



Corporate engagement at Barings

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The importance of corporate engagement

As investment managers, we are charged to secure a satisfactory rate of return on the capital entrusted to us by our clients. We do this by providing companies with their risk capital, buying stocks and shares which we believe will outperform the broader market and deliver these returns to clients.

We assess these companies and decide which to invest in through a process of fundamental research. We assess the strength and likely duration of any earnings growth. We look at valuations and balance sheet strength. We look at the economic and competitive environment the company is operating in. Above all, we assess the management of the company, and whether we think it is run properly and in the interests of investors.

As long-term investors, corporate engagement is at the heart of what we do. It is particularly relevant for equity investing, where we will develop and maintain a purposeful dialogue on strategy, performance and the management of risk, but it is also an integral part of the investment process for sub-investment grade (or “high yield”) credit.

In our assessment of the risk factors, before making an investment in these asset classes we will take into account the corporate governance structure of the company; judging whether the structure could inhibit the delivery of good returns and whether the interests of the management are aligned with those of investors in the company.

We make use of an external agency, Institutional Shareholder Services (ISS) Voting Services to assist on our voting procedures. ISS gives recommendations which we assess and then we vote in accordance with what we believe to be in the best interests of our clients.

Building a dialogue with companies has been an essential part of investing since the first joint stock company was introduced centuries ago, and something we have always taken extremely seriously at Barings.

We were one of the first UK investment management groups to publish a statement on UK corporate governance issues in 1992, following the initial work by the Cadbury Committee. More recently, we welcome the publication of the UK Stewardship Code by the Financial Reporting Council.

The impetus for this came out of the Walker Review of corporate governance in 2009, as a means of increasing investor engagement. The Stewardship Code sits in parallel with the UK Corporate Governance Code for companies, and sets out good practice on engagement with investee companies and encourages owners of assets to work together, when appropriate, in the interests of shareholders.

This document sets out the principles we follow on corporate engagement, outlines our proxy voting policy, sets out the nature of our commitment to the UK Stewardship Code, and highlights some of the standards we set ourselves on corporate responsibility at Barings. Contact details for any further information can be found at the end of the document.

Baring Asset Management

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1. What is Corporate Engagement?

Corporate engagement describes the relationship we have with companies we are considering investing in or buying bonds from on behalf of our clients. This paper sets out the principles we follow on this area and our attitude towards corporate governance, a key aspect of corporate engagement.

2. Our Principles on Corporate Engagement

- 2.1. As long-term investors, we believe it is in the interest of clients for us to develop and maintain a purposeful dialogue with companies on strategy, performance and the management of risk.
- 2.2. For equities and sub-investment grade corporate bonds, our analysts assess corporate governance and social and environmental factors prior to investing. This means that we tend not to invest in companies where we consider corporate governance is poor.

When assessing corporate governance or social or environment factors for companies prior to investing, we will hold them to local standards. We do not believe it is appropriate for us to impose a particular set of cultural values on companies - indeed, trying to do so could make it more difficult for us to engage effectively with them.

- 2.3. Where we do identify concerns, our priority is the best interest of our clients. In most cases we will disinvest rather than remain invested in companies which we expect to underperform.

- 2.4. Where we wish to challenge company management on an issue, we will make our views known privately. We do not believe it is in the interest of our clients to engage in a public debate.

- 2.5. How we engage with other security holders to make our voice heard to company management depends upon local market practice and regulatory options, and is likely to be on matters of corporate governance rather than corporate strategy.

- 2.6. We recognise the importance of corporate governance by taking advice from one of the world's leading providers of corporate governance solutions, Institutional Shareholder Services (ISS). In the absence of an instruction from a client, we will request a recommendation on proxy votes from ISS. The decision is ours, but their expertise helps us make more informed decisions.

- 2.7. The decision to include or exclude specific companies or industries from the list of eligible stocks for an investment portfolio is for our clients. We do not believe it would be appropriate for us to try to impose a set of common ethical beliefs on a diverse international client base.

- 2.8. In many developed markets there are well established and widely recognised codes which set out best practice on corporate governance. We encourage companies to follow these, taking into account that what is right for a large company in one industry may not be appropriate for a small company in another. There is no "one size fits all" solution, but important areas for us include minority shareholder rights, appropriate board structures and transparency of accounts.



3. Our Proxy Voting Policy

We have appointed Institutional Shareholder Services (ISS), a third-party company, to advise us on proxy voting. As one of the world's leading providers of corporate governance solutions, they follow market best practice, codes and standards of corporate governance in providing us with proxy analyses and voting recommendations.

We review the recommendations of ISS, and from time to time we will challenge it. However, in most cases we agree with their guidance and will follow it, unless instructed otherwise by a client. This leads us to vote against resolutions put forward by the management of the company and to challenge their proposals. Further details on Institutional Shareholder Services, including the policies and guidelines they follow, can be found on their website, www.issgovernance.com.

