



The Association of Investment Companies

Corporate Governance Guide for Investment Companies

Incorporating the Combined Code, the
AIC Code of Corporate Governance[©] and
certain requirements of the Listing Rules

March 2009

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Introduction

The AIC Corporate Governance Guide for Investment Companies (AIC Guide) is a comprehensive guide on corporate governance for Member companies of the Association of Investment Companies (AIC) which brings together the relevant requirements and recommendations from the Combined Code on Corporate Governance (Combined Code), the AIC Code of Corporate Governance® (AIC Code) and the Listing Rules. The guide will be useful for directors, company secretaries, managers and advisers to the investment company industry who deal with corporate governance compliance and implementation issues.

This guide sets out each main principle of the Combined Code, along with its supporting principles and provisions, and describes their relevance and applicability to investment companies. It also demonstrates how the AIC Code translates each element of the Combined Code into principles and recommendations suitable to the industry's unique structure. In addition it highlights specific corporate governance requirements contained in the Listing Rules which are relevant to Member companies. A separate section of the AIC Guide explains the disclosure requirements for making corporate governance statements.

This is the second version of the AIC Guide and has been produced in conjunction with the publication of the fourth edition of the AIC Code. The purpose of the AIC Code is to provide boards of our Member companies with a framework of best practice in respect of the governance of investment companies. It is intended to create a one-stop approach to corporate governance which deals with all the issues relevant to investment companies and enables boards to satisfy their responsibilities under the Combined Code. We recommend that users of this guide also refer to the separate AIC Code. The final section of the AIC Guide summarises the changes which have been made in the latest version of the AIC Code.

The preamble to the Combined Code explains that investment companies typically have unique board structures which mean that not all of its provisions are appropriate. It confirms that the AIC Code and the AIC Guide can be used to assist boards in meeting their Listing Rules obligations in relation to the Combined Code. The FRC, the body responsible for the Combined Code, has confirmed that AIC Member companies who report against the AIC Code and who follow the AIC Guide will be meeting their obligations in relation to the Combined Code and associated disclosure requirements of the Listing Rules. Page 5 contains a letter of endorsement from the FRC to this effect.

AIC Member companies may also make a statement in their corporate governance report that, by reporting against the AIC Code and by following the AIC Guide, they are meeting their obligations under the Combined Code and as such do not need to report further on issues contained in the Combined Code which are irrelevant to them. Suggested wording for this statement can be found in Appendix 2.

We hope that you find this guide useful.



Ian Sayers, Director General on behalf of the AIC Board

FRC Endorsement

Endorsement from the Financial Reporting Council in relation to reporting against the AIC Code and the AIC Guide as a way of fulfilling the requirements of the Combined Code and paragraph 9.8.6 of the Listing Rules

On 3rd February 2006, the Financial Reporting Council first confirmed that Member companies who report against the AIC Code of Corporate Governance and who follow the AIC's Corporate Governance Guide for Investment Companies will be meeting their obligations in relation to the Combined Code and paragraph 9.8.6 of the Listing Rules. On 20 February 2009 the FRC provided the AIC with an updated endorsement letter to cover the fourth edition of the AIC Code. The FRC's letter of endorsement is shown on page 5.

In our view, this endorsement means that AIC Member companies who report against the AIC Code and who confirm that they follow the AIC Guide will be able to cover, in their corporate governance report, all the issues which the AIC Guide describes as being irrelevant for investment companies within one simple sentence. This sentence would explain that all the issues on which they do not report in detail are excluded because they deem them to be irrelevant to their company as explained in the AIC Guide. The particular areas which the AIC Guide identifies as being irrelevant and which therefore can be covered in this way include (with the exception of self-managed investment companies) the role of chief executive, executive directors' remuneration and the need for an internal audit function.

The AIC has produced a preamble, which Member companies can use in their corporate governance reports when using the AIC Code. This preamble helps investors to recognise that Members reporting against the AIC Code have fulfilled their Listing Rules obligation to confirm that their corporate governance report represents a description of how they have applied the provisions of the Combined Code. This preamble can be found in Appendix 2.



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20th February 2009

Dear Daniel,

Thank you for sending us copies of the updated AIC Code of Corporate Governance and Corporate Governance Guide for Investment Companies.

I welcome the changes to the AIC Code and Guide that reflect the changes made to the Combined Code last year relating to the composition of the audit committee and the chairmanship of FTSE 100 companies, and the amendment to Principle 9 of the AIC Code which reflects the wording of Section A.4.1 of the Combined Code. The changes you have made ensure that the two Codes continue to be consistent.

I can confirm that it remains the FRC's view that by following the AIC Corporate Governance Guide investment company boards should fully meet their obligations in relation to the Combined Code and Paragraph LR 9.8.6 of the Listing Rules.

Yours sincerely,

A handwritten signature in blue ink that reads 'Chris Hogg'.

SIR CHRISTOPHER HOGG

Chairman

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Summary requirements

The following table lists the main principles of the Combined Code and matches these with the corresponding principles in the AIC Code. This is a summary table and is designed to provide an overview of the corporate governance regime for investment companies. The 'Detailed Requirements' section of this guide on pages 12 to 44 contains more detailed analysis.

Combined Code principles

Directors

The board

Every company should be headed by an effective board, which is collectively responsible for the success of the company. (A.1)

AIC Code principles

The following AIC principles cover the role of the board of an investment company:

Boards should give sufficient attention to overall strategy. (14)

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. (13)

Boards should monitor the level of the share price discount or premium (if any) and, if desirable, take action to reduce it. (17)

Boards and managers should operate in a supportive, co-operative and open environment. (12)

Combined Code principles

Directors (continued)

Chairman and chief executive

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision. (A.2)

Board balance and independence

The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking. (A.3)

Appointments to the board

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. (A.4)

AIC Code principles

With the exception of self-managed companies, executive responsibility for an investment company lies with the investment management company. The following AIC principle addresses the relationship between the board and the management company:

The board should agree policies with the manager covering key operational issues. (16)

The following AIC principles address board balance and independence for investment companies:

The chairman should be independent. (1)

A majority of the board should be independent of the manager. (2)

The board should aim to have a balance of skills, experience, ages and length of service. (6)

There should be full disclosure of information about the board. (5)

Specific Listing Rules requirements also deal with independence between the board and the investment management company (see page 23).

The following AIC principles deal with the appointment of directors to an investment company board:

The independent directors should take the lead in the appointment of new directors and the process should be disclosed in the annual report. (9)

The chairman (and the board) should be brought into the process of structuring a new launch at an early stage. (11)

Combined Code principles

Directors (continued)

Information and professional development

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge. (A.5)

Performance evaluation

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. (A.6)

Re-election

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the board. (A.7)

AIC Code principles

The equivalent AIC principle is:

Directors should be offered relevant training and induction. (10)

The same principle is included in the AIC Code.

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. (7)

The AIC Code also contains the following principles regarding performance evaluation:

The board should regularly review both the performance of, and contractual arrangements with, the manager (or executives of a self-managed company). (15)

The board should monitor and evaluate other service providers. (18)

There is a specific Listing Rule which requires disclosure regarding the continuing appointment of the investment manager on the terms agreed (see page 29).

The AIC Code contains the following principles regarding re-election:

Directors should be elected for a fixed term of no more than three years. Nomination for re-election should not be assumed but be based on disclosed procedures. (3)

The board should have a policy on tenure, which is disclosed in the annual report. (4)

Combined Code principles

Remuneration

The level and make-up of remuneration

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance. (B.1)

Procedure for setting directors' remuneration

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration. (B.2)

AIC Code principles

Remuneration issues for investment company boards are covered in the following AIC principle:

Director remuneration should reflect their duties, responsibilities and the value of their time spent. (8)

Accountability and audit

Financial reporting

The board should present a balanced and understandable assessment of the company's position and prospects. (C.1)

The equivalent AIC principle is:

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. (21)

Internal control

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets. (C.2)

AIC principle 16 (covering operational issues with the manager) and principle 18 (covering evaluation of other service providers) and their recommendations are relevant here.

