

# The AIC Code of Corporate Governance

A framework of best practice for member companies

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The Association of Investment Companies (AIC) represents closed-ended investment companies whose shares are traded on public markets.

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### 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. This document is based on our current understanding of law and practice. This can change over time and information contained within this document is based on our understanding as at time of print.

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## 1 Introduction

The purpose of the AIC Code of Corporate Governance© (AIC Code) is to provide boards of our member companies with a framework of best practice in respect of the governance of investment companies. The AIC Code also enables boards to satisfy any requirements they may have in relation to the UK Corporate Governance Code (UK Code).

Investment companies have special factors which have an impact on their governance arrangements. These special factors arise principally from two features. Firstly, the customers and shareholders of an investment company are the same, thus simplifying stakeholder considerations while magnifying the importance of this group's concerns. Secondly, an investment company typically has no employees and the roles of CEO (unofficially), portfolio management, administration, accounting and company secretarial tend to be provided by a third party fund manager (or delegated by it to others) who may have created the company at the outset and have an important voice in the original appointments made to the board.

These factors mean that the fund manager is a more important stakeholder than a typical supplier. Accordingly, most of the AIC Code deals with matters such as board independence and the review of management and other third party contracts. In practice, most of the time spent by a board of a well-functioning investment company should be spent on matters of general corporate governance (e.g. investment strategy, performance monitoring, etc).

The AIC Code contains 21 principles of corporate governance for investment companies, each with detailed recommendations. Appendix 1 explains the basis for disclosing compliance with the AIC Code. It also explains the purpose of the AIC Corporate Governance Guide for Investment Companies (AIC Guide), which has been produced in conjunction with the AIC Code. It is recommended that users of the AIC Code also refer to the AIC Guide.

Appendix 2 of the AIC Guide summarises the changes which have been made to the July 2016 edition of the AIC Code.

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

Corporate governance does not exist in a vacuum and the AIC encourages shareholders to engage with boards where and when appropriate and to give careful consideration to boards' proposals.

**Ian Sayers**  
**Chief Executive**

## 2 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 UK Corporate Governance 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 and who follow the AIC Guide will be meeting their obligations in relation to the Combined Code (now called the UK Corporate Governance Code (UK Code)) and paragraph 9.8.6 of the Listing Rules. On 14 July 2016, the FRC provided the AIC with an updated endorsement letter to cover the July 2016 edition of the AIC Code. The FRC's letter of endorsement is shown on page 6.

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 short statement. This would explain that all the issues on which they do not report in detail are excluded because they are deemed to be irrelevant to the 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 in relation to 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 UK Code. This preamble can be found in Appendix 2.



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Sir Winfried Bischoff  
Chairman

14 July 2016

*Dear Jan,*

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

The changes to the AIC Code and Guide which reflect the updates made to the UK Corporate Governance Code in April 2016 are welcomed by the FRC and will ensure that the two Codes continue to be consistent.

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

*Yours sincerely  
Winfried*

### 3 Background to the AIC Code

The AIC Code is built around an understanding of what shareholders want or expect to achieve by holding shares in investment companies and the role boards play in delivering these objectives.

#### What investment company shareholders want

- The best possible share price total return with an acceptable level of risk consistent with the objectives of the company.
- Clear objectives and transparent investment policies so that they can understand what they are buying and the risk:reward dynamics that apply.
- A low expense ratio consistent with proper incentivisation for outstanding performance and quality service.
- Good liquidity so that they can sell (or buy more) shares easily.
- Good communication from the board and fund managers.

#### The role boards play in delivering these objectives

- To bear the ultimate responsibility to shareholders at all times and over all issues notwithstanding any delegation of responsibilities to third parties.
- The provision of an external view to support and add a different perspective to the manager to help optimise performance.
- Striking the right balance between cost control and incentivisation to retain as much value as possible for shareholders whilst providing appropriate encouragement to managers to deliver superior returns at acceptable levels of risk.
- The provision of an objective view on the benefits and timing of gearing decisions.
- Ensuring that marketing, promotion and investor relations are conducted professionally, efficiently and cost effectively.
- Objective monitoring of fund manager performance and willingness to press for remedial action if necessary.
- Monitoring and responding to shareholder opinion.
- Regular review of the structure, objectives, target audiences, fund manager and continued existence of the company.
- Maintaining proper internal controls.
- Ensuring that effective shareholder communications are established.
- Ensuring that the fund manager manages within the agreed parameters set by the board.

