



The Association of
Investment Companies

Corporate Governance Guide for Investment Companies

Incorporating the UK Corporate Governance Code and the AIC
Code of Corporate Governance©

July 2016

Contact details

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 AIC Corporate Governance Guide for Investment Companies (AIC Guide) brings together the recommendations of the UK Corporate Governance Code (UK Code) and the AIC Code of Corporate Governance© (AIC Code) into a single document and demonstrates how the AIC Code translates each principle of the UK Code into principles and recommendations suitable to the industry's unique structure. The guide will be useful for investment company directors, company secretaries and managers, as well as advisers to the sector and others who have an interest in corporate governance best practice.

This guide sets out the main principles of the UK Code, along with their supporting principles and provisions, and describes their relevance and applicability to investment companies. It also sets out the AIC Code and demonstrates how the AIC Code translates each element of the UK Code into principles and recommendations suitable to the industry's unique structure. The UK Code explains that externally managed investment companies typically have unique board structures which mean that not all of its provisions are appropriate.

The AIC Code provides boards of our member companies with a framework of best practice in respect of the governance of investment companies. The FRC, the body responsible for the UK Code, has confirmed that AIC member companies who report against the AIC Code and who follow the AIC Guide will be meeting their Listing Rules obligations in relation to reporting against the UK Code. Page 6 contains a letter of endorsement from the FRC to this effect.

AIC member companies can make a statement in their corporate governance report to explain that, by reporting against the AIC Code and by following the AIC Guide, they are meeting their Listing Rules obligations in relation to the UK Code and as such do not need to report further on issues contained in the UK Code which are irrelevant to them. Suggested wording for this statement can be found in Appendix 1.

Users of this guide may also want to refer to the separate AIC Code. The most recent changes to the AIC Code are explained in Appendix 2 to the AIC Guide.

We hope that you find this guide useful.

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 1.



Ian Sayers
Chief Executive
The Association of Investment Companies
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Sir Winfried Bischoff
Chairman

14 July 2016

Dear Ian,

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 Corporate Governance best practice – overview

The following table shows the main principles of the UK 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. More detail can be found in the next section.

UK Code principles	AIC Code principles
Leadership	
<p><u>The role of the board</u> Every company should be headed by an effective board which is collectively responsible for the long-term success of the company. (A.1)</p>	<p><i>The following AIC principles address the role of an investment company board:</i></p> <p>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)</p> <p>Boards should monitor the level of the share price discount or premium (if any) and, if desirable, take action to reduce it. (17)</p> <p>Boards and managers should operate in a supportive, co-operative and open environment. (12)</p>
<p><u>Division of responsibilities</u> 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)</p>	<p><i>With the exception of self-managed companies, executive responsibility for an investment company lies with the investment management company. The following AIC principle address the relationship between the board and the management company:</i></p> <p>The board should agree policies with the manager covering key operational issues. (16)</p>
<p><u>The Chairman</u> The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role. (A.3)</p>	<p><i>This is covered as part of the recommendations to AIC principle 1:</i></p> <p>The chairman should be independent. (1)</p>
<p><u>Non-executive directors</u> As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. (A.4)</p>	<p>Boards should give sufficient attention to overall strategy. (14)</p>
Effectiveness	
<p><u>The composition of the board</u> The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively. (B.1)</p>	<p><i>The following AIC principles address board balance and independence for investment companies:</i></p> <p>The chairman should be independent. (1)</p> <p>A majority of the board should be independent of the manager. (2)</p> <p>The board should aim to have a balance of skills, experience, length of service and knowledge of the company. (6)</p> <p>There should be full disclosure of information about the board. (5)</p>

UK Code principles

AIC Code principles

Appointments to the board

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. (B.2)

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)

Commitment

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively. (B.3)

This is covered as part of the recommendations to AIC principle 6:

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

Development

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge. (B.4)

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

Information and support

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. (B.5)

This is covered as part of the recommendations to AIC 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. (13)

Evaluation

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

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

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

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

Re-election

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. (B.7)

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. (3)

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

Accountability

Financial and business reporting

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

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)

Risk management and internal control

The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems. (C.2)

The following AIC principles and their recommendations are relevant – AIC principle 13 (primary focus of board meetings), AIC principle 15 (performance of the manager), AIC principle 16 (operational issues with the manager) and principle 18 (evaluation of other service providers).

Audit committee and auditors

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors. (C3)

The following AIC principles and their recommendations are relevant – AIC principle 5 (disclosure of information about the board) and principle 18 (evaluation of other service providers).