Combined Code principles

Accountability and audit (continued)

Audit committee and auditors

The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors. (C.3)

Relations with shareholders

Dialogue with institutional shareholders

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. (D.1)

Constructive use of the AGM

The board should use the AGM to communicate with investors and to encourage their participation. (D.2)

AIC Code principles

AIC principle 16 (covering operational issues with the manager) and principle 18 (covering evaluation of other service providers) and their recommendations are relevant here.

Relationships with shareholders of investment companies are covered in the following AIC principles:

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. (19)

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. (20)

AIC principle 19 is relevant here.

Combined Code principles

Institutional shareholders

Dialogue with companies

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives. (E.1)

Evaluation of governance disclosures

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention. (E.2)

Shareholder voting

Institutional shareholders have a responsibility to make considered use of their votes. (E.3)

AIC Code principles

Outside the scope of the AIC Code

Detailed requirements

This section provides a detailed analysis of the corporate governance framework for investment companies. It sets out the full text of the Combined Code (excluding supporting schedules), the AIC Code and relevant Listing Rules. After each Combined Code principle, the corresponding principle(s) from the AIC Code is presented (in a **red box**), which is then followed by the relevant Listing Rule (in a **black box**) where appropriate.

Blue text is used to add supplementary notes to the Combined Code to explain the relevance of certain Combined Code principles and provisions to investment companies and to provide a cross-reference to the equivalent AIC principle.

- ✓ Ticks are shown on the right hand side of each page to identify items where disclosure in the annual report is required or recommended.

Self-managed investment companies

Self-managed investment companies may have different arrangements to externally managed investment companies in some areas. Directors of self-managed investment companies should bear this in mind when considering the regulations and recommendations of the AIC Code and should disclose and explain these aspects in the context of their structure.



Denotes disclosure in annual report

COMBINED CODE

Section 1 Companies

A. Directors

A.1 The board

Main principle

Every company should be headed by an effective board, which is collectively responsible for the success of the company.

Supporting principles

The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims [see AIC principle 14], ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance [for investment companies, this should be read as performance of the management company or executives of a self-managed investment company]. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

All directors must take decisions objectively in the interests of the company.

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives [see AIC principle 15] and monitor the reporting of performance [see AIC principle 21]. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors [only self-managed investment companies have executive directors] and have a prime role in appointing, and where necessary removing, executive directors [as above], and in succession planning.

Code provisions

A.1.1 The board should meet sufficiently regularly to discharge its duties effectively. [Items for discussion for investment company boards include those covered in AIC principles 13, 14 and 17.] There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management [for investment companies, read management company or executives of a self-managed investment company, see AIC principle 16]. ✓

A.1.2 The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive [only relevant for self-managed investment companies], the senior independent director [see AIC principle 1] and the chairmen and members of the nomination, audit and remuneration committees. It should also set out the number of meetings of the board and those committees and individual attendance by directors¹ [see AIC principle 5]. ✓

¹ Provisions A.1.1 and A.1.2 overlap with FSA Rule DTR 7.2.7 R; Provision A.1.2 also overlaps with DTR 7.1.5 R (see Schedule C).



Denotes disclosure in annual report

- A.1.3 The chairman should hold meetings with the non-executive directors without the executives present [only relevant for self-managed investment companies]. Led by the senior independent director [see AIC principle 1], the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance (as described in A.6.1) and on such other occasions as are deemed appropriate.
- A.1.4 Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns [see AIC principle 3].
- A.1.5 The company should arrange appropriate insurance cover in respect of legal action against its directors [see AIC principle 8].

AIC Code of Corporate Governance

The following AIC principles cover the role of the board of an investment company:

Principle 14 - Boards should give sufficient attention to overall strategy.

Recommendations

Some boards have found it useful to have a specific annual strategy session separate from the normal agenda items. For example, the board could consider matters such as the original prospectus objectives, their continuing relevance and whether the investment policy and style continue to enjoy sufficient support from investors. Issues that could also be discussed include:

- Whether it is in the interests of the shareholders that the company should continue in its present form (or at all).
- Whether the company should have regular continuation votes and, if so, how often?
- The investment mandate and long-term investment strategy and performance of the company and appropriate guidelines within which the manager should operate.

Principle 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.

Recommendations

In some cases a board may wish to set the level of gearing and asset allocation and in others it may wish to set parameters within which the manager can operate in the course of its day-to-day portfolio management.

For its review of investment performance the board might find it useful for the manager to prepare attribution and volatility analyses. Detailed advice on gearing (amount, currency, fixed or floating rate etc) can often be provided best by the fund manager's bond/currency teams rather than its equity portfolio managers. Boards should focus on share price performance as well as net asset value performance.



AIC Code of Corporate Governance (continued)

Principle 13 (continued)

A review of marketing and shareholder communication strategies should include the establishment of steps to mitigate the potential conflicts that the manager may have in promoting the company alongside any open-ended fund business that it may conduct.

Other items which should be considered include a risk map, share buy-back and treasury share policy, the performance and cost of other service providers (broker, legal advisers, custody, company secretarial etc – see principle 18), director remuneration and liability cover.

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information.

Principle 17 - Boards should monitor the level of the share price discount or premium (if any) and, if desirable, take action to reduce it.

Recommendations

Boards should discuss the company's absolute and relative level of discount and its volatility. They should consider the share price and asset performance and ways in which future share price performance might be enhanced – these should include:

- The investment mandate and objective
- The effectiveness of marketing and shareholder communication strategies. In particular, the board should ensure that any potential conflicts that the manager may have in promoting the company because of other interests they may have with open-ended funds are addressed and mitigated
- Measures of investor sentiment
- Share buy-backs and treasury shares
- The number and position of competitive companies in their peer group.

Principle 12 - Boards and managers should operate in a supportive, co-operative and open environment.

Recommendations

The ideal relationship is where the manager effectively acts as the CEO of the Member company, taking the initiative on all aspects of its operations, under the guidance and formal approval of the board.

Principle 16 - The board should agree policies with the manager covering key operational issues.

Recommendations

AIC Principle 16 recommends that the board agrees matters over which the manager has discretion and the areas of decision-making that are exclusively reserved for the board.



Denotes disclosure in annual report

A.2 Chairman and chief executive

Main principle

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. [Executive responsibility for running an investment company lies with the investment management company or executive management in the case of a self-managed investment company.] **No one individual should have unfettered powers of decision.**

Supporting principle

The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda. The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information [see AIC principle 13]. The chairman should ensure effective communication with shareholders [see AIC principle 19]. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors [only relevant for self-managed investment companies; for externally managed investment companies, this should be taken as the relationship between the investment management company and the board].

Code provisions

- A.2.1 The roles of chairman and chief executive [only relevant for self-managed investment companies] should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.
- A.2.2 The chairman should on appointment meet the independence criteria set out in A.3.1 below. A chief executive should not go on to be chairman of the same company. If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report² [other than self-managed investment companies, investment companies do not have a chief executive]. ✓

² Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.

AIC Code of Corporate Governance

With the exception of self-managed companies, executive responsibility for an investment company lies with the investment management company. The following AIC principle addresses the relationship between the board and the management company:

Principle 16 - The board should agree policies with the manager covering key operational issues.

Recommendations

The board should agree matters over which the manager has discretion and the areas of decision-making that are exclusively reserved for the board. Key operational issues could include:



AIC Code of Corporate Governance (continued)

Principle 16 (continued)

Recommendations

- Agreeing a policy with the manager regarding voting and corporate governance issues in respect of holdings in the company's portfolio. The agreement should take account of the Institutional Shareholders' Committee's "Statement of Principles" on shareholder engagement (which are available at www.institutionalshareholderscommittee.org.uk/library.html).
- Defining the scope of the manager's responsibilities, including the principal operating issues (such as the methodology for performance benchmarking, hedging, gearing, share buy-backs) and agreeing the procedure for the manager to report back to the board.
- Identifying any circumstances in which the manager should refer to the board for approval before undertaking transactions. This might include dealing in any other investment funds managed by the fund manager or investing in new issues of other closed-end funds managed by others.
- Agreeing that the manager inform the board of any conflicts surrounding share trades and votes. This can be useful to help individual portfolio managers defend themselves from unwanted pressure from within the management company.
- Agreeing a policy on whether the manager should be permitted to use the commissions paid by the company (soft commissions) to pay for services used by the manager. In this regard the board may wish to review and apply FSA disclosure proposals regarding soft commission arrangements.