### Fundamentals behind the AIC Code

- Directors must put the interests of shareholders above all others.
- Directors must treat all shareholders fairly.
- Directors should be prepared to resign or take steps that could lead to a loss of office at any time in the interests of long-term shareholder value.
- Directors should ensure that they address all issues of relevance and that they disclose the outcomes of those deliberations in a way that shareholders with limited financial knowledge can understand.

## 4 Principles of the AIC Code

### The Board

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

### Board meetings and the relationship with the manager

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

## Shareholder communications

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

## 5 Detailed Recommendations

### The Board

#### 1. The Principle – The Chairman should be independent.

##### Recommendations

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role. 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.

The chairman should not be:

- an employee of the manager or an ex-employee who has left the employment of the manager within the last five years;
- an executive of a self-managed company or an ex-employee who has left the executive team of a self-managed company within the last five years; or
- a professional adviser who has provided services to the manager or the board within the last three years.

The chairman should not serve on any other board 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 senior independent director or SID (who would fulfil the role of a deputy chairman). Alternatively, it may be appropriate for the chairman of the audit committee to fulfil this role. The SID can take the lead in the annual evaluation of the chairman. He/She can act as a channel of communication for shareholders where contact through the chairman has failed to resolve concerns or where contact with the chairman is inappropriate. He/She can also provide a sounding board for the chairman and serve as an intermediary for the other directors when necessary.

#### 2. The Principle – A majority of the board should be independent of the manager.

##### Recommendations

An independent majority is required for a UK listing and is best practice for other member companies.

Some shareholders may also expect no more than one current or recent<sup>1</sup> employee of, or professional adviser to, the manager to serve on a board. The board may wish

<sup>1</sup> 'Recent' 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.

to consider whether any such directors should offer themselves for re-election annually (if they do not do so already).

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 on the number of current or recent<sup>1</sup> 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 for the purposes of fulfilling the requirement that there must be an independent majority.

The report on the annual evaluation of the board (see principle 7) should state that each director's independence has been considered. The board should also 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.

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.

**3. The Principle – Directors should be submitted for re-election at regular intervals. Nomination for re-election should not be assumed but be based on disclosed procedures and continued satisfactory performance.**

#### **Recommendations**

Directors of FTSE 350 companies should be subject to annual re-election by shareholders. All other directors should be subject to election by shareholders at the first AGM after their appointment and to re-election thereafter at intervals of no more than three years. Non-executive directors serving more than nine years should be subject to annual re-election.

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.

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.

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

#### **Recommendations**

As mentioned in principle 2, some market participants believe directors should not be considered independent after nine years of 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 B.1.1 of the UK 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 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 UK Code (which recognises that investment companies may find some of the standard provisions of the UK Code inappropriate<sup>2</sup>) 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/she could continue as a director thereafter if consistent with the board's policy on tenure.

#### 5. The Principle – There should be full disclosure of information about the board.

##### **Recommendations**

###### Individual directors

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 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;
- shared directorships of any commercial company with other board members;
- 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.)

###### Board

The annual report should identify the chairman and the senior independent director (if there is one). It should also set out the number of meetings of the board and individual attendance by directors.

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<sup>2</sup> See the UK Corporate Governance Code, Comply or Explain, page 4, paragraph 5.

### Committees

The board should disclose in the annual report what arrangements it has made for an audit, remuneration, nomination and management engagement committee and the chairmen and members of those committees. It should also set out the number of meetings of those committees and individual attendance by directors.

### 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).

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 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 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 board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.

The audit committee as a whole shall have competence relevant to the sector.

The main role and responsibilities of the audit committee should include:

- where requested, providing advice to the board on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy;
- monitoring 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;
- reviewing 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, reviewing the company's internal control and risk management systems;
- monitoring and reviewing the effectiveness of the company's internal audit function where it has one;
- making 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 approving the remuneration and terms of engagement of the external auditor;
- reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;

- developing and implementing policy on the engagement of the external auditor to supply non-audit services, taking into account relevant 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; and
- reporting to the board on how it has discharged its responsibilities.

A separate section of the annual report should describe the work of the audit committee in discharging its responsibilities. The report should include:

- the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed;
- an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or re-appointment of the external auditor, and information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans; and
- if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence are safeguarded.

#### 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.

If the board has decided that the entire board should fulfil the role of the 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 remuneration committee.