Remuneration

The level and components of remuneration

Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied. (D.1)

Remuneration issues for investment company boards are covered in AIC principle 8:

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

Procedure

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. (D.2)

Remuneration issues for investment company boards are covered in AIC principle 8:

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

Relations with shareholders

Dialogues with 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. (E.1)

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)

Constructive use of general meetings

The board should use general meetings to communicate with investors and to encourage their participation. (E.2)

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)

4 Corporate Governance best practice – in detail

This section sets out the full text of the UK Code and the AIC Code. After each UK Code principle and supporting provisions, the corresponding principles and recommendations from the AIC Code are presented (in a red box).

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

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 recommendations of the AIC Code and should disclose and explain these aspects in the context of their structure.

5 The UK Corporate Governance Code

Section A: Leadership

A.1: The Role of the Board

Main Principle

Every company should be headed by an effective board which is collectively responsible for the long-term success of the company [see AIC principle 13].

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 read as performance of the management company or executives of a self-managed investment company, see AIC principle 15]. 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 act in what they consider to be the best interests of the company, consistent with their statutory duties¹.

Code Provisions

A.1.1. The board should meet sufficiently regularly to discharge its duties effectively. [Items for discussion at investment company board meetings include those covered in AIC principles 13, 14, 15, 17 and 18.] 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 principles 5, 16 and 21].

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 board committees² [see AIC principle 5]. It should also set out the number of meetings of the board and those committees and individual attendance by directors.

A.1.3. The company should arrange appropriate insurance cover in respect of legal action against its directors [see AIC principle 8].

¹ For directors of UK incorporated companies, these duties are set out in the Sections 170 to 177 of the Companies Act 2006.

² Provisions A.1.1 and A.1.2 overlap with the FCA Rule DTR 7.2.7 R; Provision A.1.2 also overlaps with DTR 7.1.5 R (see Schedule B).

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

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.

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.

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.

A.2: Division of Responsibilities

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, see principle 16.] No one individual should have unfettered powers of decision.

Code Provision

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.

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

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.

A.3: The Chairman

Main Principle

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role [\[see AIC principle 1\]](#).

Supporting Principles

The chairman is responsible for setting the board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues. The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors [\[only relevant for self-managed investment companies; for externally managed investment companies this should be taken as the relationship between the investment management company and the board, see AIC principle 12\]](#).

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information [\[see AIC principle 13\]](#). The chairman should ensure effective communication with shareholders [\[see AIC principle 19\]](#).

Code Provision

A.3.1. The chairman should on appointment meet the independence criteria set out in B.1.1 below [\[see AIC principle 1\]](#). 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 report³ [other than self-managed investment companies, investment companies do not have a chief executive].

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.

A.4: Non-Executive Directors

Main Principle

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy [see AIC principle 14].

³ Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.

Supporting Principle

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 [see AIC principle 15]. 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, and in succession planning [see AIC principle 6].

Code Provisions

A.4.1. The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman [see AIC principle 1] and to serve as an intermediary for the other directors when necessary. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate [see AIC principle 1].

A.4.2. 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 and on such other occasions as are deemed appropriate.

A.4.3. 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].

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.

Section B: Effectiveness

B.1: The Composition of the Board

Main Principle

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively [see AIC principle 6].

Supporting Principles

The board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy.

The board should include an appropriate combination 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].

The 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 [see AIC principle 6].

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 [see AIC principle 13]. [An investment company may also have a management engagement committee and the same principles should apply, see AIC principle 15.]

Code Provisions

B.1.1. The board should identify in the annual report each non-executive director it considers to be independent⁴ [AIC principle 1 and 2 cover 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;

⁴ A.3.1 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.

- 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 could be considered independent after nine years of service.]

B.1.2. Except for smaller companies⁵, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent [see AIC principle 2]. A smaller company should have at least two independent non-executive directors.

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

⁵ A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

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^A 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 (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^A 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.

^A'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.

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.

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.

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, 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.

B.2: Appointments to the Board

Main Principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board [\[see AIC principle 9\]](#).

Supporting Principles

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender [\[see AIC principle 6\]](#).

The board should satisfy itself that plans are in place for orderly succession for appointments to the board [\[see AIC principle 6\]](#) 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 and to ensure progressive refreshing of the board.

Code Provisions

B.2.1. There should be a nomination committee which should lead the process for board appointments and make recommendations to the board [\[see AIC principle 9\]](#). 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 [\[see AIC principle 9\]](#). The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board⁶ [\[see AIC principle 5\]](#).

B.2.2. The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

B.2.3. Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director [\[see AIC principle 3\]](#). Any term beyond six years for a non-executive director should be

⁶ 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.

subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.