A.3 Board balance and independence

Main principle

The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking [\[only self-managed investment companies have executive directors\]](#).

Supporting principles

The board should not be so large as to be unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business [\[see AIC principle 6\]](#) and that changes to the board's composition can be managed without due disruption.

To ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the board of both executive and non-executive directors [\[only self-managed investment companies have executive directors\]](#).

To value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.



Denotes disclosure in annual report

No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee. [\[An investment company may also have a management engagement committee and the same principles should apply.\]](#)

Code provisions

- A.3.1 The board should identify in the annual report each non-executive director it considers to be independent³. [\[AIC principles 1 and 2 also deal with independence.\]](#) The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:
- has been an employee of the company or group within the last five years;
 - has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
 - has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
 - has close family ties with any of the company's advisers, directors or senior employees;
 - holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
 - represents a significant shareholder; or
 - has served on the board for more than nine years from the date of their first election. [\[AIC principle 4 addresses the disclosure of a tenure policy for investment companies and whether a director of an investment company would be considered independent after nine years of service.\]](#)
- A.3.2 Except for smaller companies⁴, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent [\[only self-managed investment companies have executive directors\]](#). A smaller company should have at least two independent non-executive directors. [\[AIC principle 6 deals with board balance.\]](#)
- A.3.3 The board should appoint one of the independent non-executive directors to be the senior independent director. [\[AIC principle 1 addresses the role of the senior independent director for investment companies.\]](#) The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or finance director has failed to resolve or for which such contact is inappropriate.

³ A.2.2 states that the chairman should, on appointment, meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman.

⁴ A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.



AIC Code of Corporate Governance

The following AIC principles address board balance and independence for investment companies and should be considered in conjunction with AIC principle 4:

Principle 1 - The chairman should be independent.

Recommendations

Independence stems from the ability to make those objective decisions that may be in conflict with the interests of management. This in turn is a function of confidence (born of courage and experience), integrity (personal character) and judgement (born of knowledge and experience).

The chairman should have no relationships that may create a conflict of interest between the chairman's interest and those of shareholders.

No employee of the manager or executive of a self-managed company or ex-employee who has left the employment of the manager or the executive team of a self-managed company within the last five years should serve as chairman. Nor should a professional adviser to the manager or to the board of a company to which he/she provided services within the last three years serve as chairman. The chairman should not serve on any other boards of an investment company managed by the same manager.

The other independent directors should discuss the performance and continuing independence of the chairman on an annual basis and one of them should be deputed to speak to the chairman about their discussion.

There appear to be certain advantages in the concept of investment companies nominating a Deputy Chairman (who would fulfil the role of a senior independent director (SID)) or a SID in common with other companies. Alternatively, it may be appropriate for the chairman of the audit committee to fulfil this role. Firstly the Deputy Chairman or SID can take the lead in the annual evaluation of the chairman. Secondly, he/she can act as a channel of communication where shareholders have a problem with the chairman.

Principle 2 - A majority of the board should be independent of the manager.

Recommendations

An independent majority is required for a UK listing¹ and is best practice for other Member companies. Some shareholders may also expect no more than one current or recent² employee of or professional adviser to the manager to serve on a board. The board may wish to consider whether any such directors should offer themselves for re-election annually.

¹ Venture capital trusts listed before 28 September 2007 have until 28 September 2010 to comply with the full Listing Rules on independence (LR 15.2.11R-15.2.13AR and LR 15.4.7R). For venture capital trusts listed after 28 September 2007 these Listing Rules are effective immediately.

²Recent' employee is generally taken to mean having been in the manager's employment within the last five years. However, some individuals, because of long service or their personal identification with the company in question, may never be regarded as 'independent' for the purposes of forming an independent majority on the board.

AIC Code of Corporate Governance (continued)

Principle 2 (continued)

In the case of a self-managed company, a majority of the board should be independent of the executive management but there is no restriction to the number of current or recent² employees who may serve as directors.

Directors who have had other commercial relationships within the last three years may also be considered to be 'non-independent' of the manager or the executive team of a self-managed investment company.

Whilst directors who sit on the boards of more than one company managed by the same manager are still perfectly entitled to serve as a director, they will not be regarded as independent either for the purposes of fulfilling the requirement that there must be an independent majority or for serving as chairman.

The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee;
- has close family ties with any of the company's advisers or directors;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder;

and additionally in respect of self-managed investment companies:

- has been an employee of the company or group within the last five years;
- participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's senior employees.

Many shareholders and commentators have a view that lengthy service on a board can compromise independence from the manager or the executive team of a self-managed investment company. The AIC does not believe that there is any evidence that this is the case for investment companies and therefore does not recommend that long-serving directors be prevented from forming part of an independent majority. However, where a director has served for more than nine years, the board should state its reasons for believing that the individual remains independent in the annual report.



AIC Code of Corporate Governance (continued)

Principle 2 (continued)

Principle 3 will ensure that the independent directors formally assess the issue of directors' continuing independence from the manager or executive team of a self-managed investment company and their contribution on a regular basis and that the basis of that assessment is disclosed. Principle 6 should ensure that long-serving directors do not control a board.

Taken together, this should provide shareholders with confidence in the independence of their board or, if they disagree, sufficient information on which to make a decision to vote against re-election of a director.

Principle 6 - The board should aim to have a balance of skills, experience, ages and length of service.

Recommendations

In this way a board can bring to bear appropriate expertise to as many of the issues that it may face as possible. It will also be best placed to refresh itself in an orderly manner over time. Boards should indicate in the annual report any gaps that they have identified and, if so, how they intend to improve their balance over time. As referred to in principle 5, the annual report should spell out in the Directors' Report the relevant skills and experience of each director.



When considering new appointments the board should be seeking to fill gaps in the mix. This could be to add skills in investment management, performance analysis, corporate finance, marketing, legal, accounting and so on. It could also seek to diversify the age range of the board.

Principle 5 - There should be full disclosure of information about the board.

Recommendations

Conflicts of interest and remunerated association with any service provider – and particularly the manager – can interfere with a director's ability to act independently on some issues. All relevant facts about directors should be disclosed. Biographical details published in the Directors' Report of the annual report should include:



- Current employment and relevant experience
- All other public company directorships and employments with specific attention drawn to any other directorships of investment funds managed by the same manager. There may be occasions (e.g. Huntingdon Life Sciences) where a directorship need not be specifically identified.
- Any current or historic employment by the manager and connections to the investment company or the manager
- Length of service and age
- Shared directorships of any commercial company with other board members



AIC Code of Corporate Governance (continued)

Principle 5 (continued)

- Details of significant shareholdings in companies where:
 - the investment company has a notifiable stake in the same company; or
 - the investment company has a holding which amounts to more than 1% of the investment company's portfolio.

(In considering what amounts to significant, directors should consider both the absolute amount of the shareholding, as well as the proportion it represents of their total portfolio of investments.)

The board should disclose in the annual report what arrangements it has made for an audit, remuneration, nomination and management engagement committee. If the board has decided that the entire board should fulfil the role of the audit and/or remuneration committee, it will need to explain why it has done so. For example, a board might say that it considers its size to be such that it would be unnecessarily burdensome to establish a separate audit and/or remuneration committee. (Arrangements for the nomination committee are covered in principle 9 and arrangements for the management engagement committee are covered in principle 15.)



The company chairman may be a member of, but not chair, the audit committee in addition to the independent non-executive directors, provided that he or she was considered independent on appointment as chairman. With the exception of smaller companies (i.e. those that are below the FTSE 350 throughout the year immediately prior to the reporting year), the board should provide an explanation of why it believes that it is appropriate for the company chairman to be a member of the audit committee.