To ensure accuracy and transparency of implementation we have established a global proxy voting policy at Barings. This applies to all portfolios we manage with the exception of clients' holdings of any mutual funds or other securities managed or advised by Barings or any other member of the MassMutual Group, unless we have received prior instruction from a client on how to vote that particular holding, and irrespective of whether we are voting in line with the recommendation from ISS. The roles and responsibilities of each party at Barings are set out in brief below.

ISS

Barings have contracted ISS to provide advice on voting duties, and to vote in accordance with that advice unless we instruct them otherwise. Our investment managers are sent the recommendations by our Global Events Department, and have the option to challenge any recommendation from ISS.

Investment managers

Investment managers at Barings have the option to propose that a vote does not follow the recommendation from ISS. In such instances, the investment manager must explain why he or she believes it is not in the economic interests of our clients to follow the recommendation. All such explanations have to be approved by the Proxy Voting Committee. We are also guided by clients' investment objectives. This means that we may vote for a proposition on behalf of some clients, and either abstain or be against it for others.

The Global Events Department

The Global Events Department collects proxy proposals from ISS, distributes these to investment managers, and maintains records of Barings' proxy votes, and the reasoning behind them. These are available for review by our clients.

The Proxy Voting Committee

The Proxy Voting Committee establishes and reviews Barings' global proxy voting policy. On request it will advise investment managers on unusual proxy proposals. It reviews and must approve the recommendations of investment managers who suggest casting proxy votes that are contrary to either ISS recommendations or Barings' policies. Finally, each quarter it reviews the operation of the Barings proxy voting policy.

The members of the Proxy Voting Committee are as follows:

- Team Leader – Global Events Department
- Head of Market Activities
- Head of Equities
- Head of Organisational Risk & Compliance
- Head of Investment Operations
- Head of Compliance and General Counsel (Boston)

4. Corporate engagement and fundamental research

Implementation of our principles comes in many different ways.

4.1. Fundamental research

A key part of Barings investment policy is the avoidance of stocks which significantly disappoint the market. Recognising the risks associated with poor corporate governance is one way to assist this process.

Stock research at Barings is also based around key measures of growth, valuation and an assessment of the ability of the management, including how well the company is run. We believe that corporate governance and social and ethically responsible investment issues can have an influence on each of these measures and therefore we give them due consideration when making our investment decisions.

The issues we consider as part of our fundamental research include the following:

Growth

Non-exploitative growth plans, and longevity of growth

Management

Any specific corporate governance issues

Management's awareness of employees, customers, the local community, suppliers and government.

Managing and regard for the company's reputation

Valuation

Suitable risk premium

4.2. Corporate bonds

We also conduct fundamental research when assessing the investment prospects for sub-investment grade corporate debt. The factors we look at are very similar to those we look at when assessing equities, although our perspective as a potential lender to these companies is inevitably slightly different to that of an equity investor, as our focus is on the ability of the company to repay the loan. An assessment of the corporate governance of the company and the potential impact of any social and ethically responsible investment issues is an important part of this.

4.3. Screening

In addition we recognise that there are other areas of potentially socially irresponsible activities by companies that may pose a concern for some clients including alcohol, tobacco, gambling and military activities. These differ from client to client and although we are happy to assist clients in developing a screened Socially Responsible Investment (SRI) policy, it is for the client to produce a list of excluded stocks or sectors independently and for the resulting restrictions to be factored into the performance benchmark.

4.4. Company visits

At Barings, each year we undertake an extensive programme of meeting company management. We consider this a key strength of our investment process and in many cases, is only possible because of our extensive experience of long-term investment in the particular asset class and the relationships we have developed with these companies over many years.

Many of these meetings are in our own offices, at which we will question management about the issues we consider important to us in our management of our clients assets. We use these meetings to gather information and help form views on areas we deem particularly important such as corporate strategy, management calibre etc.

Where appropriate, we may also use these opportunities to make our views known to management on areas such as corporate governance. There may be occasions where, for what ever reason, we are unable to obtain a meeting with management. In such cases we will utilise other means to ensure our views and concerns are reflected, such as talking to the company's nominated financial adviser or other shareholders.



5. The UK Stewardship Code

The UK Stewardship code was published by the Financial Reporting Council (FRC) in July 2010. It aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities by setting out good practice in engagement with investee companies. The UK Stewardship code can be seen as complementary to the UK Corporate Governance code for listed companies.

We are supportive of the UK Stewardship code at Barings, and the following sets out our policies and processes in response to its seven principles. Further information on the UK Stewardship code can be found on the Financial Reporting Council's website at <http://www.frc.org.uk/corporate>.