B.2.4. A separate section of the annual report should describe the work of the nomination committee⁷, including the process it has used in relation to board appointments [see AIC principle 9]. This section 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 [see AIC principle 9]. 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]. 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 [see AIC principle 19].

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.

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

⁷ The provision overlaps with FCA Rule DTR 7.2.7 R (see Schedule B).

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.

B.3: Commitment

Main Principle

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively [\[see AIC principle 6\]](#).

Code Provisions

B.3.1. 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.

B.3.2. The terms and conditions of appointment of non-executive directors should be made available for inspection⁸. 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.

B.3.3. 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 [\[only relevant for self-managed investment companies\]](#).

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

⁸ The 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).

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.

B.4: Development

Main Principle

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge [\[see AIC principle 10\]](#).

Supporting Principles

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 [\[see AIC principle 10\]](#). The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

To function effectively all directors need appropriate knowledge of the company and access to its operations and staff [\[see AIC principle 13\]](#).

Code Provisions

B.4.1. The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders [\[see AIC principle 19\]](#).

B.4.2. The chairman should regularly review and agree with each director their training and development needs [\[see AIC principle 10\]](#).

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.

B.5: Information and Support

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 [see AIC principle 13].

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.

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

B.5.1. 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 [see AIC principle 13]. Committees should be provided with sufficient resources to undertake their duties.

B.5.2. 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.

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.

B.6: 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 [\[see AIC principle 7\]](#).

Supporting Principles

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 [\[see AIC principle 7\]](#).

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 [\[see AIC principle 6\]](#).

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).

Code Provisions

B.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 [\[see AIC principle 7\]](#).

B.6.2. Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years [\[see AIC principle 7\]](#). The external facilitator should be identified in the annual report [\[see AIC principle 7\]](#) and a statement made as to whether they have any other connection with the company [\[see AIC principle 7\]](#).

B.6.3. 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].

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.

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.

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.

B.7: Re-election

Main Principle

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance [see AIC principle 3].

Code Provisions

B.7.1. All directors of FTSE 350 companies should be subject to annual election by shareholders [see AIC principle 3]. All other 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 [see AIC principle 3]. Non-executive directors who have served longer than nine years should be subject to annual re-election [see AIC principle 3]. 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 [see AIC principle 3].

B.7.2. 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.

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^B) 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.

^B See the UK Corporate Governance Code, Comply or Explain, page 4, paragraph 5.

Section C: Accountability

C.1: Financial and Business Reporting

Main Principle

The board should present a fair, balanced and understandable assessment of the company's position and prospects [\[see AIC principle 21\]](#).

Supporting Principles

The board's responsibility to present a fair, balanced 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 [\[for an investment company, the key reports are the annual financial report and the half-yearly financial report\]](#).

The board should establish arrangements that will enable it to ensure that the information presented is fair, balanced and understandable [\[see AIC principle 21\]](#).

Code Provisions

C.1.1. The directors should explain in the annual report their responsibility for preparing the annual report and accounts [see AIC principle 5], and state that they consider 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 [see AIC principle 5]. There should be a statement by the auditor about their reporting responsibilities⁹ [see AIC principle 5].

C.1.2. The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company¹⁰ [this will be set out in an investment company's investment policy, see AIC principle 21].

C.1.3. In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.¹¹

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^C;
- 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.;

⁹ This requirement may be met by the disclosures about the audit scope and responsibilities of the auditor included, or referred to, in the auditor's report pursuant to the requirements of ISA (UK) 700, "Forming an Opinion and Reporting on Financial Statements". Copies are available from the FRC website.

¹⁰ Section 414C(8) (a) and (b) of the Companies Act 2006 requires a description of a company's business model and strategy as part of the Strategic Report that forms part of the annual report. Guidance as to the matters that should be considered in an explanation of the business model and strategy is provided in the FRC's "Guidance on the Strategic Report". Copies are available from the FRC website.

¹¹ This provision overlaps with FCA Rules LR 9.8.6 R (3) (see Schedule B). Additional information relating to C.1.3 and C.2 can be found in "Guidance on Risk Management, Internal Control and Related Financial and Business Reporting". Copies are available from the FRC website.

- 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^D;
- 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.

^C 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

^D 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

C.2: Risk Management and Internal Control

Main Principle

The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives [see AIC principle 13]. The board should maintain sound risk management and internal control systems [see AIC principle 15].

Code Provisions

C.2.1. The directors should confirm in the annual report 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.

C.2.2. Taking account of the company's current position and principal risks, the directors should explain in the annual report 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. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.¹²

C.2.3. The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report.¹³ The monitoring and review should cover all material controls, including financial, operational and compliance controls [see AIC principle 15].

