

Corporate Governance Overview

1. Financial Institutions – Remuneration Code and disclosure on remuneration

The Financial Services Authority ('FSA') introduced its Policy Statement on remuneration on 12 August 2009; this applied to the largest banks, building societies and broker dealers with effect from 1 January 2010. The FSA announced on 29 July 2010 that with the introduction of the Capital Requirements Directive ('CRD 3') and the Financial Services Act 2010, it would be updating its Remuneration Code in order to be compliant with the remuneration requirements under CRD 3 by 1 January 2011. The consultation on updating the Remuneration Code closed on 8 October 2010 and the finalised version of the code was published on 17 December 2010. The new code is effective as from 1 January 2011 and applies to relevant firms, which include all banks, building societies, Capital Adequacy Directive investment firms.

Firms who were required to comply with the original version of the code are required to comply in full with the new code as from 1 January 2011. For other firms who are having to comply with the new code for the first time, there are transitional rules in place, but such firms are expected to comply as soon as reasonably possible and certainly no later than 31 July 2011.

Concurrently to updating the Remuneration Code, the FSA has also published new rules implementing CRD3's requirements on disclosure of remuneration. Under these rules, firms will be required to disclose information on their remuneration policies and pay-outs. The FSA consulted on this in a separate consultation paper published on 10 November 2010. The majority of respondents agreed with the FSA's approach and as such:

- Firms will need to disclose details of their remuneration policies at least on an annual basis.
- The FSA will require firms to make their first disclosure in respect of 2010 remuneration as soon as practicable, and no later than 31 December 2011.
- Proportionality will be applied on the basis of the FSA's four tiers. Firms in the top tier will need to make full disclosure, while firms in lower tiers will be subject to less onerous requirements.

http://www.fsa.gov.uk/pages/Library/Policy/Policy/2010/10_20.shtml

http://www.fsa.gov.uk/pages/Library/Policy/Policy/2010/10_21.shtml

2. The AIC Code of Corporate Governance and the AIC Corporate Governance Guide for Investment Companies

The Association of Investment Companies ('AIC') published on 14 October 2010 for investment companies its code of corporate governance (the 'AIC Code') and its corporate governance guide (the 'AIC Guide').

The AIC is the member organisation for closed-ended investment companies, which represents a broad range of closed-ended investment companies, incorporating investment trusts, offshore investment companies and venture capital trusts which are traded on the London Stock Exchange, AIM, Specialist Fund Market and NYSE Euronext.

The AIC Code is based on the UK Corporate Governance Code and the AIC Guide is a comprehensive guide on corporate governance for investment companies. The AIC Guide aims to bring together the requirements and recommendations from the UK Corporate Governance Code, the AIC Code and, where relevant to the governance of investment companies, the Listing Rules.

This AIC Guide sets out each main principle of the UK Corporate Governance Code, along with its supporting principles and provisions, and describes their relevance and applicability to investment companies. It also sets out the AIC Code and demonstrates how the AIC Code translates each element of the UK Corporate Governance Code into principles and recommendations specific to investment companies.

Both the AIC Code and AIC Guide are endorsed by the Financial Reporting Council ('FRC').

Only AIC member companies are permitted to state publicly that they adhere to the AIC Code and follow the AIC Guide. The principles of the AIC Code are:

The Board

1. The Chairman should be independent.
2. A majority of the Board should be independent of the fund manager or managing company.
3. Directors should be submitted for re-election at regular intervals. Nomination for re-election should not be assumed but be based on disclosed procedures and continued satisfactory performance.
4. The Board should have a policy on tenure, which is disclosed in the annual report.
5. There should be full disclosure of information about the Board.
6. The Board should aim to have a balance of skills, experience, length of service and knowledge of the company.
7. The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.
8. Director remuneration should reflect their duties, responsibilities and the value of their time spent.
9. The independent directors should take the lead in the appointment of new directors and the process should be disclosed in the annual report.