The company chairman may also be a member of, but not chair, the remuneration committee.

Directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.



If separate audit, remuneration, nomination and/or management engagement committees are established, formal terms of reference reserved for that committee's decision should be made available (this requirement could be met by including the information on a website that is maintained by or on behalf of the company).

The annual report should identify the chairman, the senior independent director (if there is one) and the chairmen and members of any audit, remuneration, nomination and management engagement committees. It should also set out the number of meetings of the board and those committees and individual attendance by directors.





Listing Rules

The following Listing Rules are also relevant.

LR 15.2.11R

The board of directors or equivalent body of the applicant must be able to act independently:

- (1) of any investment manager appointed to manage investments of the applicant; and
- (2) if the applicant (either directly or through other intermediaries) has an investment policy of principally investing its funds in another company or fund that invests in a portfolio of investments ("a master fund"), of the master fund and of any investment manager of the master fund.

LR 15.2.11AR

LR 15.2.11R (2) does not apply if the company or fund which invests its funds in another company or fund is a subsidiary undertaking of the applicant.

LR 15.2.12AR

For the purposes of LR 15.2.11 R, a majority of the board or equivalent body of the applicant (including the Chairman) must not be:

(1) directors, employees, partners, officers or professional advisers of or to:

- (a) an investment manager of the applicant; or
- (b) a master fund or investment manager referred to in LR 15.2.11R (2); or
- (c) any other company in the same group as the investment manager of the applicant; or

(2) directors, employees or professional advisers of or to other investment companies or funds that are:

- (a) managed by the same investment manager as the investment manager to the applicant; or
- (b) managed by any other company in the same group as the investment manager to the applicant.

LR 15.2.13AR

A person referred to in LR 15.2.12AR (1) or (2) who is a director of the applicant must be subject to annual re-election by the applicant's shareholders.

LR 15.4.7R

LR 15.2.11R to LR 15.2.13AR apply at all times to a closed-ended investment fund.



Denotes disclosure in annual report

A.4 Appointments to the board

Main principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

Supporting principles

Appointments to the board should be made on merit and against objective criteria. Care should be taken to ensure that appointees have enough time available to devote to the job. This is particularly important in the case of chairmanships.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management [\[only relevant for self-managed investment companies\]](#), so as to maintain an appropriate balance of skills and experience within the company and on the board.

Code provisions

- A.4.1 There should be a nomination committee which should lead the process for board appointments and make recommendations to the board [\[AIC principle 9 also addresses the role of the nomination committee\]](#). A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available⁵ its terms of reference, explaining its role and the authority delegated to it by the board.
- A.4.2 The nomination committee should evaluate the balance of skills, knowledge and experience on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.
- A.4.3 For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and their impact explained in the next annual report. ✓
✓
- A.4.4 The terms and conditions of appointment of non-executive directors should be made available for inspection⁶. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.
- A.4.5 The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company [\[only relevant for self-managed investment companies\]](#).

⁵The requirement to make the information available would be met by including the information on a website that is maintained by or on behalf of the company.

⁶The terms and conditions of appointment of non-executive directors should be made available for inspection by any person at the company's registered office during normal business hours and at the AGM (for 15 minutes prior to the meeting and during the meeting).

- A.4.6 A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments⁷. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director [see AIC principle 9]. ✓

⁷This provision overlaps with FSA Rule DTR 7.2.7 R (see Schedule C).

AIC Code of Corporate Governance

The following AIC principles deal with the appointment of directors to an investment company board:

Principle 9 - The independent directors should take the lead in the appointment of new directors and the process should be disclosed in the annual report.

 ✓

Recommendations

Either the whole board should together nominate candidates for the board, or the board should establish a nomination committee of independent directors. If the whole board nominates candidates, it should explain in the annual report why it has done so rather than establish a separate nomination committee. For example, a board might say that it considers its size to be such that it would be unnecessarily burdensome to establish a separate nomination committee. In either case, only the independent directors should vote on candidates for the appointment of new independent directors. ✓

The company chairman or an independent non-executive director should chair the nomination committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship.

Principle 11 - The chairman (and the board) should be brought into the process of structuring a new launch at an early stage.

Recommendations

New companies tend to be created by the manager or sponsor. No board exists at the outset for the independent appointment of new directors.

The chairman should be selected at the earliest practicable point in the process of launching a new company, and should be involved in the selection of the rest of the board as soon as possible thereafter.

The new board should assume their responsibilities and be involved in the process at the earliest possible point. The new board should satisfy itself that the proposed new company is fundamentally sound and has a raison d'être in the market place.

The new board should be able to seek independent advice paid for by the manager and sponsor, should it feel the need, in the process of its due diligence. Recently, turbulent markets have served as a sharp reminder that directors can be personally liable for any errors, omissions or misleading statements in a prospectus.



AIC Code of Corporate Governance (continued)

Principle 11 (continued)

New companies applying for admission to membership of the AIC should be able to confirm that they have complied with this principle and disclose any deviation from the recommendations.

A.5 Information and professional development

Main principle

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

Supporting principles

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information [\[see AIC principle 13\]](#). Management [\[read investment management company or executive management for a self-managed investment company\]](#) has an obligation to provide such information but directors should seek clarification or amplification where necessary.

The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors [\[only relevant for self-managed investment companies\]](#), as well as facilitating induction and assisting with professional development as required.

The company secretary should be responsible for advising the board through the chairman on all governance matters.

Code provisions

- A.5.1 The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, the company should offer to major shareholders the opportunity to meet a new non-executive director.
- A.5.2 The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.
- A.5.3 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.



Denotes disclosure in annual report

AIC Code of Corporate Governance

Principle 10 - Directors should be offered relevant training and induction.

Recommendations

Investment companies should offer induction training to new directors about the company, its managers, their legal responsibilities and investment company industry matters. Subsequently, ongoing training should be offered as required.

A.6 Performance evaluation

Main principle

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Supporting principle

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties). The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

Code provision

A.6.1 The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted. The non-executive directors, led by the senior independent director [see AIC principle 1], should be responsible for performance evaluation of the chairman, taking into account the views of executive directors [only relevant for self-managed investment companies].



AIC Code of Corporate Governance

The AIC Code contains the following principles regarding performance evaluation:

Principle 7 - The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Recommendations

To help boards of Member companies with this specific principle, the AIC has produced a "Guide to Performance Appraisals for Non-Executive Directors of Investment Companies" which is available on the AIC's website at www.theaic.co.uk/technical.



AIC Code of Corporate Governance (continued)

Principle 15 - The board should regularly review both the performance of, and contractual arrangements with, the manager (or executives of a self-managed company).

Recommendations

It should become best practice for a management engagement committee consisting solely of directors independent of the manager (or executives) to make this review annually with its decisions and rationale described in the annual report.

The company chairman may be a member of, and may chair, the management engagement committee, provided that he or she is independent of the manager.

The long-term nature of the advantages of investment companies suggests that frequent changes in management arrangements would be undesirable. Issues include:

- Monitoring and evaluating the fund manager's investment performance and, if necessary, providing appropriate guidance.
- Considering the merit of obtaining, on a regular basis, an independent appraisal of the manager's services.
- Requiring the manager to provide attribution and volatility analyses and whether it should be published at least annually.
- Putting in place procedures by which the board regularly reviews the continued retention of the manager's services.
- Reviewing the level and method of remuneration, the basis of performance fees and the notice period. The board should give due weight to the competitive position of the company against the peer group.
- Considering whether the initial and annual fee should be based on gross assets, net assets or market capitalisation.
- If there is a performance related element, or the introduction of a performance fee is under consideration, the review should seek to ensure that the basis does not encourage excessive risk and that it rewards demonstrably superior performance by the manager in managing the portfolio against the company's stated objectives when compared to a suitable benchmark or peer group. Key factors to be considered include:
 - The views of shareholders
 - Appropriate benchmarks/hurdle rates
 - A reduction in the basic fee when a performance fee is introduced
 - A cap on the performance fee



AIC Code of Corporate Governance (continued)

Principle 15 (continued)

- A high water mark
- A combination of short-term and long-term measurements and incentives
- Ensuring that a sound system of internal control is maintained to safeguard shareholders' investment and the company's assets. A review of the effectiveness of the system of internal control should be made annually by the board. Such a review should be reported to shareholders.