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.

¹² This provision overlaps with FCA Rules LR 9.8.6 (3) R (see Schedule B).

¹³ In addition FCA 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.

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.

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.

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.

C.3: Audit Committee and Auditors¹⁴

Main Principle

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management 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 [see AIC principle 5]. 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 [see AIC principle 5].

¹⁴ "Guidance on Audit Committees" suggests means of applying this part of the Code. Copies are available from the FRC website.

¹⁵ See footnote 5.

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 in which the company operates.¹⁶

C.3.2. The main role and responsibilities of the audit committee should be set out in written terms of reference¹⁷ [see AIC principle 5] and should include [see AIC principle 5]:

- 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; and
- to report to the board on how it has discharged its responsibilities.

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 [see AIC principle 5].

C.3.4. Where requested by the board, the audit committee should provide advice 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 [see AIC principle 5].

C.3.5. The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters

¹⁶ This provision overlaps with FCA Rule DTR 7.1.1A R (see Schedule B).

¹⁷ The provision overlaps with FCA Rules DTR 7.1.3 R (see Schedule B).

¹⁸ See footnote 6.

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.3.6. The audit committee should monitor and review the effectiveness of the internal audit activities [there is unlikely to be a need for an internal audit function for an externally managed investment company]. Where there is no internal audit function, 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.3.7. The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors¹⁹ [see AIC principle 5]. 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.3.8. A separate section of the annual report should describe the work of the committee in discharging its responsibilities²⁰ [see AIC principle 5]. The report should include [see AIC principle 5]:

- 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 reappointment of the external auditor, 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.

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;

¹⁹ This overlaps with Part 3 of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 and the requirements of Chapter 2 of Part 16 of the Companies Act 2006 as inserted by the Statutory Auditors and Third Country Auditors Regulations 2016 on the appointment of auditors to public companies that are Public Interest Entities.

²⁰ This provision overlaps with FCA Rules DTR 7.1.5 R and 7.2.7 R (see Schedule B).

- 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.

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 board should satisfy itself that at least one member of the audit committee has recent, 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, 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.

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.

Section D: Remuneration

D.1: The Level and Components of Remuneration

Main Principle

Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied [\[only relevant for self-managed investment companies\]](#).

Supporting Principles

The remuneration committee should judge where to position their company relative to other companies [\[see AIC principle 8\]](#). 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 corporate and individual performance, and should avoid paying more than is necessary [\[see AIC principle 8\]](#).

They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases [\[only relevant for self-managed investment companies\]](#).

Code Provisions

D.1.1. In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code [\[only relevant for self-managed investment companies\]](#). Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.

D.1.2. Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report²¹ should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is [\[only relevant for self-managed investment companies\]](#).

²¹ As required for UK incorporated companies under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2013.

D.1.3. Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role [see AIC principle 8]. Remuneration for non-executive directors should not include share options or other performance-related elements [see AIC principle 8]. 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 B.1.1).

D.1.4. 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 [see AIC principle 8]. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.

D.1.5. 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 [see AIC principle 8].

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.

D.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 [see AIC principle 8]. No director should be involved in deciding his or her own remuneration [see AIC principle 8].

Supporting Principles

The remuneration committee should take care to recognise and manage conflicts of interest when receiving views from executive directors or senior management, or consulting the chief executive about its proposals. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration [only relevant for self-managed investment companies].

The chairman of the board should ensure that the committee chairman maintains contact as required with its principal shareholders about remuneration [see AIC principle 19].

Code Provisions

D.2.1. The board should establish a remuneration committee of at least three, or in the case of smaller companies²² two, independent non-executive directors [see AIC principle 5]. 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 [see AIC principle 5]. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board²³ [see AIC principle 5]. 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 [see AIC principle 8].

D.2.2. The remuneration committee should have delegated responsibility for setting remuneration for all executive directors [only relevant for self-managed investment companies] and the chairman, including pension rights and any compensation payments. 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].

D.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.

D.2.4. Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules²⁴) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules [only relevant for self-managed investment companies].

²² See footnote 5.

²³ This provision overlaps with FCA Rule DTR 7.2.7 R (see Schedule B).

²⁴ Listing Rules LR 9.4. Copies are available from the FCA website.

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.

Section E: Relations with shareholders

E.1: Dialogue with 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 place.²⁵

Supporting Principles

Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman should ensure that all directors are made aware of their major shareholders’ issues and concerns.

