

11 February 2010

Strictly Private & Confidential

Lord Myners
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

16 FEB 2010

In Confidence

Dear Lord Myners

Thank you for your letter of 28 January regarding bank bonus payments and your interest in how we at Scottish Widows Investment Partnership (SWIP) engage with the banks and intend to reach voting decisions on their remuneration reports.

The UK has a history of strong corporate governance and engagement. This position is a reflection of the commitment of major institutional investors like SWIP and of shareholder bodies including the ABI and IMA to encouraging appropriate behaviour by UK listed companies. Our collective interest is in encouraging governance structures that are most likely to protect shareholder value and to drive long term sustainable growth.

In response to your enquiry regarding engagement activity, I can assure you that SWIP has committed considerable resource to discussion with banks. In particular we have engaged individually or collectively on remuneration (including 2009 bonus payments) with all the major banks listed in the UK with one exception (scheduled for next week).

The purpose of our engagement has been to understand not only the approach being taken to the issue of bankers' bonuses but also the challenges banks face in reaching their decisions. We are sensitive to the need for UK banks to balance remuneration decisions with the business necessity of retaining, and where necessary attracting, the talent required to generate sustainable performance. There is a real risk that uncompetitive remuneration structures would result in talent being lost to overseas banks (operating in the UK or elsewhere) or to outside the banking sector either at home or overseas. In this respect, we have been struck by the strength of concern from banks that there is a "first mover disadvantage" when setting bonuses in the current environment. SWIP's message has been that while we understand the retention issue, there is a need for restraint and reputational risk to those who propose unjustifiable bonus arrangements.

In our discussions we have encouraged banks to consider the fit of their proposals with the FSA remuneration code and with the drive to rebuild capital ratios. As contributors to the ABI remuneration guidelines, SWIP has for many years supported deferral, clawback and the payment of a significant proportion of any bonus in shares. We have been pleased by the consideration being given by banks' remuneration committees to these features. Our engagement has included discussion of the balance between short and long term reward and between fixed and variable pay. We are mindful, for example, that any bank that proposes bonuses at the low end of comparator group levels may have to increase longer term elements of remuneration in order to retain key personnel.

SWIP has also participated in collective engagement with UKFI to discuss the approach being taken to bonus payments at banks in which the government holds a significant stake. We have collectively made known to UKFI the sensitivity around dilution where large elements of share-based reward are being considered. Our experience suggests that UKFI understands the commercial aspects of bonus awards but will, like us, challenge the banks to explain why the levels to be announced are in shareholders' best interests.

I turn now to how SWIP intends to appraise the decisions that remuneration committees ultimately take when we come to vote on firms' remuneration reports.

We take an active approach to voting at all UK plc AGMs. As regards voting on banks' remuneration reports, our practice is to scrutinise the disclosures made by the companies and to consider the research produced by two governance research services, one of which we provide input to. We consider all aspects of remuneration including bonuses. We pay attention to the structure of the overall remuneration policy and consider the degree to which the detail is aligned with strategy.

At SWIP corporate governance is an integral part of our fund management process. As a result, our fund managers will be involved in decision-taking on voting and we will engage individually or collaboratively as necessary before finalising our voting decisions. We will judge each case on its merits, having regard to overall governance, strategy and performance. There will be full transparency regarding our final decisions as we will publish on our web site the voting instructions submitted.

In summary we have undertaken considerable engagement with banks regarding bonus payments and with UKFI. Our approach to voting on remuneration reports will be considered on a case-by-case basis and our votes will subsequently be a matter of public record.

In many ways the interests of all parties to the debate on bank bonus payments are aligned. We all want successful UK banks generating sustainable growth that are well placed to lend to customers and thereby benefit the economy. To achieve that goal our banks must pay commercial rates – but be disciplined in their approach to ensure that they pay no more.

Yours sincerely



Dean Buckley
Chief Executive Officer