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

The main role and responsibilities of the remuneration committee should include:

- in conjunction with the chairman, to setting the directors' remuneration levels;
- judging where to position the company relative to other companies; and
- considering the need to appoint external remuneration consultants.

#### Nomination committee

The nomination committee is covered in principle 9.

#### Management engagement committee

The management engagement committee is covered in principle 15.

#### Formal terms of reference

If separate audit, remuneration, nomination 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).

#### Annual report and accounts

Directors should explain in the annual report their responsibility for preparing the accounts. They should state that they consider the annual report and accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the company's position and performance, business model and strategy. There should be a statement by the auditors about their reporting responsibilities.

**6. The Principle – The board should aim to have a balance of skills, experience, length of service and knowledge of the company.**

#### **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 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. Directors should also consider the diversity of the board, including gender. Directors should ensure that they can devote sufficient time to the company to carry out their duties effectively.

Similar considerations should be applied to committees of the board to ensure that membership is refreshed and that undue reliance is not placed on particular individuals.

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

#### **Recommendations**

The process of board evaluation should be explained in the annual report. For FTSE 350 companies, board evaluation should be externally facilitated at least every three years. The external facilitator should be identified in the annual report. Any connections between the company and the facilitator should be disclosed.

Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness.

**8. The Principle – Directors' 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/her own remuneration.

Where remuneration consultants are appointed, they should be identified in the annual report and a statement made as to whether they have any other connection with the company.

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.

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 or other performance-related elements.

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.

**9. The Principle – 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.

The annual report should include a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.

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. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.

**10. The Principle – 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. The chairman should regularly review and agree with each director their training and development needs.

11. The Principle – 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 its 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.

### **Board meetings and the relationship with the manager**

12. The Principle – 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 investment company, taking the initiative on all aspects of its operations, under the guidance and formal approval of the board.

13. The Principle – 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**

The board sets the level of gearing and asset allocation and 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 take into account the company's investment policy and its responsibility for delivering the long-term investment objectives, as well as the principal risks associated with pursuing the investment strategy.

Boards should focus on share price performance as well as net asset value performance.

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. Where appropriate, a representative of the management company should be invited to attend board meetings to report on activities in relation to the investment company.

The directors should have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities properly.

#### 14. The Principle – 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; and
- the investment mandate and long-term investment strategy and performance of the company and appropriate guidelines within which the manager should operate.

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

##### Recommendations

Either the whole board or a management engagement committee consisting solely of directors independent of the manager (or executives) should make this review annually with its decisions and rationale described in the annual report. If the whole board carries out this review, it should explain in the annual report why it has done so rather than establish a separate management engagement 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 management engagement committee. In either case, only directors independent of the manager should be involved with reviewing the performance of, and contractual arrangements with, the manager.

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;
  - a high water mark; and
  - a combination of short-term and long-term measurements and incentives.
- monitoring the company's risk management and internal control systems designed to safeguard shareholders' investment and the company's assets. A review of the effectiveness of these systems should be made annually by the board and reported to shareholders in the annual report.

**16.The Principle – 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 may include:

- 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 UK Stewardship Code;
- 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; and
- 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 should take into account any regulatory requirements regarding soft commission arrangements.

**17. The Principle – 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, including:

- the investment mandate and objective;
- the effectiveness of marketing and shareholder communication strategies. In particular, the board should mitigate any potential conflicts that the manager may have in promoting the company alongside competing products;
- measures of investor sentiment;
- share buy-backs and treasury shares; and
- the number and position of competitive companies in their peer group.

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

#### **Recommendations**

The board should determine which non-portfolio management services (such as secretarial, custody, settlement, registration) should be sub-contracted and establish 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.

Boards should satisfy themselves that the auditor is not conflicted by any work carried out for the manager and that any potential conflict has been satisfactorily resolved.

## Shareholder communications

19. The Principle – 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.

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. The chairman should ensure that all directors are made aware of the issues and concerns raised by major shareholders.

The chairman, and where appropriate the SID and/or other non-executive directors, should meet with major shareholders to discuss governance and strategy and to understand their issues and concerns. 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 chairman of the board should ensure that the remuneration committee chairman maintains contact as required with the principal shareholders about remuneration. Where there is no separate remuneration committee, responsibility for maintaining contact with the principal shareholders should rest with the company chairman or a nominated director.

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.