10. Directors should be offered relevant training and induction.
11. The Chairman (and the Board) should be brought into the process of structuring a new launch at an early stage.

Board meetings and the relationship with the manager

12. Boards and managers should operate in a supportive, co-operative and open environment.
13. The primary focus at regular Board meetings should be a review of investment performance and associated matters such as gearing, asset allocation, marketing/investor relations, peer group information and industry issues.
14. Boards should give sufficient attention to overall strategy.
15. The Board should regularly review both the performance of, and contractual arrangements with, the manager (or executives of a self-managed company).
16. The Board should agree policies with the manager covering key operational issues.
17. Boards should monitor the level of the share price discount or premium (if any) and, if desirable, take action to reduce it.
18. The Board should monitor and evaluate other service providers.

Shareholder communications

19. The Board should regularly monitor the shareholder profile of the company and put in place a system for canvassing shareholder views and for communicating the Board's views to shareholders.
20. The Board should normally take responsibility for, and have a direct involvement in, the content of communications regarding major corporate issues even if the manager is asked to act as spokesman.
21. The Board should ensure that shareholders are provided with sufficient information for them to understand the risk:reward balance to which they are exposed by holding the shares.

<http://www.theaic.co.uk/Documents/Technical/AICCodeofCorporateGovernance2010.pdf>

<http://www.theaic.co.uk/Documents/Technical/AICCorporateGovernanceGuide2010.pdf>

3. Stewardship Code

The Stewardship Code was adopted by the FRC on 2 July 2010.

The Code applies to firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles. They should disclose, ideally on their website, their commitment to the Stewardship Code, or state, where they do not commit to the Code, their alternative business models. The FRC has also published guidance on the implementation of the Code.

With effect from 6 December 2010, it is an FSA requirement for member firms (other than venture capital firms), which manage investments for professional clients who are not natural persons, to make the above-mentioned disclosures.

The principles of the Code are that financial institutions should:

- Publicly disclose the policy as to how the stewardship responsibilities will be discharged.
- Have a robust policy in place, which is publicly disclosed, on managing conflicts of interest in relation to stewardship.
- Monitor investee companies.
- Establish clear guidelines on when and how activities will be escalated as a method of protecting and enhancing shareholder value.
- Be willing to act collectively with other investors where appropriate.
- Have a clear policy on voting and disclosure of voting activity.
- Report periodically on stewardship and voting activities.

The National Association of Pension Funds ('NAPF') published on 30 September 2010 a statement of support to the Code and on 29 November 2010 its guidelines for complying with the Code.

Pensions and Investment Research Consultants ('PIRC') whilst it is not a shareholder itself, it believes that due to its work of providing advice to institutional investors, in particular, voting and engagement services, it too is subject to the Code. PIRC has published how it complies with the Code.

AIC has also produced a short paper for its member companies to comply with the Code.

<http://www.frc.org.uk/corporate/investorgovernance.cfm>

http://fsahandbook.info/FSA/handbook/LI/2010/2010_57.pdf

http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~media/Documents/NAPF%20Policy%20Documents/0144_Statement_of_Support_of_the_Stewardship_Code_300910.ashx

http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~media/Documents/NAPF%20Policy%20Documents/0153_Stewardship_Code_Guidance_for_Investors_2010_261110.ashx

<http://www.pirc.co.uk/sites/default/files/Stewardship%20Code.pdf>

<http://www.theaic.co.uk/Documents/Technical/AICguidanceonStewardshipCodeJuly2010.pdf>

4. UK Corporate Governance Code

The UK Corporate Governance Code applies to companies whose equity shares are listed on the London Stock Exchange with a Premium Listing for financial years beginning on or after 29 June 2010.