²⁵ Nothing in these principles or provisions should be taken to override the general requirements of law to treat shareholders equally in access to information

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

Code Provisions

E.1.1. The chairman should ensure that the views of shareholders are communicated to the board as a whole [see AIC principle 19]. The chairman should discuss governance and strategy with major shareholders [see AIC principle 19]. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders [see AIC principle 19]. 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 [see AIC principle 19].

E.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 the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion [see AIC principle 19].

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.

E.2: Constructive Use of General Meetings

Main Principle

The board should use general meetings to communicate with investors and to encourage their participation [see AIC principle 19].

Code Provisions

E.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 [see AIC principle 19]. 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 [see AIC principle 19]. 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 [see AIC principle 19].

E.2.2. The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. 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 [see AIC principle 19]:

- 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.

E.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.

E.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 [see AIC principle 19]. For other general meetings this should be at least 14 working days in advance.

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.

6 Schedule A: The design of performance-related remuneration for executive directors

Balance

The remuneration committee should determine an appropriate balance between fixed and performance-related, immediate and deferred remuneration. Performance conditions, including non-financial metrics where appropriate, should be relevant, stretching and designed to promote the long-term success of the company. Remuneration incentives should be compatible with risk policies and systems. Upper limits should be set and disclosed.

The remuneration committee should consider whether the directors should be eligible for annual bonuses and/or benefits under long-term incentive schemes.

Share-based remuneration

Traditional share option schemes should be weighed against other kinds of long-term incentive scheme. Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.

Any new long-term incentive schemes which are proposed should be approved by shareholders and should preferably replace any existing schemes or, at least, form part of a well-considered overall plan incorporating existing schemes. The total rewards potentially available should not be excessive.

For share-based remuneration the remuneration committee should consider requiring directors to hold a minimum number of shares and to hold shares for a further period after vesting or exercise, including for a period after leaving the company, subject to the need to finance any costs of acquisition and associated tax liabilities. In normal circumstances, shares granted or other forms of deferred remuneration should not vest or be paid, and options should not be exercisable, in less than three years. Longer periods may be appropriate. Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block.

Pensions

In general, only basic salary should be pensionable. The remuneration committee should consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration, especially for directors close to retirement.

7 Schedule B: Disclosure of corporate governance arrangements

Corporate governance disclosure requirements are set out in three places:

- FCA Disclosure and Transparency Rules (“DTR”) sub-chapters 7.1 and 7.2, which set out certain mandatory disclosures;
- FCA Listing Rules (“LR”) 9.8.6 R, 9.8.7 R, and 9.8.7A R, which includes the “comply or explain” requirement; and
- The UK Corporate Governance Code (“the Code”) – in addition to providing an explanation where they choose not to comply with a provision, companies must disclose specified information in order to comply with certain provisions.

These requirements are summarised below, with the full text contained in the relevant chapters of the FCA Handbook.

The DTR sub-chapters 7.1 and 7.2 apply to issuers whose securities are admitted to trading on a regulated market (this includes all issuers with a Premium or Standard listing). The LR 9.8.6 R, 9.8.7 R and 9.8.7A R and the Code apply to issuers of Premium listed equity shares only.

There is some overlap between the mandatory disclosures required under the DTR and those expected under the Code. Areas of overlap are summarised in the Appendix to this Schedule. In respect of disclosures relating to the audit committee and the composition and operation of the board and its committees, compliance with the relevant provisions of the Code will result in compliance with the relevant Rules.

Disclosure and Transparency Rules

DTR sub-chapter 7.1 concerns audit committees or bodies carrying out equivalent functions.

DTR 7.1.1 R, 7.1.1A R and 7.1.3 R set out requirements relating to the composition and functions of the committee or equivalent body:

- DTR 7.1.1 R states that an issuer must have a body or bodies responsible for performing the functions set out in DTR 7.1.3 R.
- DTR 7.1.1A R requires that a majority of the members of the relevant body must be independent, at least one member must have competence in accounting or auditing, or both, and that members of the relevant body as a whole must have competence relevant to the sector in which the issuer is operating.
- DTR 7.1.2 G states that the requirements for independence and competence in accounting and/or auditing may be satisfied by the same members or by different members of the relevant body.
- DTR 7.1.3 R states that an issuer must ensure that, as a minimum, the relevant body must:
 1. monitor the financial reporting process and submit recommendations or proposal to ensure its integrity;

2. monitor the effectiveness of the issuer's internal quality control and risk management systems and, where applicable, its internal audit, regarding the financial reporting of the issuer, without breaching its independence;
3. monitor the statutory audit of the annual and consolidated financial statements, in particular, its performance, taking into account any findings and conclusions by the competent authority under article 26(6) of the Audit Regulation;
4. review and monitor the independence of the statutory auditor, in accordance with articles 22, 22a, 22b, 24a and 24b of the Audit Directive and article 6 of the Audit Regulation, and in particular the appropriateness of the provision of non-audit services to the issuer in accordance with article 5 of the Audit Regulation;
5. inform the administrative or supervisory body of the issuer of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the relevant body was in that process;
6. except when article 16(8) of the Audit Regulation is applied, be responsible for the procedure for the selection of statutory auditor(s) and recommend the statutory auditor(s) to be appointed in accordance with article 16 of the Audit Regulation.

