ Our engagement:

- Research trip to the mine
- Continuous dialogue with management
- Talked to locals
- Assessed the financial impact on the investment case

#### ■ Freeport's response:

- Improved environmental monitoring
- Annual external audit by the SGS to maintain its ISO 14001 certification
- Correspondence from the company verified the improvements made
- Disclosure of report on their website: 'Controlled Riverine Tailings Management'

#### ■ Engagement was positive

#### ■ Stock remains a high conviction idea



# Corporate Governance – US developments

## Say on Pay and Executive Remuneration

- The American Recovery and Reinvestment Act of 2009 directs the SEC to issue final rules on say on pay within a year, likely before the 2010 proxy season. SEC Chair Mary Shapiro has been known to support this concept.
- Currently, the approximately 400 firms that have received assistance under TARP are required to provide the advisory vote on the executive compensation report until they satisfy their financial obligations to the government.
- The Act also imposes significant limits on executive bonuses. These restrictions prohibit cash bonuses to certain top executives, other than grants of long-term restricted stock. The value of restricted stock grant may not exceed one-third of the executive's total annual pay and will only vest after the company pays back its TARP obligations.
- CIL reviews say on pay and executive remuneration issues on a case-by-case basis. Some factors that CIL considers are (i) the reasonableness of the pay policy, (ii) the historical equity award grant practices and (iii) whether shareholders currently have clear venues to express their views.
- Between 2006 and to date, CIL reviewed a total of 394 proposals on US equity incentive plans and voted AGAINST 46% (183) of these proposals.
- Between 2008 and to date, CIL reviewed a total of 54 shareholder say on pay proposals and voted FOR 30% (16) of these proposals.
- Option Exchange Programs – Due to the recent economic downturns, the level of outstanding option awards becoming underwater has increased. This year, we are seeing more companies requesting approval of option exchange programs. To date in 2009, CIL has reviewed ten exchange programs and voted AGAINST all.

## Director Election / Board Structure

- CIL generally supports management's director nominees, unless the analyst has issues with certain board members. Board level approaches to risk assessment and oversight of management are scrutinised. At the recent Yahoo! AGM, CIL voted AGAINST the re-election of Jerry Yang due to his mis-steps & poor performance as CEO.
- So far in 2009, CIL reviewed three North American contested elections at Biogen Idec, Biovail Corp. and Target Corp.
  - Biogen Idec – Our analyst spoke with management and representatives of the dissident shareholder group (Carl Icahn's group) to review their positions. The analyst originally wished to support three management nominees and one dissident nominees. Because a universal proxy ballot was not available to submit such a split vote, the analyst and proxy committee ultimately determined it would be in shareholders' interests to support the one dissident nominee (Alex Denner). Mr. Denner was ultimately elected to the board.



# Corporate Governance – US developments (continued)

- Biovail Corp. – The analyst and proxy committee voted for management's slate of director nominees. The dissident shareholder is the founder and ex CEO. The analyst noted that under his stewardship, the company fell into bad practices causing the company to pay million dollar plus settlements with multiple regulators. Capital invested in this stock once the ex CEO is no longer in control of the company. With a new management team in place, there has been a strategic review and a change in direction for Biovail. The reaction has been the stock has risen over 50% in less than one year.
  - Target Corp. – CIL participated in conference calls organized by Glass Lewis whereby both management and the dissident shareholder, Pershing Square Capital Management, discussed their views. Several of our investment and governance analysts met with representatives of Pershing to discuss their views. Upon much consideration, the analyst and proxy committee ultimately voted for the slate of management's director nominees.
- Board Structure – CIL reviews proposals related to board structure on a case-by-case basis. We support the declassification of boards as we believe directors should be accountable and stand election annually. We also support the majority vote standard and cumulative voting in director election as they are a hallmark of good governance .
  - Broker Votes – In 2006, the NYSE proposed new rules to bar broker votes from being counted at uncontested director elections. The rules are awaiting approval from the SEC although it is unclear when the Commission will act on it. RiskMetrics is estimating that it may happen in 2010.

## Other US Governance Issues

- Poison Pills – CIL generally votes against poison pills without extenuating circumstances in the company's position as a takeover target.
- Right to call special meeting – CIL generally supports the ability of shareholders to exercise their ownership rights by calling a special meeting. The majority of US companies allow this. Companies targeted by shareholder proposals may either lack this provision or set the ownership requirement at an unreasonable level. A threshold of 10% of share capital is common in state law but the market cap of the company and the economic value that this represents should be taken into account.
- End supermajority vote requirement – CGII generally believes that the majority voting standard is a hallmark of good governance and shareholder friendly and that a supermajority vote requirement impedes shareholder action on ballot items that may be critical to shareholder interests.



# Corporate Governance

## Client reporting

There are a number of reporting options available to all our clients in respect of our proxy voting and corporate responsibility activity. Clients can choose to receive these reports on a monthly, quarterly, or annual basis, either in hardcopy or on our client website. They are as detailed below and except where stated are portfolio specific:

### **i) Full Proxy Voting Report**

This report contains information on every shareholder meeting voted on during the reporting period. For any votes against management or abstentions a summary is provided explaining how this decision was reached

### **ii) Full Voting Statistics Report**

This one page summary report contains statistical information on every shareholder meeting voted on during the reporting period. Information includes the number of meetings voted and the number of proposals that were voted against management

### **iii) Exceptions Report**

This is a shorter version of the Full Proxy Voting Report described above. This report contains information on shareholder meetings voted on during the reporting period. However unlike the Full report, it only shows meetings where at least one proposal was voted against management or abstained

### **iv) Exceptions Statistical Report**

This one page summary report contains statistical information on every shareholder meeting voted on during the reporting period. Information includes the number of meetings voted, and the number of proposals that were voted against management. Information contained in this report only includes meetings where at least one proposal was voted on or abstained

### **v) Quarterly Corporate Responsibility Report**

This report shares with clients examples of our SRI and Corporate Governance activity during the reporting period. It is not specific to individual client portfolios or reflective of tailored requirements. It is issued on a quarterly basis

# UK regulatory information

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