Companies are expected to comply with the Code or explain why not. The Code should not be seen as a rigid set of rules. Shareholders and analysts are encouraged to be subjective when considering a company's governance arrangements, as a departure from the Code may well be justifiable and should not be considered as a direct breach of the Code, although each side should be open to discuss the position. Further, in an attempt to avoid 'boiler-plate' disclosures, the Chairman is encouraged to report personally in the annual report on the how the principles relating to Leadership and Effectiveness of the Board have been applied.

NAPF published its Corporate Governance Policy and Voting Guidelines 2010 on 30 November 2010. The Guidelines have been updated and reflect the format of the Code, which NAPF endorses in its entirety. The NAPF has stated that a Board should give a clear explanation where a company is not in compliance with the Code and that investors should be prepared to listen to such explanations, although 'boiler-plate' explanations should not be accepted. Good corporate governance is a matter of principle and nuance, not dogma.

Whilst companies are not required to comply with the Code until financial years beginning on or after 29 June 2010 (in practice for most companies this will be for the financial year ending 31 December 2011 and the 2012 AGM), NAPF has stated that it would encourage companies to consider early application of the Code.

PIRC has already noticed an early uptake by companies, not just within FTSE 350, for the annual re-election of directors, with some companies amending their articles of association to be consistent with the Code's requirement for the annual re-election of directors.

The NAPF has suggested using tactical voting, such as voting against or abstaining on resolutions for the receiving of the reports and accounts, the remuneration report and the re-appointment of a director (especially the chairman or the chairman of the relevant committee), in order to signify displeasure with non-compliance with a particular aspect of the Code. However, NAPF recommends only using tactical voting as a last resort, where attempts to discuss concerns with the company have not resulted in satisfactory explanations being received. The NAPF also reminds shareholders to be wary that tactical voting might exacerbate the situation which they seek to remedy.

The principles of the Code are:

Section A: Leadership

- There should be an effective Board, which is collectively responsible for the long-term success of the company.
- Clear division of responsibilities between running the Board and the executive responsibility for running the business.
- No individual should have unfettered powers of decision.
- Chairman responsible for leading the Board and ensuring its effectiveness.
- Non-executive directors should constructively challenge and help develop proposals on the strategy.

Section B: Effectiveness

- Boards and their committees should have appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their duties and responsibilities effectively.
- Process for appointing new directors should be formal, rigorous and transparent.
- Each director should allocate sufficient time to the company to discharge his or her responsibilities effectively.
- Each director should receive induction on being appointed and regularly update and refresh his or her skills and knowledge.
- Information supplied to the Board should be received timely and of appropriate quality in order that it can discharge its duties.
- A formal and rigorous annual evaluation of the Board, its committees and individual directors should be undertaken. In the case of FTSE 350 companies, this should be externally facilitated once every three years.
- All directors should stand for re-election at regular intervals, subject to continued satisfactory performance. In the case of FTSE 350 companies, each director should stand for annual re-election.

Section C: Accountability

- The Board should present a balanced and understandable assessment of the company's position and prospects.
- The Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives.
- The Board should maintain sound risk management and internal control systems.
- The Board should establish formal and transparent arrangements for how it will apply corporate reporting, risk management and internal control principles and for maintaining relations with the company's auditor.

Section D: Remuneration

- Remuneration should be sufficient to attract, retain and motivate directors of the quality to run the company, but should not be more than is necessary for this purpose.
- A significant proportion of executive directors' remuneration should be structured to link rewards to corporate and individual performance.

- The process for developing the policy on executive remuneration and setting remuneration packages of individual directors should be formal and transparent.
- No individual should be involved in determining his or her own remuneration.

Section E: Relations with Shareholders

- The Board collectively is responsible for ensuring that there is satisfactory dialogue between the company and its shareholders based on a mutual understanding of the objectives.
- AGMs should be used to communicate with investors and their participation should be encouraged.

