

Take Note

MARCH 2004

Corporate governance and proxy voting at Russell

Russell recognises that corporate governance is a crucial issue confronting the investment industry. The Myrers Report and Higgs Review have resulted in an increased shareholder awareness of the difference between good and poor corporate governance and the role shareholders can play. Shareholders have a responsibility to monitor company management to exert their influence through the exercise of voting rights. Russell is an active shareholder. As such, we vote on all issues raised at company meetings. This paper summarises how we exercise these voting rights on your behalf.

What is proxy voting?

When purchasing shares in a company, an investor usually acquires the right to vote at company meetings on important issues. These issues include the election of directors, executive compensation arrangements and the approval or rejection of important policy matters, including the appointment of the company's auditor and the issuance of shares to make acquisitions.

Russell Funds hold shares on behalf of our clients and vote on shareholder issues on behalf of our clients. Hence the term 'proxy' - the authority to act for another.

What is Russell's policy on proxy voting?

Historically, the responsibility for voting the shareholdings of Russell Funds was delegated to the underlying investment managers within the Funds and implemented by the custodian of the Funds. We recently reviewed this procedure and determined that Russell would better serve you by taking the voting process in-house. In doing so, we are better positioned to promote good corporate governance through a single set of voting principles focused on maximising companies' long-term economic value. We believe that our voting principles are in your best interests and meet best practice fiduciary standards.

These principles are available for you to view on our extranet site - <http://investment.russell.com>.

Russell's Proxy Voting Guidelines are designed to implement these principles using the expertise of specialist providers of research and proxy voting services.

Russell has appointed Institutional Shareholder Services (ISS) to provide corporate governance research and proxy voting services to our funds. Through the appointment of ISS we also gain access to the expertise of the National Association of Pension Funds (NAPF) in the UK, who have concluded a joint venture with ISS. The joint venture leverages both companies' excellent reputations for quality research and informed recommendations.

When researching a company's proposal, ISS/NAPF will focus on issues such as:

- governance and financial performance
- board structure
- remuneration
- auditing and accounting disclosure
- shareholder relations.

In respect of socially responsible investing, Russell will vote for management's social, political or environmental proposals unless ISS/NAPF recommends a vote against, in which instance the proposal will be voted on a case by case basis. We will vote against company proposals for political party donations.

Printed copies of Russell's Proxy Voting Guidelines are available on request.

Russell's proxy voting procedure

Russell's Proxy Voting Committee routinely monitors voting recommendations from ISS/NAPF. Our managers will also contact Russell if they have a strong view on an upcoming corporate vote. This is particularly important in cases where our managers' recommendations may differ from those of ISS, or in the event that our principles do not specifically address a voting matter. In this situation, Russell's Proxy Voting Committee will review the manager's rationale, the recommendation of ISS, and Russell's guidelines before deciding how Russell Funds will vote. Russell will then instruct ISS to implement our decision.

Reporting to our clients

Our voting decisions will be available to all our clients. We offer client reporting on a quarterly basis, detailing information such as:

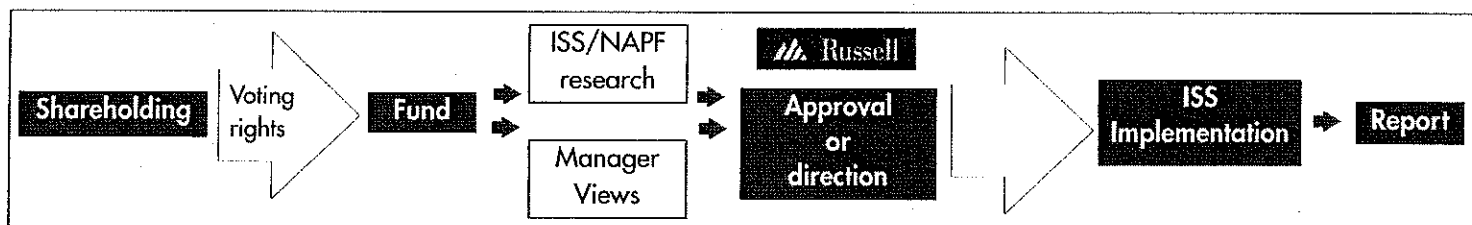
- date of the company meeting
- resolution to be voted
- whether the fund voted against a resolution, or abstained

The first of these reports will be available in the second quarter of 2004.

