

A Guide to Performance Appraisals for Non-Executive Directors of Investment Trust Companies

EXECUTIVE SUMMARY

IN RESPONSE TO THE RECOMMENDATIONS OF THE HIGGS REVIEW,
AS INCORPORATED INTO THE COMBINED CODE IN JULY 2003



THE ASSOCIATION OF
INVESTMENT TRUST COMPANIES

Foreword by Daniel Godfrey

In 2003, a number of new corporate governance initiatives were introduced which, collectively, introduce a number of new responsibilities which Boards must seek to fulfil.

The AITC has been involved in these initiatives and broadly, we believe that they can be implemented in such a way as to help, rather than hinder, Boards and Directors in the exercise of their responsibilities to shareholders.

The AITC Code, the new Combined Code and changes to the listing rules relating to investment trust companies all have implications for the work of Boards.

Some of the new requirements may well represent completely new ground for some Boards and some individual Directors. The AITC is determined that Boards should not be abandoned to invent the wheel on their own, each in their own way.

One of the new requirements which may well be causing concern is that Boards should conduct an evaluation of their performance as a Board and of the individual Directors.

Our research (amongst 40 directors of investment trusts, 8 directors of other quoted companies, 10 institutional investors, 6 private client advisors, 6 IFAs, 10 private investors, 10 managers, 6 brokers, 3 company secretaries, 2 regulators and 1 journalist) indicates that the conduct of the exercise can indeed be valuable in a process of constant improvement of the way in which the Board of an investment trust company can contribute to the successful attainment of the shareholders' objectives.

This guide, produced for the AITC by Trust Associates, provides some background to the requirement and desirability of conducting a formal Board evaluation. It proposes a variety of practical steps that Boards could take both to fulfil the requirements and to make sure that the exercise really does bring out any areas which could be improved.



Daniel Godfrey
Director General

Executive summary

The Higgs Review recommended that the board of a company should:

“...undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors”.

Performance appraisals for boards are now an integral part of the Combined Code.

The Higgs prescription is for a combination of self-assessment, peer assessment and (only sometimes, we think) third-party facilitation, all under the direction of the Chairman.

We recommend that investment trust boards should:

- Adhere to the spirit of the Combined Code guidance on appraisals;
- Follow the broad Higgs guidelines on method;
- Adapt the method to suit the circumstances and particular characteristics of the trust;
- Consider using third-party facilitation from time to time or in particular circumstances;
- Act on the findings as soon as is practicable, and take note of longer-term implications for board composition etc.;
- Be as open and positive as possible about the process.

We recommend that boards should appraise their skills and procedures in:

- Monitoring and, where appropriate, guiding investment activity;
- Performance measurement;
- Evaluating the manager’s stated investment strategy and portfolio management method;
- Understanding the macroeconomic environment in which the trust operates;
- Understanding the particular country, geographical region or industry sector in which specialist trusts operate;

- Understanding and monitoring investment risk;
- Overseeing both the implementation of gearing and its financing;
- Maintaining an appropriate perspective with regard to strategic issues and implementing fundamental changes where needed;
- The management of costs and the negotiation of management and other fees;
- The management of any discount to net asset value that may arise;
- Ensuring that there is sufficient liquidity in the market for the company's shares;
- Ensuring the company's compliance with company and tax laws, accounting, reporting and other regulations and the Combined Code;
- Communicating with the particular mix of shareholders which they represent and directing the promotion of the company to potential shareholders;
- Managing their own meetings and procedures;
- Planning board succession
- Dealing with the various service suppliers;

And, separately,

- The skill and independence of the Chairman.

Preferred approaches to the task may vary but some combination of questionnaire/checklist and interviews is likely to be the most efficient option.

Whatever method is used, it should:

- Cover the ground;
- Elicit as candid responses as possible;
- Be easy to analyse and act on.

We outline three possible approaches to evaluation:

1. DIY1: Self appraisal by interview only (For those boards which prefer to avoid committing any part of the appraisal process to paper and therefore to conduct the whole process verbally)
2. DIY2: Self appraisal using questionnaire and interview
3. Appraisal using Third Party Facilitation

There is no point in conducting an appraisal unless you are prepared to act on the findings where necessary or appropriate.

Well conducted appraisals have the potential to achieve various benefits, helping the board to:

- Confirm that the board has a suitable balance of skills and other attributes and focusing attention on the attributes required in any new director;
- Focus on any inadequacies;
- Identify strategic priorities;
- Develop skills, knowledge and understanding in the individual directors;
- Review its practices and procedures and thus to become more efficient and effective;
- Justify recommending the three yearly re-election of each Director (where appropriate).

The fact that an appraisal has been conducted should be reported in the Annual Report and Accounts, together with details of the method used, as appropriate. There is no requirement to report or comment on any findings of the review, although the Directors may wish to do so in some circumstances.

General guidance for questions to be addressed in an appraisal can be found after page 113 of the Higgs Review, which can be downloaded from: www.dti.gov.uk/cld/non_exec_review/

A practical appraisal questionnaire template for investment trusts, with guidance notes, can be found on the Trust Associates website: www.trustassociates.co.uk ; alternatively, a hard copy may be obtained from Lori Fox at the AITC.



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