<http://www.frc.org.uk/corporate/ukcgcode.cfm>

http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0154_Corporate_governance_policy_and_voting_guidelines_2010.aspx

<http://www.pirc.co.uk/news/more-plcs-adopt-annual-elections>

5. Corporate Governance Guidelines for Smaller Quoted Companies

The Quoted Companies Alliance ('QCA') published in September 2010 its new corporate governance guidelines for all smaller quoted companies (ie companies that have a Standard Listing on the London Stock Exchange or are listed on AIM or PLUS). The guidelines are:

Flexible, efficient and effective management:

1. **Structure and process:** The company should put in place the most appropriate governance methods, based on its corporate culture, size and business complexity. There should be clarity on how it intends to fulfil its objectives and, as the company evolves, so should its governance.
2. **Responsibility and accountability:** It should be clear where responsibility lies for the management of the company and for the achievement of key tasks. The Board has a collective responsibility for the long-term success of the company and the roles of the Chairman and the Chief Executive should not be exercised by the same individual.
3. **Board balance and size:** The Board must not be so large as to prevent efficient operation. A company should have at least two independent non-executive directors (one of whom may be the Chairman provided he or she was deemed independent at the time of appointment) and the Board should not be dominated by one person or a group of people.
4. **Board skills and capabilities:** The Board must have an appropriate balance of functional and sector skills and experience available to it in order to make key decisions and plan for the future. The Board should be supported by committees (audit, remuneration and nomination) that have the necessary character, skills and knowledge to discharge their duties and responsibilities effectively.

5. **Performance and development:** The Board should periodically review its performance, its committees' performance and that of individual Board members. This review should lead to updates of induction, evaluation and succession plans. Ineffective directors (both executive and non-executive) must be identified and either helped to become effective, or replaced. The Board should ensure that it has available the skills and experience it needs for its present and future business needs. Membership of the Board should be periodically refreshed.
6. **Information and support:** The whole Board and its committees should be provided with the best possible information (accurate, sufficient, timely and clear) so that they can constructively challenge recommendations made to them before making their decisions. Non-executive directors should be provided with access to external advice when necessary.
7. **Cost-effective and value-added:** There will be a cost in achieving efficient and effective governance; however, this should be offset by increases in value. There should be a clear understanding between Boards and shareholders of how this value has been added. This will normally involve the publication of key performance indicators, which align with strategy and feedback through regular meetings between shareholders and directors.

Entrepreneurial management:

8. **Vision and strategy:** There should be a shared vision of what the company is trying to achieve and over what period, as well as an understanding of what is required to achieve this ambition. This vision and direction must be well communicated, both internally and externally.
9. **Risk management and internal control:** The Board is responsible for maintaining a sound system of risk management and internal control. It should define and communicate the company's risk appetite, and how it manages its key risks, while maintaining an appropriate balance between risk management and entrepreneurship. Remuneration policy should help the company to meet its objectives whilst encouraging behaviour that is consistent with the agreed risk profile of the company.

Delivering growth in shareholder value over the longer term:

10. **Shareholders' needs and objectives:** A dialogue should exist between shareholders and the Board so that the Board understands shareholders' needs and objectives and their views on the company's performance. Vested interests should not be able to act in a manner contrary to the common good of all shareholders.
11. **Investor relations and communications:** A communication and reporting framework should exist between the Board and all shareholders, such that shareholders' views are communicated to the Board and shareholders in turn understand the unique circumstances of, and any constraints on, the company.

12. **Stakeholder and social responsibilities:** Good governance includes a response to the demands of corporate social responsibility ('CSR'). This will require the management of social and environmental opportunities and risks. A proactive CSR policy as an integral part of the company's strategy can help create long-term value and reduce risk for shareholders and other stakeholders.

<http://www.theqca.com/shop/guides/>

6. **Corporate Governance Guidance – Principles for unlisted companies in Europe and the UK**

Whilst unlisted companies are only obliged to comply with company law and other legislation and, if applicable, the regulatory rules of their particular industry (such as the FSA etc), this does not detract from the fact that successful companies are well managed and governed.