The AIC has produced a paper entitled "Evaluation of the Manager: A Paper for Non-Executive Directors of Investment Companies on meeting the requirements of the Listing Rules". This is available on the AIC's website at www.theaic.co.uk/technical.

Principle 18 - The board should monitor and evaluate other service providers.

Recommendations

The board should determine which services (such as secretarial, custody, settlement, registration) should be sub-contracted and establish the procedures by which the providers, to whom these services are delegated, should report back and the methods by which these providers are monitored and evaluated.

The board should put in place a structure for the regular review of these delegated services to ensure their continued competitiveness and effectiveness.

In practice, boards will be heavily reliant on their manager or company secretary for much of this process.

In particular, boards should satisfy themselves that the auditor is not conflicted by any work for the manager and that any potential conflict has been satisfactorily resolved.

Listing Rules

LR 15.6.2(2)R

In addition to the requirements in LR 9.8 (Annual financial report), a closed-ended investment fund must include in its annual financial report:

- (2) a statement, set out in a prominent position, as to whether in the opinion of the directors, the continuing appointment of the investment manager on the terms agreed is in the interests of its shareholders as a whole, together with a statement of the reasons for this view.





A.7 Re-election

Main principle

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the board.

Code provisions

- A.7.1 All directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.
- A.7.2 Non-executive directors should be appointed for specified terms subject to re-election and to Companies Acts provisions relating to the removal of a director. The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role. Any term beyond six years (e.g. two three-year terms) for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board. Non-executive directors may serve longer than nine years (e.g. three three-year terms), subject to annual re-election. Serving more than nine years could be relevant to the determination of a non-executive director's independence (as set out in provision A.3.1). [\[AIC principle 4 deals with tenure policy for investment companies.\]](#)

AIC Code of Corporate Governance

The AIC Code contains the following principles regarding re-election:

Principle 3 - Directors should be elected for a fixed term of no more than three years. Nomination for re-election should not be assumed but be based on disclosed procedures.

Recommendations

The chairman and the other independent directors should approve the nomination for re-election of directors and disclose the rationale in the annual report.

The deliberations over any nominee for re-election should take place in the absence of that nominee. After nine years, the term should be reduced to one year.

On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have concerns about the running of the company or a proposed action. Short of resignation, where directors have such concerns which cannot be resolved, they should ensure that their concerns are recorded in the board minutes.



AIC Code of Corporate Governance (continued)

Principle 4 - The board should have a policy on tenure, which is disclosed in the annual report.



Recommendations

As mentioned in AIC principle 2, some market participants believe directors should not be considered independent after nine years service, whereas others consider a longer tenure enhances the ability to be independent. Many boards function best when working together for years; others find regular changes to be desirable but awkward to achieve.

Provision A.3.1 of the Combined Code contains a provision that boards should state their reasons if they consider a director to be independent notwithstanding the fact that the director has served for more than nine years from the date of their first election.

Whilst the boards of investment companies, in common with the boards of other companies, are likely to benefit from a regular infusion of new blood, they are perhaps more likely than most to benefit from having at least one director with considerably longer than nine years' experience. Continuity, self-examination and ability to do the job should be the relevant criteria. The report on the annual evaluation of the board should state that each director's independence has been considered.



The key point is that a board should not become ossified with a large number of directors all serving for very long periods together. The achievement of a sensible balance is the most important objective in this regard.

It is the AIC's hope that the preamble to the Combined Code (which recognises that investment companies may find some of the standard provisions of the code inappropriate) and the AIC's recommendations on tenure and balance will give boards confidence in explaining why a director is viewed as independent, notwithstanding service which may be considerably more than nine years.

Each board should determine and disclose a policy on whether its directors should serve for a limited period of time (e.g. nine years). Given the particular importance of the chairman, the board should also consider whether his or her tenure should also be finite. If so, he or she could continue as a director thereafter if consistent with the board's policy on tenure.





B. Remuneration

B.1 The level and make-up of remuneration

Main principle

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance [\[only relevant for self-managed investment companies\]](#).

Supporting principle

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance. They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

Code provisions

Remuneration policy

- B.1.1 The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels. In designing schemes of performance-related remuneration, the remuneration committee should follow the provisions in Schedule A to this Code [\[only relevant for self-managed investment companies\]](#).
- B.1.2 Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.
- B.1.3 Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in provision A.3.1).
- B.1.4 Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report⁸ should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is [\[only relevant for self-managed investment companies\]](#).

⁸ As required under the Directors' Remuneration Report Regulations 2002.



Denotes disclosure in annual report

Service contracts and compensation

- B.1.5 The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing director's obligations to mitigate loss.
- B.1.6 Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.

AIC Code of Corporate Governance

Remuneration issues for investment company boards are covered in the following AIC principle:

Principle 8 - Director remuneration should reflect their duties, responsibilities and the value of their time spent.

Recommendations

There should be a formal and transparent procedure for developing policy for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Provision should be made for additional remuneration where directors are involved in duties beyond those normally expected as part of the director's appointment. In such instances, the board should provide details of the events, duties and responsibilities that gave rise to any additional payments in the annual report. The increased responsibilities of directors make the present level of fees look too low in many cases.

Whilst directors owning shares is strongly encouraged, it should not be compulsory. There are advantages for directors of companies that have more than one class of share in holding the shares on a pro rata basis. There is support for directors to be paid or part-paid in shares but not, in the usual case, for them to be awarded stock options.

Director's potential liability is currently a matter of concern. The first concern of directors in this regard is to ensure that their duties are carried out in such a way that no legal suit can be reasonably brought against them. They should still endeavour to ensure that they have suitable insurance cover. Cases might be brought by plaintiffs which conjoin directors to other parties and which can take years (and considerable legal fees) to be resolved. Directors need to take all action open to them to ensure that there is no possibility of any insurance cover lapsing before any legal proceedings commence, and that there are no other unforeseen limitations to their cover. Adequacy of insurance cover can be a very real issue in cases of large losses.



B.2 Procedure

Main principle

There should be a formal and transparent procedure for developing policy on executive remuneration [only relevant for self-managed investment companies] and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration. [This principle is a recommendation of principle 8 of the AIC Code.]

Supporting principles

The remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors [only relevant for self-managed investment companies]. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration [only relevant for self-managed investment companies]. Where executive directors or senior management are involved in advising or supporting the remuneration committee [only relevant for self-managed investment companies], care should be taken to recognise and avoid conflicts of interest.

The chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration in the same way as for other matters.

Code provisions

- B.2.1 The board should establish a remuneration committee of at least three, or in the case of smaller companies⁹ two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available¹⁰ its terms of reference, explaining its role and the authority delegated to it by the board. Where remuneration consultants are appointed, a statement should be made available¹¹ of whether they have any other connection with the company.
- B.2.2 The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments [only relevant for self-managed investment companies]. The committee should also recommend and monitor the level and structure of remuneration for senior management [only relevant for self-managed investment companies]. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level [only relevant for self-managed investment companies].
- B.2.3 The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.
- B.2.4 Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.

⁹ A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

¹⁰ This provision overlaps with FSA Rule DTR 7.2.7 R (see Schedule C).

¹¹ The requirement to make the information available would be met by including the information on a website that is maintained by or on behalf of the company.

AIC Code of Corporate Governance

Principle 5 - There should be full disclosure of information about the board.