DTR 7.1.5 R sets out what disclosure is required. Specifically:

- DTR 7.1.5 R states that the issuer must make a statement available to the public disclosing which body carries out the functions required by DTR 7.1.3 R and how it is composed.
- DTR 7.1.6 G states that this can be included in the corporate governance statement required under sub-chapter DTR 7.2 (see below).
- DTR 7.1.7 G states that compliance with the relevant provisions of the Code (as set out in the Appendix to this Schedule) will result in compliance with DTR 7.1.1 R to 7.1.5 R.

Sub-chapter 7.2 concerns corporate governance statements. Issuers are required to produce a corporate governance statement that must be either included in the directors' report (DTR 7.2.1 R); or set out in a separate report published together with the annual report; or set out in a document on the issuer's website, in which case there must be a cross-reference in the directors' report (DTR 7.2.9 R).

DTR 7.2.2 R requires that the corporate governance statement must contain a reference to the corporate governance code to which the company is subject (for companies with a Premium listing this is the Code). DTR 7.2.3 R requires that, where that it departs from that code, the company must explain which parts of the code it departs from and the reasons for doing so. DTR 7.2.4 G states that compliance with LR 9.8.6 R (6) (the "comply or explain" rule in relation to the Code) will also satisfy these requirements.

DTR 7.2.5 R, DTR 7.2.6 R, DTR 7.2.7 R and DTR 7.2.10 R set out certain information that must be disclosed in the corporate governance statement:

- DTR 7.2.5 R states that the corporate governance statement must contain a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process. DTR 7.2.10 R states that an issuer which is required to prepare a group directors' report within the meaning of Section 415(2) of the Companies Act 2006 must include in that report a description of the main features of the group's internal control and risk management systems in relation to the financial reporting process for the undertakings included in the consolidation, taken as a whole.
- DTR 7.2.6 R states that the corporate governance statement must contain the information required by paragraph 13(2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) where the issuer is subject to the requirements of that paragraph.
- DTR 7.2.7 R states that the corporate governance statement must contain a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees. DTR 7.2.8 G states that compliance with the relevant provisions of the Code (as set out in the Appendix to this Schedule) will satisfy these requirements.

Listing Rules

LR 9.8.6 R (for UK incorporated companies) and LR 9.8.7 R (for overseas incorporated companies) state that in the case of a company that has a Premium listing of equity shares, the following items must be included in its annual report and accounts:

- a statement of how the listed company has applied the Main Principles set out in the Code, in a manner that would enable shareholders to evaluate how the principles have been applied;
- a statement as to whether the listed company has:
 - complied throughout the accounting period with all relevant provisions set out in the Code; or
 - not complied throughout the accounting period with all relevant provisions set out in the Code, and if so, setting out:
 - i. those provisions, if any, it has not complied with;
 - ii. in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and
 - iii. the company's reasons for non-compliance.

LR 9.8.6 (3) R (3) requires statements by the directors on:

- a) the appropriateness of adopting the going concern basis of accounting (containing the information set out in provision C.1.3 of the UK Corporate Governance Code); and
- b) their assessment of the prospects of the company (containing the information set out in provision C.2.2 of the UK Corporate Governance Code);

prepared in accordance with the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014.

The UK Corporate Governance Code

In addition to the "comply or explain" requirement in the LR, the Code includes specific requirements for disclosure which must be provided in order to comply. These are summarised below.

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 (A.1.1);
- the names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees (A.1.2);
- the number of meetings of the board and those committees and individual attendance by directors (A.1.2);
- where a chief executive is appointed chairman, the reasons for their appointment (this only needs to be done in the annual report following the appointment) (A.3.1);
- the names of the non-executive directors whom the board determines to be independent, with reasons where necessary (B.1.1);
- a separate section describing the work of the nomination committee, including the process it has used in relation to board appointments; 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 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 and a statement made as to whether it has any other connection with the company (B.2.4);
- the impact of any changes to the other significant commitments of the chairman during the year should explained (B.3.1);
- a statement of how performance evaluation of the board, its committees and its directors has been conducted (B.6.1). Where an external facilitator has been used, they should be identified and a statement made as to whether they have any other connection to the company (B.6.2);