Considering that in excess of 75% of Europe's Gross Domestic Product is due to unlisted companies, the European Confederation of Directors' Associations ('ecoDa') published in March 2010 voluntary guidance on the principles of corporate governance for unlisted companies in Europe (the 'European Guidance').

Dr Roger Barker, Head of Corporate Governance at the Institute of Directors, who was on the working group and a major contributor to the European Guidance has adapted it for UK unlisted companies. The UK Guidance was published in November 2010.

The principles in both the European Guidance and the UK Guidance are the same and are not too dissimilar to those of the UK Corporate Governance Code, are:

For all unlisted companies:

1. Shareholders should establish an appropriate constitutional and governance framework for the company.
2. Every company should strive to have an effective Board, collectively responsible for the long-term success of the company, including articulating the corporate strategy. An interim step to achieving this could be creating an advisory board.
3. Board size and composition should reflect the scale and complexity of the company's activities.
4. The Board should meet regularly to discharge its duties and be supplied with appropriate information in a timely manner.
5. Remuneration should be sufficient to attract, retain and motivate executives and non-executives of the quality required for the company to be run successfully.

6. The Board is responsible for risk oversight and should maintain an effective system of internal control to safeguard the shareholders' investments and the company's assets.
7. The Board, as a whole, should ensure there is satisfactory dialogue between the Board and the shareholders based on mutual understanding of objectives and that all shareholders are treated equally.
8. Directors should receive induction training on appointment and should regularly update and refresh their skills and knowledge.
9. Family-controlled companies should establish family governance mechanisms that promote co-ordination and mutual understanding within the family, as well as to delineate between family matters (such as continuity, income, transmission on death) and corporate matters (operational and business matters).

For large and/or more complex unlisted companies:

10. No individual should have unfettered powers of decision. There should be clear delineation of the responsibilities for running the Board and running the company's business.
11. The Board should comprise directors of sufficient mix of skills and experiences. There should be no single person or faction that dominates the Board's decision making.
12. Appropriate Board committees should be established for the Board to discharge its duties effectively.
13. There should be periodic appraisal of both the Board's performance and that of each director.
14. The Board should prepare a balanced and understandable assessment of the company's position and prospects to the external stakeholders and establish a suitable programme of stakeholder engagement.

https://www.iod.com/MainWebsite/Resources/Document/policy_article_corp_gov_unlisted_companies_eu.pdf

http://www.iod.com/MainWebsite/Resources/Document/corp_gov_guidance_and_principles_for_unlisted_companies_in_the_uk_final_1011.pdf

7. ICSA Review of the Higgs Guidance on behalf of the FRC – Improving Board Effectiveness

The second stage of the consultation on the guidance closed on 14 October 2010 and will provide guidance on how companies can improve their governance arrangements. Whilst it had been hoped that the finalised guidance would be published in December 2010, this has been delayed due to the FRC's Corporate Governance Committee now considering the guidance at its January 2011 meeting.

The guidance covers:

- Role of the Board
- Role of the Chair
- Role of the Senior Independent Director
- Role of Executive Directors
- Role of Non-Executive Directors
- Role of Company Secretary
- Decision-Making
- Board Composition
- Directors' Induction and Development
- Board Evaluation
- Communication with Shareholders and Stakeholders

<http://www.icsa.org.uk/policy-guidance/consultations/improving-board-effectiveness>

8. FRC to explore best practice by UK Company Boards in determining and managing their level of risk

The FRC released a press notice on 22 December 2010 announcing its intention to explore how companies are responding to the UK Governance Code's provision on the Board's responsibilities for risk. This will involve meetings with Board chairs, as well as the chairs of audit and risk committees, executives, investors and advisers. Following such meetings, the FRC will consider whether any amendments are required to be made to the Turnbull Guidance on risk management and internal controls.