In framing our responses to this code we are mindful that we are a global asset manager. We take into account the requirements of the UK Corporate Governance code to all companies to which we provide risk capital, but we do not attempt to impose a one size fits all across the spectrum of companies nor across all markets. Indeed there are separate codes in many of the individual markets, and, in the case of many smaller companies, full compliance with established codes may be cumbersome, expensive, impractical and counter-productive. Furthermore, we recognise that there are elements in this that are intangible – management and their motivation – and therefore it is impossible to cover all circumstances.

For a full statement of our own values and beliefs, please refer to section 2 of this document.

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

This document sets out our policy. It is available on our website at www.barings.com, as a link in the “About Barings” section, under “Our investment approach”.

Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

Our conflicts of interest policy is also available on our website at www.barings.com, as a link in the “About Barings” section, under “Our investment approach”.

Principle 3: Institutional investors should monitor their investee companies.

Investee companies are monitored through the utilisation of a variety of research sources. Our investment approach means that we tend not to invest in companies with what we consider to be poor corporate governance. We aim to meet most companies we invest in on a regular basis.

By utilising ISS we monitor the resolutions put forward at annual and extraordinary meetings. We review their research and where we deem it to be in the interests of our clients vote with their recommendations. We vote against management resolutions where we believe that it is right to do so in the interest of our clients.

Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value

We think that establishing definitive guidelines is simply not practical, given the diverse nature of our client base and the markets we invest in. The process of escalation will depend upon local market practice and regulatory options. If governance does deteriorate then our first response is likely to be to sell the shares as the best means of protecting value for our clients. Companies with poor governance tend to be poor investments in our opinion. We may seek an alternative route of direct engagement or pro active voting where we have concerns about developments at the company but this is likely only in situations where we are unable to disinvest.

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.

Where there are governance issues which might be dealt with better on a collective basis then we will consider doing so. However we are very mindful of the regulatory background in various markets which may make this less than straightforward. Furthermore we are aware that other investors may have different priorities to ours, which is acting in the best interests of our clients. We also believe that it is counterproductive to engage in public debates which may harm client interests.

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.

Our policy is to vote at all meetings where practicable. We disclose how we have voted to our clients where requested.

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.

Our voting activity is reported to our clients where they request this. This document on corporate engagement, available on our website, will be updated as and when anything changes.

6. Socially Responsible Investing.

Our primary responsibility is to our clients. We will take into account environment and socially responsible investment issues where directed. We are conscious of the various shades of opinion on what constitutes good and bad practice, and hence seek guidance from clients.

If our research indicates that a company's approach to environmental, social and corporate governance could have an adverse impact on shareholder value, then we are unlikely to consider that company a good investment.

We have experience in working with KLD Analytics to screen for compliance with guidelines established by clients. KLD Analytics are owned by RiskMetrics Group (who in turn are owned by MSCI) and have one of the largest environment, social and governance teams in the industry, and specialise in the provision of corporate accountability, research and consulting services for many of the world's largest institutional money managers.

7. Investment in Sanctioned Countries

Barings will not invest in any company that is incorporated, headquartered or whose main stock exchange listing is in an internationally sanctioned country.

8. Corporate responsibility at Barings

We take corporate responsibility seriously at Barings. An employee's contribution as a good corporate citizen is formally recognised as part of the annual performance management review, and we actively encourage involvement with the local communities through our sports and social organisations.

We also have a range of initiatives to reduce our impact on the environment. These include energy efficient lighting and smart metering, active encouragement of recycling and the use of public transport to attend client meetings. Since 2003, Barings have taken part in the Clean City Awards Scheme in London. We are proud to have always received a Gold or higher award.

9. Further information

For further information on corporate engagement, please contact:

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10. Appendix: Key UK corporate governance issues

Many of the enquiries we receive tend to focus on the UK, which is also the subject of the UK Stewardship Code. To answer these questions we have outlined our thoughts on a few key areas of corporate governance in the UK below.

10.1. Directors

10.1.1. Board Structure

Company boards should be structured such that no single individual wields decision-making power in isolation. Whilst the qualities of entrepreneurial enthusiasm and conviction are important ingredients in a successful company, equally it is vital that there is strength in depth, teamwork and an understanding that whilst many heads are not always better than one, no single individual has a monopoly on wisdom.

10.1.2. Non-executive Directors

A strong, independent non-executive element to the board is essential. First this constitutes an important part of the checks and balances on the senior executives' decision-making. We acknowledge that a minimum of three non-executive directors may not be practical for all companies, but we believe that less than two non-executive directors is unhealthy.

The recommended roles of non-executive directors in audit and remuneration committees are sensible and to be encouraged. More importantly, through their distance from the day-to-day running of a company, non-executive directors have a vital role to play in challenging management to focus at all times on shareholder value and the generation of good returns on invested capital.

Guarding against dilution of this supreme executive responsibility through the pursuit of other goals – such as growth in size alone rather than as a means towards, and consequence of, high returns on capital – is a key role for non-executive directors.