Recommendations

Principle 5 includes the recommendation that the board should disclose in the annual report what arrangements it has made for a remuneration committee. If the board has decided that the entire board should fulfil the role of the remuneration committee, it will need to explain in the annual report why it has done so. For example, a board might say that it considers its size to be such that it would be unnecessarily burdensome to establish a separate remuneration committee. ✓

The remuneration committee should consist of at least three members, who should all be independent non-executive directors (or two members in the case of companies below the FTSE 350 throughout the year immediately prior to the reporting year). The chairman may also be a member of, but not chair, the remuneration committee.

The role and responsibilities of the remuneration committee should be:

- in conjunction with the chairman, to set the directors' remuneration levels
- to judge where to position the company relative to other companies
- to consider the need to appoint external remuneration consultants.

C. Accountability and audit

C.1 Financial reporting

Main principle

The board should present a balanced and understandable assessment of the company's position and prospects.

Supporting principles

The board's responsibility to present a balance and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

Code provisions

- C.1.1 The directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities [see AIC principle 5]. ✓
- C.1.2 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary. ✓



AIC Code of Corporate Governance

The equivalent AIC principle is:

Principle 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.

Recommendations

The following should be disclosed to shareholders in as plain language as possible:

- In the annual report there should be a detailed discussion of those areas of decision-making reserved to the board and those over which the manager has discretion (e.g. is the level of gearing set by the board or does the fund manager operate within pre-set limits?)
- A discussion of the manager's overall performance, e.g. investment performance, portfolio risk (e.g. concentration, gearing, liquidity and any other special factors), operational issues such as compliance etc.
- The board should ensure that a full portfolio listing is made available to shareholders at least once a year, and where it is not contained in the annual report, a reference should be given explaining where it can be found. Shareholders should normally know precisely in what securities their company is investing. There may, however, be circumstances when a board decides that such disclosure would not be in the best interest of shareholders (e.g. Huntingdon Life Sciences or a programme of buying or selling an illiquid portfolio).
- The wipe out hurdle rate (the rate of decline in the portfolio that would cause total loss of capital value) for each share class (apart from annuity shares) should be shown in the prospectus and re-calculated for each annual report and accounts.
- Total expense ratios and their impact on capital erosion per share class should be itemised.
- Sufficient disclosure of bank-borrowing covenant details (if any) should be made to allow shareholders to understand the circumstances under which loans might be repayable and the extent of any cancellation costs. If this information is not disclosed, the effect of breaching bank-borrowing covenants is not immediately obvious as has clearly been evident with some highly geared split capital investment companies. Where companies have covenants, shareholders should have sufficient information to understand the consequences of any material breach.





Denotes disclosure in annual report

Listing Rules

The following Listing Rule is also relevant:

LR 15.6.8R

A closed-ended investment fund must notify to a RIS within five business days of the end of each quarter a list of all investments in other listed closed-ended investment funds, as at the last business day of that quarter, which themselves do not have stated investment policies to invest no more than 15% of their total assets in other listed closed-ended investment funds.

C.2 Internal control¹²

Main principle

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

Code provision

C.2.1 The board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so¹³. The review should cover all material controls, including financial, operational and compliance controls and risk management systems. ✓

¹² The Turnbull guidance suggests means of applying this part of the Code. Copies are available at www.frc.org.uk/corporate/internalcontrol.cfm

¹³ In addition FSA Rule DTR 7.2.5 R requires companies to describe the main features of the internal control and risk management systems in relation to the financial reporting process (see Schedule C).

AIC Code of Corporate Governance

Principle 15 - The board should regularly review both the performance of, and contractual arrangements with, the manager (or executives of a self-managed company).

Recommendations

AIC Principle 15 addresses the contractual arrangements with the manager. One issue for consideration is to ensure that a sound system of internal control is maintained to safeguard shareholders' investment and the company's assets. A review of the effectiveness of the system of internal control should be made annually by the board. Such a review should be reported to shareholders. ✓



C.3 Audit committee and auditors¹⁴

Main principle

The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Code provisions

- C.3.1 The board should establish an audit committee of at least three, or in the case of smaller companies¹⁵ two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience¹⁶.
- C.3.2 The main role and responsibilities of the audit committee should be set out in written terms of reference and should include¹⁷:
- to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;
 - to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
 - to monitor and review the effectiveness of the company's internal audit function;
 - to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
 - to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
 - to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

¹⁴ The Smith guidance suggests means of applying this part of the Code. Copies are available at www.frc.org.uk/corporate/auditcommittees.cfm

¹⁵ A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

¹⁶ This provision overlaps with FSA Rule DTR 7.1.1 R (see Schedule C).

¹⁷ This provision overlaps with FSA Rules DTR 7.1.3 R (see Schedule C)

- C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available¹⁸. A separate section of the annual report should describe the work of the committee in discharging those responsibilities¹⁹. ✓
- C.3.4 The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters [only relevant for self-managed investment companies]. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.
- C.3.5 The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function [there is unlikely to be a need for an internal audit function for an externally managed investment company], the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report. ✓
- C.3.6 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position. ✓
- C.3.7 The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded. ✓

¹⁸ The requirement to make the information available would be met by including the information on a website that is maintained by or on behalf of the company.

¹⁹ This provision overlaps with FSA Rules DTR 7.1.5 R and 7.2.7 R (see Schedule C).

AIC Code of Corporate Governance

Principle 5 - There should be full disclosure of information about the board.

Recommendations

AIC principle 5 includes the recommendation that the board should disclose in the annual report what arrangements it has made for an audit committee. If the board has decided that the entire board should fulfil the role of the audit committee, it will need to explain why it has done so. For example, a board might say that it considers its size to be such that it would be unnecessarily burdensome to establish a separate audit committee. ✓

The audit committee should consist of at least three members, who should all be independent non-executive directors (or two members in the case of companies below the FTSE 350 throughout the year immediately prior to the reporting year).



AIC Code of Corporate Governance (continued)

Principle 5 (continued)

The company chairman may be a member of, but not chair, the audit committee in addition to the independent non-executive directors, provided that he or she was considered independent on appointment as chairman. With the exception of smaller companies (i.e. those that are below the FTSE 350 throughout the year immediately prior to the reporting year), the board should provide an explanation of why it believes that it is appropriate for the company chairman to be a member of the audit committee.

The role and responsibilities of the audit committee should be:

- to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;
- to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
- to monitor and review the effectiveness of the manager's internal audit function;
- to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

Directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.





Denotes disclosure in annual report

D. Relations with shareholders

D.1 Dialogue with institutional shareholders

Main principle

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place²⁰.

Supporting principles

Whilst recognising that most shareholder contact is with the chief executive and finance director [for investment companies, shareholder contact is usually via the manager and/or the chairman], the chairman (and the senior independent director and other directors as appropriate) should maintain sufficient contact with major shareholders to understand their issues and concerns.

The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.

Code provisions

- D.1.1 The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend meetings with major shareholders and should expect to attend them if requested by major shareholders. The senior independent director [see AIC principle 1] should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.
- D.1.2 The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion. ✓

²⁰ Nothing in these principles or provisions should be taken to override the general requirements of law to treat shareholders equally in access to information.

AIC Code of Corporate Governance

Relationships with shareholders of investment companies are covered in the following AIC principles:

Principle 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.

Recommendations

This can include the commissioning of regular reports from the company's brokers and manager or appointing a qualified independent industry consultant.



Denotes disclosure in annual report

AIC Code of Corporate Governance (continued)

Principle 19 (continued)

The chairman should ensure that a contact procedure is laid out in the annual report for shareholders who wish to communicate directly with the board. Boards should consider having the chairman or another independent director accompany the manager to some meetings with major investors so that they could contact the board member directly if they subsequently wished to do so.



Boards should make themselves aware of the corporate governance attitudes of their shareholders and give them due consideration so that they are able to hold constructive dialogue where the views of the board and those of shareholders diverge.

The board should state in the annual report the steps it has taken to ensure that the members of the board have an understanding of the views of major shareholders about their company.



Principle 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.

Recommendations

This is not intended to refer to day-to-day operational, investment or marketing communications. The board should be informed (although this should not imply formal approval) of relevant promotional material that is issued by the manager.