Summary

Corporate governance and the exercise of proxy voting rights are important issues and our clients can be assured that we are giving them serious attention. By combining of ISS and the NAPF's experience and research, together with our managers' views and our own corporate governance principles, we aim to ensure that we vote in the best interest of our clients on a globally consistent basis.

The proxy voting process



Russell Investment Group Proxy Principles

Introduction

Russell recognizes the requirements established in the US under the mutual fund proxy voting rules, the standards of best practices set up in the UK by the NAPF guidelines and in Australia by the ASX and IFSA corporate governance guidelines and other existing best practices and fiduciary standards, and on investment management concepts relating to promoting investor value. Russell has considered these rules, standards and concepts in establishing these Proxy Voting Principles and the Proxy Voting Guidelines designed to implement them. Proxy issues by their nature are often complex and fact dependent and both these Proxy Voting Principles and the Proxy Voting Guidelines are intended to be applied pragmatically

Principles

Through their corporate governance system, corporations specify the distribution of rights and responsibilities of all stakeholders. The governance system is the framework within which corporate activities are directed and controlled, through which objectives and guidelines for activity are set, and performance is monitored. Russell believes that the best interests of shareholders are served when corporate governance systems promote transparency of policy and action, accountability for results, board independence, and a maximization of the company's long-term economic value. Accordingly, we generally support proposals which increase transparency, improve accountability, ensure independence, and enhance long-term share value.

- **Transparency.** Shareholders are best able to gauge the value of and exercise their ownership when both corporate policies and actions are visible to them. Proposals which limit the ability of shareholders to see and evaluate mergers and acquisitions or evaluate tender offers are not transparent. Nor are policies which limit the ability of shareholders to reject poison pill defenses transparent. In general, any policy which improves the ability of shareholders to see into the activities of the firm are consistent with shareholders interests.
- **Accountability.** Shareholder interests are best served when management is accountable for corporate performance. Compensation plans which provide excessive compensation without suitable links to performance or which provide substantial payment for failure are against shareholder interest. Such payment should be tied to objective measures of company performance. Stock or stock options should be a significant enough source of executive compensation to align management interests with shareholders, and designed to tie management to the downside risk of stock performance.
- **Independence.** (a) Boards of Directors, Audit Committees, and Executive Compensation Committees should be sufficiently independent of the management and without personal or material financial relationships with the company or its managers to provide a reasonable check on management activity. The Board should be composed of at least a majority of these independent Directors and key committees such as audit, compensation, nominating, or governance committees should be composed exclusively of independent Directors. There should be adequate disclosure of all ties between Board members, the company and company management. (b) The company's auditors should be independent of the company. (c) The company's investment managers should be given instructions to vote shareholder proxies in the sole interest of shareholders.
- **Long-term value.** Good governance will keep a company focused on the creation of long-term value. Policies and structures which enhance that focus will benefit both shareholders and other stakeholders in the firm. When a company becomes focused on short-term profits, current earnings forecasts, or analysts estimates, good governance may be jeopardized and the fundamental soundness of the business may be compromised. Russell believes that the pursuit of goals without direct economic impact can often enhance shareholder or stakeholder interests. However, the pursuit of these types of objectives may also create conflicts between groups of stakeholders that are difficult to resolve. Accordingly, Russell assesses the short-term and long-term impact of an issue, and considers positions that are consistent with the long-term economic best interests of shareholders.