- an explanation from the directors of their responsibility for preparing the accounts and a statement that they consider that 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. There should also be a statement by the auditor about their reporting responsibilities (C.1.1);
- an explanation from the directors of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company (C.1.2);
- a statement from the directors whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements (C.1.3);
- confirmation by 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 the risks and explain how they are being managed or mitigated (C.2.1);
- a statement from the directors explaining how they have assessed the prospects of the company (taking account of the company's current position and principal risks), over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary (C.2.2);
- a report on the board's review of the effectiveness of the company's risk management and internal controls systems (C.2.3);
- where there is no internal audit function, the reasons for the absence of such a function (C.3.6);
- where the board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position (C.3.7);
- a separate section describing the work of the audit committee in discharging its responsibilities, including: the significant issues that it 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 reappointment of the external auditor, including 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 is safeguarded (C.3.8);
- a description of the work of the remuneration committee as required under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2013, including, where an executive director serves as a non-executive director elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is (D.1.2);

- where remuneration consultants are appointed they should be identified and a statement made as to whether they have any other connection with the company (D.2.1); and
- the steps the board has taken to ensure that members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company (E.1.2).

The following information should be made available (which may be met by placing the information on a website that is maintained by or on behalf of the company):

- the terms of reference of the nomination, audit and remuneration committees, explaining their role and the authority delegated to them by the board (B.2.1, C.3.3 and D.2.1); and
- the terms and conditions of appointment of non-executive directors (B.3.2) (see footnote 9).

The board should set out to shareholders in the papers accompanying a resolution to elect or re-elect directors:

- sufficient biographical details to enable shareholders to take an informed decision on their election or re-election (B.7.1);
- why they believe an individual should be elected to a non-executive role (B.7.2); and
- on re-election of a non-executive director, confirmation from the chairman that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role (B.7.2).

The board should set out to shareholders in the papers recommending appointment or reappointment of an external auditor:

- if the board does not accept the audit committee's recommendation, a statement from the audit committee explaining the recommendation and from the board setting out reasons why they have taken a different position (C.3.7).

Additional guidance

The FRC publishes guidance on the strategic report, risk management, internal control, business and financial reporting and audit committees, which relate to Section C of the Code. These guidance notes are available on the FRC website.

Appendix to Schedule 7

Overlap between the Disclosure and Transparency Rules and the UK Corporate Governance Code

Disclosure and Transparency Rules	UK Corporate Governance Code
<p>DTR 7.1.1 R and 7.1.1A R</p> <p>Sets out minimum requirements on composition of the audit committee or equivalent body.</p>	<p>Provision C.3.1</p> <p>Sets out recommended composition of the audit committee.</p>
<p>DTR 7.1.3 R</p> <p>Sets out minimum functions of the audit committee or equivalent body.</p>	<p>Provision C.3.2</p> <p>Sets out the recommended minimum terms of reference for the audit committee.</p>
<p>DTR 7.1.5 R</p> <p>The composition and function of the audit committee or equivalent body/ bodies must be disclosed in the annual report.</p> <p><i>DTR 7.1.7 RG states that compliance with Code provisions A.1.2, C.3.1, C.3.2, C.3.3. and C.3.3 8 will result in compliance with DTR 7.1.1 R to DTR 7.1.5 R.</i></p>	<p>This requirement overlaps with a number of different Code provisions:</p> <p>A.1.2: the annual report should identify members of the board and board committees.</p> <p>C.3.1: sets out the recommended composition of the audit committee.</p> <p>C.3.2: sets out the recommended minimum terms of reference for the audit committee.</p> <p>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 available.</p> <p>C.3.8: the annual report should describe the work of the audit committee.</p>
<p>DTR 7.2.5 R</p> <p>The corporate governance statement must contain a description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process.</p> <p><i>While this requirement differs from the requirement in the Code, it is envisaged that both could be met by a single internal control statement.</i></p>	<p>Provision C.2.1</p> <p>The directors should confirm 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.</p> <p>Provision C.2.3</p> <p>The board should monitor the company's risk management and internal control systems and, at least annually, carry out</p>

	<p>a review of their effectiveness, and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.</p>
<p>DTR 7.2.7 R</p> <p>The corporate governance statement must include contain a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees.</p> <p><i>DTR 7.2.8 R states that compliance with Code provisions A.1.1, A.1.2, B.2.4, C.3.3, C.3.8 and D.2.1 will result in compliance with DTR 7.2.7 R.</i></p>	<p>This requirement overlaps with a number of different Code provisions:</p> <p>A.1.1: the annual report should include a statement of how the board operates.</p> <p>A.1.2: the annual report should identify members of the board and board committees.</p> <p>B.2.4: the annual report should describe the work of the nomination committee.</p> <p>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 available.</p> <p>C.3.8: the annual report should describe the work of the audit committee.</p> <p>D.2.1: a description of the work of the remuneration committee should be made available. <i>[Note: in order to comply with DTR 7.2.7 R this information will need to be included in the corporate governance statement.]</i></p>