D.2 Constructive use of the AGM

Main principle

The board should use the AGM to communicate with investors and to encourage their participation.

Code provisions

D.2.1 At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should in particular propose a resolution at the AGM relating to the report and accounts. For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a 'vote withheld' is not a vote in law and will not be counted in the calculation of the proportion of the votes for and against the resolution.

D.2.2 The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. For each resolution, after a vote has been taken, except where taken on a poll, the company should ensure that the following information is given at the meeting and made available as soon as reasonably practicable on a website which is maintained by or on behalf of the company:

- the number of shares in respect of which proxy appointment have been validly made;



Denotes disclosure in annual report

- the number of votes for the resolution;
 - the number of votes against the resolution; and
 - the number of shares in respect of which the vote was directed to be withheld.
- D.2.3 The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.
- D.2.4 The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

AIC Code of Corporate Governance

Principle 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.

Recommendations

AIC principle 19 includes the following recommendations:

The board should use the AGM to communicate with investors and to encourage their participation.

At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should in particular propose a resolution at the AGM relating to the approval of the report and accounts.

For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a "vote withheld" is not a vote in law and will not be counted in the calculation of the proportion of the votes for and against the resolution.

The results of votes on resolutions should be published on a website.

Section 2 Institutional shareholders

E. Institutional shareholders²¹

E.1 Dialogue with companies

²¹ Agents such as investment managers, or voting services, are frequently appointed by institutional shareholders to act on their behalf and these principles should accordingly be read as applying where appropriate to the agents of institutional shareholders.



Denotes disclosure in annual report

Main principle

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

Supporting principles

Institutional shareholders should apply the principles set out in the Institutional Shareholders' Committee's "The Responsibilities of Institutional Shareholders and Agents – Statement of Principles"²², which should be reflected in fund manager contracts.

E.2 Evaluation of governance disclosures

Main principle

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention.

Supporting principle

Institutional shareholders should consider carefully explanations given for departure from this Code and make reasoned judgements in each case. They should give an explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position. They should avoid a box-ticking approach to assessing a company's corporate governance. They should bear in mind in particular the size and complexity of the company and the nature of the risks and challenges it faces.

E.3 Shareholder voting

Main principle

Institutional shareholders have a responsibility to make considered use of their votes.

Supporting principles

Institutional shareholders should take steps to ensure their voting intentions are being translated into practice.

Institutional shareholders should, on request, make available to their clients information on the proportion of resolutions on which votes were cast and non-discretionary proxies lodged.

Major shareholders should attend AGMs where appropriate and practicable. Companies and registrars should facilitate this.

²² Available at www.institutionalshareholderscommittee.org.uk

AIC Code of Corporate Governance

This area is outside the scope of the AIC Code of Corporate Governance.

Disclosure requirements

This section summarises the requirements and recommendations for disclosing corporate governance arrangements and compliance, or otherwise, with the various corporate governance regulations and codes applicable to investment companies.

AIC Code of Corporate Governance

It is best practice for AIC Members to state in their annual report whether they are adhering to the principles and following the recommendations in the AIC Code and if not, to explain why and/or to detail the steps they intend to take to bring themselves into line in the future.

Self-managed investment companies may have different arrangements in some aspects, and these should be disclosed and explained in the annual report and accounts in the context of their structure.

AIC Member companies may also make a statement that, by reporting against the AIC Code and by following this guide, they are meeting their obligations under the Combined Code and paragraph 9.8.6 of the Listing Rules and as such do not need to report further on issues contained in the Combined Code which are irrelevant to them as explained in this guide. Appendix 2 contains suggested wording for this statement.

Some of the principles and recommendations of the AIC Code also contain specific disclosure requirements. These are identified by a tick on the right hand side of the page in the 'Detailed Requirements' section of this guide.

The AIC Code is copyrighted and only Members of the AIC may state that they are following the Code.

Combined Code on Corporate Governance

Sections 9.8.6(5) and (6) of the Listing Rules require UK companies listed on the main market of the London Stock Exchange to make a statement in their annual report and accounts:

1. *Of how the company has applied the main principles set out in Section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied.*

The preamble to the Combined Code states that where a company has applied the main principles by complying with the associated provisions, it is sufficient to report that this is the case. It is not considered necessary to copy out the principles in the annual report and accounts. However, extra narrative is encouraged where the company has taken additional steps to apply principles or otherwise improve its governance.

2. *As to whether or not the company has complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code. Where there is non-compliance, the company must set out those provisions which it has not complied with, where relevant the period within which it did not comply, and the reasons for non-compliance.*

The preamble to the Combined Code states that where a company chooses not to comply with one or more provisions of the Combined Code, it must give shareholders a “careful and clear explanation” which aims to “illustrate how its actual practices are consistent with the principle to which the particular provision relates and contribute to good governance”.

In addition, certain provisions of the Combined Code contain specific disclosure requirements. These are identified by a tick on the right hand side of the page in the ‘Detailed Requirements’ section of this guide.

As explained on page 3, the preamble to the Combined Code recognises that investment companies have some characteristics which mean that not all of its provisions are relevant. Provisions which might be irrelevant to investment companies are identified in the ‘Detailed Requirements’ section of this guide.

Listing Rules

The Listing Rules require certain corporate governance disclosures to be made in the annual report and accounts. Where these Listing Rules are included in this guide, the required disclosures are identified by a tick on the right hand side of the page in the ‘Detailed Requirements’ section.

FSA Corporate Governance Rules

The Disclosure and Transparency Rules contain the FSA’s Corporate Governance Rules which impose additional obligations on UK incorporated investment companies. These rules cover requirements relating to corporate governance statements and audit committees. For example, the corporate governance report must include a reference to the corporate governance code to which the company is subject and any corporate governance code which the company voluntarily applies.

More information on the FSA’s Corporate Governance Rules can be found in the preamble to the Combined Code and in a separate AIC document called “Corporate Governance Update” which is available on the AIC’s website at www.theaic.co.uk/technical.

Changes to the AIC Code of Corporate Governance

Changes to the AIC Code

The following changes have been made in the fourth edition of the AIC Code:

- Principle 2 - Independence rules

A restriction has been deleted from the Listing Rules which prevented “no more than one director, partner, employee, or professional adviser to each such investment manager or any other company in the same group as any such investment manager” being on the board and any such director was subject to annual re-election by shareholders (LR 15.2.7).

This restriction was also reflected in the AIC Code. The wording of the AIC Code has now been amended. The revised wording within principle 2 says “Some shareholders may also expect no more than one current or recent employee of or professional adviser to the manager to serve on a board. The board may wish to consider whether any such directors should offer themselves for re-election annually”.

- Principle 4 - Age limit in Articles of Association

Principle 4 of the AIC Code previously stated that “If there is no age limit in the company's Articles of Association, the board should determine whether or not there should be an age limit.”. This recommendation has now been removed from the AIC Code, following changes to the Companies Act which removed an upper age limit for directors.

- Principle 5 - Committees of the board

Principle 5 of the AIC Code previously recommended that the board discloses in the annual report what arrangements it had made for an audit and remuneration committee. This recommendation has now been extended to include the nomination and management engagement committees (although most investment companies are likely to make these disclosures already).

A change has been made within the 2008 Combined Code allowing the company chairman of a listed company outside the FTSE 350 to sit on, but not chair, the audit committee where he or she was considered independent on appointment as chairman (CC C.3.1). The following recommendation has therefore been added to principle 5 of the AIC Code “The company chairman may be a member of, but not chair, the audit committee in addition to the independent non-executive directors, provided that he or she was considered independent on appointment as chairman. With the exception of smaller companies (i.e. those that are below the FTSE 350 throughout the year immediately prior to the reporting year), the board should provide an explanation of why it believes that it is appropriate for the company chairman to be a member of the audit committee.”

In terms of the remuneration committee, the AIC Code now contains the recommendation that the company chairman may be a member of, but not chair, the remuneration committee. This wording was previously only shown in the detailed requirements section of the AIC Guide.

