



The 2006 proxy-voting season

Introduction

On behalf of our clients, Insight routinely votes on all resolutions at both annual general meetings (AGMs) and extraordinary general meetings (EGMs) of the UK companies in which we invest. As the majority of companies' financial years end in December, their AGMs take place during the second quarter, making it a busy time of year. Between 1 April and 30 June, Insight voted on 3,847 resolutions, at 364 events, for 326 companies.

Compared to previous years, the peak voting season was relatively uncontroversial, with the most contentious issue continuing to be remuneration. Insight voted against the following FTSE 350 Remuneration Reports: Abbot; Burren Energy; Mapely; Morgan Sindall; Randgold. Insight also abstained on PartyGaming's Remuneration Report. Further details on these specific votes can be found in the Q2 2006 Voting Reports at <http://www.insightinvestment.com/uk/responsibleinvestment/riandcg/riliterature/>.

The relatively low number of votes against and abstentions reflects the fact that more companies are now consulting investors either directly, or indirectly through their advisors, on the introduction of new schemes or the changes to existing schemes ahead of meetings. A number of companies, for example, 3i and HSBC, are now holding meetings every year with major shareholders to discuss corporate governance and remuneration.

A number of issues emerged from our recent discussions with companies, namely:

- Uncapped bonuses
- Increasing variable rewards
- Pensions and associated costs following 'A-day'

Uncapped bonuses

As a general principle, Insight favours increases to variable rewards rather than to basic salaries. This is because salaries are the building blocks of remuneration; as they grow, they place large ongoing costs on a business through a multiplier effect on variable remuneration (i.e. the higher the basic salary, the larger the variable rewards based upon it). Further, it is our view that remunerating executives (and staff) through variable rewards such as bonuses and options better aligns the interests of company and shareholder.

In the second quarter of 2006, Amvescap, Henderson Group and F&C Asset Management proposed changes to the variable reward given to directors. In Box 1, we present the case of Amvescap to illustrate some of the issues with such changes.

As demonstrated by Insight's support for Amvescap's Remuneration Report, we feel there are certain circumstances in which it is appropriate to allow remuneration committees to use their discretion. However, at both Amvescap in 2003, and at F&C Asset Management this year, the remuneration proposals originally put in place were later adjusted by changing the basis on which payments would be triggered. Insight does not support companies that change schemes once they have been approved by shareholders. We therefore voted against Resolution 11 at the F&C AGM this year and against the 2003 Amvescap Remuneration Report.

Box 1: AMVESCAP – continuing engagement

Insight has been actively engaging with Amvescap on governance issues for several years. In 2003, Insight voted against the company's Remuneration Report because management was seeking to adjust the targets and, therefore, to change the basis of the Share Option Scheme. While this was within the rules of the scheme, Insight believed it was against the best interests of shareholders.

In 2004, Insight had extensive engagement with Sir John Banham (Senior Independent Director) to discuss splitting the roles of Chairman and Chief Executive.

In 2005, Charles Brady, the then Chairman of Amvescap, endured a difficult period that included fending off a hostile bid from Canadian rival CI Fund Management and the recruitment of Martin Flanagan as the next Chief Executive. In recognition of his leadership and achievements, the Remuneration Committee decided to award him a bonus of US\$9 million (£5 million). Also, Martin Flanagan, the incoming Chief Executive, received a 'golden hello' as part of the recruitment package that partly involved buying out his incentive plans from his previous employer.

Investor controversy

In April 2006, The Association of British Insurers issued a rare 'red-top' alert to investors indicating its highest level of concern over the Remuneration Report ahead of Amvescap's annual meeting. Several institutional investors were concerned about the remuneration arrangements and threatened to vote against the Remuneration Report. Insight attended a meeting with Amvescap, convened by the ABI, at which the company provided further

background to Charles Brady's bonus payment. The company re-emphasised his excellent leadership in beginning the recovery during 2005 and his pivotal role in both the selection and recruitment of Martin Flanagan and fending off a hostile bid that significantly undervalued the company. However, a number of shareholders expressed doubt about whether the level of bonus was appropriate, based upon the company's performance during the year.

Insight's view on the Chairman's bonus payment

Insight communicated to Amvescap's Company Secretary our view that the level of the award to Charles Brady was rather high. However, Insight did not feel that it was appropriate to vote against the Remuneration Report for a number of reasons. In our view, the Remuneration Committee is genuinely independent and had used appropriate decision-making processes to determine the Chairman's award. In considering the exact level of bonus to award, the Remuneration Committee reviewed the Chairman's total compensation against that of a peer group of the chief executives of 18 comparable asset management companies, which indicated that the level of his total compensation over the last five years had been close to the market median throughout the period. We believe that Charles Brady had successfully managed the company during a difficult time and that it was important to support Rex Adams, the Chair of the Remuneration Committee, who is due to become the company's first independent Chairman. Insight's view was supported by a narrow majority of Amvescap's shareholders, with 47% voting for the Remuneration Report, 8% abstaining and 45% voting against the resolution.

Increasing variable rewards

As part of Insight's rolling programme of meetings with company chairmen, we discussed remuneration and reward with the chairmen of Land Securities and Hammerson. Both highlighted the issue of the competition they face for talent from outside the quoted arena within the real estate sector. Insight believes that in such circumstances companies must

provide rewards that attract, retain and motivate high-quality management and, thus, we accept that rewards are likely to be higher in these situations than might otherwise be the case. This competition for talent within the real estate sector has resulted in increased variable rewards being offered at the Land Securities Group. See Box 2.

Box 2: Land Securities Group

This year, Land Securities Group has decided to increase variable pay for executive directors by increasing the annual bonus potential from 100% to 300% of base salary to reward the delivery of exceptional financial returns over and above the levels of financial performance covered under the previous bonus and Long Term Incentive Plans (LTIPs). The new arrangements have been backdated and will therefore apply for 2005.

Insight discussed the new remuneration arrangements with both the Chairman of the company and New Bridge Street, the company's remuneration advisors. We support the company's decision to increase the annual bonus potential to 300% of base salary. We discussed the performance metrics against which directors will be judged; we believe the targets of the scheme are appropriately stretching and that the scheme is aligned with shareholders' interests. The new scheme will require directors to genuinely add value through achieving very challenging out-performance targets.

Pensions and associated costs following 'A-day' Conclusion

A-Day is the name given to the new UK pension rules that came into effect from the 6 April 2006. The recent overhaul to the British pensions system that resulted is one of the most radical in the past fifty years prompting many companies to review their pension arrangements. It is Insight's view that if a company changes its executive pension arrangements, such changes should be cost-neutral to the company. Companies should not bear the costs of compensating directors (e.g. in the event of changes to personal tax rules). These issues have been raised at Brixton, which recently reviewed its pension provision. The review recommended that both executive directors should agree to cease to accrue future service benefits under the company's pension plan and should instead receive a cash supplement of 35% of base salary. We believe this change will be cost-neutral to Brixton but illustrates how expensive many existing defined-benefit arrangements are.

Remuneration is not a black and white issue. Investors must think carefully and use their judgement when deciding how to vote on remuneration issues, in order to ensure that what each company is proposing is appropriate to its specific circumstances. Nevertheless, the fact that there were fewer controversial votes during this year's busy proxy season demonstrates that, by and large, companies are improving their remuneration schemes and the processes by which they are established. We particularly welcome the fact that companies are consulting investors more often than in the past.

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