10.1.3. Remuneration

The key in determining executive remuneration is to align the interests of management and shareholders. This has the best chance of making sure there is a common focus on the pursuit of good returns on capital and that corporate decisions are made for the long-term benefit of the company.

This alignment of interests is achieved most effectively by making managers shareholders. The primary route to wealth accumulation by directors should be through the growth in size of a shareholding which increases in value. Large cash payments through salary or bonus are substantially less attractive in achieving this aim.

Share option schemes may have their place, but the absence of direct participation in the downside of share ownership reduces their effective alignment with shareholders. Incentive schemes should be long-term in nature, encouraging share ownership over long periods through restrictions on sales over three year rolling periods, since frequent sales mean the concept of wealth accumulation through share ownership has not been accepted.

Schemes should be spread as widely as possible throughout the management and employees of a company, rather than confined to a few top individuals. Performance criteria should be sufficiently demanding to ensure that average performance is not generously rewarded. Total shareholder return is the preferred performance criteria, with some benchmark of comparable returns – be it a broad stock market index or a peer group of similar companies. Earnings or inflation based hurdles are flawed and less attractive. Long-term schemes will overcome shorter term stock market fluctuations in share ratings and reward superior performance.

10.1.4. Contracts

Board level compensation is a topic of considerable focus in the media today. Directors of public companies should recognise the ill-feeling that excessive awards engender both within the company and with its shareholders, particularly if unrelated to the performance of the company.

Rewards for failure are unacceptable, so it is important that directors' service contracts do not offer excessive security so that they are expensive to terminate in the event of management failure.

In the event of a hostile take-over bid for a company, we will, where we have confidence in the directors, provide management with an adequate opportunity to present their case before making a final decision in what we judge to be the best commercial interests of our clients.

10.2. Auditors

Directors should display the highest standards of integrity in their reporting to shareholders. It is critical that auditors, employed on behalf of the shareholders but in practice with day-to-day contact only with the company management rather than shareholders, should be mindful of their independent role on behalf of shareholders.

Accounting standards allow a degree of flexibility in the way in which events can be reported and auditors should encourage directors not to abuse that latitude. Auditors should be seen to act independently and whilst major accountancy practices may have other trading relationships with companies they audit it is important that this should not be seen to prejudice this independence.

Audit committees of non-executive directors have a useful role to play in ensuring that this is the case and seen to be the case. They should be encouraged to communicate with shareholders through their report and meetings to express their satisfaction or concerns.

10.3. Shareholders

10.3.1. Role, responsibilities

We recognise that shareholders have a role through the provision of risk capital to businesses which brings with it both rights and responsibilities. We strive to uphold the same high standards of integrity in our activities as investors on behalf of our clients, the ultimate shareholders, as we expect of directors and auditors.

We strive to ensure through our research a clear understanding of companies and the business fields in which they operate. We place great emphasis on our communications with company management and employees to build on our understanding of corporate aims, strategy and performance. We aim to ensure that company management enjoy meeting representatives of Barings, welcome us as shareholders and understand our aspirations for the investments we make.

If we have concerns about an issue of corporate strategy or a matter of Corporate Governance, we will always try to make contact directly or via a corporate broker to discuss our concerns. Equally, we recognise that shareholders differ in investment approaches and portfolio aspirations and so companies may face conflicting advice from shareholders.

10.3.2. Rights, dilution

We welcome opportunities to support capital raising by companies, but urge companies to have respect for their equity capital and for the rights of those who provide it.

We believe firmly that all shareholders should be treated equally and are not in favour of the existence of different classes of share with different rights. We are in favour of pre-emption rights for shareholders as a protection for the owners of a company against their shareholding being diluted. We will not normally support disapplication of these rights beyond 5% of the issued ordinary share capital in respect of an issue of shares for cash or 10% in respect of a vendor placing.

We are enthusiastic supporters of share buybacks as a means of creating value for shareholders through an efficient capital structure. We don't regard underwriting as a major source of value for client portfolios, so focus mainly on those shares we hold or wish to hold.

10.3.3. Voting

We believe that the exercise of voting rights is an important expression of shareholders' rights and recognition of shareholders' responsibilities. In 1992 we were one of the first UK fund management houses to seek our clients' authority to vote on their behalf on every occasion where it is possible to do so.

Effective 1st May 2006, Barings contracted ISS, a third party vendor to advise on our voting duties.

10.3.4. Comply or explain

The UK Corporate Governance Code works on a "comply or explain" basis. It recognises that an alternative to following a provision of the code may be justified.

Barings also recognises this and will take into account a company's explanation and their size, complexity and the nature of the risks and challenges it faces.



IMPORTANT INFORMATION

This document is approved and issued by Baring Asset Management Limited.



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