Principle 5 previously recommended that the formal terms of reference of the audit committee, remuneration and nomination committee are made available. This recommendation has now been extended to include the management engagement committee.

Principle 5 previously recommended that the chairmen and members of the audit, remuneration and nomination committee are disclosed in the annual report. This recommendation has now been extended to include the management engagement committee.

- Principle 9 - Nomination committee

The AIC Code has been updated to include the following wording from the Combined Code (CC A.4.1) *"The company chairman or an independent non-executive director should chair the nomination committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship."*

- Principle 15 - Management engagement committee

The following recommendation has been added to principle 15 *"The company chairman may be a member of, and may chair, the management engagement committee, provided that he or she is independent of the manager."*

- Principle 15 - Sound system of internal control

Principle 15 previously recommended that *"A review of the effectiveness of the system of internal control should be made annually."* The words *"by the board"* have now been added to clarify that this review should be carried out by the directors.

- Principle 21 - Disclosure of sensitivity analysis

Principle 21 previously recommended that the following is disclosed to shareholders: *"For split capital and quasi split capital companies, a sensitivity analysis should be provided showing the effect on the asset backing of each share class of a matrix of possible returns, on both a short and long-term basis e.g. -5, 0, + 5, and +10% per annum over the long term and -20 and -30% per annum over two years. For split or quasi split capital "barbell" funds (those having more than one type of portfolio) these returns should be assumed for parts of the portfolio as well as the entire portfolio as appropriate."* This recommendation has been removed from the AIC Code because sufficient data is now being provided by the market.

Changes to the AIC Guide

In addition to the amendments made to the AIC Code which are stated above and which are reflected in the AIC Guide, the following changes have also been made to the AIC Guide:

- Combined Code

The AIC Guide has been amended to reflect the updated text of the 2008 version of the Combined Code. Two changes have been made to the detailed provisions of the Combined Code. The first change is to allow an individual to chair more than one FTSE 100 company. The second change relates to the ability of the company chairman to sit on the audit committee as discussed above.

- Listing Rules

The AIC Guide has been updated to reflect the current wording and referencing of the relevant Listing Rules as at the date of publication.

Changes have also been made to Listing Rule 9.8.6 which covers the 'comply or explain' requirement in relation to the Combined Code. The new disclosure requirements are explained in the 'Disclosure Requirements' section of the AIC Guide.

- Inclusion of FSA Corporate Governance Rules

Following the implementation of the 8th company law directive, the FSA has recently issued its own Corporate Governance Rules which are contained in the Disclosure and Transparency Rules. These are effective for accounting periods beginning on or after 29 June 2008. They cover audit committees and require a company to make specific disclosures in its corporate governance statement. More information about these new rules can be found in the 'Disclosure Requirements' section of the AIC Guide.

Appendix 1: Development of the AIC Code and the AIC Guide

The AIC Code has been developed over a number of years. The original version was published in July 2003[^]. In January 2004 the AIC issued a short list of amendments to the detailed recommendations in the AIC Code, which were required as certain changes were made to the Listing Rules and as the final shape of a revised version of the Combined Code was unveiled. The Combined Code contains the main corporate governance requirements for all listed companies generally, not just investment companies, and is intended to enhance board effectiveness and improve investor confidence. The preamble of this edition of the Combined Code first recognised that investment companies have some characteristics which mean that not all of its provisions are appropriate.

In April 2005 the Financial Reporting Council (FRC), the body responsible for the Combined Code, welcomed the AIC Code as a source of guidance on how to interpret the Combined Code in the context of investment companies. The FRC noted that corporate governance guidance for directors and shareholders of investment companies was contained in three separate documents (i.e. the Combined Code, the AIC's 2003 Code and the AIC's 2004 update) which could increase the risk of confusion and misunderstanding. In February 2006, the AIC produced a second edition of the AIC Code which amalgamated the 2003 AIC Code, the 2004 amendments and some minor subsequent changes, and produced the AIC Guide. The guide seeks to address the FRC's concerns by collating all the corporate governance regulations and recommendations relevant for investment companies into one document. The AIC Guide also highlights specific corporate governance requirements contained in the Listing Rules.

In February 2006, the FRC confirmed that the AIC Member companies who report against the AIC Code and who follow the AIC Guide will be meeting their obligations in relation to the Combined Code and associated disclosure requirements of the Listing Rules. The 2006 version of the AIC Code and the AIC Guide first contained a copy of the letter of endorsement from the FRC.

In May 2007 the third version of the AIC Code was published which contained some minor amendments to the detailed recommendations to reflect changes in the 2006 edition of the Combined Code and included suggested wording for a preamble to Member companies' corporate governance reports. The purpose of this preamble is to help investors to recognise that Members reporting against the AIC Code have fulfilled their Listing Rules obligation to confirm that their corporate governance report represents a description of how they have applied the provisions of the Combined Code. At the same time the AIC Guide was also updated.

In June 2008 the FRC published a further version of the Combined Code which contains a revised preamble. The reference to investment companies was enhanced from a recognition that some of

[^] At that time the AIC was known as the Association of Investment Trust Companies (AITC). It changed its name to the Association of Investment Companies in October 2006.

the provisions of the Combined Code may not be so relevant to investment companies because of their unique board structure and now includes a specific reference to the AIC Code. It confirms that the AIC Code and its accompanying guide can be used to assist boards in meeting their Listing Rules obligations in relation to the Combined Code. In other words, the preamble to the Combined Code now reflects the endorsement given by the FRC to the AIC.

In March 2009, the AIC published the fourth version of the AIC Code. It reflects changes made in the 2008 Combined Code and recent amendments to the Listing Rules following the Financial Services Authority's review of the Listing Rules for investment entities. It also contains other minor changes. At the same time the AIC has published this third edition of the AIC Guide. Pages 47 to 49 of the AIC Guide summarise the latest changes to the AIC Code. The FRC has also updated its endorsement letter which is reproduced on page 5 of the AIC Guide.

Appendix 2: Preamble to an investment company's corporate governance report

The following is suggested text for a preamble to an investment company's corporate governance report when using the AIC Code.

"The Board of XXX plc has considered the principles and recommendations of the AIC Code of Corporate Governance ("AIC Code") by reference to the AIC Corporate Governance Guide for investment Companies ("AIC Guide"). The AIC Code, as explained by the AIC Guide, addresses all the principles set out in Section 1 of the Combined Code, as well as setting out additional principles and recommendations on issues that are of specific relevance to XXX plc.

The Board considers that reporting against the principles and recommendations of the AIC Code, and by reference to the AIC Guide (which incorporates the Combined Code), will provide better information to shareholders.

The company has complied with the recommendations of the AIC Code and the relevant provisions of Section 1 of the Combined Code, except as set out below.

The Combined Code includes provisions relating to:

- the role of the chief executive
- executive directors' remuneration
- the need for an internal audit function

For the reasons set out in the AIC Guide, and in the preamble to the Combined Code, the Board considers these provisions are not relevant to the position of XXX plc, being an externally managed investment company. The company has therefore not reported further in respect of these provisions.

Main text including:

- *narrative explaining how the investment company has applied the principles of the AIC Code.*
- *areas of non-compliance with the AIC Code and/or non-compliance with Combined Code, reasons for non-compliance, period of non-compliance, etc."*

Note: when disclosing areas of non-compliance, it is not necessary to identify the specific recommendation of the AIC Code, or provision of the Combined Code (e.g. by the inclusion of paragraph/page numbers), or whether this issue is one that is covered only by the AIC Code, or the Combined Code, or both, providing that the area of non-compliance is clearly explained.

Important information

This document is intended to provide general guidance only and is not exhaustive. It has been prepared for the sole use of the AIC's Members. AIC Members in any doubt over their legal duties and responsibilities should take professional advice before relying on anything contained in this document. This document cannot in any way override the requirements of current legislation.

The AIC accepts no responsibility for any errors or omissions in this document or for any loss occasioned to any person or organisation acting or refraining from action as a result of any material contained in this document or any omissions.



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