The board should use general meetings 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.

For each resolution, where a vote has been taken on a show of hands, 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 appointments have been validly made;
- 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.

When, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result.

The company should arrange for notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting. For other general meetings this should be at least 14 working days in advance.

20.The Principle – 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.

21.The Principle – 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 board should establish arrangements that enable it to ensure that the information presented is fair, balanced and understandable. The company should publish its investment objective and investment policy in the annual report. In addition, the following should be disclosed to shareholders in the annual report in as plain language as possible:

- a detailed discussion of those areas of decision-making reserved for 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?). Disclosure should include the manager's remit regarding voting and corporate governance issues in respect of holdings in the company's portfolio;<sup>3</sup>
- a discussion of the manager's overall performance, for example, 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. Where it is not contained in the annual report, a reference should be given explaining where it can be found. This will enable shareholders to know precisely what securities their company is investing in. There may, however, be circumstances when a board decides that such disclosures would not be in the best interests of shareholders (e.g. where the portfolio is invested in illiquid assets);
- ongoing charges information.<sup>4</sup>

<sup>3</sup> For more information, please refer to the AIC's guidance note on the UK Stewardship Code which is available on the AIC's website at [www.theaic.co.uk/technical](http://www.theaic.co.uk/technical)

<sup>4</sup> For more information, please refer to the AIC's paper on 'Ongoing Charges' which is available on the AIC's website at [www.theaic.co.uk/technical](http://www.theaic.co.uk/technical)

- details of the performance fee arrangements in place including, where relevant, the outperformance required in percentage terms, the name of the relevant benchmark, and information about any high-water mark, hurdle rate, catch-up etc.;
- 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. Where companies have covenants, shareholders should have sufficient information to understand the consequences of any material breach;
- where appropriate, 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);
- a statement from the directors as to whether they considered it appropriate to adopt the going concern basis of accounting in preparing the annual financial statements, identifying any material uncertainties to the company's ability to continue to adopt this basis over a period of at least twelve months from the date of approval of the financial statements. This statement should also be made in the half-yearly financial statements;
- confirmation from the directors that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated;
- an explanation from the directors about how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate, taking into account the company's current position and principal risks. The directors should also state whether they have a reasonable expectation that the company will be able to continue in operation and meets its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

## **Appendix 1: Compliance Statement**

The AIC Code is 'principles' rather than 'rules' based. The detailed recommendations recognise that most issues boards face may have different 'right' approaches depending on the individual circumstances of the company. To give greater transparency to investors, it should be best practice for AIC members to state in their annual report whether they are adhering to the principles and following the recommendations contained in the AIC Code and if not, to explain why and, where appropriate, to detail the steps they intend to take to bring themselves into line in future.

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

AIC member companies may also make a statement that, by reporting against the AIC Code and by following the AIC Guide (see below), they are meeting their obligations under the UK Corporate Governance Code (and associated disclosure requirements under paragraph 9.8.6 of the Listing Rules) and as such do not need to report further on issues contained in the UK Corporate Governance Code which are irrelevant to them (as explained in the AIC Guide). Suggested wording for this statement can be found in Appendix 2.

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

### **AIC Corporate Governance Guide for Investment Companies**

In conjunction with the AIC Code, the AIC has also produced the AIC Corporate Governance Guide for Investment Companies (AIC Guide). This is a comprehensive guide on corporate governance which describes the relevance and applicability of each recommendation of the UK Corporate Governance Code to investment companies and documents how the AIC Code translates the UK Corporate Governance Code into a framework suitable for the industry's unique structure.

## **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 and the AIC Guide.

"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 the UK Corporate Governance 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 UK Corporate Governance Code), will provide better information to shareholders.

The company has complied with the recommendations of the AIC Code and the relevant provisions of the UK Corporate Governance Code, except as set out below.

The UK Corporate Governance 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 as explained in the UK Corporate Governance Code, the Board considers these provisions are not relevant to the position of XXX plc, being an externally managed investment company. In particular, all of the company's day-to-day management and administrative functions are outsourced to third parties. As a result, the company has no executive directors, employees or internal operations. 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; and*
- *areas of non-compliance with the AIC Code and/or non-compliance with UK Corporate Governance Code, reasons for non-compliance, period of non-compliance, etc."*

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The logo for the Association of Investment Companies (aic) consists of the lowercase letters 'aic' in a bold, red, sans-serif font.

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