Supplementary information provided by the AIC

The following FCA Listing Rules relate to additional corporate governance requirements specifically in relation to investment companies:

Independence

LR 15.2.11 R

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 15.2.11A R

LR 15.2.11 R (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 15.2.12-A R

For the purposes of LR 15.2.11 R:

- (1) the chairman of the board or equivalent body of the applicant must be independent; and
- (2) a majority of the board or equivalent body of the applicant must be independent (the chairman may be included within that majority).

LR 15.2.12A R

For the purposes of LR 15.2.11 R and LR 15.2.12-A R, the following are not independent:

- (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 15.2.11 R (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 15.2.13A R

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

LR 15.4.7 R

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

Annual financial report

LR 15.6.2 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.

Statement regarding compliance with UK Corporate Governance Code

LR 15.6.6 R

(1) This rule applies to a closed-ended investment fund that has no executive directors.

(2) A closed-ended investment fund's statement required by LR 9.8.6 R (6) need not include details about the following principles and provisions of the UK Corporate Governance Code except to the extent that those principles or provisions relate specifically to non-executive directors:

(a) Principle D.1 (including Code Provisions D.1.1 to D.1.5): and

(b) Principle D.2 (including Code Provisions D.2.1 to D.2.4).

8 Disclosure requirements

This section summarises the requirements and recommendations for disclosing corporate governance arrangements and compliance, or otherwise, in relation to the AIC Code and the UK Code. Additional disclosures in relation to corporate governance may also be required in accordance with the Listing Rules and the Disclosure and Transparency Rules.

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 of 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 the 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 this guide, they are meeting their obligations under the UK Code and paragraph 9.8.6 of the Listing Rules and as such do not need to report further on issues contained in the UK Code which are irrelevant to them as explained in this guide. Appendix 1 contains suggested wording for this statement.

Some of the principles and recommendations of the AIC Code also contain specific disclosure requirements.

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

UK Corporate Governance Code

Sections 9.8.6(5) and (6) of the Listing Rules require all companies with a premium listing of equity shares on the main market of the London Stock Exchange to make a statement in their annual report:

- of how the company has applied the main principles set out in the UK Corporate Governance Code, in a manner that would enable shareholders to evaluate how the principles have been applied; and
- as to whether or not the company has complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance 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.

As explained on page 5, the UK 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 on pages 11 to 52.

9 Appendix 1: 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 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."*

10 Appendix 2: Recent changes to the AIC Code and AIC Guide

To align with UK Corporate Governance Code

The AIC Guide has been updated to reflect the text of the April 2016 UK Code. As a result of consequential changes to the UK Code to implement the Audit Directive and Regulation, the following amendments have been made to the AIC Code. This is to ensure that the FRC can continue to endorse the AIC Code as an alternative means of meeting Listing Rules obligations in relation to the UK Code (see page 5).

- AIC Principle 5 – Audit Committee and audit tendering

Reference to the audit committee comprising at least one member with recent and relevant financial experience has been added to the recommendations for audit committees.

Reference to the audit committee as a whole having competence relevant to the sector has been added to the recommendations for audit committees.

Reference to the Boards of FTSE 350 companies putting their external audits out to tender at least every ten years has been deleted because retendering is now a legal requirement.

Reference to the audit committee providing advance notice of any external audit retendering plans has been added to requirement for a separate section of the annual report to describe the work of the audit committee in discharging its responsibilities.

- Schedule B in Section 7 of this Guide has been updated to reflect the Schedule B in the UK Code.

Other changes not related to the UK Code

There are no other changes to the AIC Guide.

Schedule B of the UK Code

Schedule B summarises the corporate governance disclosure requirements which are set out in the FCA Disclosure and Transparency Rules, the FCA Listing Rules and the UK Code. In addition to these obligations, there are other FCA corporate governance rules which relate specifically to investment companies. These are referred to at the end of Schedule B and do not form part of the UK Code.

Preamble

The preface to the revised UK Code sets out the information that should be provided in relation to disclosures of non-compliance. Accordingly, additional text has been added to the suggested preamble to an investment company's corporate governance report in Appendix 1 to explain why certain provisions of the UK Code are not relevant.

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

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