Questions that the FRC will ask are:

- What are the respective roles of the Board, Board committees and management, and how do they interact? Where does oversight end and operational management begin?
- How are Boards determining their appetite for risk?
- What are the risks that the Board needs to 'own'?
- What information and advice do the Board and audit committee need to carry out their responsibilities?
- How do Boards obtain confidence that the risk management and internal control system function effectively at operational level?
- How do Boards report effectively on these issues to shareholders?

<http://www.frc.org.uk/press/pub2479.html>

9. Narrative Reporting - Consultation

- Consultation closed on 19 October 2010 and a response is now awaited from the government.
- Narrative reporting covers: Directors' report, including the business review, Reports of the Chairman and CEO, Directors' Remuneration Report and Corporate Governance Disclosures.

- All companies other than small companies are currently required to prepare a business review.
- Government's intention to reinstate elements of the Operating & Financial Review.
- Proposal to introduce a shareholders' advisory vote on the business review.
- Other non-statutory measures, such as bench marking of companies, may be introduced to improve quality and transparency of reporting.

<http://www.bis.gov.uk/Consultations/the-future-of-narrative-reporting-a-consultation?cat=closedawaitingresponse>

10. A Long-Term Focus for Corporate Britain: A Call for Evidence

On 25 October 2010 the Secretary of State for Business, Vince Cable, launched the first stage of a review into corporate governance and economic short-termism by issuing a call for evidence. The review aims to establish whether there are further issues affecting the functioning of capital markets and, if so, what are the causes. It considers the role of directors and shareholders and asks fundamental questions; for example, about shareholder engagement, market short-termism and the functioning of the investment chain in the UK. It also considers directors' remuneration and the economic case for takeovers.

The call for evidence closes on 14 January 2011.

The questions in the call for evidence are:

The Board of Directors

1. Do UK boards have a long-term focus – if not, why not?
2. Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?

Shareholders' role in equity markets

3. What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?
4. What are the most effective forms of engagement?
5. Is there sufficient dialogue within investment firms between managers with different functions (i.e. corporate governance and investment teams)?
6. How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publicly how they have voted?
7. Is short-termism in equity markets a problem and, if so, how should it be addressed?

8. What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?
9. Are there agency problems in the investment chain and, if so, how should they be addressed?
10. What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?

Directors' remuneration

11. What are the main reasons for the increase in directors' remuneration? Are these appropriate?
12. What would be the effect of widening the membership of the remuneration committee on directors' remuneration?
13. Are shareholders effective in holding companies to account over pay? Are there further areas of pay, e.g. golden parachutes, it would be beneficial to subject to shareholder approval?
14. What would be the impact of greater transparency of directors' pay in respect of:
 - linkage between pay and meeting corporate objectives;
 - performance criteria for annual bonus schemes;
 - relationship between directors' pay and employees' pay?

Takeovers

15. Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?
16. Should the shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?

<http://www.bis.gov.uk/Consultations/a-long-term-focus-for-corporate-britain?cat=open>

Links to other sites

Association of British Insurers (Institutional Voting Information Service) Guidelines:

<http://www.ivis.co.uk/Guidelines.aspx>

Basel Committee on Banking Supervisions – Principles for enhancing corporate governance:

<http://www.bis.org/publ/bcbs176.htm>

Department for Business Innovation and Skills:

www.bis.gov.uk

Financial Reporting Council:

www.frc.org.uk

Financial Services Authority:

www.fsa.gov.uk

Institute of Chartered Secretaries and Administrators:

www.icsa.org.uk

International Corporate Governance Network's Best Practice:

<http://www.icgn.org/best-practice/>

Manifest:

<http://www.manifest.co.uk>

National Association of Pension Funds:

www.napf.co.uk

Organisation for Economic Co-operation and Development's Principles of Corporate Governance:

http://www.oecd.org/document/49/0,3343,en_2649_34813_31530865_1_1_1_1,00.html

Pensions Investment Research Consultants:

<http://www.pirc.co.uk>

Pre-Emption Group:

<http://www.pre-emptiongroup.org.uk>

United Nations Principles for Responsible Investment:

www.unpri.org